
New South Wales Auditor-General's Report
Financial Audit

Volume Four 2016
Report on State Finances



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

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

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

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The Legislative Council
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Pursuant to the *Public Finance and Audit Act 1983*,
I present Volume Four of my 2016 report.

A handwritten signature in black ink, appearing to read 'Margaret Crawford'.

Margaret Crawford
Auditor-General
6 October 2016

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Section One

Report on State Finances



Executive Summary

This report analyses the results of the financial statement audit of the Total State and General Government Sectors for the year ended 30 June 2016. The table below summarises key observations.

Audit result

Audit opinion

An unqualified opinion was issued for the 2016 Total State and General Government Sector Accounts.

Quality of financial statements

Improved financial statement preparation processes across the sector helped to identify and resolve material accounting issues, reduce the number of reported misstatements and achieve earlier reporting timeframes.

Asset revaluation

Asset revaluations and associated quality reviews need to be completed before Treasury's early close deadline.

Financial analysis Total State Sector

Restart NSW

The Restart NSW Fund has \$12.9 billion for investment in future infrastructure.

Restart NSW payments

Ten per cent of 2015-16 Fund payments were directed to rural and regional infrastructure.

Long term lease of TransGrid's assets

The State made a gain of \$3.6 billion on the long term lease of TransGrid assets.

Superannuation

The State's superannuation obligations increased by \$16 billion in 2015-16, largely due to a fall in the discount rate.

The State's Budget

Budget result

The Budget result was a \$4.7 billion surplus, \$2.1 billion higher than the Budget estimate.

State revenue

Actual revenue exceeded Budget by \$2.2 billion, largely due to higher than expected stamp duty.

State expenses

The State's controls over expenditure growth continue to be effective.

Governance

AAA credit rating

The State maintained its AAA credit rating, but the outlook was revised to negative.

Unfunded superannuation

The State's unfunded liability is at the same level it was at when the *Fiscal Responsibility Act 2005* was introduced over ten years ago.

Corporate governance

Treasury should establish an Audit and Risk Committee dedicated to the whole-of-government.

Audit result

Audit result

An unqualified audit opinion was issued on the Total State and General Government Sector Accounts for the year ended 30 June 2016.

Quality and timeliness of financial reporting

The quality and timeliness of financial reporting has continued to improve across the NSW public sector. Timeframes have reduced and the number of errors continues to fall.

Asset revaluations

Asset revaluation processes can improve

Some agencies did not complete asset revaluations by the early close deadline, and in some cases, the revaluation results were not subject to a robust quality review before being included in the financial statements and early close supporting work papers.

Financial analysis Total State Sector

Restart NSW Fund

The Restart NSW Fund has \$12.9 billion for investment in future infrastructure

In 2015-16, the Fund received \$6.1 billion from the long term lease of TransGrid, \$814 million in windfall tax revenues from the Crown Entity and \$109 million from the issue of Waratah bonds.

The Restart NSW Fund has contributed \$1.6 billion to Westconnex

In 2015-16, the Fund contributed \$1.1 billion to the State's investment in Sydney Motorway Corporation (responsible for delivering the Westconnex motorway), bringing total contributions by the Fund to \$1.6 billion.

Ten per cent of 2015-16 payments were directed to rural and regional infrastructure

Ten per cent of the 2015-16 Fund payments were directed to infrastructure projects in rural and regional areas outside metropolitan Sydney, Newcastle and Wollongong.

The Restart Act requires management to report whether payments from the Fund for infrastructure projects in rural and regional areas represents at least 30 per cent of total payments made.

Significant transactions

The State received \$10.3 billion from the long term lease of TransGrid assets

The State received proceeds of \$10.3 billion from the long term lease of TransGrid assets, which resulted in the State recording a gain of \$3.6 billion from the transaction.

Revenues and expenses

Revenues and expenses totalled \$82.4 billion (\$79.5 billion in 2014-15) and \$77.9 billion (\$74.9 billion), respectively. The State's Operating Result was a \$4.4 billion surplus (\$4.6 billion).

Taxation revenues increased by 11.8 per cent mainly due to stamp duties increasing by \$1.6 billion to \$10.8 billion, a 17.3 per cent increase from 2014-15. This was largely due to growth in residential and commercial property sales and \$438 million from the TransGrid lease transaction.

Commonwealth grants totalled \$29.2 billion, \$1.1 billion more than 2014-15. This was mainly due to higher general purpose payments from the Australian Government. This mainly comprised New South Wales' share of Goods and Services Tax.

Employee costs of \$37.3 billion were 47.9 per cent of total expenditure, an increase of 4.5 per cent on the \$35.7 billion incurred in 2014-15.

Assets and liabilities

Total assets were valued at \$377 billion at 30 June 2016 (\$360 billion at 30 June 2015). They mostly comprise property, plant and equipment needed to provide or support service delivery to the public.

The State's superannuation obligations increased by \$16 billion in 2015-16

The State's total liabilities increased to \$195 billion at 30 June 2016 (\$179 billion at 30 June 2015). This was mainly due to the net liability for defined benefit superannuation increasing by \$16 billion to \$71.2 billion, primarily due to a fall in the discount rate. Borrowings fell by \$1.9 billion to \$80.1 billion.

The State's Budget

Budget Result

The Budget Result was a \$4.7 billion surplus

The Budget Result for the year ended 30 June 2016 was a \$4.7 billion surplus (\$2.9 billion surplus for the year ended 30 June 2015). This was \$2.1 billion higher than originally budgeted in June 2015. Revenues were 3.0 per cent above original budget and expenses were in line with the budget.

Governance matters

Credit rating

The State maintained its AAA credit rating, but the outlook was revised to negative

The State has a AAA credit rating.

In July 2016, Standard & Poor's affirmed its AAA rating, but revised the outlook to negative, because of a change in the outlook for the Commonwealth. Standard and Poor's caps the long-term rating of any State at the outlook for the Commonwealth, but noted the State's very strong financial management and economy, and exceptional liquidity.

In December 2015, Moody's affirmed its Aaa rating and stable outlook.

Unfunded superannuation

The unfunded superannuation liability is at the same level it was at over ten years ago

The State's unfunded superannuation liability, measured using *AAS25 Financial Reporting by Superannuation Plans*, increased \$3.7 billion to \$16.1 billion at 30 June 2016 from \$12.4 billion at 30 June 2015. This takes the unfunded liability to the same level it was at when the *Fiscal Responsibility Act 2005* was introduced over ten years ago.

The Act sets a target of eliminating the State's unfunded defined benefit liabilities by 2030.

Corporate governance

An Audit and Risk Committee should be established for the whole-of-government

New South Wales Government agencies would benefit from a dedicated independent audit and risk committee for the whole-of-government that focuses on common issues and risks

across the New South Wales public sector. Such a committee should recommend and oversight coordinated responses to sector-wide issues.

Snapshot

NEW SOUTH WALES

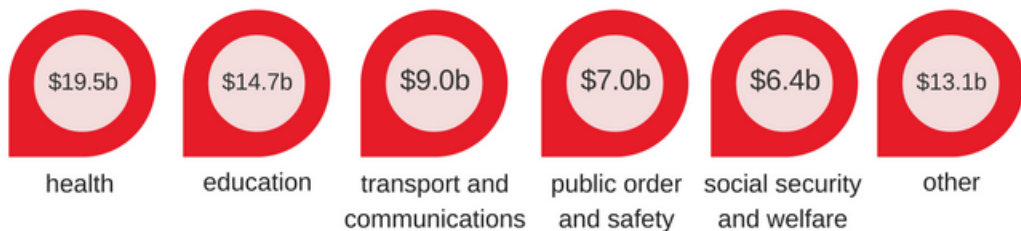
Total State Sector Structure



\$74.3 billion revenues:



\$69.7 billion expenses:



Unqualified audit opinion issued for the 2015-16 TSSA.

Audit Result

This chapter outlines the audit result for 2015-16.

Key matters

Audit opinion

An unqualified opinion was issued for the 2016 Total State and General Government Sector Accounts.

Quality of financial statements

Improved financial statement preparation processes across the sector helped to identify and resolve material accounting issues, reduce the number of reported misstatements and achieve earlier reporting timeframes.

Asset revaluations

Asset revaluations and associated quality reviews need to be completed before Treasury's early close deadline.

Auditor's opinion

The Total State and General Government Sector Accounts' audit opinion is unqualified

This year's unqualified audit opinion evidences the Government's commitment to improve the quality of financial reporting across the NSW public sector.

Key issues

Key issues noted during the 2015-16 audit are summarised below.

Technical and Further Education Commission (TAFE) revenue

In 2014-15, serious information system limitations meant TAFE was not able to provide evidence to support its recorded student revenue of \$477 million, student receivables and accrued income of \$47.6 million and unearned revenue of \$398 million. This resulted in a qualified audit opinion on that year's financial statements.

TAFE engaged a consultant to address the issue and avoid another qualified audit opinion in 2015-16. The engagement included remediating student data, developing a stand-alone database with clean data and recalculating the financial information so it met TAFE's revenue recognition principles.

Management identified and resolved over 250,000 data exceptions and estimated revenue was understated by approximately \$117 million in 2014-15. The final result will be confirmed by the end of October.

The engagement was costly. It required 185 full time TAFE employees (including contractors) and incurred costs of more than \$10 million. This exceeded initial scoping estimates.

The 2015-16 audit is ongoing at the date of this report. Further details will be included in Volume Thirteen, which focusses on the Industry, Skills and Regional Development cluster of agencies.

Lifetime Care and Support Scheme (Scheme) liabilities

Uncertainty exists in measuring Lifetime Care and Support Scheme liabilities

At 30 June 2016, significant uncertainty existed in estimating the State's \$2.9 billion liability (\$2.7 billion at 30 June 2015) for Scheme participants' care and support services and the related expense of \$40 million (\$206 million). The uncertainty arises because of the long term nature of claims and limited experience to date. The uncertainty will remain until sufficient participants' experience is available.

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. It is funded by a levy on compulsory third party insurance policies.

Crown Land Reserve Trusts

Accountability for the State's Crown Land Reserve Trusts can be improved

Hundreds of Reserve Trusts exist that are not preparing financial statements as required by the *Public Finance and Audit Act 1983*. To remedy this, the financial reporting obligations for these Trusts needs to be clarified by Treasury.

The *Public Finance and Audit Act 1983* and the *Crowns Land Act 1981* are being rewritten, which provides an opportunity to address this issue and improve accountability for the Crown Reserves.

Some Crown land is set aside for public purposes and may only be used to deliver a public benefit or good. These are generally called Crown Reserves.

Reserve Trusts have been established to act as Trustees and hold legal ownership of Crown Reserves. While the Reserve Trusts have responsibility for the care, control and management of the Crown Reserve, they cannot operate without the appointment of someone to manage their affairs. The Reserve Trust manager can be the Minister, a Trust Board, an incorporated body or an administrator.

