Queensland Audit Office

Results of audit: Queensland state government financial statements 2012–13

Report to Parliament 12 : 2013–14

Queensland Audit Office

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Your ref:
Our ref:

December 2013

The Honourable F Simpson MP
Speaker of the Legislative Assembly
Parliament House
BRISBANE QLD 4000

Dear Madam Speaker

Report to Parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009*, and is titled Results of audit: Queensland state government financial statements 2012–13.

In accordance with s.67 of the Act, would you please arrange for the report to be tabled in the Legislative Assembly.

Yours sincerely

Andrew Greaves
Auditor-General

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Summary

The state's ability to fund its service delivery to Queenslanders on an ongoing basis, its ability to borrow money and the rate at which it borrows are affected by its financial sustainability.

This report provides insight into the financial viability of the public sector and the key trends and issues in the management of its multi-billion dollar budget. It does this by utilising our independent audit opinions of the financial performance and position in 2012–13 of the total state sector (TSS) and the general government sector (GGS), and then assessing the factors affecting the financial sustainability of the state.

The financial statements for the state of Queensland must be audited each year by the Auditor-General and an independent audit opinion expressed. The audit opinion provides credibility to the financial information presented. The audited consolidated financial statements 2012–13—Government of Queensland (state government financial statements) are included as part of the Report on State Finances tabled in Parliament by the Treasurer.

The GGS represents *public sector entities* (such as state government departments, statutory bodies and commercial businesses they control) funded mainly by *appropriations*. Appropriations are monies provided to entities by the Parliament to fund the delivery of services.

The TSS comprises the GGS entities, as well as public financial corporations (PFCs) and public non-financial corporations (PNFCs). PFCs and PNFCs are entities funded mainly through their own sourced revenues, rather than by appropriations.

Result of audit

We provided an unqualified audit opinion on the state government financial statements. This means that the state government financial statements were prepared in accordance with Australian Accounting Standards and presented a true and fair view of the financial position and performance of the GGS and TSS.

Timeliness and quality of draft statements

The state’s financial statements were completed and certified within the legislative time frames.

The quality of the state government financial statements and supporting work papers provided for audit were of a high standard.

Financial performance and position

Financial performance

The primary measure of financial performance for the state’s financial statements is the *operating result* which, when positive, represents a surplus of operating revenues over expenditure; negative represents a deficit. The operating result is the net operating balance (net income from normal transactions), together with other *economic flows*. Other economic flows are changes in the value of an asset or liability that do not result from normal transactions. Usually these are unrealised gains and losses on long term assets, held by the state to fund long term liabilities and government debt.

For 2012–13, the state recorded an operating result of negative $1.2 billion. This was $3.8 billion less than the negative operating result of $5.0 billion reported in 2011–12 and represented the best result over the last 5 financial years.

The net operating balance of the state in 2012–13 was negative $5.7 billion, a significant increase from the average net operating balance of the previous four financial years of negative $2.5 billion.

This increase in 2012–13 was predominantly driven by a reduction in the state's revenue (six per cent decrease from 2011-12) rather than expenses (one per cent increase from 2011–12). The reduction in revenue is explained in part by significant grants from the Australian Government during 2011–12 for natural disaster recovery received in advance of need. The grant revenue received by the state during 2012–13 was $4.3 billion less than in 2011–12; however, the expenditure on natural disaster recovery remained.

Financial position

The *net worth* (the difference of assets over liabilities held) of the state at 30 June 2013 was $168.8 billion. This was an increase of $6.8 billion (four per cent) from 30 June 2012 and represented the first increase in the past five financial years.

The revaluation of non-financial assets added $4.5 billion to the net worth of the state, primarily at the Department of Transport and Main Roads and Seqwater. The increase in the market value of the state's investments by $4.0 billion and an actuarial gain on the net defined benefits superannuation liability of $3.7 billion both added to the net worth of the state.

These increases in net worth were, in part, offset by the negative $5.7 billion net operating balance.

Financial sustainability

Over the long term, if the state is able to fund its operations and a significant portion of its capital program from its revenues, this will ensure that the burden of debt is not unduly placed on future generations without the benefit of supporting assets and the services they provide.

The state's policy settings changed substantially in 2011–12; these are reflected in two major aims of achieving a fiscal balance, and stabilising and then reducing debt.

We assessed financial sustainability using four key financial indicators from the audited consolidated financial statements for 2012–13 to understand the effect of past and current revenue and expenditure policy settings:

- operating ratio—indicates the capacity to meet recurrent operating expenditure from recurrent operating revenues
- net operating cash flow to net purchases of non-financial assets—indicates the ability to self-finance asset acquisitions from operations, rather than relying on debt
- capital replenishment ratio—indicates whether the rate of capital outlays on non-financial assets is keeping pace with the rate of depreciation of those assets
- net financial liabilities to operating revenue ratio—indicates the capacity of the state to repay debt principal and interest.

The four indicators of financial sustainability we use show that the pattern of decline over the previous four years continued in 2012–13 and the changes in policy settings have not yet had an effect.

The persistent negative operating ratios experienced over this period continue to be unsustainable in the long term. Significant future financial risks remain to funding of the replacement and renewal of state infrastructure. The borrowing program of the state also increased faster than the growth in state revenues over the past five years. Consequently, the state's capacity to reduce debt is not as strong as it was five years ago.

Public private partnership (PPP)

Accepted as an alternative to traditional delivery methods of capital projects, PPP arrangements provide the opportunity to increase the public sector's access to debt funding; share risks between public and private sectors; reduce costs; and reduce project delivery times.

Currently 24 PPP and concession arrangements are operating within the state. More are proposed.

One positive budgetary effect of a PPP is that it defers the large up-front capital outlays ordinarily required to construct or otherwise acquire assets and spreads these out over the life of the asset. This contributes in the short to medium term to achieving a fiscal balance; however, a PPP arrangement can involve borrowing money from the private sector. Thus, PPP arrangements do not always reduce debt and many result in a finance lease liability being brought onto the state's balance sheet.

Budgetary reporting

With the introduction of Australian Accounting Standard AASB 1055 *Budgetary Reporting* in 2014-15, each department will prepare a note to its financial statements comparing actual performance to approved budgets. This will increase focus on each department's financial performance to budget.

Departmental budgets form part of the annual state budget. The budget process commences with an update of existing forward estimates for revenue and expenditure. A robust budgeting process provides Parliament and the community with an accurate picture of the financial outlook for the GGS, including the anticipated financial effect of the government's policy decisions.

Over the past five financial years, the annual state budgets produced reasonable forecasts of the actual GGS's net operating balance and net worth for the year. Unexpected factors that could not have been reasonably anticipated by the state government have meant that, in some cases, these estimates have been significantly different from the final net operating balance, net worth or both. These factors have included the recognition of land under roads in 2008–09; the effect of the global financial crisis on investment revenue and assets in 2008–09; the impact of natural disasters and the timing of natural disaster relief payments from the Australian Government; and the effect of declining bond yields on liabilities in 2012.

Reliability in budgeting has two important effects. Firstly, it means that budgetary control and monitoring throughout the year will be more effective, as variances from plan will either reflect real changes in circumstances or errors in reported balances. Analysis of variances will ultimately reduce the risk of error in the year-end financial statements. It will mean also that the explanations of variances between actual and budget in the financial statements will provide more meaningful and useful insights into the effects of factors which are outside the control of departments.

Reference to agency comments

In accordance with section 64 of the *Auditor-General Act 2009*, a copy of this report was provided to the Under Treasurer as the accountable officer for Queensland Treasury and Trade with a request for comments.

The Under Treasurer's views have been considered and are represented to the extent relevant and warranted in preparing this report.

The full comments received are included in Appendix A of this report.

1 Financial audit context

1.1 Legislative requirements

Section 25 of the *Financial Accountability Act 2009* requires the Treasurer to prepare, each financial year, financial statements for the total state sector (TSS) and the general government sector (GGS). Together, these statements are called the audited consolidated financial statements 2012–13—Government of Queensland (state government financial statements).

The Treasurer, through Queensland Treasury and Trade (QTT), is responsible for preparing and presenting the state government financial statements fairly in accordance with prescribed accounting requirements identified in the *Financial Accountability Act 2009* and with Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting* (AASB 1049).

The state government financial statements must be prepared within six months from the end of each financial year or by a later date agreed between the Treasurer and the Auditor-General.

The Treasurer, the Under Treasurer and the most senior officer of the department responsible for preparing the state government financial statements must each sign and certify whether, in their opinions, the state government financial statements have been drawn up properly, under the prescribed requirements, to present a true and fair view of:

- the financial operations and cash flows of the Government of Queensland for the financial year
- the financial position of the Government of Queensland at the end of the financial year to which the state government financial statements relate.

As soon as practicable after the state government financial statements have been prepared and certified, the Treasurer must send the state government financial statements to the Auditor-General. The Treasurer must table the state government financial statements and report in the Legislative Assembly within 14 days of the Auditor-General returning the audited state government financial statements to the Treasurer.

1.1.1 General government sector (GGS)

AASB 1049 defines the GGS as comprising all government units and non-profit institutions controlled and mainly financed by government funding. For the purposes of the Queensland Government, the GGS includes all departments and some statutory bodies as defined within sections 8 and 9 of the *Financial Accountability Act 2009*. The 73 GGS entities are listed in Appendix B of this report.

1.1.2 Total State Sector (TSS)

The TSS includes all GGS entities, together with the three public financial corporations (PFC) and 19 public non-financial corporations (PNFC). PFC and PFNC entities are listed in Appendix C of this report.

AASB 1049 defines:

- *PFC* as comprising resident government controlled corporations mainly engaged in financial intermediation or provision of auxiliary financial services
- *PNFC* as comprising resident government controlled corporations mainly engaged in the production of market goods and/or non-financial services.

In Queensland, PFC and PNFC are mainly government-owned corporations for the purposes of the *Government Owned Corporations Act 1993,* with a profit-making objective. PFC and PNFC are mainly financed from sources other than government funding.

1.2 Scope of report

The public sector entities consolidated into the state government financial statements were those controlled by the state and considered to be *material*. Public sector entities are considered material if they meet either of the criteria of net operating result in excess of $4 million or net assets in excess of $50 million.

Entities specifically excluded from consolidation into the state government financial statements include those not directly controlled by the state such as local governments and public universities.

1.3 Audit responsibilities

Section 42 of the *Auditor-General Act 2009* requires the audit of the state government financial statements and the preparation of a report about the statements. The report must state:

- whether the Auditor-General has received all the information and explanations required by the Auditor-General
- whether the financial report has been drawn up under prescribed requirements, so as to present a true and fair view, of the financial operations and cash flows of the Government of Queensland for the financial year and of the financial position at the end of that year.

As soon as reasonably practicable after the Auditor-General prepares the report, the Auditor-General must give the state government financial statements and the report to the Treasurer.

The auditor's report, which includes the audit opinion, provides assurance about the reliability of the financial report, including compliance with legislative requirements. In accordance with Australian Auditing Standards, one or more of the following audit opinion types may be issued:

- Unmodified opinions are issued where the financial statements comply with relevant accounting standards and prescribed requirements.
- A qualification is issued when the financial statements as a whole comply with relevant accounting standards and legislative requirements, but with particular exceptions.
- An adverse opinion is issued when the financial statements as a whole do not comply with relevant accounting standards and legislative requirements.
- A disclaimer of opinion is issued when the auditor is unable to express an opinion as to whether the financial statements comply with relevant accounting standards and legislative requirements.

An emphasis of matter may be included with the audit opinion to highlight an issue that the auditor believes the users of the financial statements need to be aware of. The inclusion of an emphasis of matter does not modify the audit opinion.

1.4 Report structure

This report is structured as follows:

- Chapter 2 discusses the results of the audit, including the audit opinion issued and overall quality and timeliness of the state government financial statements
- Chapter 3 provides an analysis of the state's financial performance and position in 2012–13
- Chapter 4 contains information about the state's financial sustainability, including risks that are likely to impact the future financial performance and position of the state
- Chapter 5 focuses on the state's PPPs
- Chapter 6 explains the differences between forecasted results, budgeted results, mid-year economic review results and actual results
- Appendix A contains responses received
- Appendix B contains a list of entities included in the GGS
- Appendix C details those entities not part of the GGS but included as part of the TSS
- Appendix D provides detail on the key financial sustainability indicators used in Chapter 4.

