VICTORIA

Report of the

AUDITOR-GENERAL

on the

FINANCE STATEMENT

for the year ended
30 June 1991

MELBOURNE
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OVERVIEW

Section 47 of the *Audit Act* 1958 requires that I make and sign a report explaining the *Finance Statement* in full. This requirement is met by presentation in this Report of:

- a review and analysis of the State's financial operations for the year ended 30 June 1991, and the financial position at that date;
- comment on significant trends emerging over time in regard to the financial operations and position of the State; and
- reference to other financial issues which, in my opinion, warrant Parliament's attention.

The Report also contains information on certain matters which are required to be reported to Parliament under other provisions of the *Audit Act* 1958.

In commenting on this year's *Finance Statement* I feel it is appropriate to acknowledge the improvement in the level of disclosure within the *Statement* and the various measures adopted by the Government during the year which, in my opinion, will not only enhance public sector administration but will also hopefully improve the long-term financial health of the State. These measures include:

- The establishment of an Effectiveness Review Unit within the Ministry of Finance to ensure cost-effective delivery of essential services and to address activities identified by my Office as being conducted in an inefficient manner;
- The release in 1991 of a consolidated statement of assets and liabilities for the Victorian public sector in order to allow a more constructive and informed debate on the status of Victoria's finances; and
- The announcement by the Premier in the June *Economic Statement* of strategic measures adopted to address issues raised concerning the debt of the State. The measures announced are aimed at improving management of current debt and the setting of targets to arrest debt growth and to reduce, over time, the levels of debt and unfunded liabilities.

While I acknowledge the above initiatives, I am concerned that during the year there were further instances of expenses of the State being transacted *"off balance sheet"* and not being recorded within the Consolidated Fund. A key element of the Westminster system of democratic government is the control by Parliament of the raising and spending of public moneys. If Parliament is to retain control of the public purse such stratagems should be prohibited.

In my *Report on the Treasurer's Statement, 1989-90* I made my regular plea for the adoption of accrual accounting in the budget sector. In this context, I am pleased to note that the Minister for Finance recently announced that 4 selected budget sector agencies will be required to prepare their 1991-92 financial statements on a full accrual basis as the first stage of implementing accrual accounting in the budget sector.

In the current economic environment there is increasing attention on the efficiency of public sector operations and a growing acknowledgement that government's accountability obligations go beyond compliance with spending mandates to encompass the efficient and effective use of resources. In Part 1 of this Report I have summarised various strategies such as altering the timing of cash flows adopted by the Government which have had a favourable impact on the reported result of the Consolidated Fund for 1990-91. Under an accrual accounting system, the reported result for the Consolidated Fund would not be affected by certain of these strategies and the information presented to Parliament would enable the comparison of the Fund's performance over time.

Budget sector indebtedness representing borrowings and other financial obligations which will need to be met from the Consolidated Fund on behalf of taxpayers increased by $5.5 billion during the year. This amount includes $1.7 billion representing the State's current obligations to meet the net deficiency of Tricontinental. The significant increase in indebtedness during the year accentuates the importance of the measures detailed by the Premier in the June *Economic Statement* to arrest and reduce the level of the State's debt.

In my *Report on Ministerial Portfolios* tabled in Parliament in April this year I referred to the fact that I had made representations to the Government seeking an increase in the resources of my Office in order to more effectively discharge the expanded performance audit mandate. I sought 12 additional positions for 1991-92 with a further 28 positions in 1992-93. I am pleased to inform Parliament that the Government has authorised an additional 12 staff for 1991-92.

Finally, in my *Report on the Treasurer's Statement, 1989-90* I referred to the fact that I had declined to acquit expenditure of $35 million which, in my opinion, had been paid from the Consolidated Fund without authority. This opinion was subsequently confirmed by Parliament's Economic and Budget Review Committee and the Government sought to retrospectively validate the unlawful expenditure. This was rejected by the Parliament and the expenditure remains unacquitted.

EXECUTIVE SUMMARY

Key findings are highlighted at the beginning of each Part of this Report. Major findings are summarised below.

CURRENT YEAR'S FINANCIAL RESULT *Page 11*

- The overall deficit for the year, as determined by audit, was in excess of $1.7 billion (1989-90, $1.4 billion).

  Paras 1.3 to 1.4

- Various government strategies, which had the impact of deferring payments and advancing revenue collections, conveyed a healthier cash-based result for the year by at least $610 million.

  Paras 1.12 to 1.69

- Expenditure of $146 million on finance charges, which was not recorded in the Consolidated Fund, was incurred without the sanction of the Parliament.

  Paras 1.5 to 1.11

- Recurrent expenditure of $568 million (1989-90, $432 million) was financed from capital receipts including borrowings.

  Para. 1.4

STATE BANK AND TRICONTINENTAL *Page 27*

- The cost to date to Victorian taxpayers of the failure of both the State Bank and Tricontinental exceeds $3.1 billion of which only $1.4 billion had been met by the State at 30 June 1991.

  Paras 2.11 to 2.12

- The burden on the community arising from Tricontinental's net deficiency at 30 June 1991 of $1.7 billion is likely to remain well into the next century.

  Paras 2.12 to 2.14

- The State has also retained certain contingent liabilities relating to the State Bank and Tricontinental which may result in future calls on State funds.

  Paras 2.18 to 2.20
  and paras 2.29 to 2.31

- While the formally agreed price for the sale of the State Bank was $1.6 billion, the reality from a Victorian taxpayer's perspective was that the State, after meeting certain financial obligations, only received, and the Commonwealth Bank only paid, $808 million.

  Paras 2.4 to 2.8

WORLD CONGRESS CENTRE *Page 37*

- The financing arrangement to construct the World Congress Centre has increased the State's indebtedness by $148.8 million and will result in finance charges on this indebtedness of around $235.7 million.

  Para. 3.23 and Paras 3.30 to 3.31

- The actual liability to be met by the taxpayers of the State in relation to the financing arrangement will be influenced by a number of factors including the Centre's operating performance and whether it is eventually sold.

  Paras 3.25 to 3.28

BUILDING SOCIETY SUPPORT *Page 49*

- The aggregate financial obligations of Victorian taxpayers arising from the failure of the Farrow Group of Building Societies are estimated to be $657 million, the majority of which are to be borne by motorists through a special petrol levy.

  Paras 4.18 to 4.23

BUDGET SECTOR INDEBTEDNESS *Page 57*

- Budget sector indebtedness to be funded by general taxpayers exceeds $38.1 billion (30 June 1990, $32.6 billion) which is equivalent to $8 590 per capita. These amounts do not include non-budget sector net debt of $12.8 billion to be funded from revenues raised by public bodies.

  Paras 5.3 to 5.4

- The annual cost to the community of servicing public account borrowings increased from $330 per capita in 1989-90 to $381 per capita in 1990-91.

  Paras 5.58 to 5.62

- During the year, 19.4 per cent of available revenue was used to meet finance charges.

  Para. 5.60

- Short-term borrowings to cover cash shortfalls in the Consolidated Fund cost the State $150 million in interest charges compared with $70 million in the previous year.

  Paras 5.50 to 5.52

BUDGET SECTOR ASSETS

Page 93

- Until comprehensive information on assets is available, Parliament will not be in a position to compare budget sector asset holdings with the sector's indebtedness.

Paras 6.1 to 6.5

ANALYSIS OF CONSOLIDATED FUND PAYMENTS

Page 99

- Operating expenditure of $398 million (1989-90, $300 million) was classified as *"works and services"* expenditure and funded from capital receipts including borrowings.

Paras 7.5 to 7.9

STATE TAXATION

Page 111

- Substantial efficiencies could be achieved if the operations of the State Taxation Office and Stamp Duties Office were amalgamated.

Para. 9.9

- The lenient and inconsistent approach of the Stamp Duties Office to the imposition of penalties has not encouraged the timely payment of fees and duties by taxpayers.

Paras 9.32 to 9.35

- Substantial revenue has been forgone by the Stamp Duties Office through avoidance and evasion activity. Potential evasion identified during audit examinations was in excess of $50 million. Voluntary disclosures by taxpayers accounted for a further $36.7 million.

Paras 9.36 to 9.108

- The State Taxation Office has significantly improved the timeliness of its revenue collections in the past 2 years and increased the detection of unpaid payroll tax.

Paras 9.123 to 9.142

COMPANIES, TRUSTS, JOINT VENTURES AND INCORPORATED ASSOCIATIONS

Page 157

- The growing practice of using subsidiaries to undertake activities on behalf of public bodies and government agencies has limited the effectiveness of the traditional accountability framework to the Parliament and the taxpayer.