The accounting arrangements for Reserve Trusts managed by Trust Boards differ to others because Trust Boards are not separate legal entities. They are groups of individuals appointed to manage Reserve Trust activities. Financial statements have not been prepared or audited for Reserve Trusts managed by Trust Boards.

Quality of financial reporting

The quality of financial reporting continues to improve

Since Treasury introduced 'early close procedures' in 2011-12, the number of reported misstatements and significant matters has fallen significantly across the NSW public sector. This is largely attributed to the early resolution of accounting issues as a part of the early close procedures. These procedures help agencies meet earlier reporting deadlines and improve the quality and accuracy of financial reporting by bringing forward traditional year-end activities. These include valuations of assets and the resolution of financial reporting issues.

Agencies may not always be able to fully resolve significant and complex accounting issues during the early close process. If this is the case, agencies should document a clear path that ensures timely resolution and appropriate stakeholders, including Treasury, are kept informed. The documented path should set out the issue, current status, key aspects needing resolution and responsibility for the expected deliverables.

Asset revaluation processes can improve

Although most agencies complied with Treasury's early close procedures, opportunities exist for improvements, particularly in the area of asset revaluations.

Some agencies did not complete asset revaluations by the early close deadline. In some cases, the revaluation results were not subject to a robust quality review before being included in the financial statements and early close supporting work papers.

Other opportunities for agency improvements include:

- ensuring sufficient documentation supports management's proposed accounting treatments, judgements and assumptions
- resolving significant accounting issues during the early close process, or documenting a clear path towards timely resolution
- documenting an action plan to resolve issues.

Treasury piloted a hard close initiative

Treasury ran a 'hard close' pilot with nine agencies in 2015-16 to help determine if hard close procedures should be adopted on a wider basis. Expected benefits include:

- earlier identification and resolution of issues
- greater ability to spread workloads and manage resources during peak periods
- earlier tabling of annual reports.

The outcomes of the pilot will be evaluated to determine if hard close procedures should be implemented.

Timeliness of financial reporting

More audit opinions were issued within three months of year end

Most agencies submitted their financial statements on time and most audits were completed before or by the statutory deadlines.

Since mandatory early close procedures were introduced in 2011-12, the Audit Office has issued significantly more audit opinions within a shorter period of time. In 2015-16, over 200 audit opinions were issued within three months of the year end, compared to only 67 in 2010-11.

Early close procedures have improved the timeliness of financial reporting

In 2015-16, agencies were broadly successful in performing early close procedures for year-end reporting purposes. However, preparing financial reports more frequently will help to further improve the quality and timeliness of year-end financial reporting. This should also improve the financial management of the sector, if adequate rigour is applied to the process.

Total State Sector - Financial Analysis

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

Key matters

Restart NSW

The Restart NSW Fund has \$12.9 billion for investment in future infrastructure.

Restart NSW payments

Ten per cent of 2015-16 Fund payments were directed to rural and regional infrastructure.

Long term lease of TransGrid's assets

The State made a gain of \$3.6 billion on the long term lease of TransGrid assets.

Superannuation

The State's superannuation obligations increased by \$16 billion in 2015-16, largely due to a fall in the discount rate.

Restart NSW Fund

The Restart NSW Fund has \$12.9 billion for investment in future infrastructure

In 2011, the Government established the Restart NSW Fund to fund major infrastructure projects designed to improve:

- public transport and roads
- infrastructure required for the economic competitiveness of the State (including the freight, inter-modal facilities and access to water)
- local infrastructure in regional areas affected by mining operations
- hospital and other health facilities and services
- workplaces for law and justice officers, teachers, nurses and other staff providing services to the public.

The table below shows key inflows/outflows over the life of the Fund to 30 June 2016:

Receipts	Total	Payments	Total
	\$m		\$m
Proceeds from bonds issued by the State	881	Infrastructure projects	2,013
Lease of NSW Ports	6,584	Repayment of debt of NSW Ports	767
Sale of Sydney Desalination Plant	312	Stamp duty for lease of NSW Ports	215
Windfall tax revenue from Crown Entity	2,133	Transaction cost for lease of NSW Ports	54
Stamp and mortgage duty from Crown Entity	224	Investment in shares in Sydney Motorway Corporation	1,625
Sale of Eraring Energy	48		
Sale of Macquarie Generation	620		
Sale of Green State Power	70		
Long term lease of TranGrid	6,140		
Sale of Delta Coast Assets - Vales Point	21		
Contribution from Government Property NSW	200		
Interest	371		
Total receipts since 2011	17,604	Total payments since 2011	4,674
Balance of fund at 30 June 2016			12,930

The Restart NSW Fund has contributed \$1.6 billion to Westconnex

In 2015-16, the Fund contributed \$1.1 billion towards the State's investment in Sydney Motorway Corporation (responsible for delivering the Westconnex motorway), bringing total contributions from the Fund to \$1.6 billion.

During 2015-16, the Fund also spent \$1.2 billion (\$331 million in 2014-15) on other infrastructure projects. This was split between NSW Government Projects and Programs (\$1.1 billion) and Local Government and Community Projects and Programs (\$117.7 million). The largest payments were for Rebuilding NSW projects (\$717 million) and Northern Beaches Hospital Roads (\$108 million).

In the same period, the Fund received \$6.1 billion in proceeds from the long term lease of TransGrid, \$814 million in windfall tax revenues from the Crown Entity and \$109 million from issuing Waratah bonds.

Ten per cent of 2015-16 payments were directed to rural and regional infrastructure

Ten per cent of the 2015-16 Fund payments were directed to infrastructure projects in rural and regional areas outside metropolitan Sydney, Newcastle and Wollongong.

Section 9 of the Restart Act requires the following information to be included in Restart NSW's financial report:

- total Fund payments for infrastructure projects in rural and regional areas outside metropolitan Sydney, Newcastle and Wollongong
- whether the payments represent at least 30 per cent of total payments from the Fund for infrastructure projects.

The 2016-17 Budget papers include details on how the Government intends to use the Fund.

Discontinued operations

The State received \$10.3 billion from asset sales in 2015-16

The proceeds and related accounting gains and losses from transactions finalised in 2015-16 are shown below.

Transaction	Proceeds	Gain/(Loss)
	\$m	\$m
TransGrid	10,273	3,608
Delta Coast (Vales Point)	21	(2)
Total	10,294	3,606

TransGrid

On 25 November 2015, the Premier and Treasurer of NSW announced NSW Electricity Networks Operations Pty Limited (NSWENO) was the successful bidder for the long term lease of TransGrid assets.

The State received cash proceeds of \$10.3 billion for the lease, which included:

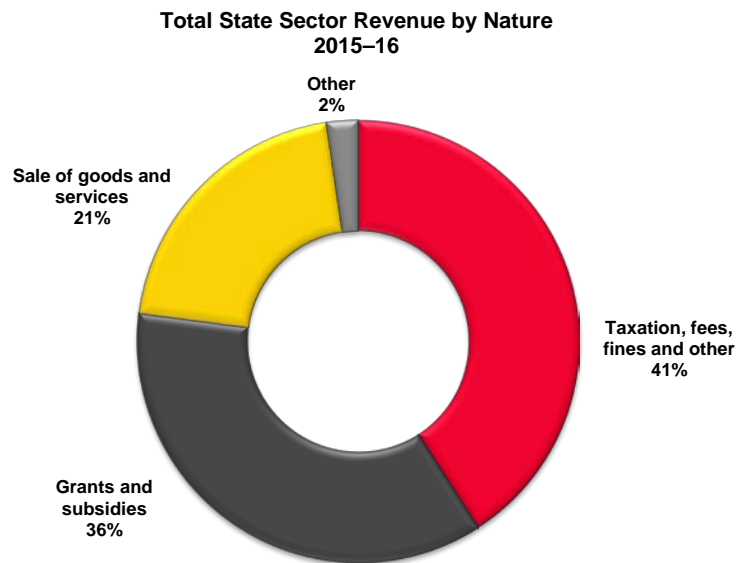
- the purchase price of \$2.6 billion
- an upfront lease premium of \$7.3 billion
- stamp duty of \$438 million.

The State recognised a gain of \$3.6 billion from the disposal of TransGrid's net assets and entering into the 99 year finance lease. This gain is not included in the State's budget result.

Financial information - statement of comprehensive income

The Total State Sector operating result was \$4.4 billion, a decrease of \$282 million from 2014-15. This comprises \$82.4 billion (\$79.5 billion) of revenue and \$77.9 billion (\$74.9 billion) of expenses.

Revenue



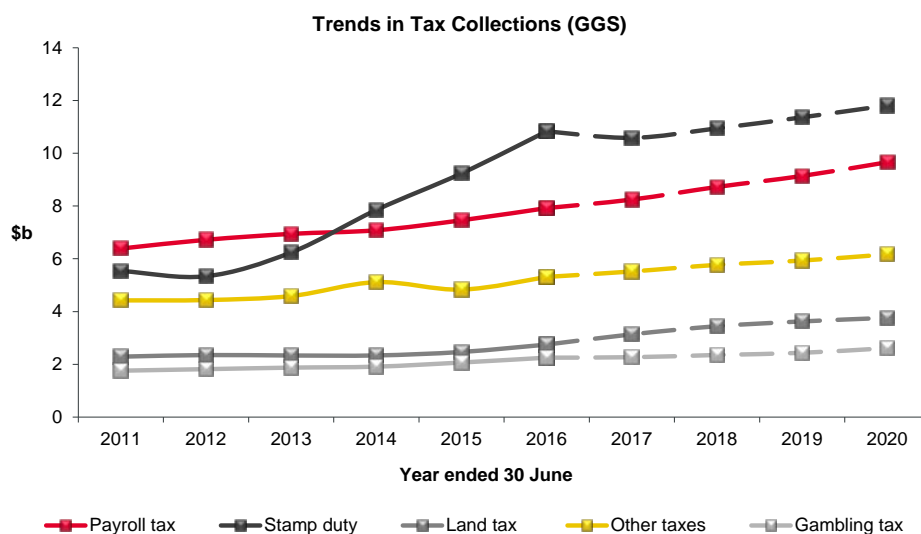
Taxation, fees, fines and other

Stamp duty has increased 103 per cent since 2011-12 from \$5.3 billion to \$10.8 billion

Taxation, fees, fines and other revenue comprises \$28.7 billion of taxation (\$25.7 billion in 2014-15) and \$5.0 billion of fees, fines and other revenue (\$5.0 billion).