2 Results of audit

In brief

Background

The audited consolidated financial statements 2012–13—Government of Queensland (state government financial statements) provide users with information about the financial management of the general government sector (GGS) and the total state sector (TSS) by the Queensland Government. The statements also detail the financial position, performance and cash flows of the GGS and TSS.

Key findings

- We issued an unqualified audit opinion on the state government financial statements and certification was achieved within statutory time frames
- The 2012–13 state government financial statements were provided for audit on 23 September 2013, eight weeks earlier than in 2011–12. This improvement was due mainly to unusual time frames in 2011–12 when extensions of time were granted to departments and 29 statutory bodies to complete their financial statements
- The statements and supporting work papers were of a high standard. The financial reporting matter identified in previous reports to Parliament about the valuation and disclosure of land under roads remained unresolved at 30 June 2013.

2.1 Background

The state government financial statements outline the operations of the Queensland Government on an accrual basis, as required by Australian Accounting Standards.

The purpose of the financial statements is to provide users with information about:

- the financial management of the general government sector (GGS) and the total state sector (TSS) and accountability for the resources entrusted to them
- the financial positions, performances and cash flows of the GGS and TSS.

The audit opinion provides assurance about the reliability of the financial report, including its compliance with legislative requirements.

2.2 Results of audit

We issued an unqualified audit opinion on the state government financial statements. This means the keeping of accounts complied with prescribed requirements and the state government financial statements presented a true and fair view.

As reported in 2011–12, further work is required in valuing land under roads to improve the comparability of financial statements between different states and territories and to ensure the valuation methodology is consistent with Australian Accounting Standards.

2.3 Timeliness

The legislative time frame for the preparation and audit of the state government financial statements by 31 December 2013 was met.

The state government financial statements were provided for audit on 23 September 2013, compared to 23 November 2012 for the previous state government financial statements. The audit opinion was issued on 30 October 2013, or eight weeks earlier than in 2011–12.

The 2012–13 financial statements were prepared earlier than in 2011–12. The additional time required to prepare the financial statements in 2011–12 was caused by changes to government structures as outlined within Administrative Arrangements Order (No 3) 2012. These changes resulted in the establishment of new entities and redistribution of responsibilities of existing entities in 2011–12.

2.4 Quality

The financial statements and supporting work papers provided were of a high standard. A number of ongoing matters relating to the financial reporting of land under roads and the comparability of land under road valuations between the states and territories continue to require attention.

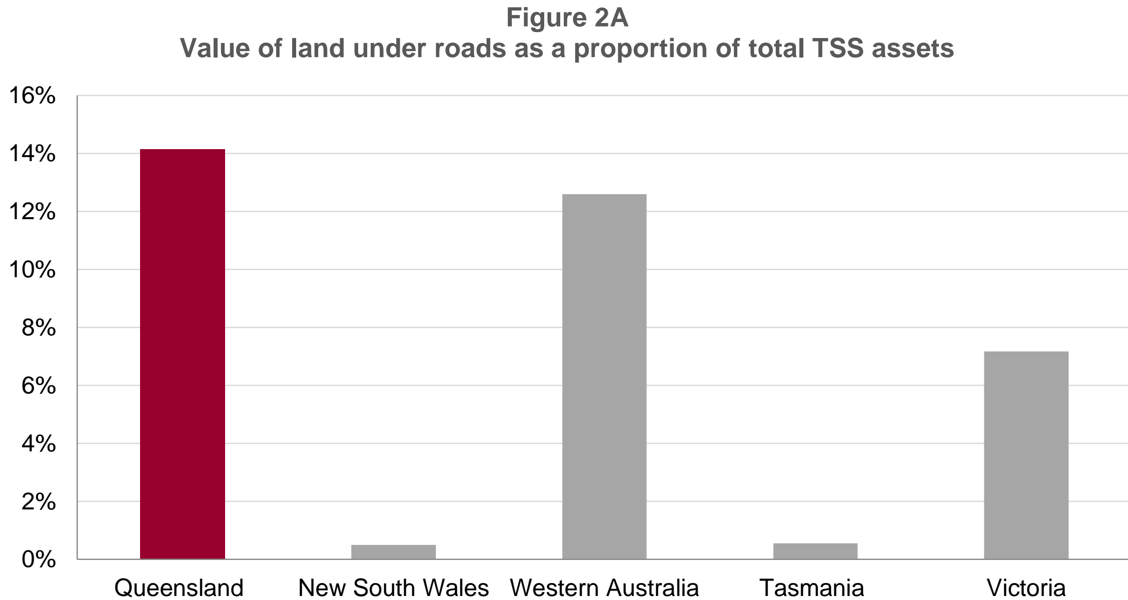
One prior year error was identified by management and required an adjustment of $495 million to the state's financial statements. This error related to the reversal of impairment for property, plant and equipment being taken to accumulated surplus instead of revaluation reserves—non-financial assets. The $495 million adjustment was performed wholly within equity accounts and did not have any effect on the total net worth of the state.

2.4.1 Land under roads

The financial reporting issues around disclosure and valuation of land under roads were reported in Report 5 for 2012–13 Results of audit: State public sector entities for 2011–12. In this report, we noted areas of financial reporting requiring further attention were accounting issues relating to the valuation methodology in Queensland; how this contrasts with other jurisdictions; and disclosure requirements for land under roads. These issues were again raised in Report 7 for 2012–13 Results of audits: Queensland state government financial statements 2011–12.

To illustrate this issue, Figure 2A compares the value of land under roads between Queensland and other states as a percentage of their respective TSS assets at 30 June 2012.

Figure 2A
Value of land under roads as a proportion of total TSS assets



Source: QAO

The introduction of Australian Accounting Standard AASB 13 *Fair Value Measurement,* applicable from 2013–14, will introduce new requirements relating to the valuation and disclosure of land, including land under roads. The issues around disclosure and valuation of land under roads and other administered land will be reassessed by the state during 2013–14.

3 Financial performance and position

In brief

Background

Financial performance relates revenues to expenditures and whether these are consistent with principles of prudent financial management and sustainability in the longer term.

The *operating result* is the sum of the extent to which the state has received sufficient operating revenues to meet operating expenditures (*net operating balance*) and *other economic flows* such as unrealised gains and losses from financial assets and liabilities.

The financial position of the state is represented by its *net worth*: the value by which its assets exceed its liabilities at 30 June of the financial year being reported.

Key findings

- While the operating result of the state remained in deficit in 2012–13 at negative $1.2 billion, it decreased 76 per cent from negative $5.0 billion in 2011–12
- This result includes the impact of unrealised net gains and losses on financial assets and liabilities as disclosed in other economic flows of $4.0 billion
- The net operating balance of the state was negative $5.7 billion; a significant increase from the average net operating balance of the previous four financial years of negative $2.5 billion; this showed that the state received less operating revenue than required to meet operating expenditure
- The increase in the net operating balance of the state was predominately driven by a reduction in the state's revenue (six per cent decrease from 2011-12) rather than expenses (one per cent increase from 2011–12)
- The net worth of the state at 30 June 2013 was $168.8 billion which was an increase of $6.8 billion (four per cent) from 30 June 2012 and represented the first increase in the past five financial years
- Over the past five financial years, liabilities of the state have increased by $35.9 billion (34 per cent) from $107 billion at 30 June 2009 to $142.9 billion at 30 June 2013. Over the same period, the state's assets increased by $20.5 billion (seven per cent) from $291.2 billion at 30 June 2009 to $311.7 billion at 30 June 2013.

3.1 Background

Financial performance and position are measured by the operating result and net worth respectively in the consolidated financial statements 2012–13—Government of Queensland (state government financial statements).

The *net operating balance* indicates the extent to which the state has received sufficient operating revenues to meet operating expenditures. The state also reports results from other economic flows that primarily represent changes in fair value of financial assets and liabilities not included in the net operating balance. The other economic flows, together with the net operating balance, represent the operating result for the state.

Net worth is the value of assets in excess of liabilities at 30 June each year.

All references to the operating result and net worth are sourced from the state government financial statements. References to the state's performance and position in this chapter relate to the total state sector (TSS).

3.2 Conclusions

In contrast to 2011–12, the overall financial performance of the state has improved.

In 2012–13, the negative operating result decreased substantially (by 76 per cent) from $5.0 billion to $1.2 billion.

Also in 2012–13, the net worth of the state increased by $6.8 billion (four per cent) to $168.8 billion. This is the first time in five financial years that the net worth of the state has increased. Also for the first time in five financial years, revenues did not increase on the prior year and employee related expenses declined.

3.3 Financial performance

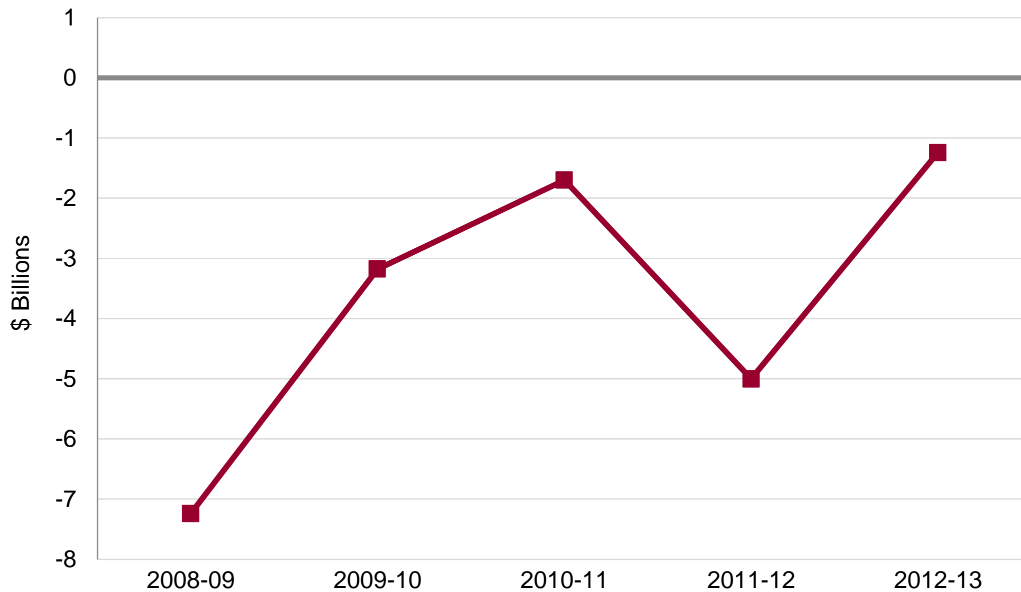
The financial performance of the state is measured in the financial statements as the *operating result*. This is the net income from normal transactions as well as the effect of unrealised changes in the value of investments, which are reported as other economic flows.

In 2012–13, there was a significant improvement in the operating result compared with 2011-12, although still negative. This was attributable to other economic flows, particularly gains on investments and positive market value interest adjustments on borrowings. The operating result was partially offset by reduced grant funding received from the Australian Government.

Grant revenues from the Australian Government for National Partnership Arrangements for expenditure in 2012–13 and beyond were brought forward and paid to the state during 2011–12. This revision in timing of grant funding inflows had a double impact in that it reduced the size of the negative operating result in 2011–12 and, correspondingly, increased the size of the negative operating result in 2012–13.

Figure 3A provides an overview of the operating result for the past five financial years. It shows the state's operating result has been negative since 2009.

