Auditor-General for the Northern Territory
Auditing for Parliament

November 2008
Report to the Legislative Assembly

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Northern Territory Auditor-General's Office

Auditing for Parliament

The Honourable the Speaker of the Legislative
Assembly of the Northern Territory
Parliament House
Darwin NT 0800

25 November 2008

Dear Madam Speaker,

Accompanying this letter is my report to the Legislative Assembly on two audits that were completed recently. They are the audits of the Treasurer's Annual Financial Statement and the Indigenous Expenditure Review.

I request that you table the report today in the Legislative Assembly.

Yours faithfully,

F McGuiness
Auditor-General for the Northern Territory

www.nt.gov.au/ago
nt.audit@nt.gov.au

GPO Box 4594
DARWIN NT 0801

Telephone (08) 8999 7155
Facsimile (08) 8999 7144

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Auditor-General's overview

The scope of this report is limited when compared with others that I submit to the Legislative Assembly in February and August each year in that it is confined to the outcomes of two audits.

The first is the audit of the Treasurer's Annual Financial Statement (TAFS) for the 2007-08 year which was tabled in the Legislative Assembly during the October sittings. The 2007-08 TAFS is notable in that it has been prepared in accordance with a new Australian accounting standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. That standard is the culmination of five years of work by the Australian Accounting Standards Board, a Commonwealth statutory body established under the *Australian Securities and Investments Commission Act,* with a substantial contribution by the Commonwealth, State and Territory treasuries. The result is an accounting standard that draws together the sometimes divergent principles of generally accepted accounting principles and those of Government Finance Statistics (GFS).

The Northern Territory is one of two jurisdictions that have applied the new standard for financial reports in respect of the 2007-08 year, one year ahead of the standard's required application date.

The second audit that is outlined in this report is that of the 2008 Indigenous Expenditure Review. This Review is the second of its type, the previous Review having been published in 2006. The Territory is the only jurisdiction to have published this type of information and it may prove to be a benchmark for other jurisdictions.

It is likely that the Review will, henceforth, be produced annually and, through that, the quality of information provided to the range of interested users of the Review should become progressively better as Agencies' systems and processes are refined in response to the increased demands placed upon them.

Both audits resulted in unqualified opinions on my part and I believe this to be a testament to the efforts of the staff of a range of Agencies who were involved in the preparation of both reports.

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Analysis of the Treasurer's Annual Financial Statement

Key Issues

My audit opinion on the Treasurer's Annual Financial Statement (TAFS) for 2007-08 differs from those of prior years. Whereas the Statement was qualified for a number of years on the grounds that it had not been prepared in accordance with Australian Accounting Standards, that is no longer the case and the audit opinion for the 2007-08 year is unqualified.

Introduction

The TAFS, which was tabled in the Legislative Assembly on 30 October 2008, is required to be prepared each year in accordance with the requirements of section 9 of the *Financial Management Act*. The Act requires the Treasurer to prepare the statement in a form that the Treasurer considers appropriate. This requirement needs to be considered in conjunction with the requirements of the *Fiscal Integrity and Transparency Act* (FITA). The FITA requires the Treasurer to prepare a final fiscal results report each year, with that report based on either the Australian Accounting Standard AAS 31 *Financial Reporting by Governments* or the *Government Finance Statistics Australia, Concepts, Sources and Methods* (GFS). The Accounting Standard AAS 31 has now been superseded by a new standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting* that draws together the accounting principles that formed the basis of AAS 31 and the economic and statistical principles that underpin the GFS. In effect the new standard has resulted in financial statements that are intended to meet the needs of a broad range of users.

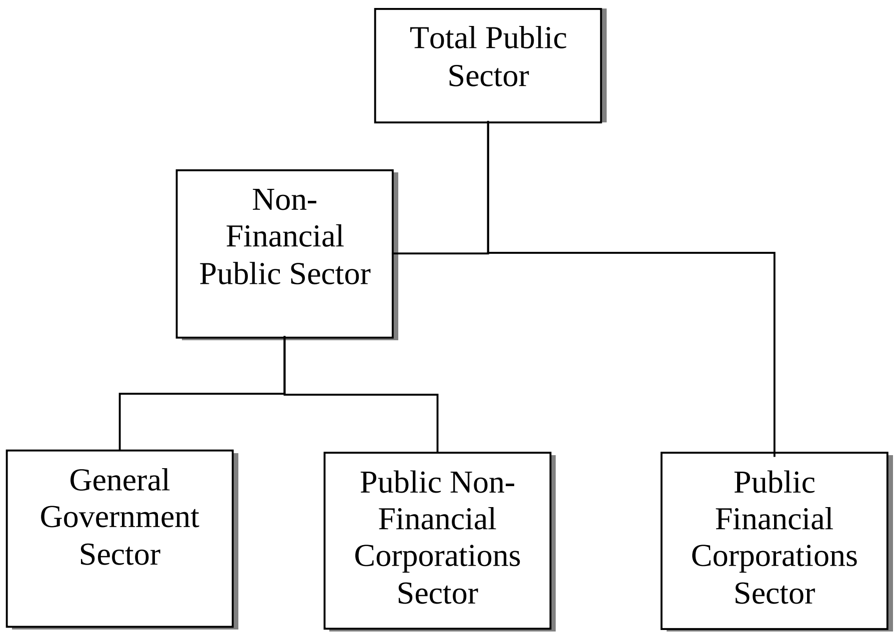
Notwithstanding that the TAFS may not have complied with accounting standards in past years, it did comply with the Uniform Presentation Framework (UPF). The UPF sets out the standard presentation for financial reporting by all Australian jurisdictions and has it origins in the May 1991 Premiers' Conference. In the intervening years the UPF has been amended in line with developments in Accounting Standards and in 2008 was further amended to align it with the accounting requirements and presentation set out in AASB 1049.