Tax revenue for the Total State Sector increased by \$3.0 billion, or 11.8 per cent compared to 2014-15, primarily due to:

- transfer duty increasing by \$979 million from growth in residential and commercial property sectors
- one-off business asset sales and lease transactions, including \$438 million from the TransGrid lease transaction
- a \$474 million increase in payroll tax from growth in NSW employment and average employee compensation
- a \$282 million increase in land tax.



Sources: Reports on State Finances 2011 – 2016, 2016-17 NSW Budget Papers.

Growth in stamp duty projections is lower than the strong growth since 2011-12

General Government Sector stamp duties have increased from \$5.3 billion in 2011-12 to \$10.8 billion in 2015-16, an annual average growth rate of 19.5 per cent. The Treasury estimates an average annual growth rate of 2.2 per cent between 2015-16 and 2019-20.

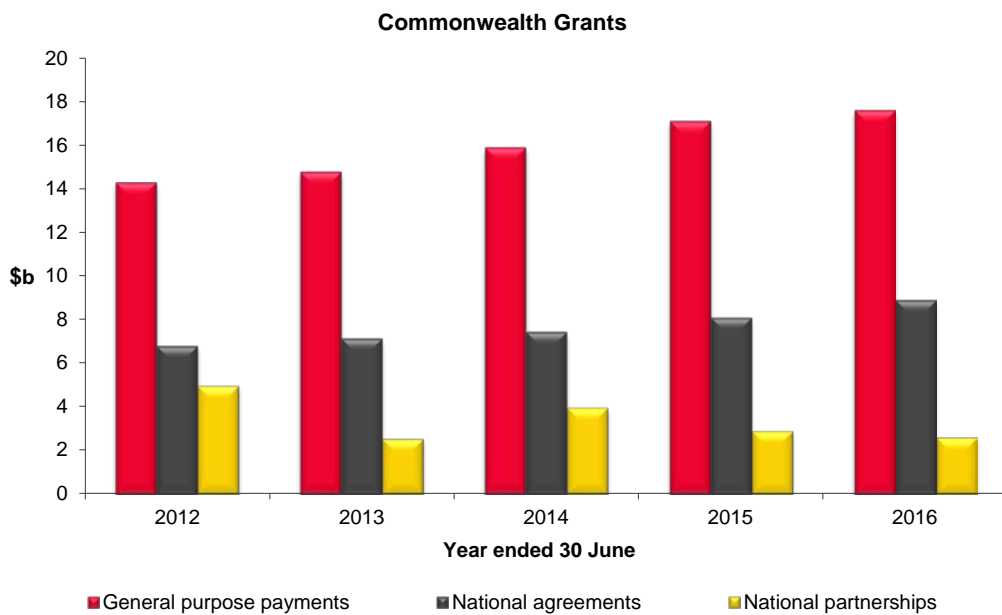
Grants and subsidies

The State received grants and subsidies of \$29.8 billion in 2015-16

The State received \$29.2 billion from the Australian Government in 2015-16, \$1.1 billion more than 2014-15. This was mainly due to a \$572 million increase in general purpose payments, which mainly comprises New South Wales' share of the Goods and Services Tax (GST).

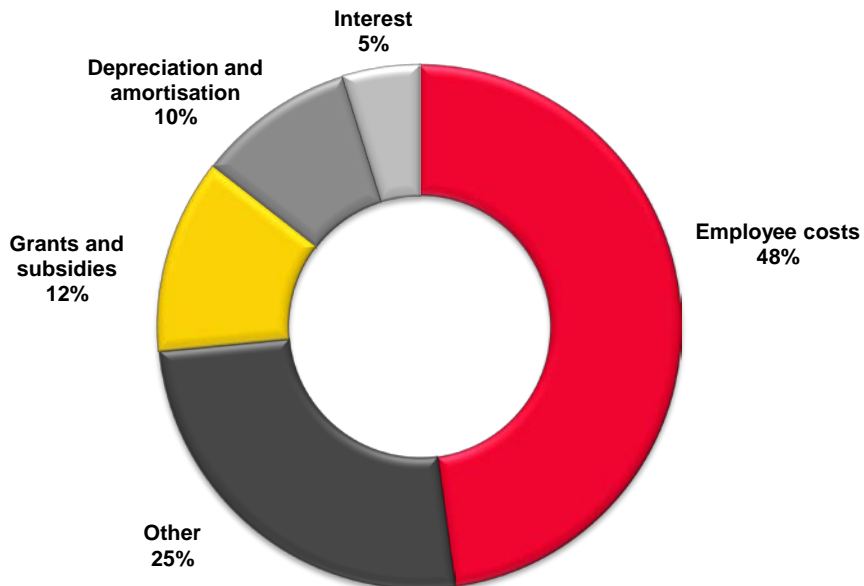
Grants and subsidies are provided under various arrangements, which fall into three broad categories – general purpose payments, national agreements and national partnerships.

Other Commonwealth grants increased by \$527 million compared to 2014-15.



Expenses

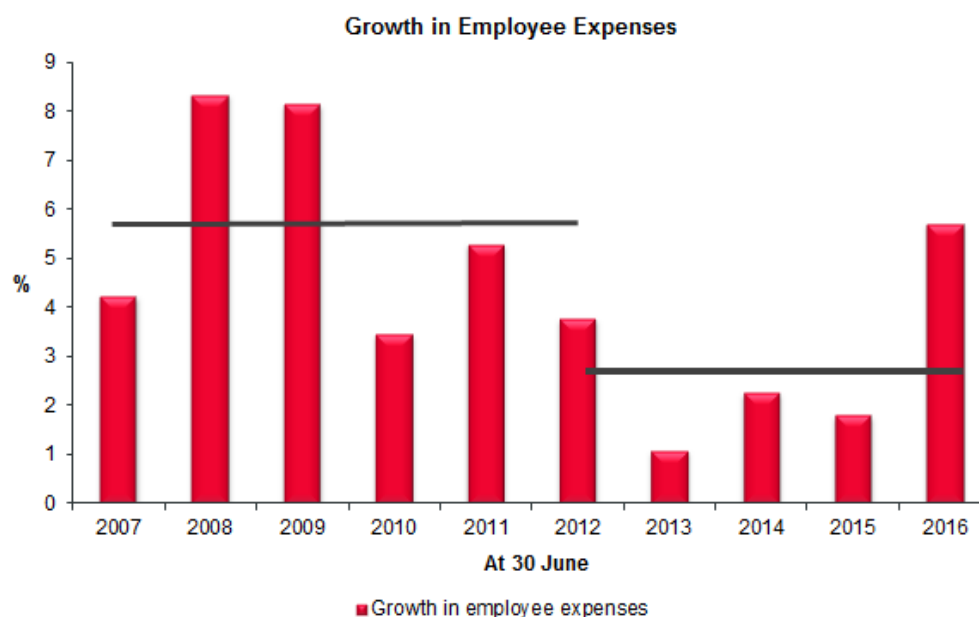
**Total State Sector Expenses by Nature
2015-16**



Total employee costs (less superannuation) increased by approximately 5.7 per cent compared to 2014-15 and account for almost half the State's total expenditure. The costs increased by \$1.8 billion from \$30.7 billion in 2014-15 to \$32.5 billion in 2015-16. They include \$29.3 billion (\$28.2 billion) for salaries and wages and \$1.2 billion (\$1.1 billion) for long service leave. The increase was due to:

- wages growth, which is consistent with the Government's wages policy limiting growth to 2.5 per cent per annum
- increased numbers of frontline staff for health, schools and justice
- employee redundancy costs.

Treasury advises the Government has achieved substantial savings from its 2.5 per cent wages cap. Between July 2011 and March 2016, it helped lower overall expense growth and the aggregate expense profile by an estimated avoided cost of \$2.5 billion.



The wages policy reduced employee expense growth from almost 6 per cent for the four years, 2007 to 2011, to 3 per cent for the four years, 2012 to 2016. Employee expenses increased 5.7 per cent in 2015-16 compared to 2014-15 for the reasons given above.

The policy aims to ensure fair working conditions and increases in remuneration and other employment conditions that do not reduce services and maintain fiscal sustainability. It is designed to maintain the real value of public sector wages over the medium term in line with the Reserve Bank of Australia's mid-point target range for inflation over the cycle.

Key financial information - statement of financial position

The Government is changing financial management in the New South Wales public sector to revise financial governance, budgeting and reporting arrangements for public sector financial and performance management information. The changes aim to help address fiscal pressures, transparency and efficiency, and to enable a stronger focus on risk management and risk informed decision making. They are expected to support high quality performance and resource management with program budgeting supporting an outputs focus.

A strong balance sheet with robust financial oversight should help the State:

- maintain its triple-A credit rating
- support a low cost of borrowing
- attract a wide range of potential investors to the State's debt issuance and private financing for capital projects

- respond to emerging fiscal and economic pressures
- provide capacity to absorb adverse fiscal shocks
- raise debt in a fiscally responsible manner.

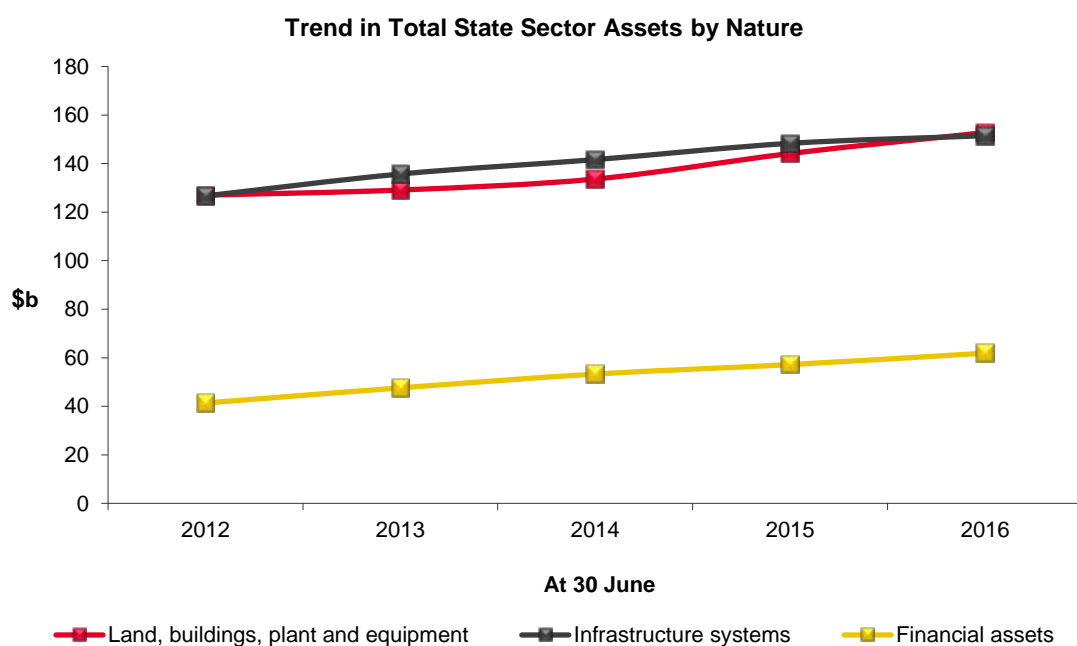
A strong balance sheet and the triple-A credit rating facilitate the State's other financial management reform goals. The reform includes creating an Asset and Liability Committee (ALCO) to provide advice on suitable asset and liability management policies and supervise implementation. A supporting legislative reform program will be undertaken with the aim of enhancing operating processes as well as whole-of-government budgeting, financial reporting, managing cash, debt and financial investments.