Paras 11.12 to 11.15

REVIEW OF THE 1990 - 91 FINANCE STATEMENT

PART 1

CURRENT YEAR'S FINANCIAL RESULT

KEY FINDINGS

- The overall deficit for the year, as determined by audit, was in excess of \$1.7 billion (1989-90, \$1.4 billion).
Paras 1.3 to 1.4

- Expenditure of \$146 million on finance charges, which was not recorded in the Consolidated Fund, was incurred without the sanction of the Parliament.
Paras 1.5 to 1.11

- Recurrent expenditure of \$568 million (1989-90, \$432 million) was funded from capital receipts including borrowings.
Para 1.4

- Various government strategies, which had the impact of deferring payments and advancing revenue collections, conveyed a healthier cash-based result by at least \$610 million.
Paras 1.12 to 1.19

- The major items which assisted in improving the reported cash-based result were:
  - deferral of the impact of debt related payments - \$233 million;
  - early recall of public account advances - \$97 million;
  - retention of Farrow Group petrol levy revenue - \$64 million;
  - deferral of payments to suppliers by transport bodies - \$51 million; and
  - postponement of grants to non-government schools - \$40 million.

Paras 1.19 to 1.68

ANALYSIS OF REPORTED FINANCIAL RESULT

What was the result for the year according to the Finance Statement?

1.1 The *1990-91 Finance Statement* discloses a balanced position, on a cash basis, of the Consolidated Fund at 30 June 1991, in that recorded receipts (including borrowings) are shown as equal to payments.

1.2 However, the *Finance Statement* also discloses that when recorded borrowings are excluded, the reported position of the Consolidated Fund at year-end translates into a deficit (**described in the Finance Statement as a "shortfall of receipts"**) of $1.4 billion, an increase of $380 million on the previous year.

Understatement of result

1.3 **Audit considers that the Consolidated Fund's financial result as disclosed in the Finance Statement** (page xv) **is understated by $333 million and the deficit is in fact in excess of $1.7 billion.** This understatement occurred because of the treatment applied to the following 3 items:

- Borrowings of **$146 million** obtained by the Victorian Public Authorities Finance Agency (VicFin) on behalf of the Consolidated Fund were not recorded within the Fund. This amount was netted-off outside the Consolidated Fund against interest payments due to VicFin from the Fund;
- Borrowings of **$101 million** from sale and lease-back of transport stock have not been correctly included as revenue from asset sales (refer Part 5 of this Report); and
- Borrowings of **$86 million**, raised in previous years **but not paid into the Consolidated Fund until 1990-91**, have been incorrectly classified as general works and services receipts.

Re-statement of financial results by audit

1.4 Table 1A presents the operating results of the Consolidated Fund for the year, as determined by audit.

TABLE 1A. OPERATING RESULTS OF THE CONSOLIDATED FUND
($million)

Item	*Actual(a) 1989-90*	**Actual***(a)* **1990-91**	*Budget 1990-91*	**Variation from Budget**
Recurrent -				
Receipts	10 663	**11 242**	11 760	**(518)**
Payments	11 095	**11 810**	11 760	**(50)**
Recurrent deficit for year	(432)	*(b)***(568)**	0	**(568)**
Works and services -				
Receipts excluding borrowings	922	**905**	980	**(75)**
Payments	1 936	**2 012**	2 106	**94**
Works and services deficit for year	(1 014)	**(1 107)**	(1 126)	**19**
Sale of State Bank *(c)*	-	(37)	-	-
Overall deficit for year (funded from borrowings)	(1 446)	**(1 712)**	(1 126)	(586)

(a) As determined by audit.

(b) The recurrent deficit was financed from capital receipts including borrowings.

(c) Represents difference between receipts of $2 017 million and payments of $2 054 million recorded by the Government within the Consolidated Fund relating to the sale of the State Bank of Victoria. These receipts and payments were not specified in the Government's *1990-91 Budget Paper No. 3.*

Payments made without parliamentary authority

1.5 As previously mentioned, the understatement of the year's deficit was partly attributable to the off-setting outside the Consolidated Fund of borrowings of $146 million (obtained on behalf of the Fund) against interest costs (paid on behalf of the Fund) and the non-recording of these transactions within the Fund. **The practice of off-setting borrowings against interest costs during 1990-91 has most serious implications in that it has allowed expenditure of $146 million to be incurred without the sanction of the Parliament.** As a consequence of this practice:

- **significant State financial obligations, transacted outside the Consolidated Fund on its behalf, were not recorded within the Fund; and**
- **interest payments and borrowings of the Consolidated Fund have been understated by the amount of the off-set.**

1.6 The final expenditure on the relevant appropriation item (Finance Charges - Capital Works Authority), after taking account of the $146 million mentioned above, was $877 million, which exceeded the parliamentary authority of $731 million.

1.7 Table 1B compares the final expenditure of this appropriation item with the relevant parliamentary authority.

TABLE 1B. EXPENDITURE WITHOUT PARLIAMENTARY AUTHORITY
(Program 726 - Item 3611)
($million)

Item	*Amount*
Appropriation -	
Appropriation as per *Appropriation (1990-91, No.1) Act* 1990	700
Transfer from Program 726 - Item 3612	13
Treasurer's Advance provided	18
Final appropriation (which equates with payments recorded in the *Finance Statement*)	731
Payment of finance charges by VicFin not covered by parliamentary appropriation	**146**
Total expenditure for year	877

1.8 My October 1990 Report on the *1989-90 Treasurer's Statement* commented critically on 2 similar off-sets which occurred in that year, namely, an amount of $35 million netted-off, under an interest swap, against interest payments within the Consolidated Fund and $65 million netted-off outside the Fund.

1.9 The Parliamentary Economic and Budget Review Committee (EBRC) subsequently conducted an inquiry into the accounting treatment and disclosure of the interest swap transaction of $35 million. The Committee, in its March 1991 report, confirmed the audit view that the expenditure had been incurred without parliamentary authority. It recommended that retrospective authority be obtained from the Parliament to validate this expenditure. **The Government subsequently unsuccessfully sought parliamentary approval to authorise the expenditure.**

1.10 While the EBRC inquiry confirmed the inappropriateness of netting-off transactions within the Consolidated Fund, it **did not examine** the audit concerns raised on **the practice of not recording transactions off-set outside the Fund**. In fact, the off-setting of expenditure of $146 million during 1990-91 represented a continuation of the practice of off-sets outside the Consolidated Fund ($65 million in 1989-90) referred to above.

1.11 I consider that concerted action now needs to be taken by the Parliament to prohibit the type of off-setting practices which have been identified by my Office in the last 2 years. If such practices are allowed to continue Parliament will become subservient to the Executive Government in terms of its authority and control over the public purse.

Management response

Paragraph 1.3

The Department of the Treasury does not agree that the Consolidated Fund's financial result reported in the Finance Statement has been understated by the treatment of the transactions mentioned above:

- *The amount of $146 million relates to a series of zero coupon interest rate swaps undertaken by VicFin on behalf of the Capital Works Authority ($115 million) and discount on debt which matured or was refinanced ($31 million). The swaps receipts are off-set against amounts payable by the Capital Works Authority to VicFin. The discount is a refinancing entitlement under global borrowing arrangements.*
- *Independent legal and accounting advice confirms that the arrangements represent operating leases. Funds received from the proceeds of asset sales of transport vehicles have therefore correctly been treated as receipts.*
- *As the $86 million was counted as a borrowing in 1989-90, it would be inappropriate to treat it as a borrowing again in 1990-91.*

Paragraphs 1.5 to 1.11

As the payments do not require parliamentary sanction it is misleading to describe them as "payments made without parliamentary authority", and incorrect to describe them as Consolidated Fund expenditure.

The Department of the Treasury submitted legal advice to the Auditor-General and the Economic and Budget Review Committee which indicated that the swaps and associated payment arrangements were accounted for legally and properly and that the transactions produced neither revenue that should be credited to the Consolidated Fund nor expenditure without parliamentary appropriation.

The Capital Works Authority finance charges appropriation was not exceeded as evidenced by the fact that audit has acquitted all payments out of the Consolidated Fund.

The practice of off-setting provides efficiencies in debt management. It should be noted that it is normal practice for State borrowing authorities entering into swap transactions as principal on behalf of their clients, to treat the cash flows on a net basis.

Government has disclosed details of all off-setting arrangements in respect of swap transactions in the Finance Statement (Supplementary Information, Part 2(e) Debt - Interest Swaps) to provide appropriate information to Parliament.

STRATEGIES IMPACTING ON REPORTED FINANCIAL RESULT

1.12 The financial result of the Consolidated Fund for the 1990-91 year was arrived at after:

- deferral of payment of substantial levels of expenditure to future financial periods;
- advanced collection of certain 1991-92 revenues to the current year;
- post-budget decisions which increased the level of other revenues; and
- transfers of financial responsibility for certain budget sector activities to non-budget sector bodies.

