A2. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES AND FORECAST ASSUMPTIONS

Scope of the Estimated Financial Statements

The budget papers present the Estimated Financial Statements of the general government sector (GGS), including revised estimates for the current year ending 30 June 2018, and estimates for the budget year ending 30 June 2019 and the three forward years ending 30 June 2020, 2021 and 2022.

These comprise the GGS operating statement, GGS balance sheet and GGS cash flow statement. These are prepared in accordance with this Statement of Significant Accounting Policies and Forecast Assumptions.

Collectively, the statements and the Statement of Significant Accounting Policies and Forecast Assumptions are referred to as the 'Estimated Financial Statements'.

The Estimated Financial Statements are prepared for the NSW GGS, which is determined in accordance with the principles and rules contained in the Australian Bureau of Statistics, *Australian System of Government Finance Statistics: Concepts, Sources and Methods 2015 (cat. No. 5514)* (ABS-GFS Manual) as amended from time to time.

The GGS comprises government agencies controlled by the State that:

- undertake regulatory functions
- redistribute income and wealth
- provide or distribute goods and services on a non-market basis to individuals and the community and/or
- provide other services to general government agencies.

The scope of the GGS is outlined in Appendix A3 of this *Budget Statement*.

Basis of preparation

The Estimated Financial Statements are prepared using the accrual basis of accounting, which recognises the effect of transactions and events when they are forecast to occur.

They have been prepared in these budget papers to reflect existing operations and the impact of new policy decisions taken by the NSW Government (where their financial effect can be reliably measured). The 2017-18 revised estimates are based on actual results for the 10 months period ending 30 April 2018, and updated year end projections provided by agencies. They have also been prepared to take into account other economic and financial data available to Treasury up to 13 June 2018, including Commonwealth Government funding decisions announced in the *2018-19 Commonwealth Government Budget*.

In keeping with these principles, where the impact of a policy decision or planned event cannot be reliably estimated, the impact is not reflected within the Estimated Financial Statements (e.g. due to uncertainties regarding the timing and amount of future cash flows).

Any estimates or assumptions made in measuring revenue, expenses, other economic flows, assets or liabilities are based on the latest information available at the time, professional judgements derived from experience and other factors considered to be reasonable under the circumstances. Actual results may differ from such estimates. Key assumptions are detailed below, under the headings *Material economic and other assumptions* and *Summary of other key assumptions*.

Accounting policies

Australian Accounting Standards (AAS) do not include requirements or provide guidance on the preparation or presentation of prospective financial statements. However, recognition and measurement principles within AAS have been applied in the presentation of the Estimated Financial Statements to the maximum extent possible.

The Estimated Financial Statements do not include the impact of major asset transactions until they are finalised. The financial impact of these future planned discontinuing operations or restructuring transactions are not recognised due to the commercial-in-confidence nature of these transactions.

The Estimated Financial Statements adopt the accounting policies expected to be used in preparing general purpose financial statements for 2017-18. Except for the change in the revenue recognition policy for government-assessed tax revenue as discussed below, the policies are not materially different from those applied in the *Total State Sector Accounts 2016-17*. Note 1 of the audited *2016-17 Total State Sector Accounts* sets out the significant accounting policies, including the principles of consolidation, significant accounting judgements and estimates, and the recognition and measurement policies for revenue, expenses, other economic flows, assets and liabilities.

Change in accounting policies

The existing accounting policy for government-assessed tax revenue is to recognise revenue at the time assessments are made. This has now been changed to recognising government-assessed revenue when the underlying event that results in a right to receive revenue has occurred and assessments have been issued, or when the amount can be reliably measured. The change has been made to better reflect the underlying events that give rise to control of the associated economic benefits, in accordance with AASB 1004 *Contributions* (AASB 1004).

The main impact of this change in accounting policy relates to the Emergency Services Levy received from insurers. Following the introduction of the *Emergency Services Levy Act 2017*, initial assessments are now issued in the financial year preceding the year in which the relevant insurers' premiums are earned. A final assessment is issued in the year following the year in which the relevant insurers' premiums are earned.

Application of the previous accounting policy would have led to the recognition of an additional $0.8bn of revenue relating to 2018-19 insurers' premiums being recorded in 2017-18 when the initial assessment is made.