The ALCO will draw on the technical and financial market expertise of TCorp and the private sector by including representatives from these groups. Independent members will provide expertise on managing market, credit and operational risks.

Assets

The State's assets are valued at \$377 billion

The total value of the State's assets has increased from \$304 billion in 2011-12 to \$377 billion in 2015-16, 24.2 per cent over four years. This equates to an average annual growth rate of 5.2 per cent.



Financial assets

The State's financial assets increased \$4.7 billion in 2015-16

NSW Treasury Corporation (TCorp) is the central financing authority for the State. It raises funds in financial markets, which it lends to government agencies, and provides investment management services.

TCorp manages client investments through 'Hour-Glass' investment facilities and discrete client mandates. Cash and fixed income Hour-Glass sectors are primarily managed internally while remaining sectors are outsourced to external fund managers. Hour-Glass Investments are managed fund investment products designed for the investment needs of a broad range of NSW public entities.

Funds under management within the Hour-Glass grew from \$13.8 billion at 30 June 2015 to \$14.8 billion at 30 June 2016.

Most core Hour-Glass investments outperformed 5 year benchmark returns

The Hour-Glass Medium Term Growth Fund and Hour-Glass Long Term Growth Fund have substantial exposure to equity markets. Volatility in the equity markets has seen the strong returns in past years falling. However, over the five years, most Funds outperformed the respective five year benchmark (net of fees and expenses).

TCorp Hour-Glass Facility					
Investment return at 30 June	2016 (%)	2015 (%)	2014 (%)	2013 (%)	2012 (%)
Hour-Glass Cash Fund return	2.48	2.73	2.92	3.69	4.90
Five year benchmark return	3.10				
Five year return	3.34				
Hour-Glass Strategic Cash Fund return	2.57	2.88	3.23	4.16	5.02
Five year benchmark return	3.10				
Five year return	3.57				
Hour-Glass Medium-term Growth Fund return	2.22	7.37	7.65	10.74	4.28
Five year benchmark return	6.41				
Five year return	6.41				
Hour-Glass Long-term Growth Fund return	0.57	12.68	13.49	20.55	(0.73)
Five year benchmark return	9.30				
Five year return	9.01				

Source: TCorp financial statements (audited).

The State had around \$10.8 billion in cash and cash equivalents at 30 June 2016 (\$15.5 billion at 30 June 2015) and \$11.5 billion in term deposits (\$2.6 billion). The increases were mainly due to proceeds from the long-term lease of TransGrid, held in the Restart NSW Fund.

The \$4.7 billion decrease in cash and cash equivalents is a result of the Government's cash management reforms. The reforms are designed to ensure agencies have adequate levels of liquidity and surplus funds are invested for better returns.

The Government is developing a new investment approach for funds earmarked for future infrastructure spending in the State. The investment strategy will initially focus on the funds in the Restart NSW Fund.

The State will invest Restart NSW funds in cash and growth assets to maximise returns

The 2016-17 Budget papers describe the Government's investment strategy for proceeds of asset and lease transactions earmarked for new infrastructure. The strategy will enable the funds, including those in the Restart NSW Fund, to be more efficiently managed by matching investment horizons with future spending commitments. The approach will centralise the State's risk management activities and help maximise the return on these monies. The investment vehicle will include a range of cash and growth assets, targeting investment returns with minimal levels of risk.

Property, plant and equipment

Property, plant and equipment assets, primarily land, buildings and infrastructure systems, represent 81 per cent of the State's total assets. This is consistent with 2014-15.

Over the last five years, the State has spent \$71.5 billion on capital works, an average of \$14.3 billion per year. In 2015-16, additions to property, plant and equipment totalled \$16.0 billion, \$2.1 billion more than 2014-15.

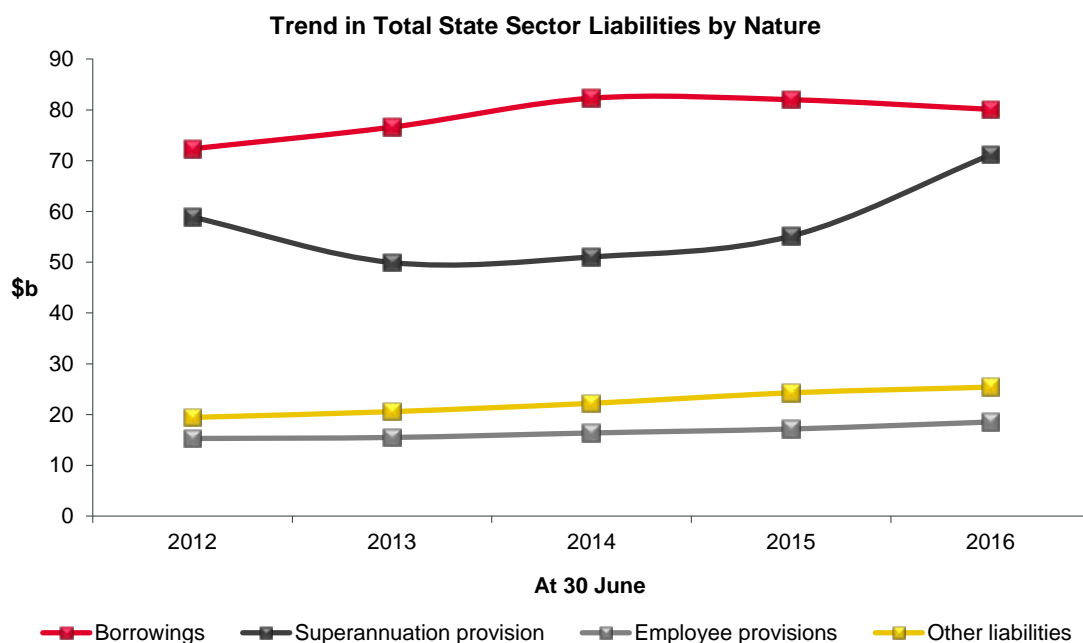
The value of the State's property, plant and equipment rose by \$11.7 billion in 2015-16

Major increases in agencies' asset valuations in 2015-16 included:

- New South Wales Land and Housing Corporation, \$6.4 billion
- Department of Education, \$1.6 billion
- Rail Corporation New South Wales, \$951 million
- Sydney Water Corporation, \$888 million.

Liabilities

The State's liabilities grew by \$16.6 billion to \$195 billion in 2015-16



Borrowings

The State's borrowings totalled \$80.1 billion at 30 June 2016

The State's borrowings totalled \$80.1 billion at 30 June 2016, slightly lower than the previous year.

TCorp issues bonds to raise funds for NSW Government agencies. The bonds are actively traded in financial markets providing price transparency and liquidity to public sector borrowers and institutional investors. All TCorp bonds are guaranteed by the NSW Government, providing NSW public sector entities with funding at the lowest possible cost.

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

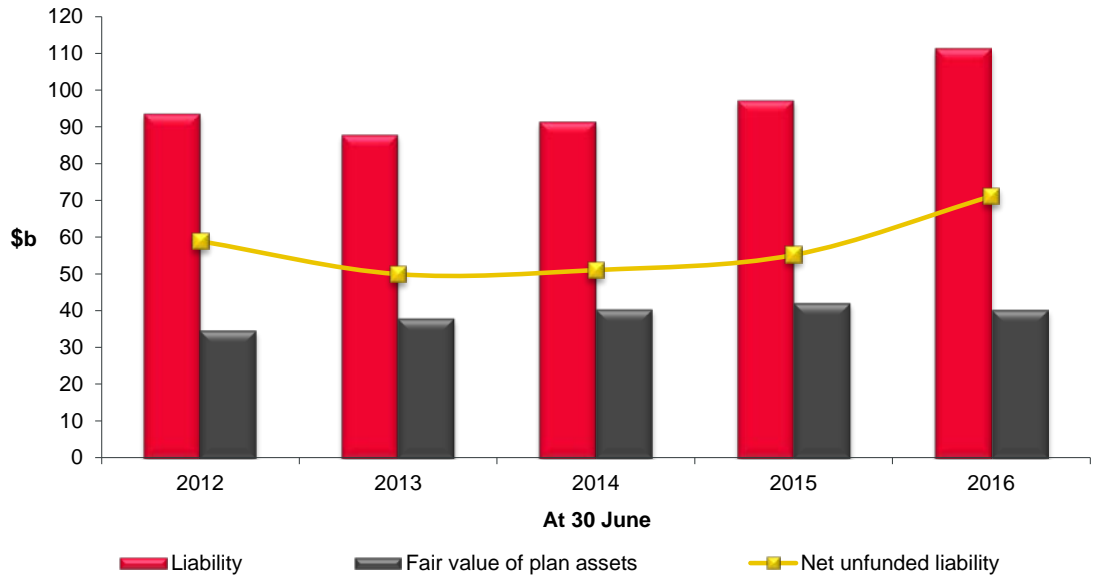
General Government Sector debt is being restructured by replacing shorter-term debt with longer-term debt. This lengthens the portfolio to better match liabilities with the infrastructure assets funding requirements and reduces refinancing risks. It also allows the Government to take advantage of the low interest rate environment.

Superannuation provisions

The State's superannuation obligations increased by \$16 billion in 2015-16

The State's \$71.2 billion superannuation liability represents obligations for past and present employees, less the value of assets set aside to meet those obligations. The unfunded superannuation liability increased \$16 billion (29.0 per cent) to \$71.2 billion at 30 June 2016.

Trend in Unfunded Superannuation Liability



Note: From 30 June 2012, superannuation liabilities were restated to include contributions tax on net unfunded liabilities.

Superannuation investment returns were lower than anticipated in 2015-16

Superannuation investments that back related liabilities did not perform as well as expected in 2015-16. The overall return was lower than target and the previous year mainly due to global economic volatility in the last six months of 2015-16. However, returns were in line with the higher performing investment funds in the industry.