1.13 Audit does not question the merits of the strategies adopted by the Government, however, for the purpose of explaining the *Finance Statement*, **audit has identified that the collective impact of these strategies, in terms of conveying a healthier cash-based result of the Consolidated Fund for the year, was at least $610 million (1989-90, $161 million).**

1.14 While an improved reported position for the Consolidated Fund was achieved under these strategies, substantial levels of current costs have been transferred to future periods. In addition, certain of the deferral arrangements represented in substance borrowings as they will lead to future financing costs to the State.

1.15 It follows, therefore, that the financial impact of these strategies needs to be considered when assessing the 1990-91 Consolidated Fund deficit of $1.7 billion, or when comparing this result with other periods.

1.16 While there has been limited disclosure of some of the strategies impacting on the 1990-91 reported result of the Consolidated Fund, improved disclosure in the *Finance Statement* will enhance its value as a medium for economic decision-making and enable comparisons of the Consolidated Fund's performance over time.

1.17 The impact of these strategies on the Consolidated Fund's cash-based reported result for the year also reinforces the importance of the call that has been made by audit over many years (the most recent in my October 1990 Report) for the application of accrual accounting principles across the whole of government. Under accrual accounting, expenses are recognised at the time an obligation to pay arises, and not when paid, and revenue when it is due or earned, rather than when received. In other words, a reported result for the Consolidated Fund under accrual accounting would not be affected by government decisions which alter the timing of cash flows.

1.18 It was pleasing, therefore, to note that the Government in its *1991-92 Budget Papers* has indicated an intention to reform the legislative provisions relating to the Public Ledger to facilitate the reporting of improved financial information and the recording of transactions on an accrual basis.

1.19 Table 1C brings together the financial effect of the strategies identified by audit, which impacted on the 1990-91 reported result.

TABLE 1C. STRATEGIES IMPACTING ON 1990-91 REPORTED RESULT OF CONSOLIDATED FUND
($million)

	Financial impact	
Strategy (a)	*1990-91*	*1989-90*
Deferrals of expenditure -		
Debt payments	**116**	59
Special 1990-91 bridging finance	**59**	-
Interest costs on long-term borrowings	**58**	22
Payments to suppliers by transport bodies	**51**	26
Grants to non-government schools	**40**	-
Municipal rate concessions and library subsidies	**26**	-
Employer superannuation contributions	**18**	9
Monash Medical Centre development	**15**	-
Private bus subsidies	**14**	-
Ambulance vehicle replacement program	**3**	-
	400	116
Advanced or additional revenue collections -		
Recall of public account advances	**97**	30
Farrow Group petrol levy	**64**	-
Transport charges	**13**	-
Collections from racing industry and Tattersalls	**9**	5
Traffic infringement notice revenue collections	**4**	-
Contribution from Victorian Development Fund	**3**	-
	190	35
Transfers of financial responsibility -		
Occupational health and safety activities	**10**	3
Non-commercial ports	**5**	-
Accident prevention and road safety programs	**5**	7
	20	10
Total impact of strategies on Consolidated Fund	**610**	**161**

(a) Reference to a number of these strategies is contained in the Government's *1990-91 Budget Papers* or in the *Finance Statement*.

Deferrals of expenditure

Debt payments

Commonwealth Financial Agreement and housing debt

1.20 Up until May 1991 all principal and interest payments relating to the State's debt to the Commonwealth were made from the Consolidated Fund **in the month in which payments were due**. In June 1991, the Government entered into an agreement with the Victorian Public Authorities Finance Agency (VicFin) which resulted in:

- VicFin assuming responsibility to initially meet debt payments, on behalf of the State, to the Commonwealth relating to debt totalling $5.4 billion under the Financial Agreement, Commonwealth-State Housing Agreement and the *State (Works and Housing) Assistance Act* 1982; and
- the payment arrangement for this category of debt becoming the same as for all other debt managed by VicFin on behalf of the State, that is, reimbursement by the Consolidated Fund **in the month following payments by VicFin.**

1.21 **The changed arrangements resulted in the deferral to the following financial year of Consolidated Fund payments totalling $98.8 million.**

Non-Commonwealth debt payments

1.22 As mentioned above, VicFin is reimbursed from the Consolidated Fund, in the month following payment, for debt servicing costs relating to debt which it manages on behalf of the State. **The deferral to 1991-92 of June 1991 non-Commonwealth debt servicing payments from the Consolidated Fund to VicFin amounted to $17 million (June 1990, $59 million).**

Special 1990-91 bridging finance

1.23 In June 1990, the Government obtained bridging finance of $90 million from the Victorian Development Fund (VDF) to help offset a shortfall in proceeds from asset sales during 1989-90. The arrangement with the VDF provided for the repayment of the bridging finance by May 1991 from the proceeds of designated asset sales including the Queen Victoria and Royal Mint sites.

1.24 Because of the continued downturn in the property market in 1990-91, all designated properties were not sold and proceeds of only $31 million were available for repayment to the VDF. Given these circumstances the Government entered into a new arrangement with the VDF in June 1991 **under which the outstanding bridging finance of $59 million was carried over into 1991-92**. Financing costs associated with this deferral, which are required to be met from the Consolidated Fund in 1991-92, are estimated by the Government to be around $5.9 million.

Interest costs on long-term borrowings

1.25 As explained in my October 1990 Report, the Government followed a policy in 1989-90 of managing increases in finance charges on long-term borrowings through debt restructuring strategies with a view to spreading finance costs over future years. This policy was continued during 1990-91 with the State obtaining specific financial instruments such as zero coupon inscribed stock, promissory notes and indexed annuities. **Interest costs for the year deferred to future financial periods under these debt instruments amounted to $58 million.** Detailed discussion on finance charges is provided in Part 5 of this Report.

Payments to suppliers by transport bodies

1.26 The operations of the 2 major transport bodies, the Public Transport Corporation and Roads Corporation, are substantially financed from the Consolidated Fund.

1.27 The Government's policy in relation to the payment of accounts by public sector bodies, including transport bodies, is set out in Accounting Policy Statement No. 2 *Accounts Payable*. The policy provides that all supplier accounts received in any one month should be paid by no later than 3 days after the end of the following month. An audit review of amounts owing by the 2 transport bodies to suppliers at 30 June 1991 found that the value of creditors in the *overdue* category (that is, not paid in accordance with the government policy) had approximately doubled from $26.1 million at 30 June 1990 to $51.2 million at 30 June 1991.

1.28 Any delays in payments to suppliers by these bodies postpones the drawdown of funds from the Consolidated Fund. The overdue creditors of $51.2 million, if paid in 1990-91 in accordance with government policy, would have required financing from the Consolidated Fund in that year. As transport program expenditure was within $4.2 million of the parliamentary appropriation limit for 1990-91, settlement of these accounts would have required the use of the Treasurer's Advance.

Grants to non-government schools

1.29 The Government provides assistance to non-government schools in the form of periodic grants. In previous years, schools received instalments in February (25 per cent), July (50 per cent) and October (balance of grant). In its *1990-91 Budget Papers*, the Government announced a decision to defer to July 1991 grant instalments from the Consolidated Fund, which were due in February 1991.

1.30 The impact of this decision on the 1990-91 reported result of the Consolidated Fund was the deferral of expenditure of $40.4 million to the 1991-92 financial year.

1.31 Table 1D highlights the impact of this government strategy on payments from the relevant appropriation line item.

TABLE 1D. GRANTS TO NON-GOVERNMENT SCHOOLS

Year	*Payment*	*Change*
	($m)	*(%)*
1988-89	151.4	-
1989-90	156.8	4
1990-91	**123.2**	**(21)**
1991-92	*(a)***186.3**	**51**

(a) Amount provided in Government's *1991-92 Budget Papers* under Program 299 - Item 2915.

1.32 To ensure no change occurred in the timing of cash flows to schools, the Treasurer entered into an arrangement with a major private bank under which the Bank advanced funds to schools in February 1991 up to the value of grants that would have been received from the Consolidated Fund.

1.33 In July 1991 the Government repaid, from the Consolidated Fund, the advances of $40.4 million provided by the Bank, together with associated finance charges of $2.1 million.

Municipal rate concessions and library subsidies

1.34 In previous years, municipal councils have received 2 separate payments from the Consolidated Fund during their financial year, which ends on 30 September. These payments related to:

- Pensioner Rate Remission Scheme (November/December and July/August); and
- Municipal Library Subsidy Scheme (October and July).

1.35 In 1990-91 the Government determined to defer until July/August 1991 the first round of instalments due from the Consolidated Fund to the municipal councils under the above schemes. **As a result of this decision, the Consolidated Fund was relieved of payments totalling $26.2 million in 1990-91.**

1.36 In order to offset the impact of this deferral on councils' financing costs, the Government agreed to include in the July/August 1991 payments a loading totalling $2.9 million, **which was equivalent to an interest payment of 17 per cent on the deferred amounts.**

Employer superannuation contributions

1.37 Under longstanding arrangements the Consolidated Fund received **$18.3 million in 1990-91** ($8.6 million, 1989-90) from non-budget sector agencies as employer contributions to the State Superannuation Fund for employees who are members of the Fund.