Figure 3A
State's operating result over the past five financial years

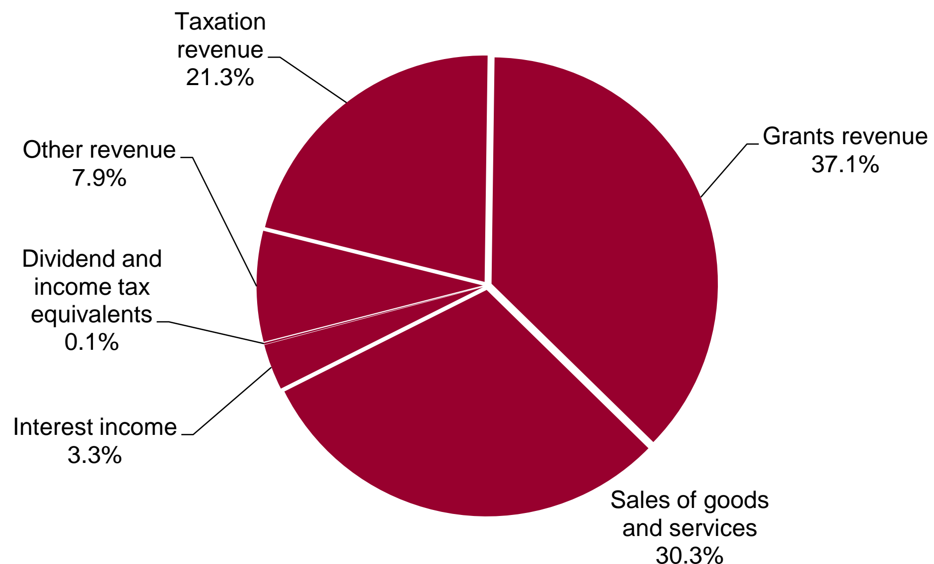


Source: QAO

3.3.1 Revenues

The state's revenue was $49.6 billion in 2012–13. This was a $3.1 billion (six per cent) decrease from the prior year and was the first time in the past five financial years that revenues did not increase from the prior period. As illustrated in Figure 3B, grant revenue is the single largest component of the state's revenue and is predominantly received from the Australian Government. The other major revenue items are revenue from the sale of goods and services and the state's taxation revenue from sources such as payroll tax and transfer duties.

Figure 3B
TSS revenue sources



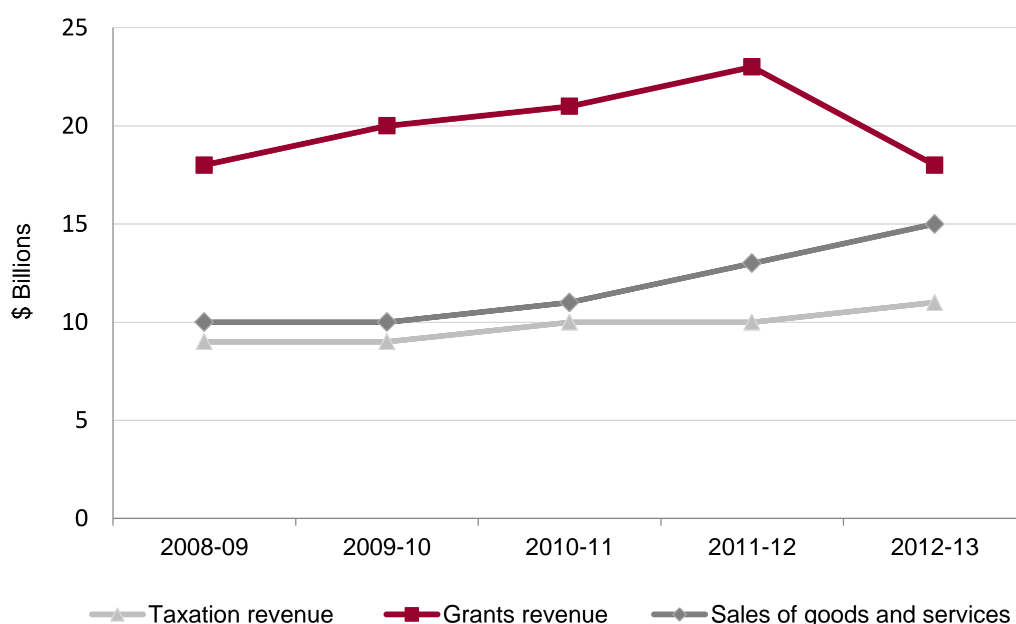
Source: QAO

Figure 3C shows that two of the three major sources of revenue have increased year after year for the past five financial years—the exception being grant revenue in 2013. National Partnership Payments (NPPs) for capital projects and Natural Disaster Relief and Recovery Arrangements grants decreased by 75 per cent or $5.1 billion in 2012–13. This was partially offset by a nine per cent increase in the goods and services taxation (GST) revenue grants totalling $9.5 billion in 2012–13.

The decline in total revenues was further affected by reduced royalties of $656 million in 2012–13, primarily driven by the export coal prices being significantly lower than expected.

The $1.5 billion increase in revenues from the sale of goods and services was due largely to the application of the carbon pricing scheme across state owned electricity companies.

Figure 3C
Trends in TSS revenues

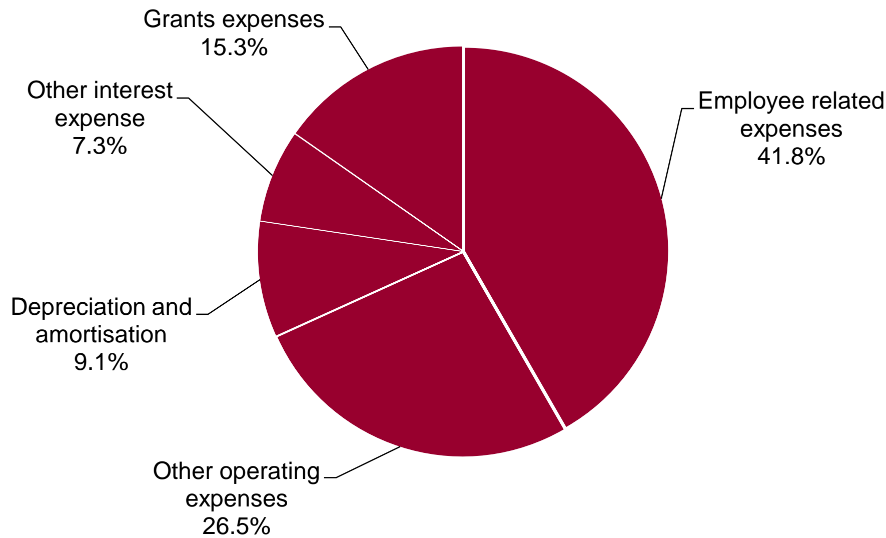


Source: QAO

3.3.2 Expenses

The state's expenditure was $55.3 billion, an increase of $535 million (one per cent) from 2011–12 which continues the trend of increases in expenditure for the past five financial years. Employee related expenses (including superannuation expenses) are the single largest component of the state's expenditure and historically account for more than 40 per cent of the state's expenses. The other major expense items are other operating expenses and grant expenses.

Figure 3D
TSS expense categories



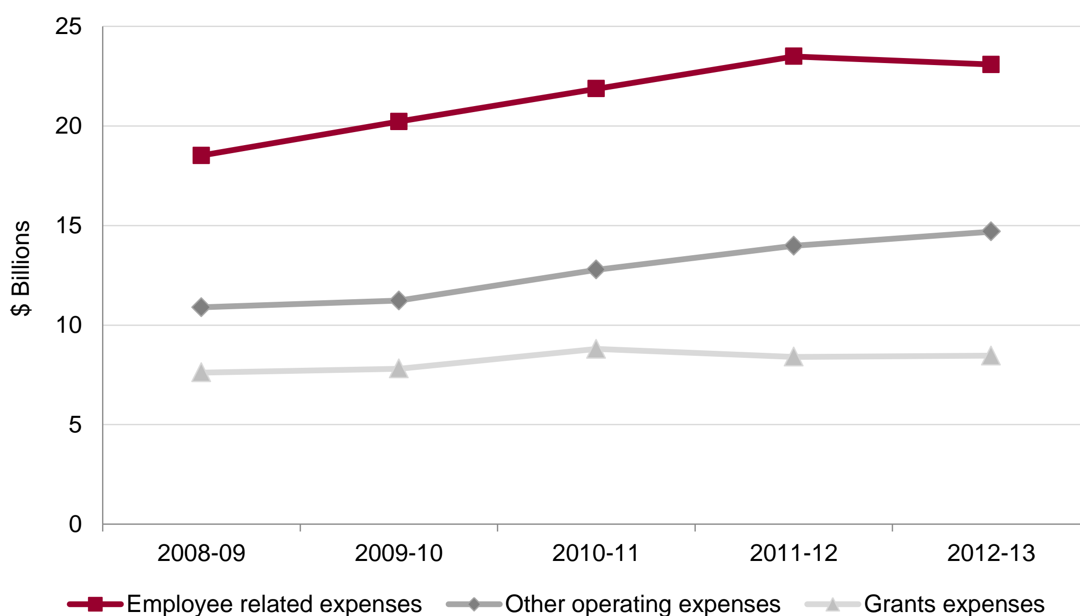
Source: QAO

Other operating expenses increased by $710 million (five per cent), due largely to the higher cost of electricity and other supplies for electricity entities.

The increase in other operating expenses was partly offset by reductions in employee related expenses (including superannuation expenses) of $408 million (1.7 per cent) from 2011–12. This was the first decrease in employee related expenses in the past five financial years. The decrease was due to staff redundancies and terminations (reduction in full time equivalents from 30 June 2012 to 30 June 2013 by 14 878 for the state) and to reduced interest costs on superannuation interest expenses.

Figure 3E shows the trends in TSS expenses over the past five financial years.

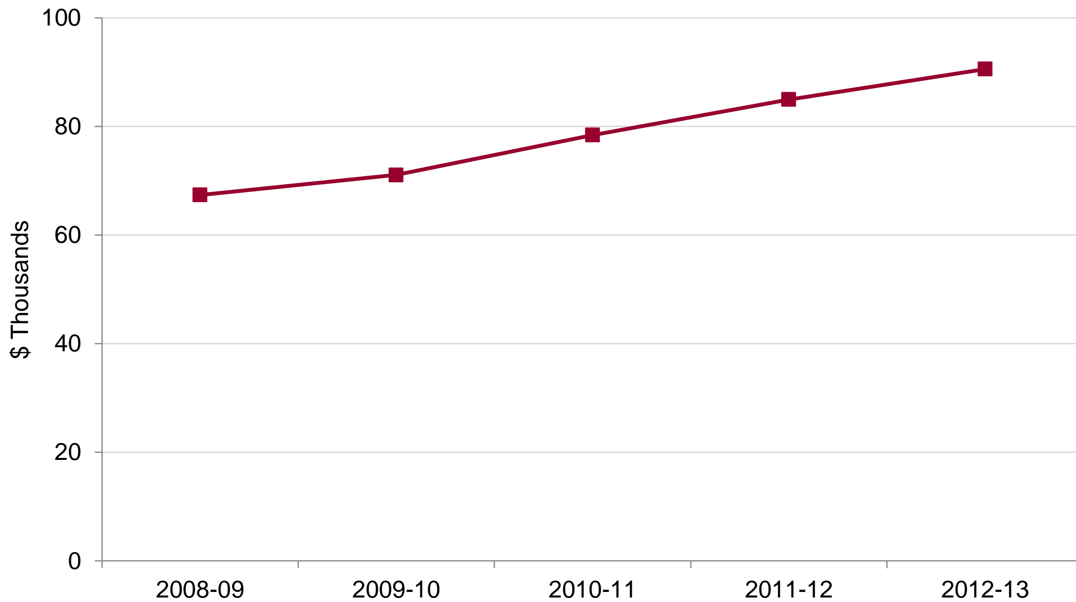
Figure 3E
Trends in TSS expenses



Source: QAO

While employee related expenses declined slightly from 2011–12, Figure 3F demonstrates that the average employee related expenses per full time employee continued to increase over the last five financial years.

Figure 3F
Average employee related expenses per full-time employee



Source: QAO

3.4 Operating result

The *operating result* is the net operating balance, together with other economic flows. *Other economic flows* are changes in the value of an asset or liability that do not result from transactions. Usually these are unrealised gains and losses on long term assets, held by the state to fund long term liabilities and government debt.

As indicated in Figure 3G, over the past five financial years the operating result has changed significantly as a result of unrealised gains and losses included in the other economic flows. In 2008–09, the global financial crisis resulted in large unrealised losses to the asset portfolio which reversed in subsequent years. In addition to gains on investments, the valuation movements in 2011–12 and 2012–13 were from changes in the value of bonds issued by Queensland Treasury Corporation (QTC) to fund the state's debt. The value of those bonds changed as a result of market interest rates and a different composition of bonds issued.

Figure 3G
Operating result over the past five financial years

	2008–09 $ m	2009–10 $ m	2010–11 $ m	2011–12 $ m	2012–13 $ m
Net operating balance	-2 172	-2 058	-3 776	-2 079	-5 704
Other economic flows	-4 931	722	2 130	-2 922	4 464
Discontinued operations*	-138	-1 841	-55	0	0
Operating result	-7 241	-3 177	-1 701	-5 001	-1 240

*the discontinued operations relate to the state's sale of assets including QR National and Forestry assets.