Analysis of the Treasurer's Annual Financial Statement cont…

The Uniform Presentation Framework and the Structure of the Public Sector

A key aspect of public sector reporting is the classification of the public sector into three primary sub-sectors; the General Government Sector, the Public Non-Financial Corporations Sector and Public Financial Corporations Sector. The General Government and the Public Non-Financial Corporations Sector are then consolidated to form the Non-Financial Public Sector. That sector is then further consolidated with the Public Financial Corporations Sector to form the Total Public Sector. These sectoral relationships are depicted in Figure 1, below:

Figure 1
Structure of the Public Sector



Analysis of the Treasurer's Annual Financial Statement cont…

A description of the principal sectors that comprise the public sector for reporting purposes under the UPF is as follows:

General Government Sector	Comprises those entities that are mainly engaged in the production of goods and/or services outside the normal market mechanism. Goods and services are provided free of charge or at nominal charges well below their costs of production.
Public Non Financial Corporation Sector	Comprises those entities that are primarily engaged in the production of goods or services of a non-financial nature, at a price which aims to recover most of the costs involved.
Public Financial Corporation Sector	Comprises those entities that perform central banking functions or which have the authority to incur liabilities and acquire financial assets in the market on their own account.
Total Public Sector	Comprises the General Government, Non Financial Corporation and Financial Corporation sectors after eliminating inter-sector transactions and balances in order to present the relationship between the total public sector and the "outside world".

Analysis of the Treasurer's Annual Financial Statement cont…

The Principles of Consolidation

The financial statements for each of the entities that lie within a particular sector are consolidated to provide information about that sector, and are then consolidated further to provide information about the total public sector. Consolidation, for the purposes of the TAFS, involves initially the elimination of all intra-sector transactions and balances in order to provide a picture of the relationship between a sector and the rest of government, and other sectors of the economy. Inter-sector transactions and balances are then eliminated to provide a picture the relationship between the total public sector and the "outside world".

Recent developments in public sector financial reporting

In previous reports I have referred to the development and impending release of the Australian Accounting Standard AASB 1049, *Whole of Government and General Government Sector Financial Reporting*. The issue of that standard by the Australian Accounting Standards Board represents an important milestone in the evolution of financial reporting by governments in Australia.

AASB 1049 came into effect on 1 July 2008 and the Northern Territory elected to adopt the standard for the 2007-08 year, twelve months ahead of the application date specified by the standard and in advance of most Australian jurisdictions. The Territory's ability to report under the new standard ahead of most jurisdictions reflects the decision by the Treasury in prior years to adopt a reporting format based on Government Finance Statistics.

The form of presentation of financial statements prepared under AASB 1049 now comprises three principal financial statements:

- the income statement;
- the statement of financial position; and
- the statement of cash flows.

Analysis of the Treasurer's Annual Financial Statement cont…

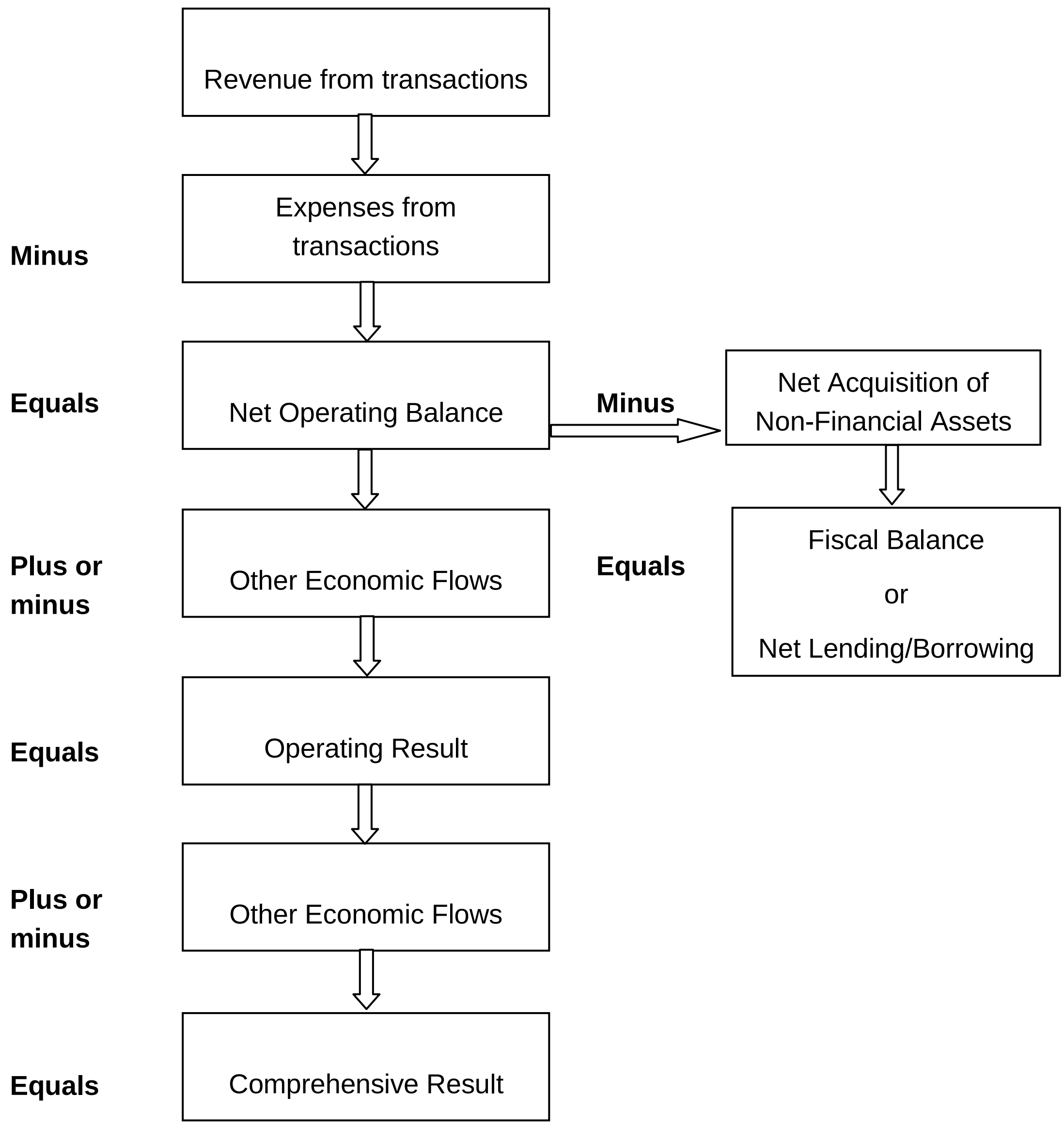
The form of presentation adopted for AASB 1049 is similar to the previous financial statements that constituted the TAFS. Where the new statements differ most notably from those prepared previously by the Treasurer under the UPF format is in the Operating Statement. The new operating statement contains four measures of performance. These are:

- **Net Operating Balance** – the excess of revenue from transactions over expenses from transactions, excluding transactions involving the acquisition of capital assets. The net operating balance encompasses the full cost of providing government services and provides a good measure of the sustainability of a government's fiscal position over time, while also providing an indication of the sustainability of the existing level of government services.
- **Operating Result** – is analogous to the concept of net income that is reported in a set of commercial financial statements. It consists of the net operating balance together with gains and losses (which can be viewed as changes in the values of certain assets and liabilities) and is a measure of the extent to which a government has been able to maintain the value of its "capital" as a result of its operations during the year.
- **Comprehensive Result** – represents the change in the net worth (i.e. the difference between total assets and total liabilities) of either a particular sector or the Total Public Sector as a result of operations, coupled with the effects of all economic events that have resulted in changes to the values of assets and liabilities.
- **Net Lending or Borrowing, or Fiscal Balance** – is a measure of a government's investment-saving balance. A fiscal surplus indicates that a government is saving more than is required to finance all of its investment spending and is therefore not been required to draw upon the savings of other sectors to finance its consumption and capital spending.

Analysis of the Treasurer's Annual Financial Statement cont…

The relationship between these measures of performance is summarised below:

Figure 2



Analysis of the Treasurer's Annual Financial Statement cont…

In addition to the four performance measures outlined above, the financial statements also include three measures of financial position. These are:

- **Net debt:** the stock of financial liabilities, comprising borrowings, advances received and deposits held, less the stock of financial assets comprising cash and deposits, advances paid, investments, loans and placements. The stock of net debt is used to assess the overall strength of a jurisdiction's fiscal position. High levels of net debt impose a call on future revenue flows to service that debt and can therefore limit a government's flexibility to adjust expenditure.
- **Net financial worth:** the value of the net holding of financial assets. It is a broader measure than net debt, in that it incorporates provisions made (such as provisions for superannuation, or employee benefits) as well as holdings of equity. Net financial worth includes all classes of financial assets and all liabilities, only some of which are included in net debt.
- **Net worth:** the value of total assets (both financial and non-financial) less total liabilities and is intended to provide a more comprehensive picture of a government's financial position than either net debt or net financial worth. However net worth can, at the same time, be seen as an inferior measure to net debt or net financial worth because it incorporates non-financial assets that for which there is often no market and for which reliable current values may not be available.

Analysis of the Treasurer's Annual Financial Statement cont…

Entities Excluded From the TAFS

The consolidated financial statements for the Total Public Sector comprise all Agencies, Government Business Divisions, Government Owned Corporations, the Territory Insurance Office and other entities that are deemed to be controlled by the Northern Territory Government. The TAFS consolidation process involves the aggregation of all entities' financial reports into a single set of financial statements after eliminating inter and intra-sector transactions and balances in the process.

The principal determinant as to whether an entity is included in the TAFS is "control", which is the capacity of the Northern Territory Government to dominate the financial and operating policies of that entity so as to enable it to operate with the Government in pursuing the Government's own objectives. Important indicators of the existence of control include the extent to which an entity is accountable to executive government or to a particular Minister, and the extent to which the Government has a residual financial interest in the net assets of the other entity.

The entities listed below have not been consolidated into the TAFS because they are not considered to have satisfied the control test outlined above:

- Charles Darwin University
- Cobourg Peninsula Sanctuary and Marine Park Board
- Conservation Land Corporation
- Legislative Assembly Members' Superannuation Trust
- Local Government/Regional Councils
- Nitmiluk (Katherine Gorge) National Park Board
- Northern Territory Government and Public Authorities Employees' Superannuation Fund
- Northern Territory Grants Commission
- Northern Territory Land Corporation
- Northern Territory Police Supplementary Benefit Scheme
- Public Trustee Common Funds
- Surveyors Board of the Northern Territory of Australia

Analysis of the Treasurer's Annual Financial Statement cont…

While the TAFS excludes superannuation schemes, as noted above, on the grounds that the schemes themselves are neither controlled by the Government nor are their assets available to the Government, it does include the unfunded superannuation liabilities of the Government.

Most assets and liabilities of the public sector that can be said to be controlled by the Northern Territory Government have been included as part of the TAFS. However, some assets and liabilities of Territory schools, and some heritage or cultural assets have not been included either because reliable information was not available or because reliable measurement was not possible. This is an area where it is expected that information will be incorporated progressively into TAFS as systems are developed or improved, or where better information becomes available.

The discussion that follows about the financial performance and position of the sectors is confined to the Total Public Sector and the General Government Sector. The Total Public Sector is examined because its financial statements provide an overall picture of the Northern Territory public sector's financial performance and position, based on the performance and position of each of the entities that it controls. The General Government Sector is also examined because it is, arguably, the most important sector of government. It is that sector which is funded largely through taxation and on that basis alone deserves to be considered separately, but it is also the sector that is responsible for the provision of those services that the community commonly associates with the role of a government.

Analysis of the Treasurer's Annual Financial Statement cont…

Fiscal Strategy and Associated Performance Measures

The *Fiscal Integrity and Transparency Act* requires the Treasurer to publicly release and table a fiscal strategy statement for the Government at the time of each Budget, setting out the Government's medium-term fiscal objectives and key fiscal indicators.

The fiscal strategy is required to be based upon principles of sound fiscal management which are specified in the Act and which require the Government to:

- formulate and apply spending and taxing policies having regard to the effect of those policies on employment, economic prosperity and development of the Territory economy;
- formulate and apply spending and taxing policies so as to give rise to a reasonable degree of stability and predictability;
- ensure that funding for current services is provided by the current generation; and
- manage financial risks faced by the Territory (having regard to economic circumstances), including the maintenance of Territory debt at prudent levels.