1.38 The major reason for the increased contributions in 1990-91 was a special payment into the Consolidated Fund of $8 million by the Rural Finance Corporation of Victoria, in line with a direction by the Treasurer, to eliminate its unfunded liability which had accrued to the State Superannuation Fund at 30 June 1990.

1.39 Employer contributions paid into the Consolidated Fund under these arrangements are not passed on to the State Superannuation Fund until such time as superannuation benefits are paid to relevant employees.

1.40 In effect, the Consolidated Fund gains from the use of these funds to finance current operations while assuming employer liability for superannuation which will not be paid until future periods.

Monash Medical Centre development

1.41 The Consolidated Fund's budgeted contribution towards Stage 2 of the Monash Medical Centre development project was $38 million in 1990-91. However, as works had progressed ahead of expectations, actual construction costs for the year amounted to $53 million.

1.42 The Government decided to defer funding from the Consolidated Fund of the additional works of $15 million until 1991-92. As a result, the Centre was required to obtain an interim finance facility of $15 million from the Victorian Development Fund, the repayment of which was guaranteed by the Government.

1.43 In July 1991, the Consolidated Fund repaid the interim finance facility of $15 million together with associated financing costs of $280 000.

Private bus subsidies

1.44 In November 1990 the Government entered into an agreement with the Bus Proprietors Association in relation to the provision of metropolitan bus services. Two of the key components of the agreement were:

- alteration of the timing of payments to bus operators from monthly payments in advance to quarterly payments in arrears; and
- an undertaking that the Public Transport Corporation (PTC) would meet any financing costs associated with additional debt raised by operators as a consequence of the change to the timing of payments.

1.45 Under the agreement, the first payment in arrears was due on 1 July 1991 and was to cover expenditure incurred by bus operators in the months of May and June 1991. The change in timing of payments to bus operators was dependent upon the operators and the PTC arranging appropriate credit facilities.

1.46 The Ministry of Transport indicated that the credit facilities could not be arranged through locally owned banks and, as a consequence, the PTC advanced funds to the bus operators totalling $14.2 million in May and June 1991.

1.47 On 28 June 1991, the last working day of the financial year, a credit facility was established with an overseas bank (operating under licence in Australia) which enabled the bus operators to repay the amount of $14.2 million to the PTC. On 1 July 1991 the PTC returned this amount to the operators, together with associated financing costs of $245 000, and was reimbursed from the Consolidated Fund early in 1991-92.

1.48 The sequence of transactions between the PTC and the bus operators enabled the deferral to July 1991 of payments of $14.2 million from the Consolidated Fund for bus services rendered in May and June 1991.

Ambulance vehicle replacement program

1.49 In prior years, Victorian ambulance services were reimbursed from the Consolidated Fund for the purchase of ambulances in the year of acquisition. Under a new arrangement introduced by the Government during 1990-91, ambulance services are now required, in the first instance, to finance all ambulance purchases, with repayments from the Consolidated Fund for acquisition and interest costs spread over a 5 year period.

1.50 As a result of this new funding structure, payments from the Consolidated Fund of $3.5 million were deferred to future years.

Advanced or additional revenue collections

Recall of Public Account advances

1.51 While the 1990-91 Budget provided for the collection of $23 million relating to the early repayment of public account advances, **during the year, the Government collected and paid into the Consolidated Fund an amount of $96.6 million from this source,** comprising:

- $87.8 million from the Mornington Peninsula and District Water Board (Mornington);
- $6.2 million from various other water boards; and
- $2.6 million from other public bodies.

1.52 The early repayment of Mornington's $87.8 million advance (which was paid into the Consolidated Fund on the second last working day of the financial year), was financed as follows:

- borrowings of $75 million from the Melbourne and Metropolitan Board of Works which issued promissory notes to this value, through a major private bank with the approval of the Treasurer, in order to provide the loan to Mornington; and
- a further borrowing of $12.8 million directly from the State Bank Victoria (part of the Commonwealth Bank of Australia).

1.53 By way of comparison, the value of advances recalled by the Government ahead of their due dates in the previous year was $29.6 million.

Farrow Group petrol levy

1.54 In December 1990 the Government introduced a special 3.2 per cent levy on the wholesale price of petrol as the major funding source for its financial obligations to depositors of the failed Farrow Group of Building Societies. A special purpose trust account was established within the Trust Fund to administer these obligations.

1.55 The revenue of $64 million collected from this new levy in 1990-91 and paid into the Consolidated Fund formed part of reported revenue for the year. Under the *Business Franchise (Petroleum Products) Act* 1979, this revenue is not required to be transferred to the Trust Fund until 1991-92. **It follows, therefore, that there has been a gain to the Consolidated Fund of $64 million in 1990-91 due to this legislative requirement.**

1.56 Detailed comment on the petrol levy is contained in Part 4 of this Report.

Transport charges

Public transport fares

1.57 The Government's *1990-91 Budget Papers* provided for an increase of 15 per cent in public transport fares, however, during the year, the Government introduced an additional 10 per cent increase, effective from March 1991. **This post-budget decision generated extra revenue of $5.8 million for the Public Transport Corporation (PTC) which led to a reduced call on the Consolidated Fund to finance PTC operations.**

Collection charges

1.58 The Roads Corporation acts as agent for the Transport Accident Commission in the collection of annual transport accident charges payable by motorists.

1.59 During 1990-91, by agreement between the 2 parties, the fee payable by the Commission to the Corporation for providing this service was increased from a rate of 1 per cent to 2 per cent of actual collections. The fee increase, together with an advanced payment from the Commission in June 1991, resulted in additional revenue of **$7.1 million** for the Corporation. **This decision also led to a reduced call by the Corporation of an equivalent amount on the Consolidated Fund.**

Collections from the racing industry and Tattersalls

1.60 The *Racing Act* 1958 requires racing clubs to pay fractions, arising from rounding of dividends, to the Consolidated Fund by no later than January and July of each year. In the previous year, agreement was reached between the racing clubs and the Government for fractions totalling $4.2 million, due by July 1990, to be paid into the Consolidated Fund in June 1990. **This arrangement was again followed in 1990-91 and resulted in an advance payment of $4.1 million into the Consolidated Fund.**

1.61 Under the *Tattersall Consultations Act* 1958, Tattersalls is required to pay a share of its net profit to the Consolidated Fund. Prior to 1989-90, the bulk of this net profit share was paid in September of the following financial year. In May 1990, an advance payment of $1.1 million was made in respect of the Government's share of the net profit for 1989-90. **The level of the advanced payment by Tattersalls into the Consolidated Fund in 1990-91 was increased by $3.9 million to $5 million.**

Traffic infringement notice revenue collections

1.62 Prior to 1990-91 the Transport Accident Commission was entitled to receive one-third of revenue collected by the State from the issue of certain traffic infringement notices, with the balance retained within the Consolidated Fund.

1.63 In April 1991, the relevant Regulations dealing with the Commission's share of revenue were revoked and, since that date, the total revenue generated from traffic infringement notices has been paid into the Consolidated Fund. **The financial benefit to the Consolidated Fund in 1990-91 from this decision was $4.5 million.**

Contribution from Victorian Development Fund

1.64 The *Public Account Act* 1958 provides that, where at the end of any financial year the Victorian Development Fund (VDF) is in surplus, the Treasurer in the following year may authorise the transfer into the Consolidated Fund of an amount not exceeding that surplus.

1.65 In prior years, the Treasurer has authorised the transfer into the Consolidated Fund of 50 per cent of the annual VDF surplus. **In 1990-91, this proportion was increased to 75 per cent, resulting in the collection of additional revenue of $2.6 million by the Consolidated Fund.**

Transfer of financial responsibilities to public bodies

1.66 Over recent years, the Government has determined to transfer to non-budget sector bodies financial responsibility for certain functions previously funded from the Consolidated Fund. In essence, such actions reflect the increasing application by government of the *user-pays* principle. Under this principle, where the beneficiaries of particular activities can be directly associated with specific sections of the community serviced by a public body, the costs of such activities should be met by that section of the community from charges levied by the public body, rather than by the general taxpayer via the Consolidated Fund.