The change in accounting policy has reduced revenue from transactions – taxation by $0.8 billion for 2017-18. In subsequent years, insurers' premiums would have been recorded one year earlier under the previous accounting policy, meaning the impact of the change is not as significant (increases/(decreases) of 2018-19: -$40 million, 2019-20: $40 million, 2020-21: -$60 million, 2021-22: $40 million). The (decreases)/increases in revenue also (decrease)/increase other line items in the operating statement, including total revenue from transactions; budget result - surplus/(deficit); operating result; comprehensive result - total change in net worth; and net lending/(borrowing).

The (decreases)/increases in revenue have a corresponding impact on receivables, as well as total financial assets and total assets.

Revenue reported in prior periods is not impacted by the change in accounting policy because under the previous legislation, Emergency Services Levy assessments were raised in the relevant tax year.

Except for the above change in revenue recognition policy, there are no other significant changes to AAS or accounting policies adopted in 2018-19 that would significantly impact on the Estimated Financial Statements.

New Accounting Standards issued but not effective

- AASB 9 Financial Instruments and AASB 2014-7 Amendments to Australian Accounting Standards arising from AASB 9 (December 2014)
  - AASB 9 Financial Instr*uments* (AASB 9) is effective from reporting periods commencing on or after 1 January 2018. AASB 9 addresses the classification, measurement and derecognition of financial assets and financial liabilities, introduces new rules for hedge accounting and a new impairment model for financial assets.
  - The impact on the State's statement of financial position overall is not expected to be significant.
- AASB 15 Revenue from Contracts with Customers and AASB 2014-5 Amendments to Australian Accounting Standards arising from AASB 15
  - AASB 15 Revenue from Contracts with Customers (AASB 15) is effective from reporting periods commencing on or after 1 January 2018 for for-profit entities and on or after 1 January 2019 for not-for-profit entities. AASB 15 establishes a five-step model to account for revenue arising from contracts with customers. Under AASB 15, revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.
  - Some revenue streams may be impacted by AASB 15 to varying degrees. In particular, the application of AASB 15 may result in the identification of separate performance obligations that could change the timing of the recognition of revenue. The estimated impact of AASB 15 on future estimated financial statements has not been sufficiently quantified at this stage.
- AASB 1058 Income of Not-for-Profits
  - AASB 1058 Income of Not-for-Profits (AASB 1058) is effective for reporting periods commencing on or after 1 January 2019 and will replace most of the existing requirements in AASB 1004. The scope of AASB 1004 is now limited mainly to parliamentary appropriations, administrative arrangements and contributions by owners.
  - Under AASB 15, not-for profit entities will need to determine whether a transaction is a donation (accounted for under AASB 1058) or a contract with a customer (accounted for under AASB 15). The estimated impact of AASB 1058 on future estimated financial statements has not been sufficiently quantified at this stage.
- AASB 16 Leases
  - AASB 16 Leases (AASB 16) is effective from reporting periods commencing on or after 1 January 2019. For lessees, AASB 16 will result in most leases being recognised on the statement of financial position, as the distinction between operating and finance leases is largely removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognised at the commencement of the lease. The only exceptions are short-term and low-value leases. The accounting for lessors will not significantly change.

  - AASB 16 will therefore increase assets and liabilities reported on the balance sheet. It will also increase depreciation and amortisation and interest expenses, and reduce operating lease rental expenses. The estimated impact of AASB 16 on future estimated financial statements has not been sufficiently quantified at this stage.
- AASB 1059 Service Concession Arrangements: Grantors
  - AASB 1059 Service Concession Arrangements: Grantors (AASB 1059) is effective from reporting periods commencing on or after 1 January 2019. Service concession arrangements (SCA) involve a private sector entity operating a service concession asset to deliver public services on behalf of a public sector grantor.
  - Currently, under TPP 06-8 Privately Financed Projects (TPP 06-8), most SCA in New South Wales are generally treated as leases or as assets gradually recognised over the concession period.
  - AASB 1059 will require service concession assets to be recognised immediately at the start of the arrangement, with a corresponding liability to reflect any payments due, and/or the grant of a right, to the operator. Further, AASB 1059 has a broader scope than TPP 06-8, possibly resulting in more arrangements being recognised in the State's statement of financial position.
  - These changes are expected to significantly increase assets and liabilities in the State's statement of financial position and impact in the operating statement depreciation and amortisation expenses and income from the amortisation of grant of right liability. The estimated impact of AASB 1059 on future estimated financial statements has not been sufficiently identified and quantified at this stage.

There are no other standards that are not yet effective and that would be expected to have a material impact on the estimated financial statements.