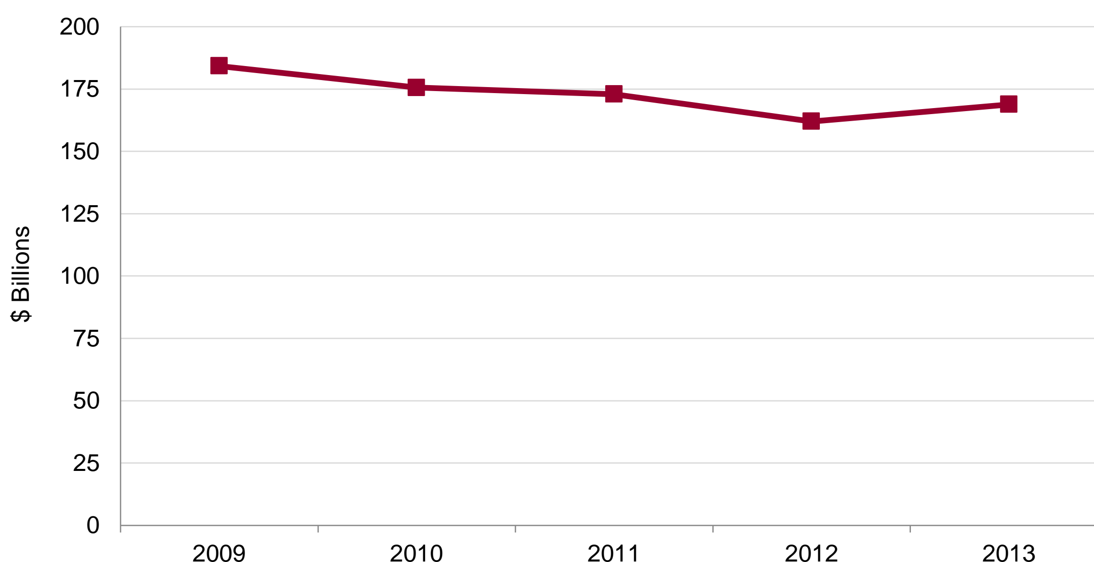
Source: Reports on State Finances of the Queensland Government

3.5 Financial position

Net worth is the measure the financial position of the state. Under the reporting framework, it is defined as the total value of assets less the total value of liabilities.

For the first time in the past five financial years, the state's net worth increased: by $6.8 billion (four per cent) to $168.8 billion. The revaluation of non-financial assets added $4.5 billion to the net worth of the state, primarily at the Department of Transport and Main Roads and Seqwater. The increase in the market value of the state's investments by $4.0 billion and an actuarial gain on the net defined benefits superannuation liability of $3.7 billion both added to the net worth of the state. These increases in net worth were, in part, offset by the negative $5.7 billion net operating balance.

Figure 3H
State's net worth as at 30 June over the past five years



Source: QAO

Prior to 2013, the decrease in the state's net worth arose from a combination of ongoing substantial asset valuation write-downs resulting from natural disaster events, and adjustments to superannuation liabilities and investments resulting from external market factors.

3.5.1 Assets

Year-end position

The state's assets increased by $12.0 billion (four per cent) to $311.7 billion from 2011–12.

The main factors contributing to the net increase in the state's assets were:

- acquisitions, revaluation increments and other movements of property, plant and equipment of $8.1 billion
- an increase in the value of Queensland Treasury Corporation (QTC)-held securities of $4.6 billion
- an increase in loans to other public sector entities, such as universities and local councils, of $1.1 billion
- a decrease of $2.0 billion in the value of shares held by the state. This was due to the sale of shares in Aurizon Pty Ltd (formerly QR National Pty Ltd) which resulted in a gain on sale of $694 million.

Over the past five financial years

The values of the state's total assets have grown by seven per cent since 2009. Property, plant and equipment have increased in value by four per cent over the last five financial years. Cash and investments have increased by 21 per cent over the same period (investments includes the long term asset held to fund the state's superannuation defined benefit liability).

3.5.2 Liabilities

Year-end position

The state's liabilities increased by $5.1 billion (four per cent) to $142.8 billion from 2011–12. The main contributing factors for the increase in the state's liabilities were:

- an increase in government-issued securities and bonds of $8.9 billion (10 per cent), used to fund borrowings across the government; while these borrowings increased, the net borrowing position for the general government sector (GGS) was less than forecast due to an improved fiscal balance
- an increase of $1.0 billion (32 per cent) in customer deposits held by QTC.

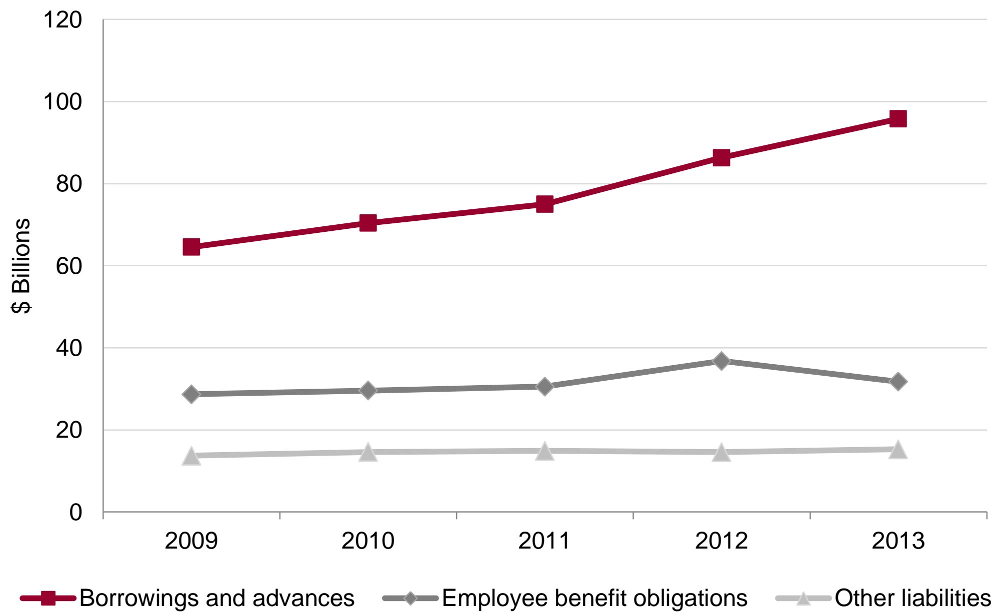
These increases in the state's liability were offset by a decrease of $5.0 billion (15 per cent) in the state's defined benefit superannuation liability. This was due to a combination of factors, including the effects from increased staff redundancies and terminations across government ($1 billion) and the increase in the interest rates used to estimate the value of the liability ($2.9 billion).

The effect of changes in interest rates on the valuation of the state's superannuation liability can result in material increases or decreases in the liability, as disclosed from year to year.

Over the past five financial years

Figure 3I shows the state's liabilities for the past five financial years. Borrowings and advances represent the most significant liability, accounting for 67 per cent of total liabilities. Total borrowings and advances increased by 48 per cent over the past five financial years, from $64.6 billion in 2009 to $95.8 billion in 2013.

Figure 3I
Trends in TSS liabilities



Source: QAO

Employee benefit obligations—primarily defined benefit superannuation liabilities—make up 22 per cent of the total state's liabilities. These obligations decreased at 30 June 2013 for the first time in five years.

The defined benefits scheme superannuation liability is measured by estimating today's value of future expected benefit obligations. Variables in the calculation of superannuation liabilities include salary increases, inflation and other assumptions provided by the State Actuary.

Movements in the Australian Government bond yields can contribute significantly to movements in the value of the state's superannuation liabilities. Figure 3J shows the state's superannuation liability and the Australian Government bond yields over the past five years.

Figure 3J
State superannuation liability over the past five years

Superannuation liability	2009	2010	2011	2012	2013
Value of liability ($ billion)	23.554	24.782	25.159	30.856	25.888
Australian Government gross bond yields at 30 June (per cent)	5.6	5.3	5.3	3.2	3.9

Source: Reports on State Finances of the Queensland Government

4 Financial sustainability

In brief

Background

The state's long term financial sustainability depends on its revenue and expenditure policies. Users of financial statements can obtain a better understanding of the sustainability of these policies by calculating and analysing key financial indicators, based on information in the audited consolidated financial statements 2012–13—Government of Queensland (state government financial statements), including:

- operating ratio—indicates the capacity to meet recurrent operating expenditure from recurrent operating revenues
- net operating cash flow to net purchases of non-financial assets—indicates the ability to self finance asset acquisitions from operations, rather than relying on debt
- capital replenishment ratio—indicates whether the rate of capital outlays on non-financial assets is keeping pace with the rate of depreciation of those assets
- net financial liabilities to operating revenue ratio—indicates the capacity of the state to repay debt principal and interest.

Key findings

- All four key indicators of the state's financial sustainability used in this report have declined over the past five financial years
- The persistent negative operating ratios experienced over the past five financial years are not sustainable in the long term
- Significant future financial risks remain to fund the replacement and renewal of state infrastructure without also increasing debt. The state's fiscal principle of stabilising and significantly reducing debt will require the state to access alternate sources of funding for infrastructure investment
- The borrowing program of the state increased faster than the growth in state revenues over the past five years and, accordingly, its capacity to reduce debt is worse than five years ago.

4.1 Background

The state's financial sustainability is a critical element of its ability to meet its economic, social and environmental obligations both now and into the future. Like any organisation, it must live within its means and manage its finances soundly over the long term.

Over time, the accrual information presented in state government financial statements allows assessments to be made about financial management and whether past and current revenue and expenditure policies are sustainable.

Over the long term, the state must be able to fund its operations and a significant portion of its capital program from its revenues, to ensure that a burden of debt is not unduly placed on future generations without the benefit of supporting assets and the services they provide.

Indicators of financial sustainability will incorporate operating performance, capital expenditure and financing activity; however, the ultimate measure of financial sustainability is that the state can absorb reasonably foreseeable adverse financial risks and exposures without having to significantly alter its revenue settings. This must include any risks or outflows that may eventuate from funding capital or social programs through the use of public private partnerships (PPPs). The state must ensure that PPPs are assessed, sufficiently and critically, to prove that the use of a private operator produces greater value for the government for the risks adopted.

4.2 Conclusions

The four key sustainability ratios analysed in this report show that the state's financial sustainability declined over the past five financial years.

Total state sector (TSS) expenditures remained higher than revenues and the persistent net operating deficits indicated that the state had less capacity to self finance acquisitions of property, plant and equipment from operating cash flows.

Cash in the general government sector (GGS) decreased and net operating cash flows across both the GGS and the TSS have only funded a limited portion of the asset acquisition program, leading to fiscal deficits. A fiscal deficit is a negative fiscal balance. A fiscal balance is calculated as the net operating balance less the net acquisitions of non-financial assets (that is, purchases of non-financial assets less sales of non-financial assets less depreciation).

The state's stock of non-financial assets was growing at a faster rate than existing assets were depreciating, although this rate has been declining for the past four years.

The rate of growth in borrowings required to finance asset acquisitions has been greater than the rate of growth in state revenues, reducing the state's capacity to repay debt from its own sourced revenues.

4.3 Financial sustainability

The charter of fiscal responsibility and state budget include four fiscal principles: stabilise then significantly reduce debt; achieve and maintain a GGS fiscal balance by 2014-15; maintain a competitive tax environment for business; and target full funding of long term liabilities such as superannuation in accordance with actuarial advice.

The four financial indicators used in this report focus on the information included in the state government financial statements and provide complementary information to these four fiscal principles.

Figure 4A summarises the results of these four financial indicators of financial sustainability. Appendix D in this report provides further information about the key financial indicators.