Investment return at 30 June	STC - Pooled Fund		EISS Pool B	
	2016 Actual (%)	2016 Target (%)	2016 Actual (%)	2016 Target (%)
Short term securities	2.3	4.8	2.3	2.2
Australian fixed interest	6.5	5.0	N/A	N/A
International fixed interest	7.9	5.3	N/A	N/A
Australian equities	1.4	8.3	(2.2)	0.6
International equities	(1.1)	8.3	(3.3)	(4.8)
Property	16.1	8.3	15.3	16.5
Alternatives	10.9	9.3	4.8	6.3
Overall	3.6	7.1	3.3	4.0

Source: Data provided by Trustee (unaudited).

The objective of defined benefit superannuation funds is to achieve long term investment returns rather than annual targets. Both the STC Pooled Fund and the EISS Pool B returns have exceeded long term targets over the last five years.

Investment performance affects the net assets available to pay member benefits. The return on investments is calculated by dividing investment revenue for the year by the average value of investments under management.

Discount rates fell to 1.99 per cent, adding \$13.4 billion to superannuation obligations

The State discounts superannuation liabilities using the 10 year Commonwealth Government bond rate. These rates fell in 2015-16 from 3.03 per cent to 1.99 per cent. Superannuation liabilities are very sensitive to changes in the government bond rate. A one per cent decrease in the bond rate increases the accrued superannuation liability by \$18.0 billion, while a one per cent increase decreases the liability by \$14.3 billion.

The State's Budget

The NSW Government's Budget Papers focus on the General Government Sector's financial and service delivery performance. One of the principal measures of this performance is through the Budget Result (Net Operating Balance).

The Budget Result is the difference between the cost of delivering the General Government's services and the revenues it earns to fund them.

Key matters

Budget result

The Budget result was a \$4.7 billion surplus, \$2.1 billion higher than the estimate.

State revenue

Actual revenue exceeded budget by \$2.2 billion, largely due to higher than expected stamp duty.

State expenses

The State's controls over expenditure growth continue to be effective.

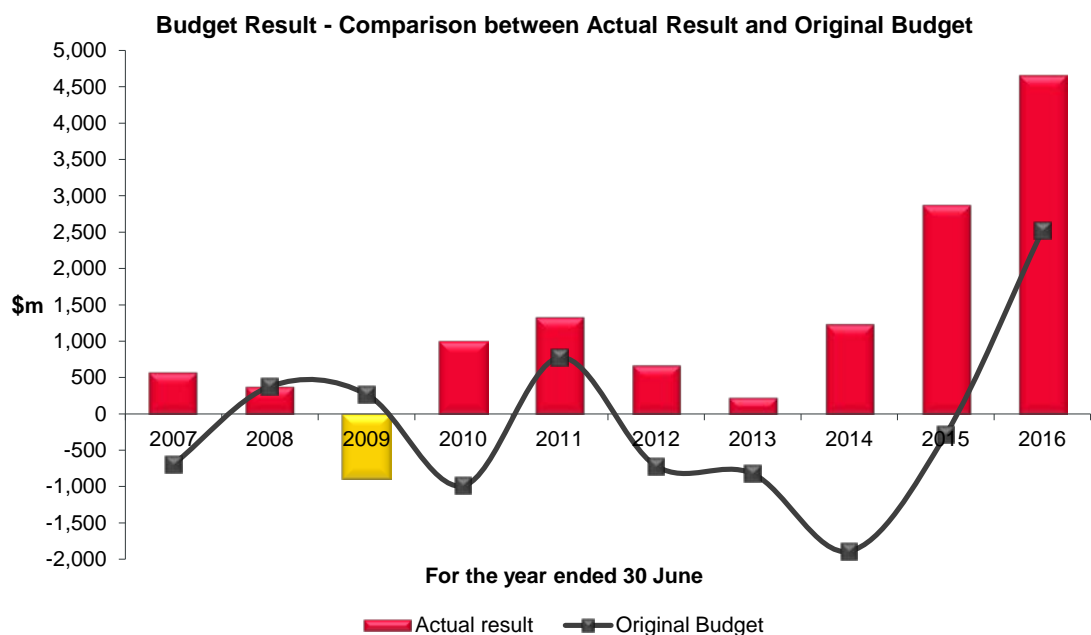
2016-17 Budget

An unqualified conclusion was issued on the 2016-17 budget estimates and forecasts.

Actual result

The Budget result was a \$4.7 billion surplus, \$2.1 billion higher than the estimate

The State has recorded budget surpluses and exceeded the original budget result in nine of the last ten years. The 2015-16 surplus of \$4.7 billion is the largest surplus since current budget standards came into effect in 1996. The largest previous surplus was \$2.9 billion in 2014-15.



Source: Report on State Finances 2006-07 to 2015-16 (audited) and NSW Budget Papers 2006-07 to 2015-16 (unaudited).

Actual revenue exceeded budget by \$2.2 billion

The 2015-16 result was higher than expected mainly due to revenues exceeding budget by \$1.1 billion for stamp duties and \$322 million for grants and subsidies. Overall costs were

slightly higher than expected. Employee expenses exceeded budget by \$682 million, but operating expenses were \$705 million lower than budget.

Net gains from the sale of State assets, such as TransGrid, are not included in the Budget Result. This revenue is recognised in 'Gains/(Losses)', which is included in 'Other Economic Flows' in the Statement of Comprehensive Income.

Budget variances

The tables below compare actual results for the past five years with the original budgets.

Revenue

	2011–12	2012–13	2013–14	2014–15	2015–16
	\$b	\$b	\$b	\$b	\$b
Total revenue					
Original Budget	59.0	59.7	62.6	67.1	72.1
Actual result	59.0	60.1	66.0	69.6	74.3
Variance	--	0.4	3.4	2.5	2.2
Major components:					
Taxation					
Original Budget	20.6	22.1	23.5	25.5	27.9
Actual result	20.7	22.0	24.3	26.1	29.1
Variance	0.1	(0.1)	0.8	0.6	1.2
Grants and subsidies					
Original Budget	27.0	25.4	26.8	28.3	29.8
Actual result	26.7	25.4	28.3	29.2	30.1
Variance	(0.3)	--	1.5	0.9	0.3

All sources of actual revenue were consistently higher than originally budgeted in 2015-16. This was partly due to the variability in certain taxation streams, which is influenced by economic and market conditions. Taxation revenues were \$1.2 billion higher than originally budgeted because growth in the residential and commercial sectors increased stamp duty by \$1.1 billion and the long term lease of TransGrid assets resulted in transfer duty of \$438 million. Land Tax was \$87 million higher than budget due to growth in land values.

Grants and subsidies were \$322 million higher than originally budgeted mainly due to a \$291 million increase in General Purpose grants.

Expenses

	2011–12	2012–13	2013–14	2014–15	2015–16
	\$b	\$b	\$b	\$b	\$b
Total expenses					
Original Budget	59.7	60.6	64.5	67.4	69.6
Actual result	58.4	59.9	64.8	66.7	69.7
Variance	(1.3)	(0.7)	0.3	(0.7)	0.1
Major components:					
Employee expenses					
Original Budget	29.2	29.1	30.6	32.5	28.9
Actual result	28.5	28.4	31.5	32.3	29.6
Variance	(0.7)	(0.7)	0.9	(0.2)	0.7
(Other) operating expenses					
Original Budget	13.3	14.2	15.0	14.6	17.6
Actual result	13.4	14.2	14.3	14.8	16.9
Variance	0.1	--	(0.7)	0.2	(0.7)

The State's expense controls continue to be effective

In recent years, the Government's expense control measures have kept actual expenses in line with budget. In 2015-16, total expenses exceeded the original budget by \$51 million.

Employee expenses, excluding superannuation, were \$682 million higher than budget, largely driven by:

- higher than expected long service leave costs (\$89 million)
- restructuring costs for redundancy and transfer payments, and payroll tax on-costs associated with the transition of direct disability services to the non-government sector as part of the National Disability Insurance Scheme (\$197 million)
- additional teachers for higher than expected student enrolments (\$73 million).

Other operating expenses were \$705 million lower than budget, largely due to:

- lower than expected costs in TAFE NSW (\$185 million)
- lower than expected expenditure on Aboriginal land claims and State Priority Plan and Basin Plan projects (\$171 million)
- lower than expected expenditure on Sydney Metro Northwest (\$112 million)
- lower than expected costs in NSW Self Insurance due to favourable claims outcomes (\$109 million).

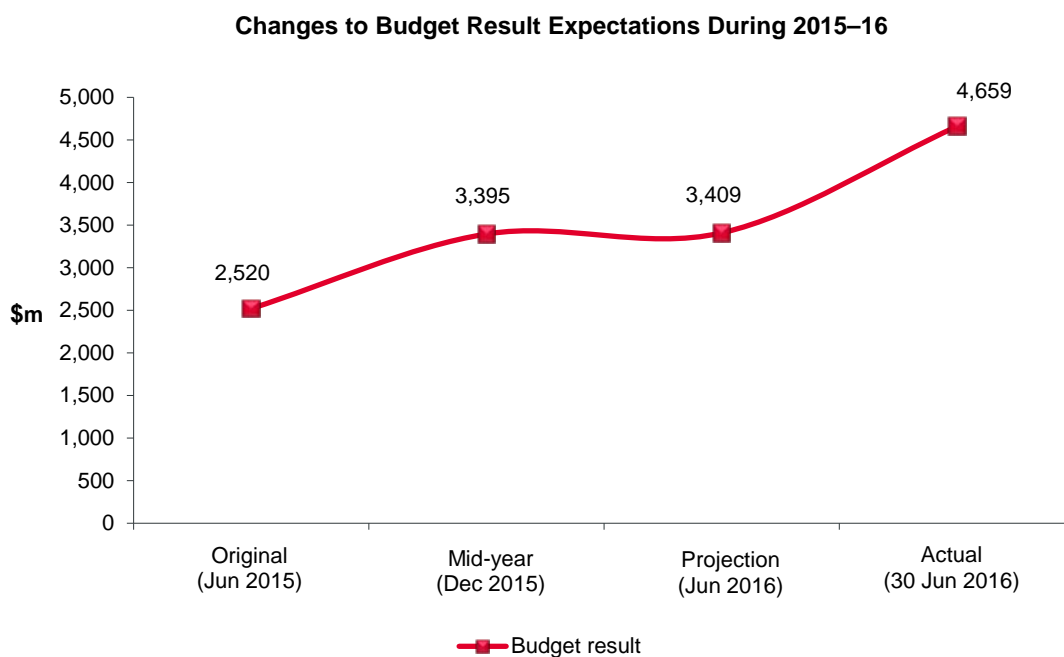
These were offset by higher than expected costs for:

- Hepatitis C treatments in public hospitals (\$157 million)
- Westconnex (\$130 million).

Changes to the Budget Result during 2015-16

The actual Budget Result exceeded the June 2016 projection by \$1.3 billion

The NSW Government's 2015-16 Budget was announced in June 2015. Budgets are publicly revised twice each year, in December as part of the mid-year review, and in June when the following year's Budget is handed down. The graph below shows the changes in the State's expectations for the Budget Result during 2015-16.