1.67 The following examples of transfers of financial responsibility to non-budget sector bodies, which occurred during 1990-91, illustrate the resultant financial benefit to the Consolidated Fund:

- *Occupational health and safety*. During 1990-91 the level of funding provided by the Accident Compensation Commission to the Department of Labour for certain of its occupational health and safety activities was increased by **$9.7 million**, with an equivalent saving to the Consolidated Fund;
- *Non-commercial ports (e.g. Port Welshpool)*. Up until 1990-91 the various port authorities received contributions from the Consolidated Fund to finance their non-commercial port activities. During 1990-91, the Government began to phase-out this financial assistance, resulting in savings to the Consolidated Fund of **$4.9 million** during that year; and
- *Accident prevention and road safety*. The Transport Accident Commission (TAC), since its establishment in 1987, has administered certain accident prevention and road safety programs, and has jointly funded with the Consolidated Fund similar activities managed by the Roads Corporation and Victoria Police. The overall level of TAC funding for accident prevention and road safety has significantly increased in recent years ($3.2 million, 1987-88; $16.3 million, 1990-91). While the additional funding provided by TAC in 1990-91 totalled $7.4 million, the rate of increase of TAC's funding for the year was higher than that of contributions by the Consolidated Fund for these programs. The higher contribution by TAC was equivalent to **$4.6 million.**

1.68 In summary, the reported financial result of the Consolidated Fund can be substantially impacted by government decisions to transfer financial responsibility to non-budget sector entities.

Management response

The total of $610 million (1990-91) detailed in Table 1C contains a number of items which were the subject of decisions taken by the Government at the time of the preparation of the 1990-91 Budget. These related to changes in the timing of certain payments and were documented in the Budget Papers as well as being reflected in appropriations for the year. Such changes represent appropriate management of the State's cash flows, in particular to minimise interest charges.

Further, other amounts detailed did not reduce the call on the Consolidated Fund to the extent indicated in Table 1C because of associated expenditure Increases. For example, the table lists $64 million as proceeds of the "Farrow Group Petrol Levy", however, expenditure of $42.1 million was incurred in 1990-91 in respect of the Farrow Group arrangement.

PART 2

STATE BANK AND TRICONTINENTAL

KEY FINDINGS

- The cost to date to Victorian taxpayers of the failure of both the State Bank and Tricontinental exceeds $3.1 billion of which only $1.4 billion had been met by the State at 30 June 1991.

  Paras 2.11 to 2.12

- The burden on the community arising from Tricontinental's net deficiency at 30 June 1991 of $1.7 billion is likely to remain well into the next century.

  Paras 2.12 to 2.14

- The State has also retained certain contingent liabilities relating to the State Bank and Tricontinental which may result in future calls on State funds.

  Paras 2.18 to 2.20 and 2.29 to 2.31

- While the formally agreed price for the sale of the State Bank was $1.6 billion, the reality from a Victorian taxpayer's perspective was that the State, after meeting certain financial obligations, only received, and the Commonwealth Bank only paid, $808 million.

  Paras 2.4 to 2.7

- At the time of sale the State Bank's net assets, excluding government financial support, were only $58 million.

  Para. 2.8

- In addition to the sale proceeds, the State obtained a $413 million tax compensation package from the Commonwealth Government which only equated to the financial benefit the State would have received had the Bank not been sold.

  Paras 2.9 to 2.10

SALE OF STATE BANK

2.1 The substantial deterioration during 1989-90 in the financial position of **both** the State Bank and Tricontinental Corporation Limited, a wholly-owned subsidiary of the Bank, resulted in a requirement for massive financial support from the State. Due to the burden that such support would have placed on Victorian taxpayers, the Government was of the view that the most viable option was to sell the Bank.

2.2 Expressions of interest for the purchase of the State Bank were sought in August 1990 from 6 financial institutions. The Government subsequently accepted the offer of the second highest tenderer, the Commonwealth Bank of Australia, whose offer was $55 million below the highest tenderer. The Government indicated that the reasons for accepting the Commonwealth Bank offer included the security afforded to depositors from Commonwealth Government control and the belief that the community wanted the operations of the State Bank kept under public control.

2.3 The arrangements between the Government and the Commonwealth Bank were formalised under a November 1990 agreement. Parliamentary ratification of this agreement was provided through the *State Bank (Succession of the Commonwealth Bank) Act* 1990 and settlement between the parties of the financial terms of the sale occurred on 31 December 1990.

How much did the State actually receive for the sale?

2.4 The Government's *1990-91 Budget Papers* indicated that the sale of the State Bank would involve a package valued at approximately $2 billion, which included:

- a sale price of $1.6 billion; and
- a tax compensatory package of $413 million from the Commonwealth Government.

2.5 **An analysis by audit of the financial transactions entered into by the parties in relation to the sale revealed that, while the formally agreed price for the sale of the State Bank was $1.6 billion, the reality from a Victorian taxpayer's perspective was that the State, after meeting certain financial obligations** (refer to paragraphs 2.6 to 2.8), **only received, and the Commonwealth Bank only paid, $808 million.**

2.6 The difference between the agreed sale price ($1.6 billion) and the actual net proceeds ($808 million) can be attributed to the following transactions between the parties:

- reduction of the agreed sale price by $194 million, as a condition of the sale, for acquisition (and the retention) by the State of the State Bank's investment in Tricontinental;

- refund to the Commonwealth Bank of $36 million, following the due diligence process, as the State Bank's assets were less, by this amount, than the value originally envisaged by the parties; and
- payment of $562 million by the Government to the State Bank immediately prior to the sale, **but in effect to the Commonwealth Bank**, for State Bank debts previously assumed by the State.

2.7 Table 2A summarises the complex inter-party financial transactions which took place in accordance with the formal arrangements under the sale.

TABLE 2A. NET PROCEEDS TO STATE GOVERNMENT FROM COMMONWEALTH BANK FOR SALE OF STATE BANK
($million)

	Seller	Buyer and acquired asset	
	State Gov't	*C'wlth Bank (Buyer)*	*State Bank (Acquired asset)*
Between buyer and seller			
Agreed sale price	1 600	(1 600)	
Less - adjustment by C'wlth Bank for State retention of Tricontinental	(194)	194	
	1 406	(1 406)	
Refund to C'wlth Bank resulting from completion of due diligence process*(a)*	(36)	36	
Gross cash proceeds from C'wlth Bank to State Gov't	1 370	(1 370)	
By buyer and seller with State Bank*(b)*			
Payment by C'wlth Bank to State Bank, conditional upon deduction of an equivalent amount from the agreed sale price and retention of Tricontinental by the State		(194)	194
Payment by State Gov't to State Bank for debt assumed because of the serious financial position of the Bank	(562)		562
		(1 564)	756
Net proceeds to State Government after elimination of inter-party transactions*(c)*	808	(808)	

(a) The due diligence process valued the State Bank's net tangible assets at $814 million, $36 million less than previously anticipated by the parties.

(b) Transactions entered into immediately prior to sale and which converted book assets to cash.

(c) Delays in finalising the settlement resulted in the State receiving an additional $4 million interest on a Commonwealth Bank deposit.

2.8 The net proceeds of $808 million, as outlined in Table 2A, in effect represent the State Bank's net assets which amounted to only $58 million (excluding the financial support of $194 million and $562 million provided by the parties immediately prior to the sale) and goodwill valued under the purchase arrangements at $750 million.

2.9 In a separate arrangement to the above sale transactions with the Commonwealth Bank, the State obtained $413 million from the Commonwealth Government as a tax compensatory package. **However, an audit examination of the relevant documentation revealed that the value of this package only equated to the estimated future financial benefit which would have accrued to the State, over at least a 5 year period, from the State Bank if the sale had not taken place.**

2.10 In accordance with this arrangement, the amount of $413 million was immediately returned to the Commonwealth Government to reduce the State's Financial Agreement debt to the Commonwealth.

WHAT HAVE STATE BANK AND TRICONTINENTAL COST VICTORIAN TAXPAYERS?

2.11 **The cost to date to Victorian taxpayers of the failure of both the State Bank and Tricontinental exceeds $3.1 billion.** Table 2B details the aggregate cost of each entity.

TABLE 2B. COST TO VICTORIAN TAXPAYERS OF STATE BANK AND TRICONTINENTAL
($million)

Entity	*Amount*
State Bank	756
Tricontinental	2 373
Total cost	**3 129**

2.12 The residual obligations of the State at 30 June 1991 in relation to this cost were $1.7 billion, which was the magnitude of Tricontinental's net deficiency at that date.

2.13 The Government's *1991-92 Budget Papers* indicate that an annual subsidy of $180 million will be payable from the Consolidated Fund in relation to Tricontinental for at least the next 3 years. The Government anticipates that a subsidy of this level will be sufficient to cover financing costs associated with Tricontinental's deficiency. **However, it has not yet formulated a strategy for the long-term extinguishment of Tricontinental's debt.**

2.14 Given the magnitude of Tricontinental's current net deficiency, audit considers that, without a substantial increase in the level of government assistance, the burden on the Victorian community arising from Tricontinental is likely to remain well into the next century.