Figure 4A
Results of key financial sustainability indicators

		2008–09	2009–10	2010–11	2011–12	2012–13	Five year avg.
Operating ratio (%)	GGS	-0.1	0.3	-3.5	-0.5	-10.5	**-2.9**
Capacity to meet recurrent operating expenditure from recurrent operating revenue, with a positive ratio indicating that funds are also available for capital expenditure	TSS	-5.2	-4.6	-7.9	-3.9	-11.5	**-6.6**
= Net operating balance divided into total operating revenue	A negative operating ratio means that the state has not earned sufficient operating revenue to cover its operating expenditure. Five-year trend—persistently negative other than one year for GGS.						
Net operating cash flow ratio (%)	GGS	55.6	38.9	26.3	36.3	-42.1	**23.0**
Capacity to self finance non-financial asset acquisitions	TSS	23.3	29.5	15.7	25.3	-22.6	**14.2**
= Net cash flows from operations (excludes depreciation) divided into net purchases of non-financial assets (as reported in the cash flow statement)	In total over the five financial years, less than a quarter of non-financial asset purchases were financed through operating cash flows, indicating a high reliance on other funding sources including debt. Five-year trend—the state's ability to finance non-financial asset acquisitions from operating cash flows declined this year, and has deteriorated since 2009–10.						
Capital replenishment ratio (times)	GGS	2.6	3.5	3.2	2.8	2.1	**2.8**
Net rate of replacement of non-financial assets	TSS	3.7	3.4	2.8	2.4	1.9	**2.8**
= Net purchases of non-financial assets divided into depreciation expense	A ratio greater than one means the state is replacing its property, plant and equipment asset base at a rate faster than it is being depreciated. Five-year trend—asset replenishment rate remains favourable, but is declining.						
Net financial liabilities ratio (%)	GGS	31.4	48.4	54.5	72.0	87.6	**58.8**
Capacity of the state to repay debt and interest	TSS	111.2	126.7	106.1	127.8	138.9	**122.1**
= Net financial liabilities divided into total operating revenues	The growth in borrowings has been greater than the growth in state revenues resulting in a reduced ability to repay debt and interest. Five-year trend—the growth in debt has been significantly greater than the growth in revenues						

Source: QAO

4.3.1 Operating sustainability

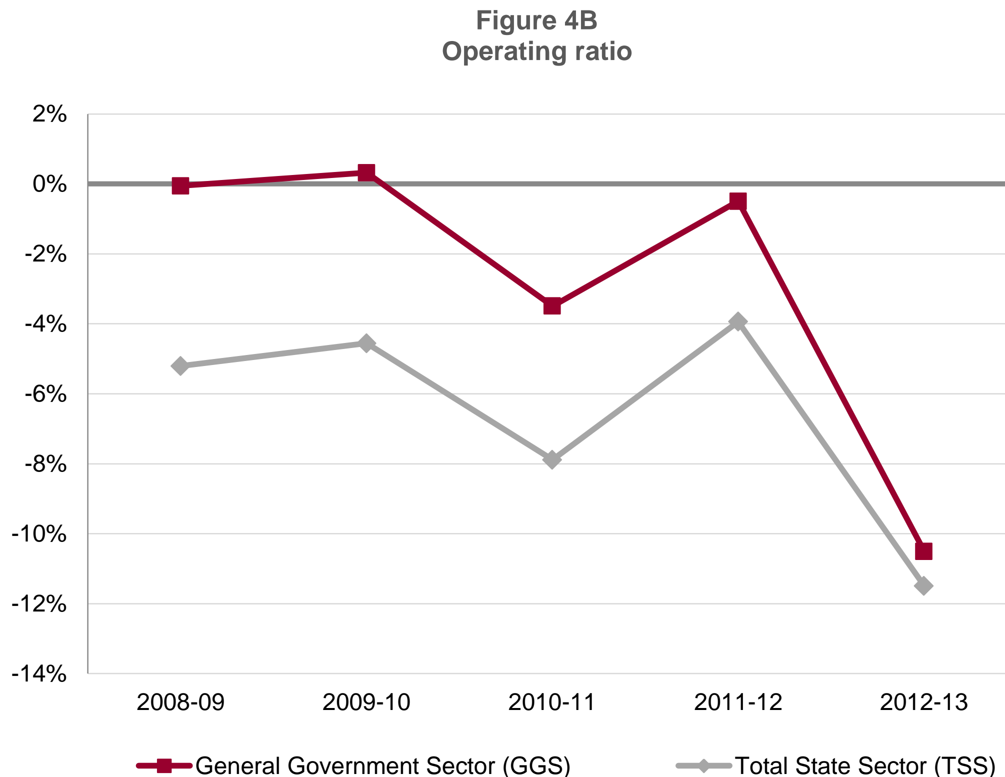
The state reported net operating deficits in the TSS for the past five financial years and in the GGS for four of the past five financial years, meaning it has consistently spent more than it earns. The growth in GGS and TSS operating expenditure has not been matched by similar growth in revenues.

Operating sustainability is measured by the operating ratio and by the ratio of net operating cash flows to net purchases of non-financial assets. Ongoing negative ratios indicate insufficient operating revenue and cash is being generated to fund operating and capital expenditure, leading to fiscal deficits, depletion of cash reserves and increased borrowings. According to the state's *Budget Strategy and Outlook 2013–14*, a return to a positive net operating balance for the GGS is not forecast until 2014–15.

Operating ratio

The operating ratio in Figure 4B is the net operating balance expressed as a percentage of total operating revenue, and shows the capacity of the state to meet operating expenditures from operating revenue.

Figure 4B
Operating ratio



Source: QAO

This ratio needs to become positive over the medium term for the state to remain financially sustainable in the long term. The higher the ratio is above zero, the more capacity there is to replace assets using revenue generated from its own operations and the better placed it is to achieve a fiscal balance.

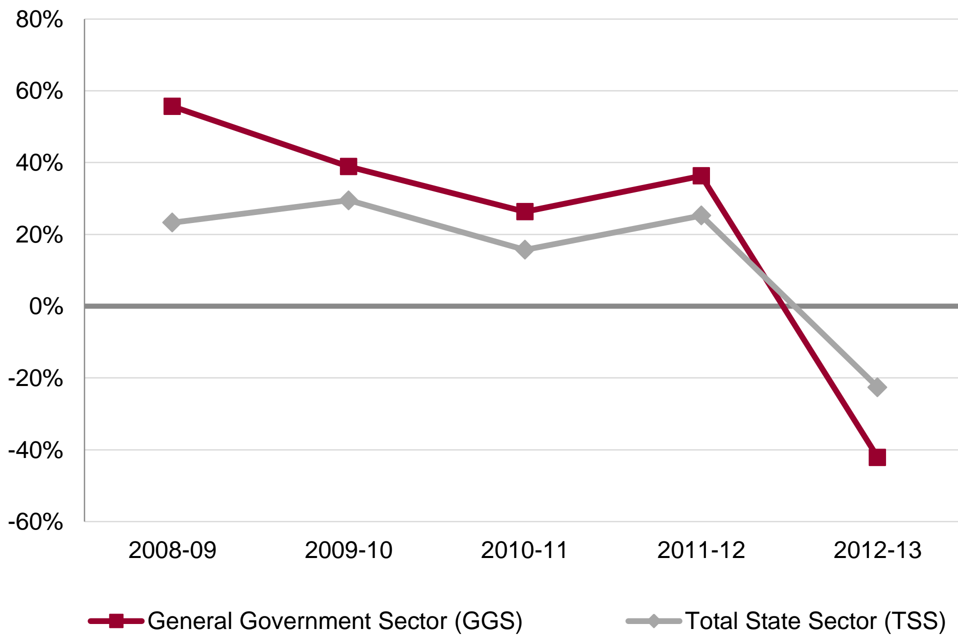
Net operating cash flow ratio

The ratio of net operating cash flow to net purchases of non-financial assets shows the state's capacity to self-finance acquisitions of property, plant and equipment from operations rather than sources such as borrowings or asset sales. This ratio has been derived from the cash flow statement.

Similar to the operating ratio, there may be temporary periods where this ratio is negative to allow the state to support economic activity; however, this ratio should generally be positive.

Figure 4C shows that the ratio of net operating cash flow to net purchases of non-financial assets turned sharply negative in 2012–13 as, overall, the state had insufficient operating cash receipts to fund its total operating cash payments and any of its non-financial assets purchases.

Figure 4C
Net operating cash flow to net purchases of non-financial assets ratio



Source: QAO

In total, the state funded only 25 per cent (GGS) and 17 per cent (TSS) of net purchases of non-financial assets through operating cash flows over the past five financial years. This resulted in significant increases in government borrowings. While the funding of a portion of long term critical infrastructure through long term debt is financially sound, the state must ensure that it has capacity to repay the debt, including interest. The state's *Budget Strategy and Outlook 2013-14* forecasts a return to a positive ratio for the GGS of close to 100 per cent in 2014–15.

Risks to operating sustainability

A number of risks to the state's future revenues and its operating and capital expenditures require close attention.

At 30 June 2013, there was an estimated $5.3 billion in work outstanding to repair and replace infrastructure assets damaged by past natural disasters under Natural Disaster Relief and Recovery Arrangements (NDRRA). These works must be undertaken in accordance with NDRRA funding conditions and completed by agreed time frames so that the approximate 75 per cent contribution by the Australian Government of the remaining work is not put at risk. In addition, around $930 million of NDRRA expenditure over the financial years 2009–10, 2010–11 and 2011–12 could not be verified by audit as being spent in accordance with funding conditions. We are currently working with the Queensland Reconstruction Authority to determine if any further audit evidence can be gathered to support the issue of a revised, unqualified opinion.

Estimated future net nominal cash outflows of $6.5 billion—approximately half of which will be paid in more than 10 years—are effectively 'locked-in' for the state's 24 social and economic PPP agreements and service concession agreements. Social infrastructure built using PPPs, including the Southbank Education and Training Precinct and Gold Coast Rapid Transit, expose the state to demand risk and also potentially the need to step in if there is service provider failure.

Operating lease commitments have increased by $1.2 billion, primarily as a result of entering into lease agreements on government buildings sold to QIC Limited trusts. The state has also committed to operating lease payments of around $1.0 billion on the 1 William Street Brisbane building, commencing on completion of the project.

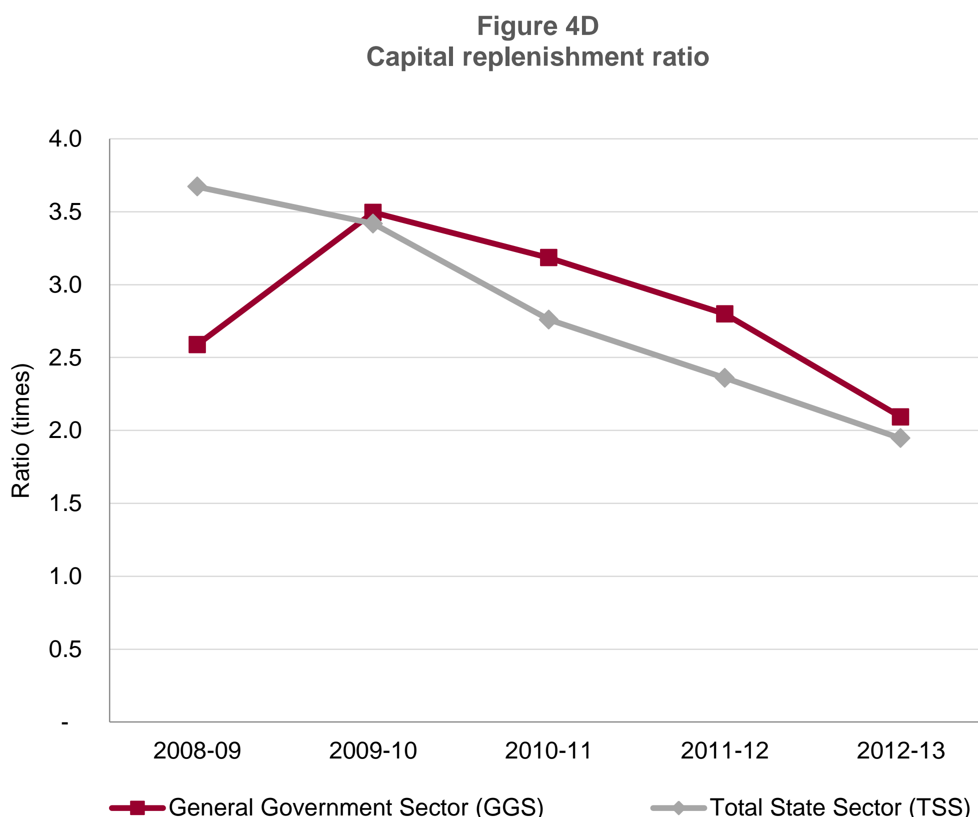
The funding required for the facilities and staging of the 2018 Gold Coast Commonwealth Games (the Games) is currently estimated at $2.0 billion. The state has guaranteed to cover any budget shortfalls for the Games as incurred by the organising committee. A significant capital works program is required to deliver the necessary facilities, including the athletes' village. Revenues from ticket sales, television rights, sponsorship and merchandising to offset cost cannot be 'locked in' at this stage. These revenues are subject to general economic conditions and highly sensitive to market supply and demand which prevail closer to, and at the time of, the Games.