Budget Paper No 2 for 2007-08, *Fiscal and Economic Outlook* set out the Government's medium-term fiscal objectives and targets as follows:

- **Sustainable service provision**. The target is a general government positive net operating balance by 2012-13, with the achievement of the target being assessed by the ability to achieve sustainable operating surpluses by that date.
- **Infrastructure for economic and community development**. The target is to maintain total public sector infrastructure investment at appropriate levels and achieve a general government net lending balance by 2012-13. This target is to be assessed on the basis of infrastructure spending for 2008-09 and subsequent years, in conjunction with the extent to which sustainable fiscal balances are achieved.
- **Competitive tax environment**: The target is to ensure territory taxes and charges are competitive with the average of jurisdictions. This target is to be on the basis of inter-jurisdictional comparisons.
- **Prudent management of liabilities**. The target is the continuing decline in the value of net debt plus employee liabilities as a proportion of revenue. The target is assessed on the extent to which the ratio continues to decline over the forward estimates period.

Analysis of the Treasurer's Annual Financial Statement cont…

As indicated above, targets were established for each principle and these are set out below together with audit comments:

Principal	What Is Required?	Extent To Which Target Achieved In 2007-08
Sustainable government services	The ability of the government to maintain positive net operating balances will require fiscal discipline to ensure that costs of service delivery are controlled while also ensuring that associated economic flows are also minimised. It is anticipated that other economic flows should not pose a significant obstacle to achieving the fiscal objective provided existing fiscal policies are maintained.	The achievement of a positive net operating balance for 2007-08 indicates that the General Government Sector operated at a sustainable level for the year. The continued ability to maintain positive net operating balances over the medium will depend, in part, on the state of the economy; internationally, nationally and locally, and the effect that may have upon GST revenues and spending priorities of the Government.
Competitive tax environment	The rates of increase of Territory taxes will need to be confined to average increases across all jurisdictions. This is considered achievable.	Based on such data that are available at the time of preparing this report, the level of per capita taxation remains below the average for the States.
Prudent management of liabilities	The achievement of this objective is linked to that of sustainable service provision. Continued operating surpluses will lead to a decline in liabilities.	The value of net debt plus employee liabilities as a percentage of total revenue declined for 2007-08. This is consistent with the Government's fiscal strategy, but the ability to maintain past trends may be tested by economic conditions expected to prevail over the next few years.

Analysis of the Treasurer's Annual Financial Statement cont…

Financial Performance and Position of the General Government Sector

The General Government Sector is that sector of government that is overwhelmingly dependant upon "own source" taxation and Commonwealth grants as its source of funds. It can be viewed as the principal sector of government as it is this sector that is responsible for the provision of services such as health, education, justice, policing and emergency services; services that are central to the role of a modern government.

The Sources of General Government Sector Revenue

The financial relationship between the Commonwealth, and the states and territories, is affected by the existence of what is known as "vertical fiscal imbalance". This is the result of a progressive shift of taxing powers from the states to the Commonwealth in the years following federation, while the responsibility for the delivery of services remains largely the responsibility of the states. Vertical fiscal imbalance is arguably more pronounced in Australia than in other federal systems.

The imbalance between taxing powers on the one hand and service delivery obligations on the other requires the transfer of revenues from the Commonwealth to the states. The relative shares of revenues to be transferred to states are agreed by the Premiers' Conference and based upon recommendations made by the Commonwealth Grants Commission. The Commonwealth Grants Commission uses a complex methodology that takes account of differences in the per capita capacities of the states to raise revenues, and differences in the per capita amounts required to be spent by the states in providing an average standard of public services. The process by which the Commission's recommendations seek to ensure that each state has the capacity to provide the average standard of state-type public services if it makes the same effort to raise revenue as the states on average, and operates at an average level of efficiency, is referred to as "horizontal fiscal equalisation".

The General Government Sector financial performance for 2007-08, as measured by the Net Operating Balance of $340.5 million, represents a significant improvement over the prior year. However, any analysis of the Net Operating Balance needs to take account of the timing of grants received from the Commonwealth. For example grants paid by the Commonwealth at the end of a financial year will be included in the TAFS as revenues of the General Government Sector, but will not be matched by expenses thus leading to an improved financial result being reported for the year, but which may overstate true performance.

Analysis of the Treasurer's Annual Financial Statement cont…

GST revenues received from the Commonwealth have exhibited steady growth throughout the years since the introduction of the GST, reflecting buoyant economic conditions that have existed throughout that period. However, there is a likelihood that 2008-09 and the forward estimates period may experience rates of growth in GST revenues that are lower than those seen for the past few years as a result of financial market instability and accompanying declines in economic activity that have been experienced over the past months. The Commonwealth Government's Mid-Year Economic and Fiscal Outlook that was released in early November 2008 indicates that general revenue assistance to be paid to the Territory for 2008-09 may decline by $64 million (or 2.6 per cent) when compared with amounts set out in the Commonwealth Budget delivered earlier in 2008 although the extent of that decline may be offset by growth in the Territory's population. Lower levels of financial assistance are forecast to extend over the forward estimates period to 2011-12.

In addition to revenues from the Commonwealth, the Territory also received revenues by way of taxes and charges, and through the sale of goods and services. For 2007-08 these "own source" revenues totalled $700.1 million, compared with $643.2 million for 2006-07, an increase of 8.8 per cent. Most notable were:

- payroll tax (including payroll tax received from public sector entities lying outside the General Government Sector) which increased by 10 per cent to $140.8 million;
- taxes on gambling which increased by 10.5 per cent to $71.3 million; and
- royalties which increased by 23.1 per cent to $95.2 million.

In the cases of payroll tax and royalties, the increases are a reflection of the level of economic activity that prevailed in the Territory throughout 2007-08.

Analysis of the Treasurer's Annual Financial Statement cont…

General Government Sector Expenses

The General Government Sector's expenses for 2007-08 totalled $3,529.0 million, an increase of 12.2 per cent over the prior year. This increase should be interpreted bearing in mind the increase in the level of Commonwealth grants received during the year, which increased by 17.5 per cent compared with the prior year.