Cost of State Bank

2.15 The aggregate cost to the Victorian taxpayer in regard to the State Bank was $756 million, comprising:

- **an outlay of $194 million for acquisition of the State Bank's investment in Tricontinental, which effectively had no value; and**
- **a pre-sale loss of $562 million relating to debt assumed from the State Bank, representing the value of the Bank's non-performing loans to be written off.**

2.16 Under the sale arrangement, the Commonwealth Bank paid an amount of $194 million to the State Bank which was conditional upon deduction of an equivalent amount from the agreed purchase price and retention of Tricontinental by the State. **The deduction by the Commonwealth Bank of this amount was equivalent to the State outlaying $194 million for acquisition of the State Bank's investment in Tricontinental. At 31 December 1990, Tricontinental had a net deficiency of $1.7 billion which meant that the State acquired an investment that had no value.**

2.17 My October 1990 *Report on the Treasurer's Statement, 1989-90,* indicated that the Government's financial assistance to the State Bank would include the assumption of State Bank debt and associated financing costs totalling $562 million. **During 1990-91 the State assumed the $562 million debt and paid this amount to the State Bank immediately prior to the sale.** As a consequence of the sale, the right to any recoveries from realisation of securities underlying this debt was forgone by the State.

2.18 In addition to the cost of $756 million, the State has retained certain contingent liabilities, relating to pre-sale actions or events, which may result in future calls on State funds.

2.19 The Treasurer has provided certain indemnities and warranties to the Commonwealth Bank which in broad terms cover any future losses or damages incurred by the Commonwealth Bank arising from events occurring prior to the date of sale. Individual claims submitted by the Commonwealth Bank against these indemnities and warranties are restricted to a minimum value of $1 million and certain time limitations, and must be lodged within 7 years.

2.20 The Commonwealth Bank has to date served numerous anticipated claims (**with an assigned value in excess of $760 million**) on the Treasurer in respect of indemnities and warranties provided by the State. The State's eventual liability, **if any**, in respect of these claims could not be determined by the Government at the date of preparation of this Report as the claims had not been settled.

Cost of Tricontinental

2.21 As described above, the terms of the sale of the State Bank provided for a reduction of $194 million from the agreed sale price to reflect retention by the State of Tricontinental. **At that time, Tricontinental had a net deficiency of $1.7 billion.**

2.22 Subsequent to the sale of the State Bank, the Treasurer entered into a Deed of Undertaking with Tricontinental under which, inter alia, the State became obligated to provide all necessary financial support to ensure that Tricontinental will be able to meet its obligations as and when they fall due.

2.23 In short, the State is now obligated to meet the substantial net deficiency of Tricontinental and any future variations to this deficiency (for example, any subsequent increases in Tricontinental's bad debts).

2.24 In the 6 months to 30 June 1991, there were no payments made by the State under the Deed of Undertaking relating to Tricontinental. However, as indicated in the Government's *1991-92 Budget Papers*, annual subsidies of around $180 million will be payable from the Consolidated Fund over the period 1991-92 to 1993-94.

2.25 My October 1990 *Report on the Treasurer's Statement, 1989-90*, referred to action taken by the State during 1989-90 to assume other debt of Tricontinental amounting to $576 million. Finance charges incurred to 31 December 1990 relating to this assumed debt totalled $48 million.

2.26 After taking the debt assumed in 1989-90 and the associated financing charges into account, **the aggregate cost to Victorian taxpayers at 31 December 1990 in regard to Tricontinental was $2.3 billion. In the period up to 30 June 1991, the financial position of Tricontinental had deteriorated by a further $67 million.**

2.27 Table 2C summarises the aggregate cost of Tricontinental at 30 June 1991.

TABLE 2C. AGGREGATE COST TO VICTORIAN TAXPAYERS OF TRICONTINENTAL, AT 30 JUNE 1991
($million)

Cost items		*Amount*
Net deficiency at 31 December 1990*(a)*		1 682
Add -		
Further deterioration*(b)*		67
Net Deficiency at 30 June 1991		1 749
Add -		
Debt assumed in 1989-90	576	
Cost of servicing debt assumed	48	624
Total cost to Victorian taxpayers		**2 373**

(a) Based on audited financial accounts as at 31 December 1990.
(b) As disclosed in unaudited management accounts.

2.28 During 1990-91 the State settled the assumed debt and finance charges, of which the principal debt ($576 million) was funded from the net proceeds of the sale of the State Bank. **The residual obligations of the State arising from Tricontinental were therefore $1.7 billion at 30 June 1991.**

2.29 In addition to the aggregate cost to Victorian taxpayers in regard to Tricontinental, **the State may become responsible for additional obligations arising from Tricontinental's contingent liabilities at and beyond 31 December 1990.**

2.30 The contingent liabilities outlined in the latest audited financial statements of Tricontinental at 31 December 1990 were:

- guarantees of $103 million issued by Tricontinental in respect of moneys borrowed by other entities;
- guarantees of $3 million for units issued by the Tricontinental Cash Management Trust;
- a specific guarantee relating to a revolving Euro-note facility agreement entered into by Tricontinental;

- outstanding litigation cases against Tricontinental which cannot be quantified; and
- any claims against Tricontinental arising from its capacity as trustee for property development trusts or as nominee on behalf of third parties.

2.31 The financial position of the State in respect of Tricontinental may be improved if certain litigation actions which have been initiated by the Government prove to be successful.

Royal Commission

2.32 In response to significant parliamentary and community concern over the unprecedented losses of Tricontinental, the Government on 28 August 1990 announced a Royal Commission into the affairs of Tricontinental. The Royal Commission was formally established in September 1990 by the Governor-in-Council and its continuous hearings commenced in January 1991.

2.33 The Commission's first report was tabled in the Parliament on 21 August 1991 and the final report is expected in late May 1992.

2.34 The total cost to the State of the Royal Commission in 1990-91 was $5.7 million. The Government's *1991-92 Budget Papers* make provision for further expenses of $7.5 million.

Management response

Paragraphs 2.1 to 2.10

The State Bank (Succession of Commonwealth Bank) Act was passed by both Houses of Parliament during the Spring Session 1990. Full briefings of the net position were provided to the Opposition prior to this to ensure that both sides of Parliament were fully advised. All moneys have been dispensed in accordance with the Act and documented in the Budget Papers and the Finance Statement.

The information shown in Table 2A has been previously published in Table 1.4 of 1991-92 Budget Paper No. 2, and appears also in the Finance Statement among details of receipts and special appropriations. However, Table 2A is deficient in not recording as part of the net proceeds to the "seller" the $413 million received by the State Government from the Commonwealth Government as compensation for future revenue forgone and not utilising the tax losses of Tricontinental. The table is further deficient in not recording the application of these funds by the "seller" to a reduction of its liabilities to the Commonwealth Government under the Financial Agreement.

Paragraphs 2.11 to 2.14

The Government has appointed a new Board of Directors to the Tricontinental Group which has established a management team highly experienced in the recovery of loans. The Board is managing the loan portfolio with a view to rationalising or disposing of it by 1993. The final position of the Group will emerge as the recovery process works through over the next 2 years.

The eventual shortfall in Tricontinental will become part of State debt to be retired by the Victorian Debt Retirement Authority in accordance with its Annual Debt Retirement Strategy.

Paragraphs 2.21 to 2.31

The Deed on Undertaking also assigns certain rights to the Treasurer in regard to reporting and control (2.22).

PART 3

WORLD CONGRESS CENTRE

•

KEY FINDINGS

- The financing arrangement to construct the World Congress Centre, which in audit opinion is equivalent to a borrowing, has increased the State's indebtedness by $148.8 million.

  Paras 3.30 and 3.31

- The estimated financing charges over the 12 year financing term relating to this indebtedness will be around $235.7 million.

  Para. 3.23

- Although the State's financial obligations from this arrangement are estimated at $384 million, the actual liability to be met by the taxpayers will be influenced by:

  - the extent of surpluses or deficits incurred by the Centre over the 12 year term;
  - the effect of any changes to underlying taxation assumptions;
  - whether circumstances over the financing period necessitate indemnity payments to be made by the Treasurer; and
  - whether the Centre is in fact sold to the private sector in the year 2002.

  Paras 3.25 to 3.28

FINANCING OF THE WORLD CONGRESS CENTRE

3.1 The Government, in claiming that Victoria's population growth is rapidly outpacing its ability to provide the community with adequate and efficient infrastructure, has recognised a need to upgrade or replace many basic facilities and also construct new infrastructure to service the needs of the State. While capital works have, in the past, been funded through borrowings in accordance with Loan Council limitations, in recent times the Government has entered into a number of complex financial arrangements, particularly with the private sector, to supplement the conventional methods by which it raises funds for its infrastructure program.

World Congress Centre.

3.2 In the past, the non-disclosure by the Government of the financing arrangements for the construction of the World Congress Centre and the impact of such arrangements on the financial obligations of the State have been the subject of considerable discussion and debate at a parliamentary level.