4.3.2 Investing sustainability

The state's property, plant and equipment assets were valued at $233.9 billion at 30 June 2013, with just over half of this balance comprising buildings and infrastructure.

The capital replenishment ratio compares the annual net expenditure on non-financial assets (predominantly property, plant and equipment) to annual depreciation. Figure 4D shows that the ratio over the past five financial years for both the GGS and the TSS is well above one, meaning that assets are being built or refurbished at a faster rate than the non-financial asset base is being depreciated.

Figure 4D
Capital replenishment ratio



Source: QAO

From a peak in 2009–10, the ratio for the GGS has declined over the past three years and net purchases of non-financial assets are expected to reduce by 40 per cent by 2016–17 as reported in the *Budget Strategy and Outlook 2013-14*. This should result in an anticipated ratio of around one in 2016–17, reflecting anticipated reductions in capital spending with the completion of a number of large infrastructure projects and natural disaster repairs and pursuit of alternative means of delivering infrastructure. One such example is the use of PPPs to deliver infrastructure, including the Sunshine Coast University Hospital and the SEQ Schools Project, which defers capital expenditures by spreading them over the life of the asset.

Risks to investing sustainability

The state is currently replacing its existing non-financial asset base faster than it is being depreciated, with the capital replenishment ratio above one. Consideration should be given to risks to the financial sustainability of the state's assets and associated capital program, including:

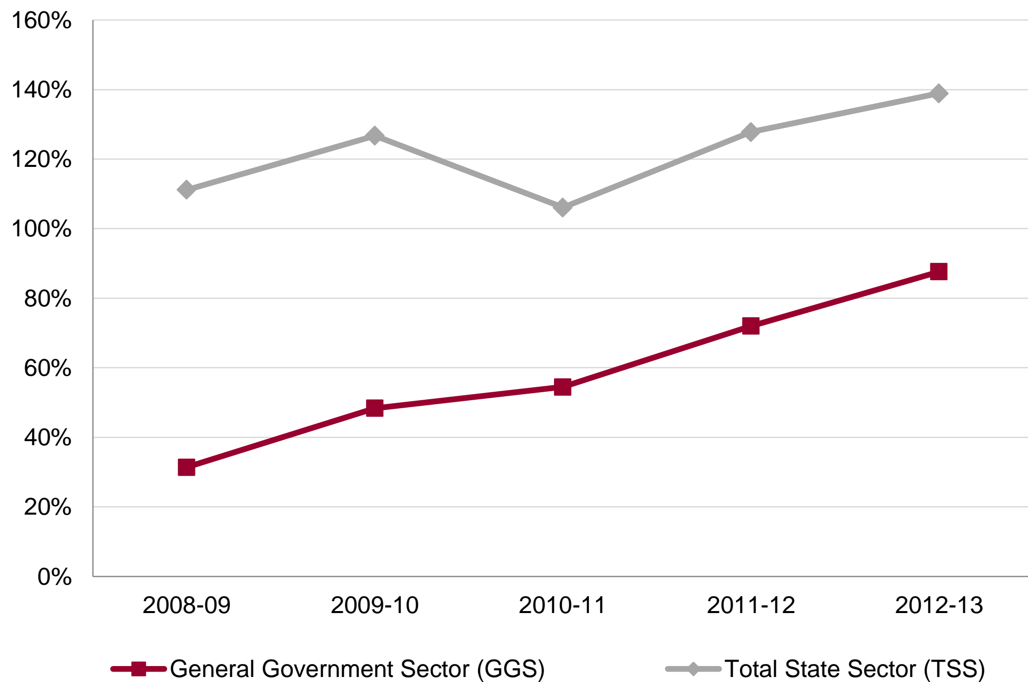
- ensuring that the state's capital works program, including $11 billion of works forecast in 2013–14 particularly across the health, energy, transport and main roads sectors, is subject to rigorous project planning, evaluation and management controls to avoid cost overruns
- funding associated with future maintenance costs as the non-current asset base grows
- ensuring that, in the move away from owning information and communications technology (ICT) assets to an 'ICT as a service' model (as foreshadowed in the *Queensland Government ICT Strategy 2013–17*), there is adequate scrutiny of the anticipated cost and service delivery benefits prior to implementation.

4.3.3 Debt sustainability

Debt sustainability requires that the state can pay its debts and interest charges and meet its long term obligations to employees and insurance schemes while maintaining its assets and community services. The ratio of net financial liabilities to operating revenue is an indicator of the capacity of the state to repay debt and interest from its revenues.

Figure 4E shows that the growth in net financial liabilities, primarily due to an increase in borrowings, has been greater than the growth in state revenues across the past five financial years for both the GGS and the TSS. The increase in the ratio in 2012–13 would have been larger still, had it not been for the state’s sale of government buildings for $527 million which was used to pay down debt. Based on the state’s *Budget Strategy and Outlook 2013–14*, the ratio for the GGS is forecast to peak at 105 per cent in 2013–14 before trending downwards.

Figure 4E
Net financial liabilities to operating revenue ratio



Source: QAO

While this ratio is more volatile than the debt to revenue ratio, it takes into account the long term liabilities associated with employees of defined benefit superannuation and long service leave, and the insurance fund.

While there are yearly fluctuations in the liability resulting from discount rate changes, the latest actuarial update at 30 June 2013 showed that the state has investments that are expected to be sufficient to pay for these obligations when they become due.

The gross debt to revenue ratio (calculated as gross borrowings divided into operating revenue) for both the GGS and the TSS has also grown significantly over the past five financial years. Increased borrowings have been used to fund buildings and infrastructure; they also have contributed to the downgrade in the state's credit rating.

Risks to the sustainability of the state's debt

Borrowings by the GGS increased by 255 per cent between 2009 and 2013 and annual interest expenses increased from $599 million in 2008–09 to more than $1.9 billion in 2012–13. This affects long term financial sustainability, particularly because:

- as at 30 June 2013, Queensland is the largest issuer of bonds of any Australian state or territory
- the state is likely to continue to pay higher costs for funding while it holds a AA+ credit rating compared with the AAA rating previously held (Standard & Poor's Rating Services affirmed the AA+ credit rating on 25 November 2013 with a stable outlook)
- the state has 24 PPPs and service concession arrangements in place (plus three existing co-location hospitals), which will provide services and infrastructure but which are not directly funded using government debt. Depending on the structure of PPPs, they may result in finance lease liabilities and corresponding leased assets being recognised on the state's balance sheet, which will impact on the state's ratio of net financial liabilities to operating revenue. One example is the south-east Queensland schools PPP which at 30 June 2013 represented a leased asset of $206 million and an associated finance lease liability of $201 million, with total future commitments (including future finance charges) of $657 million. Future effects on the balance sheet will continue to be revised as the PPP arrangements are fully assessed by agencies; in particular, the potentially significant impact from the Sunshine Coast University Hospital PPP.

5 Public private partnerships

In brief

Background

- Government agencies may view public private partnerships (PPPs) as an effective means of funding and involving the private sector in infrastructure projects. The state has a significant number of PPP arrangements in place and proposed for future periods.

Key findings

- Currently 24 PPP and concession arrangements are operating within the state, with an additional three co-location hospitals
- The complexity of the PPP arrangements makes it harder to interpret financial reporting requirements. The early assessment of the accounting treatment and consultation by departments with Queensland Treasury and Trade (QTT) will improve consistency of application at a whole-of-government level and will reduce the cost of accounting for a PPP.

5.1 Background

Commonly accepted as an alternative to traditional delivery methods of capital projects, public private partnerships (PPPs) provide the opportunity to increase the public sector's access to debt funding; share risks between public and private sectors; reduce costs; and reduce project delivery times.

Currently 24 PPP and concession arrangements operate within the state, with an additional three co-location hospitals.

Each arrangement has its own unique characteristics with the major differences relating to the risk allocation between the state and the private operator; the level of involvement of the private operator within the project; the payment of lease/service fees to the private operator; the recognition/effect on assets; and the receipt of sales revenue.

The PPP method of delivery has come under increasing scrutiny, given recent examples of inflated revenue estimates and underestimated costs, which suggest there is room for improvement in modelling. PPP arrangements have also received criticism regarding the content of their business cases and the extent that value for money issues are considered. To assure value for money for the state, it is important that a proper business case exists which defines risk allocation and which demonstrates this arrangement to be cost-effective value for money rather than solely an alternative to government-sourced debt funding.

5.2 Conclusions

Accounting for PPPs is complex, with the application of multiple accounting standards and guidance papers. Early in the project, agencies should assess and resolve the accounting for PPPs and the risk of material misstatement within the financial statements or non-compliance with accounting requirements.

While entering a PPP arrangement may help to alleviate the state’s need to access debt funding directly, there are balance sheet effects as a result of the arrangement if the PPP represents a finance lease. In 2012–13, PPPs did not affect the net worth of the state significantly; however, the state has a commitment to undiscounted future payments of $6.5 billion over the life of the current arrangements, half of which will be paid in the next 10 years. The value of assets and liabilities from PPPs determined to be finance leases will continue to be assessed, particularly considering any effect from the Sunshine Coast University Hospital PPP.

5.3 Accounting for PPPs

In the absence of a specific Australian Accounting Standard that is tailored to address PPP arrangements from a grantor’s perspective, Queensland state government entities have applied the principles of the Australian Accounting Standard AASB 117 *Leases.* Queensland Treasury and Trade (QTT) issued the *Accounting Policy Guideline on Service Concessions Arrangements – Grantor* (APG17) to determine appropriate financial statement reporting. Presently, some PPP arrangements result in an asset and liability in financial statements and all are included as a note to the accounts describing the arrangements.

QTT guidance states that there are essentially two forms of PPP arrangement: economic and social. The two types of arrangements have different accounting treatments.

Economic PPPs are generally arrangements where the state compensates an operator for the construction of infrastructure by granting the operator the right to earn revenue from the constructed infrastructure. The infrastructure provided under an economic PPP usually comprises roadways, bridges and/or railways. The demand risk associated with earning sufficient revenue to support the investment, which is often linked to patronage, lies with the operator. While the state does not provide revenue, it often makes an upfront contribution to the construction of the infrastructure to ensure the economic viability of the project or to compensate for necessary upgrades to state assets.

Typically, economic PPPs do not result in an asset in the state's books as the state does not control the asset nor does it receive any benefit during the PPP concession period. The state will receive the infrastructure asset at the end of the PPP arrangement or in the event of default of the operator. State entities entering into PPP arrangements need to assess the accounting treatment for any upfront contribution as to the nature of the payment and its classification in the financial statements as an expense or asset.

Social PPPs represent arrangements where the state, as grantor, pays an operator of an asset for the community's use of the infrastructure. Examples of social infrastructure are schools and hospitals. The state makes regular service payments to the operator over the life of the PPP contract in lieu of the operator being able to earn a suitable return of revenue due to the nature of the asset. The services payments to operators are typically not affected by the level of community use, so the state bears any demand risk.

Social PPPs affect the state's balance sheet as they are a lease arrangement. Where the state bears all of the risks and rewards of the infrastructure asset and is paying for the operation of the asset through concession payments, the value of the asset and the payments will be recognised on the balance sheet. The asset is written down over the period of the PPP arrangement.

The assessment of risks and rewards under the PPP arrangements is complex and involves significant subjectivity. The complexity of PPP agreements means that the assessment of whether the state bears the risks and rewards is extensive, and agencies should plan to resolve the accounting for these arrangements as early as possible.

5.4 Current PPPs

The Queensland government recently entered into a variety of PPP arrangements largely spanning three main sectors: transport; health; and housing and public works. Key projects include 1 William Street (housing and public works), Gold Coast Light Rail (transport), Sunshine Coast University Hospital (health), and SEQ Schools (education).

The audited consolidated financial statements 2012–13—Government of Queensland (state government financial statements) reported that Queensland has 24 PPP and service concession arrangements in place (plus three existing co-location hospitals), with three of those PPPs expected to result in a net lease asset recorded in the state's balance sheet.