Employee expenses continued to be the largest component of total expenses and increased by 7.7 per cent for the year, with this increase being influenced by:

- increased salary and wage costs stemming from enterprise bargaining outcomes;
- increases in provisions for annual and long service leave as a result of a review of accounting policies;
- increased General Government Sector employee numbers. The number of employees who are employed pursuant to the *Public Sector Employment and Management Act*, and measured by their full-time equivalents, increased from an average of 16,107 for the June 2007 quarter to an average of 16,485 for the June 2008 quarter. This increase is attributable largely to new policy initiatives by the Government and to staffing linked to Commonwealth funded programs. The figures above exclude personnel employed under specific Acts of Parliament, for example the *Police Administration Act*.
- Superannuation expenses increased by 8.9 per cent for the year to $263.7 million. For the purposes of the TAFS the unfunded liability for superannuation has been treated as a liability to public sector employees, carrying an appropriate rate of interest. Thus the total superannuation expense includes a notional interest expense of $136.5 million, based on the interest rate used for actuarial valuation of the liabilities of the various schemes.

The performance measures of Operating Result and Comprehensive Result are affected by the value of what are described as Other Economic Flows. These items represent changes in the values of assets and liabilities that are not a result of requited transactions by the Sector. For 2007-08, other economic flows resulted in a net gain of $160.4 million for the year. This was due largely to an increase in the value of the General Government Sector's "investment" in other government sectors ($103.6 million), net actuarial gains in respect of the liability for superannuation ($65.3 million), offset by declines in asset values ($85.0 million).

Analysis of the Treasurer's Annual Financial Statement cont…

The final element of financial performance is the net acquisition of non-financial assets. For 2007-08, the net value of acquisitions of non-financial assets was $143.0 million, compared with $81.3 million for the prior year, resulting in a Fiscal Balance of $197.5 million, compared with $93.2 million for the prior year.

The financial performance of the General Government Sector is summarised in Table 1, below:

Table 1
Financial Performance of the General Government Sector

	2007-08	2006-07
	$'million	$'million
Revenue from transactions	3,869.5	3,320.8
Expenses from transactions	3,529.0	3,146.4
Net Operating Balance	**340.5**	**174.4**
Other economic flows	(18.9)	(226.4)
Operating Result	**321.6**	**(51.9)**
Other economic flows	179.3	64.8
Comprehensive Result	**500.9**	**12.9**
Other economic flows	(160.4)	161.6
Net Acquisition of Non-financial Assets	(143.0)	(81.3)
Fiscal Balance	**197.5**	**93.2**

Note: Totals may not add due to rounding.

Analysis of the Treasurer's Annual Financial Statement cont…

Financial performance, as measured by Net Operating Balance and Fiscal Balance, is also reflected in the cash flows of the Sector. For 2007-08, the General Government Sector's operating activities resulted in net cash inflows of $599.7 million. This surplus was applied to:

- acquisition of non-financial assets $291.7 million;
- acquisition of financial assets $226.5 million;
- reduction of indebtedness $25.4 million;
- increase in cash and deposits of $56.1 million.

The significant increase in the level of the Sector's holding of financial assets flows from the timing of the receipt of Special Purpose Payments by the Commonwealth.

General Government Sector Financial Position

Each of the measures of financial position that are described previously showed improvements when compared with the position at 30 June 2007.

Net Debt declined by $188.4 million to $886.5 million. This decline is linked to the cash surplus from operations and the investment of that surplus in liquid financial instruments as described above.

Net Financial Worth improved by $278.3 million to a negative value of $2,207.0 million at 30 June 2008. This improvement flows from the improved net debt position described above, but was also affected by factors such as the increase in the value of the Sector's equity interest in other sectors of government ($103.6 million), the increase in the value of receivables ($63.1 million), offset by the increase in the liabilities for superannuation and employee benefits ($34.7 million).

Net Worth improved by $500.9 million. This was a result of the improvements in Net Debt and Net Financial Worth, coupled with a net increase in the value of non-financial assets stemming from investment in new assets and revaluations of existing assets.

Analysis of the Treasurer’s Annual Financial Statement cont…

The Financial Performance and Position of the total Public Sector

The financial performance of the Northern Territory public sector mirrors that of the General Government Sector. Revenues increased by $584.0 million, or 15.1 per cent. As was the case with the General Government Sector, most of that increase was represented by the increase in grants from the Commonwealth.

Total expenses increased by $369.7 million, or 10.3 per cent, and were dominated by employee expenses and the purchases of goods and services. The result was a net operating balance of $480.0 million, an increase of $214.3 million or 80.1 per cent when compared with the prior year.

The Total Public Sector financial performance is summarised in Table 2, below:

Table 2
Financial Performance of the Total Public Sector
2007-08

	2007-08	2006-07
	$’million	**$’million**
Revenue from transactions	4,442.0	3,858.0
Expenses from transactions	3,962.0	3,592.3
Net Operating Balance	**480.0**	**265.7**
Other economic flows	(63.1)	(361.9)
Operating Result	**417.0**	**(96.2)**
Other economic flows	83.9	109.1
Comprehensive Result	**500.9**	**12.9**
Other economic flows	(20.8)	252.8
Net acquisition of non-financial assets	(263.2)	(147.5)
Fiscal Balance	**216.9**	**118.2**

Note: Totals may not add due to rounding.

Analysis of the Treasurer's Annual Financial Statement cont…

The financial performance of the Total Public Sector as shown in Table 2 was reflected in the cash flows for the year. Operating activities resulted in a cash surplus of $777.7 million which was applied as follows:

- net investment in non-financial assets of $461.2 million;
- net investment in financial assets of $209.1 million;
- net reduction in indebtedness of $33.5 million; and
- increase in cash and deposits of $73.9 million.

Total Public Sector Financial Position

The financial position of the Total Public Sector, as represented by each of the fiscal aggregates, which have been described previously, improved at 30 June 2008 when compared with 30 June 2007. The principal factor underlying the improvement in net debt and net financial worth was the significant increase in the total public sector holding of financial assets, which rose by $214.0 million and which was accompanied by a relatively small increase of $67.0 million in total liabilities.

The improvement in the total public sector's net worth is a combination of the improvement in net debt, modest growth in total liabilities and an increase in the value of non-financial assets at 30 June 2008. The increase of $353.9 million in the recorded values of land and buildings reflects additions to the asset stock of $1,210.4 million for the year offset by the net effect depreciation, disposals and upwards revaluations that, in total, amounted to $856.5 million.