Presentation of the Estimated Financial Statements

The Estimated Financial Statements follow the presentation requirements for GGS reporting contained in AASB1049 Whole of Government and General Government Sector Financial Reporting (AASB 1049).

AASB 1049 harmonises generally accepted accounting principles (GAAP, ie. AAS) with Government Financial Statistics (GFS) principles in accordance with the GFS framework adopted by the Australian Bureau of Statistics . This occurs by requiring that the statement of comprehensive income (referred to as the operating statement) classifies income and expenses as either transactions or other economic flows to be consistent with GFS principles, applied from a GAAP perspective.

The net operating balance (i.e. the budget result) is the net result of harmonised GFS-GAAP transactions for the GGS.

In the operating statement:

- the *net operating balance* is the net result of *revenue and expenses from transactions*. It excludes *other economic flows*, which represent changes in the volume or value of assets or liabilities that do not arise from transactions with other entities and which are often outside the control of government
- the *operating result* is the same under both the harmonised GFS-GAAP and pure GAAP presentations.

Further, AASB 1049 requires:

- the GGS financial statements adopt the recognition, measurement and disclosure requirements of GAAP
- where options exist in GAAP, the GGS financial statements adopt the option that is aligned with GFS, to minimise differences between GAAP and GFS and/or
- where options do not exist in GAAP and there is conflict between GAAP and GFS, GAAP prevails.

Due to the prospective nature of the statements, detailed notes to the Estimated Financial Statements are not required to be presented within the meaning of AAS as outlined in Section 27A (5) of the *Public Finance and Audit Act 1983*.

Each year ends on 30 June, all monetary amounts are presented in Australian dollars and rounded to the nearest million dollars ($m).

Use of a zero ("0") represents amounts rounded to zero. Use of three dots ("…") represents nil amounts.

Tables may not add in all instances due to rounding to the nearest million dollars.

Presentation changes

There have been no presentation changes since the release of the 2017-18 Budget Papers. The presentation of information in the financial estimates remains consistent with GAAP and GFS presentation requirements.

Definitions

Key technical terms, including fiscal aggregates, are defined in the Glossary to this *Budget Statement*.

Material economic and other assumptions

The Estimated Financial Statements have been prepared using the material economic and other assumptions as set out in Table A2.1.

Table A2.1: Key economic performance assumptions[(a)]

	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
	Outcomes	Forecasts	Forecasts	Forecasts	Projections	Projections
New South Wales population (persons)[(b)]	7,861,000	7,988,000	8,112,000	8,233,000	8,352,000	8,467,000
Nominal gross state product ($million)	576,700	606,000	630,400	658,000	690,000	724,400
Real gross state product (per cent)	2.9	3	2¾	2¾	2½	2½
Real state final demand (per cent)	3.9	3¾	3	3	-	-
Employment (per cent)	1.0	3	1¾	1½	1¼	1¼
Unemployment rate (per cent)[(c)]	5.0	4¾	4¾	4¾	4¾	4¾
Sydney consumer price index (per cent)[(d)]	1.8	1¾	2	2	2¼	2½
Wage price index (per cent)[(e)]	2.0	2	2½	2¾	3	3¼
Nominal gross state product (per cent)	6.4	5	4	4½	5	5

(a) Per cent change, year average, unless otherwise indicated.
(b) As at 30 June each year.
(c) Year average, per cent.
(d) 2017-18 to 2021-22 excludes ¼ percentage point from tobacco excise increases.
(e) Weighted private and public sector wages.

Source: ABS 3101.0, 5206.0, 5220.0, 6202.0, 6401.0, 6345.0 and Treasury

Summary of other key assumptions

The following section outlines the other key assumptions used in the preparation of the Estimated Financial Statements. The summary takes into account materiality in relation to the GGS's overall financial position and sensitivity to changes in key economic assumptions.

Notwithstanding these key assumptions, agency finance officers apply appropriate professional judgement in determining estimated financial information.

Revenue from transactions

Taxation

Taxation revenue is forecast by assessing economic and other factors that influence the various taxation bases. Payroll tax, for example, involves an assessment of the outlook for employment and wages. Forecasts of government debt guarantee fees take into account an assessment of the level of debt of PNFCs and their credit rating differential compared with the State as a whole. The forecasts of taxation revenue also involve the analysis of historical information and relationships (using econometric and other statistical methods) and consultation with relevant government agencies.

Grants and subsidies revenue

Forecast grants from the Commonwealth Government are based on the latest available information from the Commonwealth Government and projections of timing of payments at the time of preparation of the Budget. This takes into account the conditions, payment timetable and escalation factors relevant to each type of grant.