The net effect on the state's balance sheet for 2012–13 is not material; however, there are significant long term obligations associated with the PPPs that will be off-balance sheet. The state is committed to future undiscounted payments of $6.5 billion over the lives of the PPPs. In addition, the state has entered operating lease agreements as part of the 1 William St arrangements with around $1 billion to be paid over 15 years, commencing in 2016.

In future years, the effect of the Sunshine Coast University Hospital PPP on the state's balance sheet is likely to be significant, with around half of the estimated future outflows from PPPs relating to this project.

To ensure consistency in accounting for PPP arrangements, the accounting treatment applied to four key PPPs—1 William Street, Gold Coast Light Rail, Sunshine Coast University Hospital and the SEQ Schools Projects—was reviewed as part of the audit.

5.4.1 1 William Street

On 21 December 2012, the government announced the successful proponent to develop 1 William Street. The 1 William Street PPP project is for the construction of a high rise by the private sector proponent on public sector land.

Under the project deed, the state has entered into a sub-lease of the entire 75 000 square metres of office space, which commences on the completion of construction. The gross nominal commitment for the lease payments is approximately $1 billion over 15 years. Part of these payments may be offset by private sector tenants occupying up to 15 000 square metres of the commercial office tower. Given the relatively short duration of the lease terms contracted by the state in comparison to the 99-year lease term and economic and physical life of the building, the lease arrangement has been classified appropriately as an operating lease. This means that the building is not controlled by the state and will not appear on the state's balance sheet when the building is completed in 2016.

The land will be leased to the successful proponent at a nominal value for 99 years, at the end of the three-year development lease. Consideration was given as to whether this value should be fully written-off on completion of construction in 2016, when control passes; or whether the value of the contributed land effectively forms part of the minimum lease payments to be made by the state. It was determined that the land contribution formed part of the lease transaction and will be amortised over the building lease term of 15 years as a lease expense.

5.4.2 Gold Coast Light Rail

In an arrangement between the government as represented by the Department of Transport and Main Roads (DTMR), the Australian Government and the Gold Coast City Council, the construction of Stage 1 of the Gold Coast Rapid Transit (Light Rail) project has commenced and is due for completion in June 2014. Capital and operating funding for the project consisted of contributions totalling $1.3 billion from the federal, state and local governments.

DTMR entered into a project deed with a consortium to construct and operate the Light Rail project from 2011 to 2029, representing a 15-year arrangement commencing after the construction phase is complete. DTMR committed to provide an upfront capital contribution of $365 million towards the project, of which $268 million was paid at the end of June 2013, with the remainder of the contribution to be made during 2013–14.

In addition to the upfront capital contribution, monthly service payments will be made to the consortium for operating and maintaining the assets and to pay them for the remaining capital cost, on the basis that performance criteria are met. DTMR takes on the demand risk and will collect the fare box revenue while the consortium takes on the asset operating risks.

The consortium leased the land for the construction and operation/maintenance of the Light Rail system from the state. The accounting treatment for this social PPP resulted in a prepaid lease recognising the $268 million upfront capital contribution made by the state as a prepayment of the lease liability. On completion of the Light Rail project, the fair value of the prepayment will be assessed and designated as a leased asset. A corresponding lease liability will also be brought to account. The fair value of the completed asset has been estimated at $721 million.

5.4.3 Sunshine Coast University Hospital

On 17 July 2012, the Department of Health entered into contractual arrangements with a consortium to design, construct, commission, maintain and partially finance the Sunshine Coast University Hospital (SCUH) for a period of 25 years. At the end of this period, management of the facility will transfer to the Department of Health for nil consideration and from the Department of Health to the Sunshine Coast Hospital and Health Service.

The SCUH PPP includes a limited scope of operational support services that are closely linked to the hospital building and its systems, such as security, pest control and car parking services, but does not include the provision of any clinical services. A co-located private hospital will be designed, built and operated by a private provider.

At the end of construction phase in 2016, the Department of Health will lease back the SCUH from the consortium. The department will make a capital contribution of $840 million, due in 2013–14, and has estimated it will pay around $3.3 billion over the 25-year agreement, inclusive of the capital contribution. The Department of Health is investigating how this arrangement will be reported in the state's accounts.

5.4.4 SEQ Schools

The Department of Education has entered into a series of long term PPPs to construct seven schools. The construction of the schools commenced in 2009 and is expected to be completed in January 2014. At 30 June 2013, the PPPs were classified as a finance lease arrangement and an asset and finance lease liability were reported with a net asset position of $5 million. The PPPs have a total contract value of over $1.1 billion over the life of the agreement to 2039 for the development of the seven schools. A further 10 new schools to be built under the PPP model are in the early procurement stages.

6 Budgetary reporting

In brief

Background

The Queensland Government produces a state budget annually. The process commences with an update of existing forward estimates for revenue and expenditure. The forward estimates are compiled on a rolling five-year basis and provide an initial fiscal context for the government to consider and prioritise proposed policy initiatives as part of its overall budget strategy.

A robust budgeting process is fundamental to providing Parliament and other parties such as ratings agencies and the community with an accurate picture of the financial outlook for the General Government Sector (GGS), including the anticipated financial effect of the government's policy decisions. The accuracy of budget forecasts can be assessed against results subsequently reported in the audited consolidated financial statements 2012–13—Government of Queensland (state government financial statements).

Key findings

- Over the past five financial years, the annual state budgets have provided a reasonable forecast of the net operating balance and net worth of the GGS for each financial year.
- Unexpected factors which could not have been reasonably anticipated by the state government have meant that, in some cases, these estimates have been significantly different from the final net operating balance and/or net worth.
- With the introduction of the Australian Accounting Standard AASB 1055 *Budgetary Reporting* in 2014–15, each department will prepare a note to the financial statements comparing individual budgets to actual performance. This will increase the focus on each department's performance to budget, resulting in a more reliable budget process and reducing the risk of errors in financial statement reporting.

6.1 Background

The Queensland Government produces a state budget (the budget) annually. The budget is prepared on a rolling five-year basis and details expected revenue and recurrent and capital expenditure. A rigorous preparation, assessment and approval process is necessary to ensure that the state's resources are appropriately allocated and spent.

The robustness of the budget process and accuracy of predictive models is reflected in the actual performance compared to budget.

With the introduction of Australian Accounting Standard AASB 1055 *Budgetary Reporting* in 2014–15, each department will prepare a note to the financial statements comparing its individual budget to actual performance. This will result in an increased focus on each department's performance to budget.

6.2 Conclusions

Over the past five financial years, the annual state budgets have provided a reasonably accurate forecast of the net worth and net operating balance of the general government sector (GGS) when compared to actual results reported in the state government financial statements.

Factors such as the effect of natural disasters, recognition of land under roads in 2008–09, overestimation of the impact that the global financial crisis would have on GST revenue and the effect of declining bond yields have caused the state's actual net worth to differ from budgeted results by up to $56.1 billion. These factors have contributed to the actual net operating balance differing from the budgeted result by up to $3.8 billion.

It is reasonable to conclude that the factors that have caused the state's budget to differ from actual results have been, in the main, beyond the state's fiscal control.

6.3 Budget process

The annual budget process requires departments to develop forward estimates which, after they are approved, are included in Service Delivery Statements (SDS). Once passed by Parliament, departments formulate their internal departmental budget allocations.

The reliability of the budget process is key to ensuring that appropriate resource allocation decisions are made. The budget process is assessed by comparing actual performance to budget at three points during the year. The Mid-Year Fiscal and Economic Review presents revised fiscal estimates for the current budget year and the following three years. These revised estimates take into account fiscal and economic developments since the preparation of the budget. The following year's budget (generally tabled in June) also compares the prior year budget to estimated actuals for the year. At the end of the financial year, the state government financial statements include a note to the accounts which details the performance and position of the state compared to the estimates included in the budget.

As well as the state reporting on the whole-of-government actual performance to budget, each department will, from 2014–15, also prepare a note to the financial statements comparing its individual budget to actual performance.

The reporting of budget to actual in the financial statements of both the state and individual departments will enhance the accuracy and reliability of the budget process; reflect circumstances that are beyond the fiscal control of the state; and reduce the risk of errors in the year-end financial statements.

6.4 Analysis of past budget results

6.4.1 Overview

The state government financial statements include a disclosure that compares final actual operating statement, balance sheet and cash flow statement results for the financial year against initial state budget estimates. Explanatory information is also included in the statements, detailing the reasons for major variances and differences between final actual results and budget estimates for the financial year. The accuracy of the budget process and predictive economic models was assessed against results subsequently reported in the state government financial statements over the past five financial years. Figure 6A provides a summary of the variances for total operating revenue and expenditure and total assets and liabilities.

Figure 6A
Comparison of GGS budget versus actual results from 2008–09 to 2012–13

	2009	2010	2011	2012	2013
	Variance $ m (%)	Variance $ m (%)	Variance $ m (%)	Variance $ m (%)	Variance $ m (%)
Operating statement					
Revenue from transactions	427 (1.2%)	2 536 (6.8%)	1 350 (3.3%)	2 787 (6.5%)	-478 (-1.1%)
Expenses from transactions	1 201 (3.4%)	638 (1.6%)	1 121 (2.6%)	-1 038 (-2.2%)	-2 390 (-4.9%)
Balance sheet					
Total assets	61 640 (36.6%)	22 765 (11.1%)	-13 699 (-5.5%)	-4 463 (-1.8%)	7 755 (3.2%)
Total liabilities	5 584 (14.1%)	-1 746 (-3.2%)	3 644 (6.1%)	1 907 (2.7%)	-2 165 (-2.7%)

Source: QAO and Consolidated Financial Statements of the Government of Queensland for financial years 2008–09 to 2012–13

6.4.2 Operating statement

While the actual net operating balance each year varies significantly from budget, total actual revenue and expenses from recurrent transactions are consistent with budget forecasts.

Over the five financial years, variances in revenue and expense forecasts to actual results mainly relate to:

- higher than anticipated federal grants income received across the 2008–09 to 2011–12 financial years, including payments under the Natural Disaster Relief and Recovery Arrangements (NDRRA) to restore infrastructure following Queensland's numerous cyclone and flooding events
- a reduction of $1.2 billion in taxation revenue in 2008–09, with a fall in transfer duty of $1.3 billion as a result of a weaker housing market
- a decline in interest revenue in 2008–09 from reduced valuation of assets held to fund the long term employee related liabilities of the state, primarily due to the global financial crisis; numerous unanticipated natural disaster events occurring after budgets were developed making total revenue and expenditure amounts difficult to estimate during the budget process; and federal grant funding is not determined by the state government and thus inherently difficult to predict
- variances in expenses forecasts to actual results. These relate mainly to budgeted grants expense varying significantly from actual results, particularly as a result of changes in the timing of NDRRA funding to local governments as well as changes to various other grant programs.

6.4.3 Balance sheet

Over the past five financial years, forecasts for total assets and liabilities have proven to be accurate, except for 2008–09 which was affected by the global financial crisis and a change in accounting standards in relation to the accounting for land under roads.

Variances between forecast and actual assets have been driven by:

- the first time recognition of $40.4 billion in land under roads in 2008–09
- a decline in the valuation of assets held to fund the long term, employee related liabilities of the state in 2008–09 as a result of the global financial crisis
- major classes of GGS property, plant and equipment, which comprise the majority of GGS total assets, being measured at fair value and therefore subject to annual revaluation adjustments that are difficult to predict
- the sale of government owned assets including QR National, the long term leases of Abbot Point Coal Terminal and Port of Brisbane and the transfer of Queensland Motorways Limited in 2009–10 that were not included in the original budget. Due to the uncertainty of timing and value of asset sales, the state does not include a budget for the proceeds of asset sales prior to financial close.

Differences between forecast and actual liabilities have been mainly due to:

- a significant decline in the discount rate used to value the defined benefit superannuation liability in 2011–12
- actual borrowing requirements differing from forecast requirements as a result of changes in expected operating and investing cash flows, particularly in 2008–09. Borrowings were also affected by the transfer and repayment of debt associated with the asset sales.