The components of the Total Public Sector's financial position at 30 June 2008 are shown in the following table:

Analysis of the Treasurer's Annual Financial Statement cont…

Table 3
Total Public Sector
Financial Position as at 30 June 2008

	Balance at 30 June 2008	Movement for 2007-08	Balance at 30 June 2007
	$' million	$'million	$' million
Cash and deposits	327.7	73.9	253.8
Advances paid	136.0	(31.0)	167.0
Investments, loans and placements	1,851.5	100.1	1,751.4
Deposits held	(430.7)	10.9	(441.6)
Advances received	(275.5)	10.3	(285.8)
Borrowings	(2,332.7)	(12.7)	(2,320.0)
Net Debt	**(723.8)**	**151.4**	**(875.2)**
Non-equity assets	304.4	71.1	233.3
Equity assets	-	-	-
Superannuation liabilities	(2,098.8)	(11.4)	(2,087.4)
Other employee entitlements and provisions	(445.6)	(26.7)	(418.9)
Other non-equity liabilities	(690.1)	(37.5)	(652.6)
Net Financial Worth	**(3,653.9)**	**147.0**	**(3,800.9)**
Carrying amount of non-financial assets	6,861.5	353.9	6,507.6
Net Worth	**3,207.6**	**500.9**	**2,706.7**

Note: Totals may not add due to rounding.

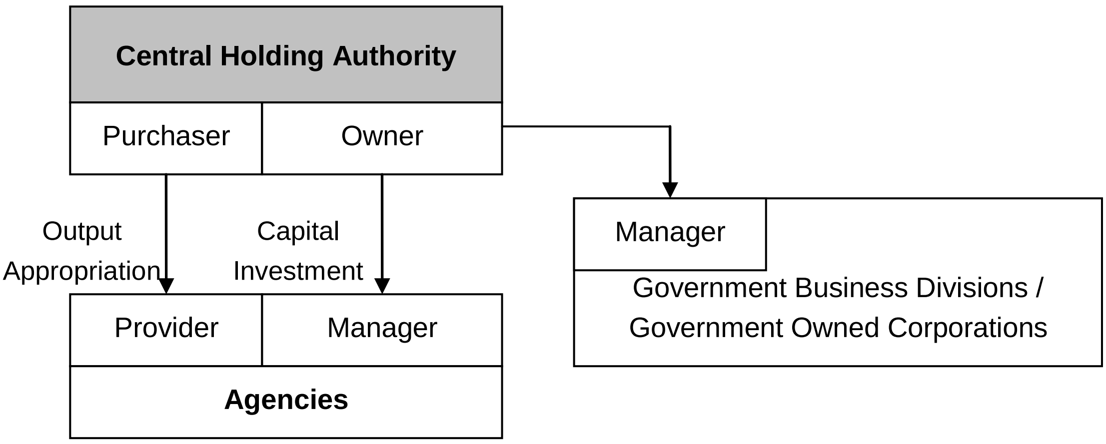
Analysis of the Treasurer's Annual Financial Statement cont…

The Central Holding Authority

The Government's Budget is framed around a set of principles that are sometimes referred to as the "purchaser-provider" model. Under this approach, Ministers are deemed to purchase "outputs" from agencies so as to achieve a set of higher order "outcomes" determined by the Government. The Government is also viewed as the "owner" of, and lender to, agencies and, in that capacity, makes equity advances and loans to agencies.

From an accounting perspective the various roles of purchaser and funder are performed by the Central Holding Authority (CHA) and the relationship between the CHA and agencies is depicted in Figure 3.

Figure 3
Central Holding Authority Relationship



Source: Northern Territory Treasury

The CHA is included as part of the General Government Sector and owes its existence to section 5 of the *Financial Management Act*. That Act also establishes the general rule that all money received by or on behalf of the Territory or an Agency is to be credited to the CHA. The Act also reinforces the well established principle that no money may be paid from the CHA except as authorised under an Act of Parliament.

Analysis of the Treasurer's Annual Financial Statement cont…

The CHA is a central element in the Territory's financial management processes and is used to record:

- all revenues that are received by the Northern Territory Government with the exception of those revenues that are permitted to be credited to an Operating Account or an Accountable Officer's Trust Account. The principal revenues credited to the CHA are taxation, and untied grants (predominately GST revenues and fines);
- all expenses incurred in relation to the provision of outputs by Agencies, together with those expenses that are managed at a whole-of-government rather than at an Agency level such as borrowing expenses, superannuation expenses and long service leave expenses;
- assets, other than physical assets, that have not been assigned to individual Agencies; and
- liabilities that are best managed at the whole-of-government level such as the Territory's stock of debt, and certain employee obligations.

The financial performance of the CHA, in a general sense, will reflect policy decisions made by the Government to ensure that the objectives set for the General Government Sector are achieved, and the Government's capital program is adequate. Given this, it is to be expected that the financial performance of the CHA, as measured by the operating surplus or deficit will fluctuate from one year to another. The performance for 2007-08, compared with that of 2006-07 is illustrated in Table 4, below:

Analysis of the Treasurer's Annual Financial Statement cont…

Table 4
Central Holding Authority
Financial Performance

	2007-08	2006-07
	$'000	**$'000**
Taxation	503,861	452,694
Grants and subsidies	2,271,471	2,030,562
Royalties, rents and dividends	126,017	103,439
Interest revenue	84,925	64,376
Other	(13,489)	72,836
Total Revenues	**2,972,785**	**2,723,907**
Output expense	(2,347,214)	(2,127,603)
Interest expense	(121,659)	(118,674)
Superannuation expense	(142,762)	(424,970)
Other	(86,454)	(23,736)
Total Expenses	**(2,698,089)**	**(2,694,983)**
Net Operating Surplus	**274,696**	**28,924**

Analysis of the Treasurer's Annual Financial Statement cont…

As can be seen from the preceding table, income of the CHA grew strongly, increasing by $248.9 million for the year. The factors that led to the growth in revenues included:

- an increase in Commonwealth grants of $240.9 million;
- taxation revenue which increased by $51.2 million;
- royalties, rents and dividends which increased by $22.6 million; and
- interest revenue which increased by $20.5 million.
- The increases listed above were offset by the value of unrealised losses of $82.7 million on financial assets as a result of the general decline in financial asset prices that occurred towards the end of the financial year.