The Goods and Services Tax (GST) grants are forecast based on estimates of the national GST pool by the Commonwealth Government. For 2018-19, the GST forecast is based on the assessed relativity for New South Wales in 2018-19 and the Commonwealth Government's population projections. The assessed relativity is based on the three-year average of actual data (2014-15, 2015-16 and 2016-17) as published by the Commonwealth Grants Commission.

Beyond 2018-19, the State's share of GST is based on New South Wales' forecast relativities and the Commonwealth's GST pool and population projections. The forecast per capita annual relativities are based on the projected fiscal capacity of New South Wales compared to other States and Territories.

Sale of goods and services

Revenue from the sale of goods and services is forecast by taking into account all known factors, including estimates of changes in demand for services provided or expected unit price variations based on proposed fee increases imposed by general government agencies and/or indexation.

Dividend and income tax equivalents from other sectors

Dividend and income tax equivalent revenue from other sectors are estimated by PNFC and PFC sectors based on expected profitability and the agreed dividend policy at the time of the Budget.

Other dividends and distributions

Other dividends include estimates of dividends to be received from investments in entities other than the PNFC and PFC sectors, with the revenue recognised when the right to receive payment is expected to be established. Estimates are based on advice from external parties.

Distributions are mainly from managed fund investments administered by TCorp, with the revenue recognised when the right to receive payment is expected to be established based on advice from TCorp. It excludes estimated fair value movements in the unit price of the investments, which are recognised as 'other economic flows – included in the operating result'.

Fines, regulatory fees and other revenues

Fines, regulatory fees and other revenues include estimates of fines issued by the Courts, estimated traffic infringement fines, estimated revenue from enforcement orders, and regulatory fees and contributions. It also includes estimated royalty revenue based on assessments of coal volumes and prices, and the Australian dollar exchange rate. Other revenue forecasts are adjusted for indexation where appropriate.

Expenses from transactions

To improve the accuracy of budget estimates, consistent with longstanding practice and reflecting historic trends, the Budget includes adjustments:

- to account for parameter and technical adjustments expected to be required to maintain service provision on a no policy change basis reflecting the historic conservative bias in aggregate spending estimates
- to account for expenses expected to be carried forward into future years reflecting changes in timing of delivery of government activity, consistent with the policy set out in *Treasury Circular NSW TC 15-08* and
- to reflect government decisions that are not yet included in agency estimates, for example due to timing or because they are commercial in confidence or subject to further requirements.

Employee expenses

Employee expenses are forecast based on expected staffing profiles, current salaries, conditions and on-costs. Employee expenses are adjusted over the forecast period for approved wage agreements. Beyond the period of the agreements, allowance is made for further adjustments consistent with the State's wages policy at a net cost of 2.5 per cent per annum, inclusive of scheduled increases in the superannuation guarantee levy. The forecasts for employee expenses also reflect the impact of newly approved initiatives and required efficiency savings.

Superannuation expense (and liabilities)

Superannuation expense comprises:

- for the defined contribution plan, the forecast accrued contribution for the period
- for defined benefit plans, the forecast service cost and the net interest expense. This excludes the re-measurements, (i.e. actuarial gains and losses, and return on plan assets in excess of the long-term Commonwealth Government Securities (CGS) rate) which are classified as 'other economic flows – other comprehensive income'.

Superannuation expenses for defined contribution plans are based on assumptions regarding future salaries and contribution rates.

Superannuation expenses for defined benefit plans are estimated based on actuarial advice, applying the long-term CGS yield as at 30 June in the prior year to the opening value of net liabilities (gross superannuation liabilities less assets), less benefit payments at the mid-point of the contribution year, plus any accruing liability for the year.

Forecasts of defined benefit superannuation liabilities are based on actuarial estimates of cash flows for the various defined benefit superannuation schemes, discounted using a nominal long-term CGS yield as at 30 June. Gross liability estimates are based on a number of demographic and financial assumptions.

The table below sets out the major financial assumptions used to estimate the superannuation expense and liability in respect of defined benefit superannuation for the Budget and forward estimates period.

Table A2.2: Superannuation assumptions – pooled fund / state super schemes

	2017-18	2018-19	2019-20	2020-21	2021-22
	%	%	%	%	%
Liability discount rate	3.02	3.28	3.53	3.53	3.79
Expected return on investments	7.36	7.40	7.40	7.40	7.40
Expected salary increases	2.70	2.70	3.20	3.20	3.20
Expected rate of CPI	2.25	2.25	2.25	2.50	2.50

Depreciation and amortisation

Property, plant and equipment are depreciated (net of residual value) over their respective useful lives. Depreciation is generally allocated on a straight-line basis.