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Appendices

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Appendix A—Comments

Auditor-General Act 2009 *(Section 64)*—Comments received

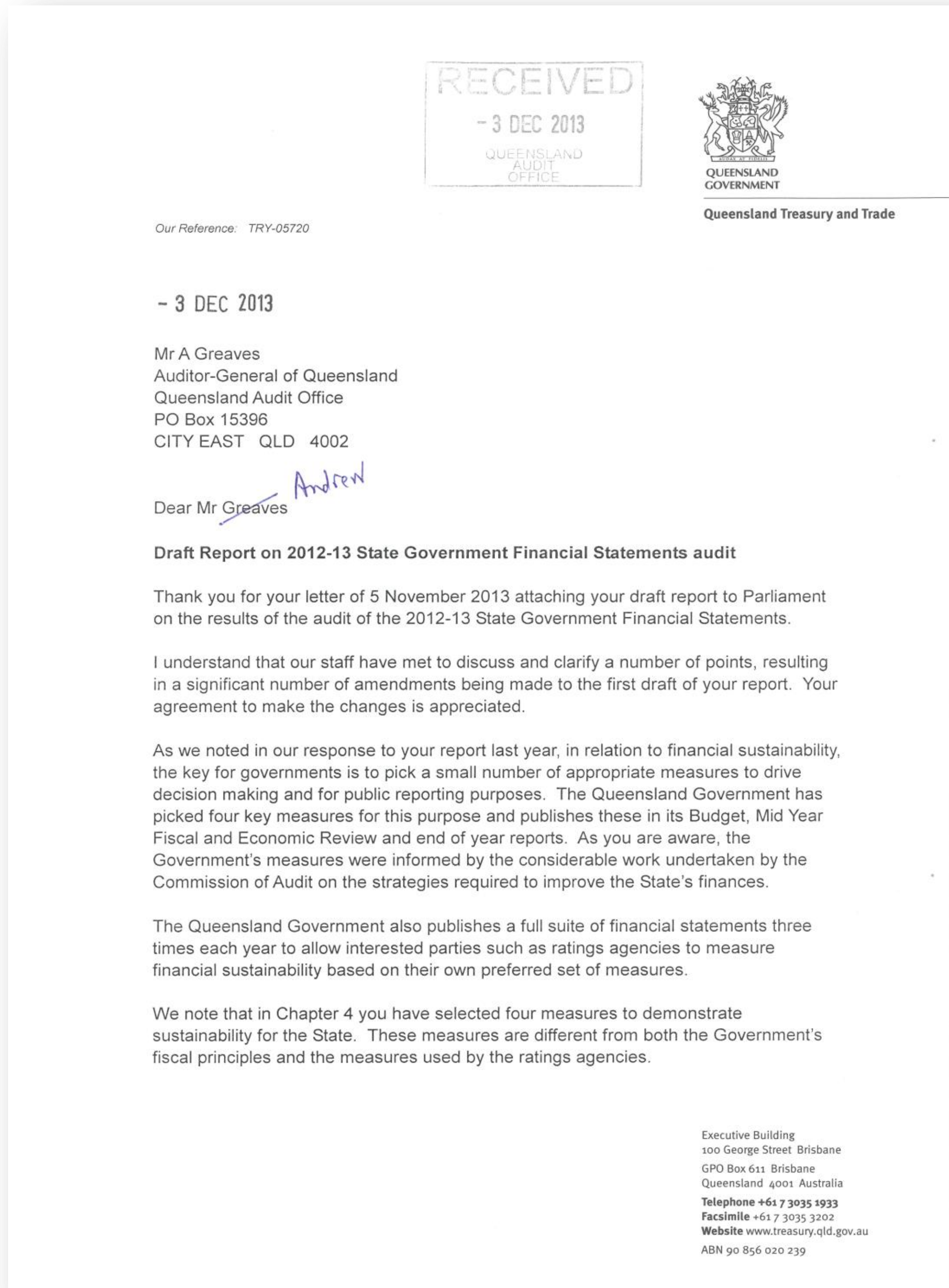
Introduction

In accordance with section 64 of the *Auditor-General Act 2009*, a copy of this report was provided to Queensland Treasury and Trade with a request for comment.

Responsibility for the accuracy, fairness and balance of the comments rests with the head of this agency.

Comments received

Response provided by the Under Treasurer, Queensland Treasury and Trade on 3 December 2013.



RECEIVED
- 3 DEC 2013
QUEENSLAND AUDIT OFFICE

QUEENSLAND GOVERNMENT

Queensland Treasury and Trade

Our Reference: TRY-05720

- 3 DEC 2013

Mr A Greaves
Auditor-General of Queensland
Queensland Audit Office
PO Box 15396
CITY EAST QLD 4002

Dear Mr ~~Greaves~~ Andrew

Draft Report on 2012-13 State Government Financial Statements audit

Thank you for your letter of 5 November 2013 attaching your draft report to Parliament on the results of the audit of the 2012-13 State Government Financial Statements.

I understand that our staff have met to discuss and clarify a number of points, resulting in a significant number of amendments being made to the first draft of your report. Your agreement to make the changes is appreciated.

As we noted in our response to your report last year, in relation to financial sustainability, the key for governments is to pick a small number of appropriate measures to drive decision making and for public reporting purposes. The Queensland Government has picked four key measures for this purpose and publishes these in its Budget, Mid Year Fiscal and Economic Review and end of year reports. As you are aware, the Government's measures were informed by the considerable work undertaken by the Commission of Audit on the strategies required to improve the State's finances.

The Queensland Government also publishes a full suite of financial statements three times each year to allow interested parties such as ratings agencies to measure financial sustainability based on their own preferred set of measures.

We note that in Chapter 4 you have selected four measures to demonstrate sustainability for the State. These measures are different from both the Government's fiscal principles and the measures used by the ratings agencies.

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Comments received

Response provided by the Under Treasurer, Queensland Treasury and Trade on 3 December 2013.

Section 4.2 of your report uses the results of the measures to comment that "the state's financial sustainability has declined over the past five financial years". It should be acknowledged that applying the same measures to the out-years as contained in the 2013-14 State Budget clearly demonstrates an expected strengthening of the State's financial performance and position.

If your officers require further information in relation to this letter, they can contact Mr Dennis Molloy, Assistant Under Treasurer, Fiscal and Macroeconomics on (07) 3035 1988.

Thank you for the opportunity to comment on the Report.

Yours sincerely

Mark Gray
Under Treasurer

Appendix B—General government sector (GGS)

Entities in the general government sector comprise:

- Anti-Discrimination Commission
- Australian Agricultural College Corporation
- Board of the Queensland Museum
- City North Infrastructure Pty Ltd
- Commission for Children and Young People and Child Guardian
- Crime and Misconduct Commission
- Department of Aboriginal and Torres Strait Islander and Multicultural Affairs
- Department of Agriculture, Fisheries and Forestry
- Department of Communities, Child Safety and Disability Services
- Department of Community Safety
- Department of Education, Training and Employment
- Department of Energy and Water Supply
- Department of Environment and Heritage Protection
- Department of Health
- Department of Housing and Public Works
- Department of Justice and Attorney-General
- Department of Local Government, Community Recovery and Resilience (renamed on 4 February 2013, previously Local Government)
- Department of National Parks, Recreation, Sport and Racing
- Department of Natural Resources and Mines
- Department of the Premier and Cabinet
- Department of Science, Information Technology, Innovation and the Arts
- Department of State Development, Infrastructure and Planning
- Department of Tourism, Major Events, Small Business and the Commonwealth Games
- Department of Transport and Main Roads
- Electoral Commission of Queensland
- Gold Coast 2018 Commonwealth Games Corporation
- Gold Coast Institute of TAFE
- Gold Coast Waterways Authority (established on 1 December 2012)
- Health Quality and Complaints Commission
- Hospital and Health Services (established on 1 July 2012):
  - Cairns and Hinterland
  - Cape York
  - Central Queensland
  - Central West
  - Children's Health Queensland
  - Darling Downs
  - Gold Coast
  - Mackay
  - Metro North
  - Metro South
  - North West
  - South West
  - Sunshine Coast

- Townsville
  - West Moreton
  - Wide Bay
- Legal Aid Queensland
- Legislative Assembly
- Library Board of Queensland
- Motor Accident Insurance Commission
- Nominal Defendant
- Office of the Governor
- Office of the Information Commissioner
- Office of the Ombudsman
- Prostitution Licensing Authority
- Public Service Commission
- Queensland Art Gallery Board of Trustees
- Queensland Audit Office
- Queensland Building Services Authority
- Queensland Future Growth Corporation (abolished on 1 July 2013)
- Queensland Performing Arts Trust
- Queensland Police Service
- Queensland Reconstruction Authority
- QRAA
- Queensland Studies Authority
- Queensland Treasury and Trade
- Residential Tenancies Authority
- South Bank Corporation
- Southbank Institute of Technology
- The Council of the Queensland Institute of Medical Research
- The Public Trustee of Queensland
- Tourism and Events Queensland (renamed on 11 December 2012, previously Tourism Queensland)
- TransLink Transit Authority (ceased on 1 January 2013, assets and liabilities transferred to Transport and Main Roads)
- Workers' Compensation Regulatory Authority (QComp).

Appendix C—Public non-financial corporations and public financial corporations

Public non-financial corporations comprise:

- CS Energy Ltd
- Energex Ltd
- Ergon Energy Corporation Limited
- Far North Queensland Ports Corporation Limited
- Gladstone Area Water Board
- Gladstone Ports Corporation Limited
- Mount Isa Water Board
- North Queensland Bulk Ports Corporation Limited
- Port of Townsville Limited
- Powerlink Queensland
- Queensland Bulk Water Supply Authority
- Queensland Bulk Water Transport Authority
- Queensland Rail (established as Queensland Rail Transit Authority on 3 May 2013 and renamed on 2 June 2013)
- Queensland Treasury Holdings Pty Ltd
- SEQ Water Grid Manager (assets and liabilities transferred to Queensland Bulk Water Supply Authority on 1 January 2013)
- Stadiums Queensland
- Stanwell Corporation Limited
- SunWater Limited
- The Trustees of Parklands Gold Coast.

Public financial corporations comprise:

- QIC Limited
- Queensland Treasury Corporation
- WorkCover Queensland.

Appendix D—Financial sustainability indicators

Ratios used to assess financial sustainability in Chapter 4 of this report are explained in Figure D.

Financial sustainability indicators

Indicator	Formula	Description
Operating ratio	Net operating balance divided into total operating revenue Expressed as a percentage	Capacity to meet recurrent operating expenditure from recurrent operating revenue
	A negative ratio indicates a net operating deficit and the larger the negative percentage, the worse the result. Net operating deficits cannot be sustained in the long term. A positive percentage indicates that surplus revenue is available to support the funding of capital expenditure.	
Net operating cash flow ratio	Net cash flows from operations (excludes depreciation) divided into net purchases of non-financial assets (as reported in the cash flow statement) Expressed as a percentage	Capacity to self finance non-financial asset acquisitions from operations rather than sources such as borrowings or asset sales
	A negative ratio indicates that the state has insufficient operating cash receipts to fund its total operating cash payments and any of its non-financial assets purchases (mainly property, plant and equipment). A positive ratio indicates the extent to which non-financial asset purchases are funded by net cash flows from operations.	
Capital replenishment ratio	Net purchases of non-financial assets divided into depreciation expense Expressed as a number	Comparison of the rate of net spending on non-financial assets with depreciation
	A ratio greater than one means the state is replacing its property, plant and equipment asset base at a rate faster than it is being depreciated.	
Net financial liabilities ratio	Net financial liabilities divided into total operating revenues Expressed as a percentage	Capacity of the state to repay debt and interest
	Indicates the extent to which operating revenues can cover the state's net financial liabilities. The higher the ratio, the lower the capacity of the state to repay debt and interest.	

Source: QAO

Auditor-General Reports to Parliament

Tabled in 2013–14

Report number	Title of report	Date tabled in Legislative Assembly
1	Right of private practice in Queensland public hospitals	July 2013
2	Supply of specialist subject teachers in secondary schools	October 2013
3	Follow up—Acquisition and public access to the Museum, Art Gallery and Library collections	October 2013
4	Follow up—Management of offenders subject to supervision in the community	October 2013
5	Traffic management systems	November 2013
6	Results of audit: Internal control systems	November 2013
7	Results of audit: Water sector entities 2012–13	November 2013
8	Results of audit: Hospital and Health Services entities 2012–13	November 2013
9	Results of audit: Energy sector entities 2012–13	December 2013
10	Contract management: Renewal and transition	December 2013
11	Results of audit: State public sector entities 2012–13	December 2013
12	Results of audit: Queensland state government financial statements 2012–13	December 2013

Reports to Parliament are available at www.qao.qld.gov.au.