3.3 Resulting from debate within the Legislative Council on the financing of the Centre, the Council on 8 May 1991 passed the following resolution:

> *"That this House calls upon the Auditor-General to undertake an inquiry into the funding of the World Congress Centre and report his findings to the Parliament as a matter of urgency".*

3.4 As part of my legislative obligation to report to the Parliament on the financial position of the budget sector at 30 June 1991, I had already decided that my Office would review the financing arrangements associated with the construction of the World Congress Centre. I had also formed the view that any significant exposures in terms of liabilities and commitments on the budget sector resulting from these arrangements would be reported to Parliament for the purpose of enhancing public accountability. **The results of the review, which are contained in this Report, fulfil the request made to me by the Legislative Council in May 1991.**

3.5 In order to commence the review, my Office, over a 5 week period, entered into a frustrating and exhaustive process to gain access to the required contractual documentation surrounding the financial arrangement. **This information, which was deemed to be commercially confidential and sensitive by the Government, was eventually provided to audit on 22 August 1991 after much deliberation by officers of the Department of the Treasury. This situation now seems particularly ludicrous given that a position paper detailing the financial arrangement was made public immediately prior to anticipated comment by the media on the continuing secrecy and intrigue which has surrounded this matter.**

3.6 While it may be appropriate for a government to enter into financial arrangements with private sector organisations, in my opinion it is totally inappropriate to refuse to release sufficient information to properly support the impact of such arrangements on the State. In view of the Government's recent measures to arrange various financial deals with the private sector for the funding of infrastructure projects, I am concerned that such deals, which impose massive financial obligations on the taxpayers of the State, may proliferate with only minimal accountability to the Parliament and the public.

3.7 **It is my view that the issue of commercial confidentiality and sensitivity should not override the fundamental obligation of government to be fully accountable at all times for all financial arrangements involving public moneys.**

3.8 Comments in relation to my Office's review of the funding of the World Congress Centre follow.

Summary of the financing arrangement

3.9 In simple terms the funding arrangement for the World Congress Centre consists of bank finance to construct the Centre and the replacement of this debt in 1990 by way of an equity refinancing arrangement from funds invested by a major Australian private bank and 4 foreign financial institutions. Bank finance is to be obtained in 1997 to redeem the investments under the equity arrangement. Provision exists for the Centre to be sold in the year 2002 upon which time all outstanding amounts will be repaid.

3.10 The major parties involved in the arrangement are banks, a property trust consisting of investors (finance unitholders), a Centre manager and the Government. **Under the financing arrangement the Treasurer is, in essence, the guarantor for the project and as such the other parties are not subject to any risks whatsoever.** The indebtedness and financial obligations of the State relating to the Government's sponsorship of the Centre over the 12 year term comprise:

- the shortfall between any net operating income generated by the Centre and the interest payments due on the financing arrangement obtained to construct the Centre at a cost of $148.8 million;
- operating subsidies to the Centre to meet outstanding expenditure; and
- a wide range of indemnities provided by the Treasurer to the property trust and the respective banks as protection against any losses which may be incurred by them during their involvement in the arrangement.

Why did the Government decide that there was a need for Victoria to have a World Congress Centre?

3.11 The Centre was designed to provide a state-of-the-art, multi-purpose centre which could cater for a variety of national and international conventions, exhibitions and related activities with the aim of becoming a major focus for attracting visitors to Melbourne and Victoria. The Government decided that a convention centre was required to compete effectively with similar facilities interstate and overseas in relation to convention, exhibition and related activities. The Government also felt that any loss of Melbourne's prominent place in the convention and exhibition market would adversely effect tourism and the Victorian economy.

What role do the main parties play in the Centre's financing?

3.12 The respective roles of the major parties are detailed below:

- Principal banks (4 foreign banks) provided the construction and debt financing for the project.
- The Centre is now financed by a special purpose private unit trust (Melbourne Convention Centre Property Trust). The components of the property trust are as follows:
  - trustee (Allco Nominees Vic Pty Ltd);
  - investment unitholder (Allco Investments Limited);
  - finance unitholders; and
  - trust manager (Allco Management Ltd).

- The property trust entered into construction contracts with a private developer to build the Centre under the supervision of the Victorian Government Major Projects Unit.
- The World Congress Centre Melbourne Pty Ltd, an exempt proprietary company, acts as a Centre manager (agent) for the property trust and is responsible for operating the Centre on behalf of the trust. (Further comment on the lack of accountability of exempt proprietary companies is contained in Part 11 of this Report.) The company is 40 per cent owned by the Victorian Tourism Commission (4 000, $1 shares) and 60 per cent owned by 4 individuals (1 500, $1 shares each) who are also directors of the company. An additional director is nominated by the Victorian Tourism Commission. The company's financial statements for 1989-90 revealed that:
    - directors' remuneration totalled $53 845 ($52 500, 1988-89); and
    - dividends amounted to $27 895.
- Under the Centre's financing arrangements the Treasurer of Victoria provides indemnities to the trustee and subsidies to the Centre manager from the parliamentary appropriation relating to tourism which is administered by the Victorian Tourism Commission. Prior to making these payments cash flow projections of the Centre and distribution payments are verified by both Treasury and Commission officials. The Centre's budget is approved by the Commission and the Department of the Treasury.

What are the key elements of the financing arrangement?

3.13 The financing arrangement relating to the Centre consists of a number of key elements which are summarised in Table 3A.

TABLE 3A
KEY ELEMENTS OF THE FINANCING ARRANGEMENT

Period	*Financing*
1987-1990	Construction financing from banks
1990-1997	Debt replaced by way of equity financing
1997-2002	Equity financing converted to debt
2002	Sale of the Centre to repay debt

3.14 A brief explanation of these elements is outlined below.

Construction phase

3.15 During the construction phase the trustee raised finance of $148.8 million ($125.1 million principal and $23.7 million capitalised interest) through credit and cash facilities provided by 4 foreign banks.

Equity financing

3.16 Upon project completion in 1990 the construction debt was refinanced by way of long-term equity financing. Under this arrangement 5 finance unitholders (one major Australian bank and 4 foreign financial institutions) purchased units in the Special Purpose Private Unit Trust for a 7 year investment period to 14 February 1997. In essence, the debt of $148.8 million was replaced by equity financing whereby moneys obtained from the finance unitholders were used to repay the original debt incurred during the construction phase.

3.17 The finance unitholders are guaranteed a return (interest) on their investment by way of agreed distribution payments paid on a quarterly basis over the 7 year term. These payments are to be met from any net operating income of the Centre and from subsidies provided by the Government.

3.18 As the return payable to the finance unitholders is based on a variable interest rate, an interest rate swap was arranged by the trustee in May 1990 as a safeguard against increased obligations by way of possible increased interest rates over the equity financing term. This risk management strategy provided for a counterparty to pay the floating rate obligations in exchange for a fixed interest rate commitment to be met by the Government.

Debt financing

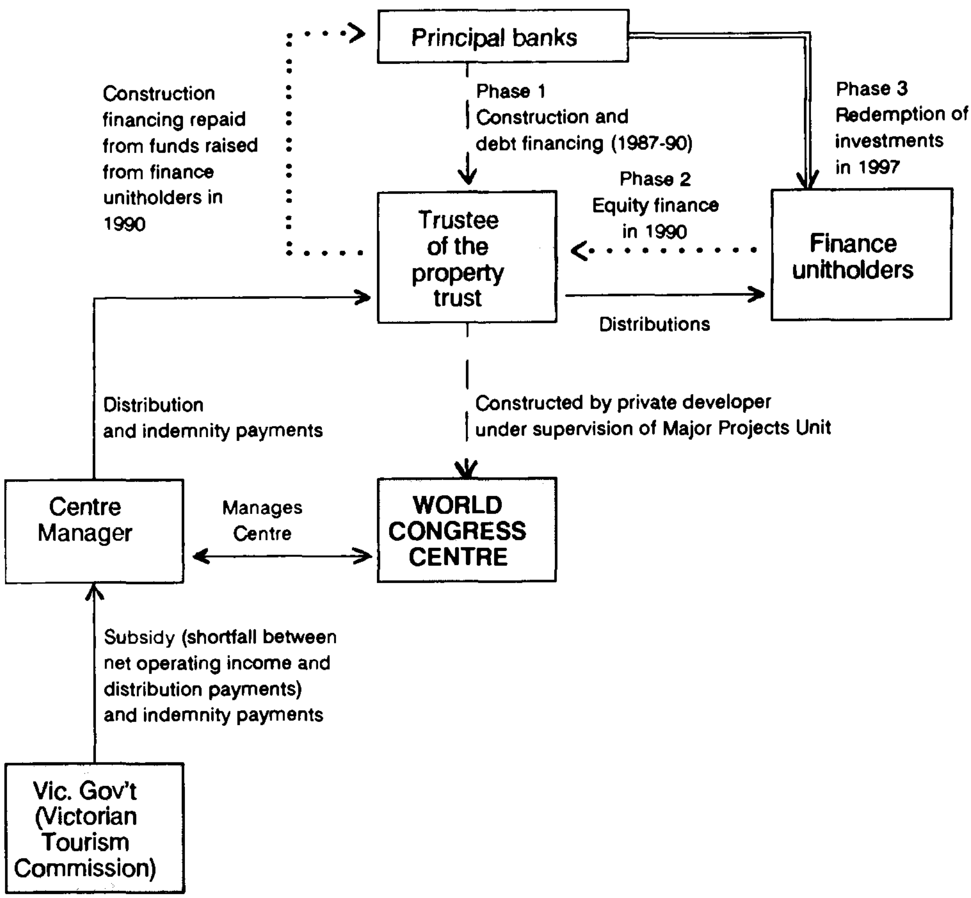
3.19 At the conclusion of the equity phase of the financing arrangement (1997), the trustee will receive advances from banks to enable the finance unitholders to be paid out in full. In effect, equity financing will be re-converted into debt financing for the remaining 5 year term. During this period only interest on the advances will be paid and this will be met by the Government to the extent that operating surpluses of the Centre are insufficient to meet this commitment.