The Treasury attributed the \$1,250 million increase between the June 2016 projections and the 30 June 2016 actual Budget Result to higher revenue of \$562 million and lower expenses of \$688 million.

The higher revenue was largely due to an unexpected \$350 million investment income distribution from NSW Self Insurance Corporation and a \$167 million adjustment to multi-year licence fee revenue.

Expenses were lower than expected largely due to smaller actuarial adjustments for Workers Compensation Dust Diseases and NSW Self Insurance Corporation liabilities of \$168 million and \$155 million respectively. Transport for NSW also incurred lower than expected operating expenditure of \$267 million.

Assurance on estimates and forecasts in 2016-17 Budget Papers

An unqualified conclusion was issued on the 2016-17 Budget estimates and forecasts

The Treasurer requested the Auditor-General 'undertake a review of the reasonableness of the estimates and forecasts in the 2016-17 Budget'. The review was performed in accordance with applicable assurance standards. The review resulted in an unqualified conclusion being issued on the estimates and forecasts.

The Auditor-General's Independent Assurance Practitioner's Review Report and the engagement subject matter appear in Budget Paper 1 of the 2016-17 Budget Papers published at www.budget.nsw.gov.au.

Objective of the engagement

The objective of the review was to conclude whether anything had come to the Auditor-General's attention that caused her to believe the estimated financial statements of the General Government Sector had not been prepared consistently with the basis of preparation, and the assumptions stated or the methodologies used to determine those assumptions were unreasonable. The conclusion was deliberately expressed in the negative form because it offered 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 on 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 could be expressed as to whether the forecasts would be achieved.

Governance

Governance refers to high-level frameworks, processes and behaviours established to ensure an entity meets its intended purpose, conforms with legislative and other requirements and meets expectations of probity, accountability and transparency.

Good governance promotes public confidence in the Government and its agencies.

Key matters

AAA credit rating

The State maintained its AAA credit rating, but the outlook was revised to negative.

Expenditure growth

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

Unfunded superannuation

The State's unfunded liability is at the same level it was at when the *Fiscal Responsibility Act 2005* was introduced over ten years ago.

Corporate governance

Treasury should establish an Audit and Risk Committee dedicated to the whole-of-government.

Fiscal Responsibility Legislation

The Fiscal Responsibility Act 2012 (the Act) sets the overall goal for managing government finances and maintaining 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. It also helps maintain business and consumer confidence so economic activity and employment are sustained. The legislation sets out targets and principles for financial management.

AAA credit rating

The State maintained its AAA credit rating, but the outlook was revised to negative

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

In July 2016, Standard & Poor's affirmed its AAA rating, but revised the outlook to negative, because of a change in the outlook for the Commonwealth. Standard and Poor's caps the long-term rating of any State at the outlook for the Commonwealth, but noted the State's very strong financial management and economy, and exceptional liquidity.

In December 2015, Moody's affirmed its Aaa rating and stable outlook.

General Government expenditure growth

General Government expenditure growth is lower than long term revenue growth

General Government expenditure growth was 4.4 per cent in 2015-16, below long term revenue growth of 5.6 per cent.

The Act sets a target that General Government expenditure growth cannot exceed its long term average revenue growth. The Fiscal Responsibility Regulation 2013 prescribes the long term revenue growth rate at 5.6 per cent. This rate equals the growth over fourteen years published in the 2011-12 Long Term Fiscal Pressures Report. The NSW Intergenerational Report, published in 2016, reported growth in revenue has been 5.7 per cent.

Eliminating unfunded superannuation liabilities

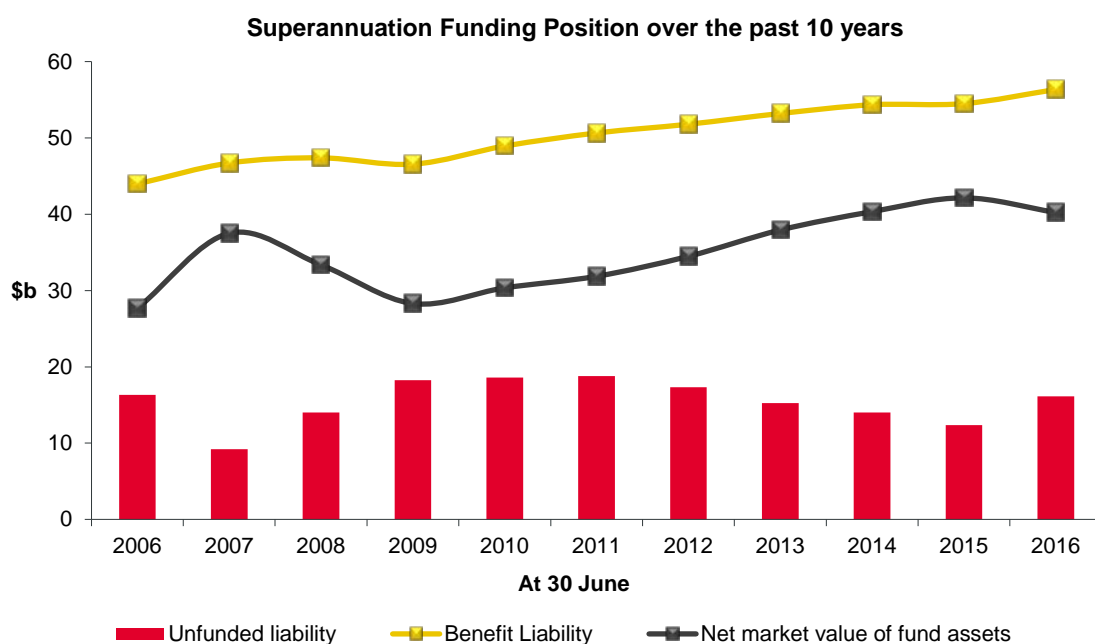
The unfunded superannuation liability is at the same level it was at over ten years ago

The State's unfunded superannuation liability, measured using *AAS25 Financial Reporting by Superannuation Plans*, increased \$3.7 billion to \$16.1 billion at 30 June 2016 from \$12.4 billion at 30 June 2015. This takes the unfunded liability to the same level it was at when the *Fiscal Responsibility Act 2005* Act was introduced over ten years ago.

The Act sets a target of eliminating the State's unfunded defined benefit liabilities by 2030.

The Government predicts the 2030 target will be achieved. The State's funding plan is to contribute amounts escalated by five per cent each year so the State Superannuation Schemes will be fully funded by 2026. In 2015-16, the State made employer contributions of \$1.7 billion, which is largely consistent with contributions over the past five years.

The graph below shows the superannuation liability funding position over the last ten years.



In 2015-16, member benefits for the year exceeded investment returns and employer contributions. The Funds had to sell investments to pay member benefits.

Audit and Risk Committee

An Audit and Risk Committee should be established for to the whole-of-government

New South Wales Government agencies would benefit from a dedicated independent audit and risk committee for the whole-of-government that focuses on common issues and risks across the New South Wales public sector. Such a committee should recommend and oversight coordinated responses to sector wide issues.

The scope of work for a dedicated whole-of-government independent audit and risk committee would be extensive and significantly broader than a review of the General Government and Total State Sector Accounts.

Independent audit and risk committees are widely accepted as a fundamental component of a good corporate governance structure.

Audit and risk committees typically focus on issues relevant to the integrity of financial reporting and oversee risk management, internal control, compliance and internal audit activities. TPP 15-03 Internal Audit and Risk Management Policy for the NSW Public Sector requires most New South Wales Government agencies to operate an independent audit and risk committee, but this does not apply to the whole-of-government.

Financial Management Transformation

The Financial Management Transformation (FMT) Program aims to change and improve financial governance, budgeting and reporting arrangements of the NSW public sector.

The vision is to create a world class financial management framework for NSW to support high quality performance and resource management. This is planned to be achieved through:

Capability and culture change		
New PRIME IT system	Policy reform	Legislation reform
Financial risk management		
to deliver		
Enhanced strategic and operational financial management 'capabilities' within NSW public sector	More up-to-date legislation, rules, policies and guidance, which are easy to access and understand	More effective relationships between agencies and Treasury
A 'single source of truth' for public sector financial and performance management information	A platform for agencies to focus on core service delivery	Improved efficiency through automated operating processes, whole-of-government budgeting and financial reporting

The State is moving to program budgeting and reporting

A key reform of the FMT Program is to replace the 'service group' budgeting and reporting structure with program based budgeting and reporting. The programs will become the focal point of budget management across the NSW public sector.

Treasury is implementing a new IT system called PRIME

The FMT Program will implement a modern IT system for Treasury's whole-of-government budgeting and reporting. PRIME will replace existing outdated and inefficient systems which is expected to give the Government strategic, relevant and timely information to plan and deliver its policy priorities and the Budget as a whole.

PRIME is expected to capture and monitor financial and non-financial performance data and provide business intelligence and analytics to inform the Government's decisions.

Financial management legislation is being updated

Financial management legislation and the Constitution are the foundations for the managing public resources. Planned key changes to the legislative framework include:

- moving from a compliance to a performance focus
- simpler, principles based legislation which sets clear and consistent responsibilities for accountable authorities (agencies)
- support for accountable authorities, in return for greater accountability, by:
 - clearly defined duties
 - more flexible delegation powers
 - a less prescriptive financial management framework
- clarifying relationships between the accountable authorities and the Minister by:
 - requiring Ministers to make reasonable enquiries of accountable authorities
 - requiring accountable authorities to exercise due care and diligence in providing advice to Ministers, which they will not be obliged to accept
- expanding the Treasurer's access to information from financial compliance to performance evaluation
- allowing Treasurer's Directions to target specific agencies rather than applying to the entire sector

- decriminalising breaches.

The State is moving to outcomes based budgeting

The policy component of the FMT Program is expected to tie the PRIME system and legislative reform together in a useable financial management framework. The policy focus will be on outcome-based budgeting and the accompanying governance framework.

Developing the financial management framework is at the conceptual stage, with strategic questions posed to key stakeholders including the Secretaries Board for their input and direction. The framework will be co-designed with the sector and partners throughout the remainder of phase 1 and implemented in phase 2.

Key benefits of the Program

Expected key benefits of the program include:

Strategic benefits for the sector		
Improved alignment of resources with the government's priorities	Enhanced transparency of State finances	Enhanced confidence in financial management and certainty of fiscal performance
Strategic benefits for clusters and agencies		
Provide a platform for agencies to focus on core service delivery		
Improved collaboration within government		
Operational benefits		
Enter once - use many times	Automated workflows	Integrated planning, budgeting and reporting

Business case and cost

The Program's business case was approved in March 2014. It includes delivery of the 2017-18 budget using the PRIME system as a key milestone.