Depreciation is forecast on the basis of known asset carrying valuations, the expected economic life of assets, assumed new asset investment and asset sale programs. The depreciation expense is based on the assumption that there will be no change in depreciation rates over the forecast period, but includes the estimated impact of the current and future revaluation of assets over the forecast period. The depreciation expense may also be impacted by future changes in useful lives, carrying value, residual value or valuation methodology.

Certain heritage assets, including original artworks and collections and heritage buildings, may not have limited useful lives because appropriate custodial and preservation policies are adopted. Such assets are not subject to depreciation. Land is not a depreciable asset.

Intangible assets with finite lives are amortised under the straight-line method. Intangible assets with indefinite lives are not amortised, but tested for impairment annually.

Interest expense

The forecasts for interest expense are based on:

- payments required on outstanding borrowings
- expected payments on any new borrowings (including any refinancing of existing borrowings) required to finance general government activities based on forward contracts for TCorp bonds and
- the unwinding of discounts on non-employee provisions.

Other operating expenses

Other operating expenses mainly represent the day-to-day running costs incurred in the normal operations of agencies and include the cost of supplies and services. They are forecast by applying appropriate economic parameters and known activity changes, including planned changes in the method of service delivery and the application of government policies. Other operating expenses also reflect the impact of government efficiency strategies, such as efficiency dividends.

Grants and subsidies expense

Grants and subsidies expenses generally comprise cash contributions to local government authorities and non-government organisations. For the GGS, they include grants and subsidies paid to the PNFC and PFC sectors. The forecast grant payments are determined by taking into account current and past policy decisions, the forecast payment schedules and escalation factors relevant to each type of grant.

Other economic flows

Revaluations

The estimates are based on an examination and extrapolation of historical trends in the valuation of property, plant and equipment. The forward estimates include the estimated impact of revaluations of property, plant and equipment.

Superannuation actuarial gains / losses

The forecast actuarial gains or losses on defined benefit superannuation are based on the revised estimates of the margin of forecast fund earnings in excess of the expected discount rate.

Net gain / (loss) on equity investments in other sectors

The net gain / (loss) on equity investments in other sectors is based on estimates of the PNFC and PFC sectors' forward comprehensive results adjusted for transactions with owners. The underlying management estimates of future comprehensive results are based on current Statements of Corporate Intent. Future distributions to owners are based on Treasury's *Commercial Policy Framework*.

Net acquisition of non-financial assets

Sale of non-financial assets

Sale of non-financial assets includes the proceeds from the sale of an intangible asset recognised upfront in GFS, but amortised over the term of the arrangement for GAAP. This is presented consistently in the cash flow statement.

Assets

Property, plant and equipment

The estimates of property, plant and equipment over the forecast period are at fair value and take into account planned acquisitions, disposals, and the impact of depreciation, impairment and revaluations. New investments in assets are valued at the forecast purchase price and, where appropriate, recognised progressively over the estimated construction period. The forward estimates include the estimated impact of revaluations of property, plant and equipment. These estimates are based on an examination of expected cost trends.

The Estimated Financial Statements also include adjustments for future capital expenditure. These include agency estimates of approved projects and future new works held within agencies, as well as a central estimate for future new works still to be approved at the agency level. The central estimate for future new works is based upon historical trends.

Liabilities

Borrowings

Estimates for borrowings are based on current debt levels, amortisation of any premiums or discounts, and the cash flows expected to be required to fund future government activities.

Employee provisions

Employee provisions are forecast based on expected staffing profiles and current salaries, conditions and on-costs. For the forecast period, employee benefits are adjusted for approved wage agreements. Beyond the period of the agreements, allowance is made for further adjustments consistent with the State’s wages policy at a net cost of 2.5 per cent per annum, inclusive of scheduled increases in the superannuation guarantee levy. The forecasts for employee expenses also reflect the impact of new initiatives and required efficiency savings.

Superannuation provisions

Refer to *Superannuation expense (and liabilities)* (above) for information on assumptions that also impact the measurement of the superannuation provisions.

Other provisions

Other provisions include the State’s obligations for several insurance schemes. To estimate future claim liabilities, actuarial assumptions have been applied for future claims to be incurred, claim payments, inflation and liability discount rates. Actual liabilities may differ from estimates.