Output expense (the amount allocated to Agencies in accordance with the provisions of the *Appropriation Act* and *Public Finance Act*) increased by $219.6 million when compared with the prior year, while superannuation expenses declined by $282.2 million for the year largely as a result of an actuarial gain of $65.3 million for 2007-08 compared with a loss of $236.9 million for 2006-07.

The financial performance of the CHA as outlined above was reflected in its cash flows for the year. The CHA recorded a cash surplus of $352.8 million as a result of operations. To this must be added a net increase in liabilities (due largely to an increase in deposits received) of $166.3 million received for the year. The resulting total of $519.1 million was applied as follows:

- capital appropriations to Agencies of $216.9 million;
- increases in loans and investments of $241.6 million;
- net provision of equity to public sector entities of $6.0 million; and
- increase in cash and deposits of $54.6 million.

Analysis of the Treasurer's Annual Financial Statement cont…

The CHA's cash flows for the year are summarised in Table 5:

Table 5
Central Holding Authority
Abridged Statement of Cash Flows

	2007-08	2006-07
	$'000	$'000
Net cash inflows from operating activities	352,784	348,864
Cash outflows from investing activities	(464,513)	(362,770)
Cash inflows from financing activities	166,350	37,538
Net increase in cash held	**54,621**	**23,632**
Opening Balance of Cash and Deposits	61,387	37,755
Cash at end of financial year	**116,008**	**61,387**

Central Holding Authority and Appropriation of Monies by the Legislative Assembly

It is a fundamental principle of the Westminster system of government that no money may be spent without proper approval. The *Financial Management Act* sets out the mechanisms that govern the expenditure of public money in the Northern Territory and to this end all monies appropriated for specified purposes are applied from the Central Holding Authority (CHA).

The *Appropriation Act 2007* authorised an amount of $2,755,081,000 to be applied from the CHA. Increases to amounts appropriated for the year were necessary in the light of higher special purpose payments from the Commonwealth as a result of the Northern Territory Emergency Response. Those increased allocations were facilitated by either Treasurer's Advances made pursuant to Section 18 of the *Financial Management Act* or by the transfer, pursuant to Section 20 of the Act, of excess allocations originally made for other purposes.

Analysis of the Treasurer's Annual Financial Statement cont…

Table 6
Allocations By Central Holding Authority
2007-08

	Actual	**Appropriated**	**Variance**
	$,000	**$'000**	**$'000**
Purpose			
Output Appropriation	2,347,214	2,183,628	163,586
Capital Appropriation	216,898	215,014	1,884
Employee Entitlements	149,831	172,490	(22,659)
Interest, taxes and administration	174,719	143,949	30,770
Total	**2,888,662**	**2,715,081**	**173,581**
The increase in Allocation was financed by:			
Treasurer's Advance appropriated by the *Appropriation Act*			40,000
Increase in Treasurer's Advance approved pursuant to Section 19 of *Financial Management Act*			137,754
Total Treasurer's Advance Approved for 2007-08			**177,754**
Less Unexpended Balance of Treasurer's Advance			4,173
Treasurer's Advance Applied for 2007-08			**173,581**

Analysis of the Treasurer's Annual Financial Statement cont…

Public Sector Superannuation Liabilities

The largest liability of Northern Territory Government is that of superannuation. The liability for superannuation represents the value of unfunded employee benefits and at 30 June 2008 that liability was $2,098.8 million ($2,087.4 million at 30 June 2007). That liability is held entirely by the General Government Sector.

The various schemes, and the unfunded liability in respect of each, at 30 June 2008 were as follows:

Table 7
Unfunded Superannuation Liabilities
As At 30 June

	2008	**2007**
Scheme	**$'million**	**$'million**
Northern Territory Government and Public Authorities Superannuation Scheme	601.7	593.4
Commonwealth Superannuation Scheme	1,203.3	1,208.5
Northern Territory Supplementary Superannuation Scheme	164.2	167.2
Northern Territory Police Supplementary Benefit Scheme	32.0	30.8
Legislative Assembly Members Superannuation Trust	11.7	7.0
Northern Territory Death and Invalidity Scheme[1]	41.2	37.4
Other Schemes[2]	44.7	43.1
	2,098.8	**2,087.4**

[1] The Northern Territory Death and Invalidity Scheme took effect from 1 July 2007 following amendments to the Superannuation Act passed by the Legislative Assembly in October 2007.

[2] Comprises the unfunded liability of vested benefits pursuant to the *Administrators Pensions Act* and the *Supreme Court (Judges Pensions) Act*.

Analysis of the Treasurer's Annual Financial Statement cont…

Superannuation schemes can be characterised generally as being either defined benefit or defined contribution schemes. A defined benefit scheme is one where the accrued benefits payable to a member are a function of his or her final salary and/or length of service. A defined contribution scheme is one where the accrued benefits payable to a member are represented by the accumulated contributions to the scheme together with associated investment earnings.

Defined contribution schemes are, by definition, fully funded.

Each of the liabilities shown in the preceding table represents the value of the unfunded defined benefits that had accrued under the respective schemes as at 30 June 2008.

The value of the liabilities shown at Table 7 is a function of a number of factors including expected real wage growth, expected earning rates on scheme assets and the timing of benefit payments. In the case of defined benefit pension schemes, the expected longevity of members and pensioners will also affect the value of the liability. Adverse movements of any of these factors will have the effect of increasing the overall unfunded liabilities of the public sector, with an accompanying increase in the annual superannuation expenses, and with that being reflected ultimately in higher future cash flows.

Most schemes listed in the table have been closed to new members. It is likely that the value of the accrued liability will continue to grow over the medium term, to be followed by a steady decline to the second half of the century.

Some years ago a Conditions of Service Reserve was established to hold assets intended to meet the emerging costs of employee obligations, including superannuation. In the 2006-07 the Treasurer transferred $181.9 million to the Reserve, with a further $64 million being transferred in 2007-08. The balance of the Reserve at 30 June 2008 was $403.8 million.