The FMT Program is forecast to cost less than the \$92.3 million budget

At 31 July 2016, approximately \$42 million had been spent on the Program, including capital costs of \$21.4 million. The Program's total forecast cost is \$91 million, within the \$92.3 million budget.

Timing of delivery

The FMT Program is broken into three phases. Phases 1 and 2 are scheduled to complete by June 2018. Phase 3, which focuses on maturity and optimisation of program budgeting and embedding change, capability and outcome focused strategic and resource management, is to be transitioned into business as usual by 2019 and beyond.

2016–17	2017–18	2018–19
Phase 1	Phase 2	Phase 3
PRIME progressively rolled out from November 2016	End to end budget process and functionality in PRIME	The infrastructure and changes needed to take outcome based budgets to the next level
17/18 Budget delivered using PRIME, reconciled on an agency/entity basis	Budget reconciled on programs and an agency/entity basis	
Expenditure outcomes allocated to programs in Budget Paper 3	Complete suite of policy framework changes (including legislative reform)	
Core improved processes and dashboard reports	Optimised suite of reports and analytics	
New financial management in place	New culture and behaviours in place to support world class financial management	
Continual refinement of program structures and data quality with clusters		
Commence roll out of Capability and culture framework		

Section Two

Appendices



Appendix One – Prescribed Entities

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

The following were prescribed entities as at 30 June 2016:

Entity/Fund	Latest financial statements audited	Type of audit opinion issued
Agricultural Scientific Collections Trust	30 June 2015 ^(a)	Unmodified
AustLII Foundation Limited	31 December 2015	Unmodified
Belgenny Farm Agricultural Heritage Centre Trust	30 June 2015 ^(a)	Unmodified
Buroba Pty Ltd	30 June 2016	Unmodified
C. B. Alexander Foundation	30 June 2015 ^(a)	Unmodified
City West Housing Pty Ltd	30 June 2015	Unmodified
The Commissioner for Uniform Legal Services Regulation	-- ^(d)	--
Cowra Japanese Garden Maintenance Foundation Limited	31 March 2016	Unmodified
Cowra Japanese Garden Trust	31 March 2016	Unmodified
Crown Employees (NSW Fire Brigades Firefighting Staff Death and Disability) Superannuation Fund	30 June 2016	Unmodified
Dumaresq-Barwon Border Rivers Commission	30 June 2011 ^(c)	Unmodified
Eif Pty Limited	30 June 2015 ^(a)	Unmodified
Energy Investment Fund	30 June 2015 ^(a)	Unmodified
Gosford City Council, being a water supply authority listed in Schedule 3 to the <i>Water Management Act 2000</i>	30 June 2015 ^(e)	Unmodified
Home Building Compensation Fund	30 June 2015 ^(a)	Unmodified with Emphasis of Matter - significant uncertainty in the measurement of the provision for outstanding claims
The funds for the time being under the management of the New South Wales Treasury Corporation, as trustee	30 June 2016	Unmodified
<ul style="list-style-type: none"> • Hour-Glass Cash Fund • Hour-Glass Strategic Cash Fund • Hour-Glass Medium Term Growth Fund • Hour-Glass Long Term Growth Fund • Treasury Managed Fund Investment Portfolio • Long Service Corporation Investment Fund • NSW Trustee and Guardian Growth Portfolio • Hour-Glass Liquidity Cash Fund • Hour-Glass Australian Bond Fund • Hour-Glass International Bond Fund • Hour-Glass International Share (Unhedged) Fund • Hour-Glass International Share (Hedged) Fund • Hour-Glass Indexed International Share (Unhedged) Fund • Hour-Glass Emerging Market Share Fund • Hour-Glass Listed Property Fund • Hour-Glass Unlisted Infrastructure Fund 		

Entity/Fund	Latest financial statements audited	Type of audit opinion issued
<ul style="list-style-type: none"> Hour-Glass Unlisted Property Fund Hour-Glass Multi-Asset Class Fund TCorp Direct Infrastructure Fund A TCorp Specialist Emerging Markets Share Fund Hour-Glass Australian Share Fund Hour-Glass Indexed Australian Share Fund 		
The Illawarra Health and Medical Research Institute Limited	30 June 2015 ^(a)	Unmodified
The Legal Services Council	-(^b)	N/A
Macquarie University Professorial Superannuation Scheme	30 June 2016	Unmodified
Minister administering the <i>Environmental Planning and Assessment Act 1979</i> (a corporation)	30 June 2016	Unmodified
Minister administering the <i>Heritage Act 1977</i> (a corporation)	30 June 2015 ^(a)	Unmodified
National Art School	31 December 2015	Unmodified
NSW Fire Brigades Superannuation Pty Limited	30 June 2016	Unmodified
Parliamentary Contributory Superannuation Fund	30 June 2015 ^(a)	Unmodified
The Brett Whiteley Foundation	30 June 2015 ^(a)	Unmodified
The superannuation fund amalgamated under the <i>Superannuation Administration Act 1991</i> and continued to be amalgamated under the <i>Superannuation Administration Act 1996</i> (known as the SAS Trustee Corporation Pooled Fund)	30 June 2015 ^(a)	Unmodified
The trustees for the time being of each superannuation scheme established by a trust deed as referred to in section 127 of the <i>Superannuation Administration Act 1996</i>	30 June 2015 ^(a)	Unmodified
The trustees for the time being of The Art Gallery of New South Wales Foundation	30 June 2015 ^(a)	Unmodified
Trustee of the Home Purchase Assistance Fund	30 June 2015	Unmodified
Trustees of the Farrer Memorial Research Scholarship Fund	31 December 2015	Unmodified
United States Studies Centre	31 December 2015	Unmodified
Universities Admissions Centre (NSW and ACT) Pty Limited	30 June 2015 ^(a)	Unmodified
University of Sydney Professorial Superannuation System	31 December 2015	Unmodified
Valley Commerce Pty Ltd	30 June 2016	Unmodified
Wyong Council, being a water supply authority listed in Schedule 3 to the <i>Water Management Act 2000</i>	30 June 2015 ^(e)	Unmodified

a 30 June 2016 financial statements have been submitted for audit. Audit still in progress at 26 September 2016.

b Applicable to financial statements for the year ended 30 June 2016 and onwards.

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

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

e The audit for the period 1 July 2015 to 12 May 2016 is in progress with expected completion by 31 December 2016.

Appendix Two – Legal Opinions

The Auditor-General is 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.

One legal opinion was received since my last report in Volume Four 2015, which was released on 15 October 2012.

The opinion relates to whether the secrecy provisions in section 38 of the *Public Finance and Act 1983* would be breached if the Audit Office moved its email hosting service to a third party provider.



CROWN SOLICITOR
NEW SOUTH WALES

Advice

Application of s. 38, PFA Act to transfer of Email hosting service

Contents

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3. Advice sought	2
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Agent and principal	3
Exceptions	4

Prepared for: AUD018 Audit Office of New South Wales
Date: 20 May 2016
Client ref: A011440 A T Whitfield
CSO ref: 201601310 T01 John McDonnell

1. Summary of advice

- 1.1 My advice is sought as to whether the secrecy provision in s. 38 of the *Public Finance and Audit Act 1983* ("the *PFA Act*") would be breached if the Audit Office moved its email hosting service to a third party provider.
- 1.2 In my view, on the proper interpretation of s. 38, there are several arguments in favour of the conclusion that no breach would take place in the circumstances described.
- 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 I am instructed that the Audit Office is considering moving its email hosting from a self-managed system to Microsoft's Exchange Online service. This proposed change would involve all email information being held and managed by a third party (that is, Microsoft) at locations in Sydney and Melbourne.
- 2.2 If the email hosting were to migrate to Microsoft, I am instructed that a small number of staff at Microsoft would have access to the email information in an unencrypted (that is, readable) form. This access would be subject to contractual terms ensuring that it would only be used for the purpose of providing the hosting service. Otherwise, the confidentiality of the information would be ensured by virtue of strict access controls and encryption.

3. Advice sought

- 3.1 My advice is sought as to whether the requirements of s. 38 of the *PFA Act* would be satisfied if email hosting were to migrate to Microsoft as described above.

4. Advice

- 4.1 Section 38 of the *PFA Act* provides:

"(1) The Auditor-General, an auditor and an authorised person shall preserve and aid in preserving secrecy with respect to all matters and things that come to the knowledge of the Auditor-General, auditor or authorised person in the exercise of the functions of the Auditor-General, auditor or authorised person under this Act and the prescribed requirements and shall not communicate to any person any such matter or thing.

(2) Nothing in subsection (1) applies to or in respect of:

- (a) the conduct of any matter necessary for the proper administration of this Act or the prescribed requirements, or

- (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, or
- (c) disciplinary proceedings brought against an officer of an authority, or
- (d) a report or communication authorised or required to be made by or under this Act or the prescribed requirements, or
- (e) a report or communication that the Treasurer authorises the Auditor-General to make to a person for the purposes of a due diligence or similar process relating to the sale of any government undertaking."

- 4.2 In my view, the encryption and access controls described would meet the requirements of s. 38(1). However, it is necessary to consider whether any breach would be occasioned by the fact that a small number of Microsoft employees would have access to the unencrypted data.
- 4.3 In my view, there are two arguments in favour of the proposition that the ability of Microsoft to access unencrypted Audit Office emails would not amount to a breach of the secrecy requirements of s. 38.

Agent and principal

- 4.4 The first of these is an argument of agency. I have previously advised, on a number of occasions on which privacy legislation has been invoked, that a third party acting or providing a service on behalf of government (whether by way of contract or less formally) is acting, for the purpose of the legislation, as the agent of the government body. Since the law for certain purposes treats the act of the agent as the act of the principal, the use of personal information by an agent in a manner that is contrary to, for example, s. 17 of the *Privacy and Personal Information Protection Act 1998* ("the *PPIP Act*"), would in my view amount to a breach of that provision by the government agency. On the other hand, the communication of such information by a government agency to an agent (for example, a solicitor representing the agency in legal proceedings) would not amount to a "disclosure" of the information for the purpose of s. 18 of the *PPIP Act*.
- 4.5 In the context of privacy legislation, the word "disclosure" means the communication of information to a person external to the government agency: where the communication is internal, the conduct would amount, if anything, to "use". In s. 38 of the *PFA Act*, neither word is used; rather, there is a general prohibition on the "communication" (a word which is not defined) of information. Nevertheless, it cannot be supposed that s. 38(1) intends to prohibit any and all communication of information as between persons employed in the Audit Office: to do so would be to cripple the mechanisms whereby the administration of the *PFA Act* is carried out. Despite the express words of s. 38, some

communications of information must be intended to take place in order for the Act to have any practical operation. In my view, the most likely meaning of "communication" that is intended by s. 38(1) is equivalent to "disclosure" when used in the privacy context.

- 4.6 Of course, it cannot be suggested that a government agency operating in the current economy can do so without an email service. Currently, persons are employed within the Audit Office for the purpose of facilitating the provision of that service. However, it is relatively common practice for government bodies to outsource such a service to a private third party. In my view, there is a good argument to be made for the proposition that Microsoft, in providing that service, acts as the agent of the Audit Office, and as such, that there is no communication of that information in the sense meant by s. 38(1).


Exceptions

- 4.7 Although my preferred view is that no communication within the meaning of s. 38(1) takes place, in the event that my interpretation of that provision is incorrect and information would be communicated to Microsoft, I am of the view that one of two exceptions in s. 38(2) would be applicable.
- 4.8 Section 38(2)(a) constitutes an exception to the secrecy requirement for "the conduct of any matter necessary for the proper administration of this Act or the prescribed requirements". The words are not defined, so it is not clear whether "the conduct of any matter" is intended to denote the narrower meaning of conducting legal proceedings or, more broadly, any action, object, or thing that might be necessary for the proper administration of the Act. Given that two other paragraphs of s. 38(2) deal with legal or administrative proceedings more clearly and specifically (s. 38(2)(b) and (c)), I incline to the view that the broader meaning is the one intended. Assuming this is correct, it seems to me that the provision of an email hosting service is necessary for the proper administration of the Act and, this being the case, the access of Microsoft to unencrypted emails for the purpose of providing that service would come within the exception in s. 38(2)(a).
- 4.9 Alternatively, s. 38(2)(d) may apply. In *Re NSW Grains Board; Smith (as Administrator of New South Wales Grains Board) v Lawrence* [2002] NSWSC 913 ("*NSW Grains Board*"), Barrett J considered the effect of s. 38 of the *PFA Act* in the context of compulsory powers for obtaining evidence under the *Corporations Act 2001 (Cth)*. In relation to s. 38(2)(d), his Honour stated at [107] (emphasis added):

"[The] purpose [of s. 38(2)(d)] is merely to free from the s. 38(1) restraint reports and communications authorised or required by the Act, together with disclosures **incidental to and necessary for** such reports and communications."

4.10 In my view, it is arguable that the provision of an email hosting service is incidental to and necessary for enabling communications authorised or required by the *PFA Act*; that being the case, any disclosure to the body providing the hosting service for the purpose of enabling that service would come within the scope of s. 38(2)(d), as interpreted in *NSW Grains Board*.

Signed:

A handwritten signature in blue ink, consisting of a vertical line with a loop at the top and a horizontal line crossing it, ending in a small arrowhead.

John McDonnell
A/Deputy Crown Solicitor
for Crown Solicitor

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Appendix Three – The Treasury Cluster

The Treasury cluster provides leadership in financial management across the public sector and is the lead cluster in delivering State Priorities to:

- maintain the State's triple-A credit rating
- deliver strong budget management ensuring expenditure growth is less than long term revenue growth.

This appendix includes the results of the 30 June 2016 financial statement audits of the agencies in the Treasury Cluster.

Agency	Audit result		Early close procedures	Financial statements	Audit
	Modified opinion	Number of significant matters	Received by statutory date	Received by statutory date	Completed by statutory date
The Treasury****	No	--	N/A	Yes	Yes
Crown Entity**	No	--	Yes	Yes	Yes
Electricity Assets Ministerial Holding Corporation	No	--	Yes	Yes	Yes
Electricity Transmission Ministerial Holding Corporation***	No	--	N/A	Yes	Yes
Ministerial Holding Corporation	No	--	N/A	Yes	In progress
Restart NSW	No	--	N/A	Yes	Yes
Liability Management Ministerial Corporation	No	--	Yes	Yes	Yes
Lotteries Assets Ministerial Holding Corporation	No	--	N/A	Yes	Yes
Cobbora Holding Company Pty Limited	No	--	Yes	Yes	In progress
Cobbora Rail Company Pty Limited	No	--	N/A	Yes	In progress
Cobbora Coal Mine Pty Limited	No	--	N/A	Yes	In progress
State Rail Authorities Residual Holding Corporation	No	--	N/A	Yes	Yes
Port Assets Ministerial Holding Corporation	No	--	Yes	Yes	Yes
Port Botany Lessor Pty Limited	No	--	N/A	Yes	Yes
Port Kembla Lessor Pty Limited	No	--	N/A	Yes	Yes
Port of Newcastle Pty Limited	No	--	N/A	Yes	Yes
New South Wales Long Service Corporation	No	--	Yes	Yes	Yes
Internal Audit Bureau*	No	--	N/A	Yes	In progress

Agency	Audit result		Early close procedures	Financial statements	Audit
	Modified opinion	Number of significant matters	Received by statutory date	Received by statutory date	Completed by statutory date
New South Wales Treasury Corporation	No	--	Yes	Yes	Yes
TCorp Nominees Pty Limited	No	--	Yes	Yes	Yes
SAS Trustee Corporation	No	--	Yes	Yes	Yes
STC - Pooled Fund	No	--	N/A	Yes	In progress
Energy Industries Superannuation Scheme Pool B	No	--	N/A	Yes	Yes
Parliamentary Contributory Superannuation Fund	No	--	N/A	Yes	In progress
Energy Industries Superannuation Scheme Pool A	No	--	N/A	Yes	Yes
Energy Industries Superannuation Scheme Pty Limited	No	--	N/A	Yes	Yes
Local Government Superannuation Scheme Pty Ltd	No	--	N/A	Yes	Yes
Energy Investment Fund	No	--	N/A	Yes	In progress
EIF Pty Limited	No	--	N/A	Yes	In progress
Trustees of the Parliamentary Contributory Superannuation Fund	No	--	N/A	Yes	Yes
Macquarie University Professorial Superannuation Scheme	No	--	N/A	Yes	Yes
University of Sydney Professorial Scheme	No	--	N/A	Yes	Yes
Buroba Pty Ltd	No	--	N/A	Yes	Yes
Valley Commerce Pty Limited	No	--	N/A	Yes	Yes
Crown Employees (NSW Fire Brigades Firefighting Staff Death and Disability) Superannuation Fund	No	--	N/A	Yes	Yes
NSW Fire Brigades Superannuation Pty Ltd	No	--	N/A	Yes	Yes
Superannuation Administration Corporation	No	3****	Yes	Yes	Yes

* Internal Audit Bureau was abolished on 1 July 2016.

** Crown Entity received Treasury approval to extend the due date for financial statements submission to 5 August 2016.

*** Electricity Transmission Ministerial Holding Corporation received Treasury approval to extend the due date for financial statements submission to 1 August 2016.

**** The Treasury participated in a hard close pilot with an effective date of 31 May 2016. It was exempt from the early close requirements set out in TC 16/01.

***** The three significant matters related to the Corporation's liquidity, the potential sale of the Corporation, and the progress of an ongoing IT project.

	Total assets		Total liabilities		Total revenue		Total expense		Net result	
	2016 \$m	2015 \$m	2016 \$m	2015 \$m	2016 \$m	2015 \$m	2016 \$m	2015 \$m	2016 \$m	2015 \$m
The Treasury	73	46	57	45	137	794	118	811	19	(17)
Crown Entity	35,764	24,945	122,610	97,959	57,046	55,040	57,518	56,369	(327)	(1,328)
Electricity Assets Ministerial Holding Corporation	80	76	46	45	2	5	--	5	2	--
Electricity Transmission Ministerial Holding Corporation	177	6,647	250	4,554	3,771	211	6	8	3,766	203
Ministerial Holding Corporation	6	7	--	--	--	--	--	--	(1)	--
Liability Management Ministerial Corporation	103	84	11	22	19	26	--	--	19	26
Lotteries Assets Ministerial Holding Corporation	--	--	--	--	--	--	--	--	--	--
Cobbora Holding Company Pty Limited	96	145	3	7	9	11	(44)	(26)	(44)	(26)
Cobbora Rail Company Pty Limited	--	--	--	--	--	--	--	--	--	--
Cobbora Coal Mine Pty Limited	--	--	--	--	--	--	--	--	--	--
State Rail Authorities Residual Holding Corporation	--	--	--	--	--	--	--	--	--	--
Port Assets Ministerial Holding Corporation	191	180	--	1	45	43	33	31	12	12
Port Botany Lessor Pty Limited	151	141	--	--	34	32	24	22	10	10
Port Kembla Lessor Pty Limited	16	15	--	--	6	6	5	5	1	1
Port of Newcastle Pty Limited	24	23	--	--	6	6	4	4	1	2
New South Wales Long Service Corporation	1,184	1,073	943	880	196	239	148	133	48	106
Internal Audit Bureau	--	8	--	5	5	17	6	16	(1)	--
New South Wales Treasury Corporation	80,318	78,038	80,099	77,871	168	200	95	94	73	106
TCorp Nominees Pty Limited	--	--	--	--	--	--	--	--	--	--
SAS Trustee Corporation	12	10	12	10	49	57	49	57	--	--
STC - Pooled Fund	41,601	42,461	562	473	3,611	6,355	4,560	4,615	(949)	1,740
Energy Industries Superannuation Scheme Pool B	2,062	2,400	12	15	258	345	592	346	(334)	(1)
Parliamentary Contributory Superannuation Fund	271	278	2	2	21	43	28	23	(7)	20
Energy Industries Superannuation Scheme Pool A	3,004	2,552	1	15	719	564	35	29	684	535
Energy Industries Superannuation Scheme Pty Limited	15	11	15	11	30	19	29	19	--	--
Local Government Superannuation Scheme Pty Ltd	9	8	9	8	33	32	33	32	--	-
Energy Investment Fund	4,956	4,922	16	80	146	383	250	664	(104)	(281)
EIF Pty Limited	--	--	--	--	--	--	--	--	--	--
Trustees of the Parliamentary Contributory Superannuation Fund	--	--	--	--	--	--	--	--	--	--
Macquarie University Professorial Superannuation Scheme	14	15	--	--	--	2	1	2	(1)	--
University of Sydney Professorial Superannuation System	35	37	--	--	1	3	4	4	(3)	(1)
Buroba Pty Ltd	--	--	--	--	--	--	--	--	--	--
Valley Commerce Pty Limited	--	--	--	--	--	--	--	--	--	--
Crown Employees (NSW Fire Brigades Firefighting Staff Death and Disability) Superannuation Fund	7	2	6	2	15	18	15	18	--	--
NSW Fire Brigades Superannuation Pty Ltd	--	--	--	--	--	--	--	--	--	--
Superannuation Administration Corporation	69	55	30	28	100	109	97	104	3	5

Source: Financial statements (audited).

Our vision

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