The funds held to the credit of the Reserve are invested in a range of financial assets possessing cash flow characteristics that match those of the expected liabilities to be met from the Fund.

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Indigenous Expenditure Review

Background

In September 2006 the first Indigenous Expenditure Review was released by the Northern Territory Treasury. The Review was the first attempt by the Northern Territory, and possibly by any jurisdiction in Australia, to examine the level of public sector spending that is attributable to the indigenous residents of the Territory.

A second Indigenous Expenditure Review, based on expenditure for the 2006-07 year, was completed in September 2008 and on this occasion I audited the financial data that underpinned the Review, together with the financial information included in the Review. In terms of elapsed time, this audit was one of the longest audits undertaken by the NTAGO, extending over nine months from December 2007.

The audit consisted of two stages. The first being an examination of selected agency systems and data; the second being an examination of the process by which the data were collated by the Northern Territory Treasury and, flowing from that, the extent which the information contained in Treasury's Indigenous Expenditure Review might be considered to be reliable.

The data selected for the first stage was based upon a sample of Agencies' expenditure returns provided to the Northern Territory Treasury and which represented approximately 64 per cent of the total expenditure attributable to the Territory's indigenous population.

For each of the selected Agencies, the audit:

- examined the systems and methods used to allocate direct and indirect costs to indigenous programs;
- determined the extent to which service delivery to indigenous groups was identifiable;
- to the extent to which service delivery to indigenous groups was not recognised specifically, identified the approach by which costs were determined as being related to indigenous activities and formed a view about the validity of the approach adopted; and
- assessed the reliability of the systems used to capture, store and extract the relevant data.

Indigenous Expenditure Review cont…

At the whole of government level, the audit:

- examined the methodology used to determine the proportion of indigenous expenditure attributed to central Agencies, and Agencies that provide support services with a view to forming an opinion on the validity of the cost allocation methodologies adopted; and
- flowing from the previous steps, determined whether the proportion of expenditure deemed to be attributable to the Territory's indigenous population and reported in the IER was supported by Agencies' data and consistent with the proportions reported in the 2006 Review.

Audit Observations

The review identified that 52.4 per cent of total expenditure by Agencies was related either directly or indirectly to the Territory's indigenous population, while 44.4 per cent of the Territory's revenues were indigenous related.

The proportion of expenditure identified as being indigenous related was determined using an absorption costing method in that the total includes those costs that can be traced directly to the delivery of indigenous programs, together with a share of overhead costs (including a share of the costs of support agencies and central agencies) to arrive at a total cost to the Northern Territory budget.

As a result of the audit I advised the Under Treasurer that, in my opinion, the data that were the subject of the review, and the systems and processes adopted by the Treasury in collating the data and the information contained in the Indigenous Expenditure Review resulted in a fair presentation of the level of expenditure attributable to the indigenous population of the Territory.

The audit raised some issues that will require consideration before the next review is commenced. These included the need for Agencies to:

- strive to meet the specified deadlines for the submission of returns to the Treasury;
- have fully documented, established systems and processes for the extraction of relevant data; and
- ensure that cost allocation methodologies are reviewed regularly.

Appendix 1: Overview of the approach to auditing the Public Account and other accounts

The requirements of the *Audit Act* in relation to Auditing the Public Account and other accounts are found in:

- Section 13, which requires the Auditor-General to audit the Public Account and other accounts, with regard to:
- the character and effectiveness of internal control; and
- professional standards and practices.
- Section 25, which requires the Auditor-General to issue a report to the Treasurer on the Treasurer's Annual Financial Statement.

What is the Public Account?

The Public Account is defined in the *Financial Management Act* as:

- the Central Holding Authority; and
- Operating accounts of Agencies and Government Business Divisions.

Audit of the Public Account

Achievement of the requirements of section 13, including the reference to the character and effectiveness of internal control, as defined, can occur through:

- annual financial statement audits of entities defined to be within the Public Account, in particular Government Business Divisions, which have a requirement for such audits under the *Financial Management Act*; and
- an audit approach which the Northern Territory Auditor-General's Office terms the Agency Compliance Audit. This links the existence of the required standards of internal control over the funds administered within the Public Account, to the responsibilities for compliance with required standards as defined for Accountable Officers.

Appendix 1: Overview of the approach to auditing the Public Account and other accounts cont…

Areas of internal control requiring a more in-depth audit, because of materiality or risk, can also be addressed through:

- specific topic audits of the adequacy of compliance with prescribed internal control procedures. These can be initiated as a result of Agency Compliance Audits, or pre-selected because of the materiality or inherent risk of the activity; and
- reviews of the accounting processes used by selected Agencies at the end of the financial year, to detect if any unusual or irregular processes were adopted at that time.

Other accounts

Although not specifically defined in the legislation, these would include financial statements of public entities not defined to be within the Public Account, as well as the Trust Accounts maintained by Agencies.

Audit of the Treasurer's Annual Financial Statement

Using information about the effectiveness of internal control identified in the overall control environment review, Agency Compliance Audits and financial statement audits, an audit approach is designed and implemented to substantiate that balances disclosed in the Statement are in accordance with the disclosure requirements adopted by the Treasurer, and are within acceptable materiality standards.

The audit report on the Statement is issued to the Treasurer. The Treasurer then tables the audited Statement to the Parliament, as a key component of the accountability of the Government to the Parliament.

Appendix 2: Abbreviations

AAS	Australian Accounting Standard
CHA	Central Holding Authority
FITA	Fiscal Integrity and Transparency Act
GFS	Government Finance Statistics Australia, Concepts, Sources and Methods
GST	Goods and Services Tax
IER	Indigenous Expenditure Review
LAMS	Legislative Assembly Members Superannuation Trust
NTAGO	Northern Territory Auditor-General's Office
TAFS	Treasurer's Annual Financial Statement
UPF	Uniform Presentation Framework

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Index of matters reported

Auditor-General for the Northern Territory
GPO Box 4594
Darwin NT 0801
Australia

Level 12
Northern Territory House
22 Mitchell Street
Darwin NT 0800
Australia

Telephone: (08) 8999 7155
Facsimile: (08) 8999 7144

E-mail: nt.audit@nt.gov.au
www.nt.gov.au/ago