Sale of the Centre

3.20 Provision exists for the Centre to be sold in the year 2002, with the advances from the banks being repaid from the sale proceeds at the end of the 5 year interest only debt period. **If the Centre is not sold, the Treasurer will be required to meet the outstanding loan obligation of $148.8 million and as a consequence ownership of the Centre will revert to the Government.**

3.21 A diagramatic presentation of the main parties and key elements of the financing arrangement is illustrated in Chart 3B.

CHART 3B. PARTIES INVOLVED IN THE FINANCING ARRANGEMENT



What was the cost of constructing the Centre?

3.22 Construction commenced in 1987 with an approved budget of $147.2 million. Audit did not have access to the records of the Centre manager and as a consequence it was not possible to verify the cost of constructing the Centre. Advice received from the Department of the Treasury in October 1991 revealed that outstanding bills were still held for project control and administration and for works and services found necessary during the defects liability period. The total cost, following all defect rectification, will according to Treasury be slightly less than $148.8 million, the amount of the credit facility provided by the banks for construction.

What is the total estimated financing cost of the Centre?

3.23 An estimate of the financing cost, prepared by the Department of the Treasury in April 1991 is outlined in Table 3C. This estimate will vary over the term of the financing arrangement due to changes to the tax assumptions and fluctuations in interest rates.

TABLE 3C. ESTIMATED FINANCING COST OF THE CENTRE
($million)

Phase	*Period*		*Amount*
Equity financing phase *(a)* -			
Distribution payments			
	1990	*(b)*0.86	
	1991	*(b)*13.89	
	1992	15.57	
	1993	18.13	
	1994	21.17	
	1995	23.21	
	1996	25.47	
	1997	20.87	139.17
Debt financing phase *(c)* -			
Interest only debt period			
	1998	19.30	
	1999	19.30	
	2000	19.30	
	2001	19.30	
	2002	19.30	96.50
			235.67
Sale of the Centre -			
Principal amount of the debt			
	2002		*(d)*148.80
Total estimated financing cost			***(e)*384.47**

(a) The after tax yield (return payable to the unitholders) is based on a projected floating bank bill rate (estimated variable interest rate at the time). To minimise the impact on the Consolidated Fund, increased distribution payments are deferred to later years when it is expected that greater revenue to be generated by the Centre will partly contribute to these obligations.

(b) Actual distribution payments met from the Consolidated Fund. In addition, the shortfall in the Centre's operating expenses of $1.7 million for 1990 and $2 million for 1991 was subsidised by the Government.

(c) Estimated interest payments calculated at an assumed interest rate of 13 per cent.

(d) In October 1991 the Department of the Treasury estimated that the principal amount of the debt financing that will have been in place for the final stage of the financing arrangement will amount to $151.4 million.

(e) Excludes any subsidy payments to be made to the Centre and various other contingent liabilities outlined in para. 3.26. The financing costs to be met by the Treasurer will be reduced by any surpluses made by the Centre over the 12 year term and any proceeds from the sale of the Centre. Although the Centre's management has predicted that operating surpluses will be made from 1991, the Centre has also indicated that these surpluses, which are estimated to peak at around $4.7 million in the year 2002, will not be sufficient to fully repay the required distributions and interest payments.

3.24 An estimate by the Department of the Treasury in August 1991 revealed that the revised distribution payments in the equity refinancing phase will amount to approximately $142.4 million compared with the April 1991 estimate of $139.2 million. Based on this prediction the total estimated financing cost would increase by $3.2 million to some $387.7 million.

What are the financial obligations on the Victorian taxpayer?

3.25 The Government subsidises the Centre manager's obligations to make distribution payments and to meet any operating deficits of the Centre. In addition the Treasurer has indemnified the trustee in respect of all expenses, losses, damages, costs and liabilities incurred by the trustee.

Obligations throughout the period (1990-2002)

3.26 Set out below is a list of financial obligations underwritten by the Government.

Subsidies

- Any shortfall between the level of net operating income of the Centre and the distribution payments to be made to the finance unitholders.
- Any shortfall between income and operating expenses of the Centre.

Indemnities

- Any liabilities, losses, costs and expenses incurred by the trust manager of the property trust or the finance unitholders as a result of contesting any decision regarding a redetermination of the scheduled distribution payments or redemption prices due to, for example, a change in the original assumptions relating to the tax treatment of certain project costs.
- In the event of the fixed interest rate exceeding the variable interest rate (less the margin charged by the counterparty), under the interest rate swap arrangement the Treasurer will meet this shortfall.
- Any expenses, losses, damages, costs and liabilities incurred by the counterparty to the interest rate swap arrangement which may result from the failure of the trustee of the property trust to pay moneys on the due date under the Swap Agreement.
- The 4 banks involved in the financing arrangement have agreed to provide financial accommodation to the trustee of the property trust for the purpose of redeeming the units of the finance unitholders at the end of the 7 year investment period. Any shortfall between the eventual redemption prices payable to the finance unitholders and the advances from the banks will be met by the Treasurer.
- Any capital expenses associated with the Centre which become due and payable by the trustee of the property trust such as future refurbishment costs.
- Any liabilities, losses, costs and expenses incurred by the trust manager or finance unitholders as a result of any fraud, misconduct or default by the trustee.
- Any withholding tax obligations (tax on the return payable to 4 non-resident finance unitholders) to be met by the Trustee.
- Any bank charges, duties and other fees connected with the financing arrangement.

- Any moneys owing to the banks in relation to:
  - any shortfall between the level of net operating income of the Centre and the agreed equity refinancing interest payments over the 5 year debt refinancing arrangement;
  - any losses and expenses incurred by the banks as a consequence of non-compliance by the trustee with the prescribed withdrawal procedures;
  - any losses incurred by the banks through fraudulent activity which would result in their inability to meet their credit obligations;
  - any increased costs incurred by the banks due to any changes in laws, regulations binding on the banks or legal judgements; and
  - any legal costs and expenses incurred by the banks.

At the end of the 12 year period what will happen to the Centre?

3.27 Under the financing arrangement the Centre can be sold by auction in 2002. If the Centre is sold at the reserve price, which will be set at a level to at least extinguish all amounts owing, the sale proceeds will be used to repay outstanding loan obligations and reimburse the Treasurer for subsidies and indemnity payments made up to that time including interest. Any proceeds in excess of all outstanding amounts will be retained by the trustee. Alternatively control of the trust may be transferred to the public by means of the public listing of the trust.

3.28 In the event that the sale or the public listing do not eventuate, the Government will have to purchase the Centre and become responsible for the payment of the $148.8 million residual (i.e. repayment of the principal amount outstanding on the loan obligations to the banks). In this regard the Treasurer has indemnified the trustee in relation to any moneys owing to the banks in order to meet the principal outstanding on cash advances.

Who controls the operations of the World Congress Centre?

3.29 In view of the above financial obligations of the Government (which are to be met from the parliamentary appropriation administered by the Victorian Tourism Commission), the role of the Department of the Treasury and the Commission in approving the Centre's budget, the importance of the Centre to the Government's tourism objectives for the State and the Government representation on the Board of the Centre, audit is of the view that the Government, in substance, effectively exercises overall control over the operations of the Centre.

Does this financing arrangement increase the Government's indebtedness?

3.30 Audit is of the view that although conventional debt funding has not been arranged within the global borrowing limits imposed by the Loan Council, the complex mechanism chosen to sponsor the construction of the Centre increases the Government's indebtedness by $148.8 million as:

- The financing arrangement has not transferred the risks and many of the benefits incidental to ownership of the Centre to the external parties but has committed the State to future financial obligations;
- Financial commitments will be incurred by the Government in relation to any shortfall between the distribution payments payable to the unitholders and the interest on loans compared with the net operating income of the Centre. In substance, these commitments represent financing costs associated with the financing arrangement;
- The Centre to which the finance arrangement relates constitutes one of the Government's largest tourism infrastructure projects, the plans and specifications of which were approved by the Victorian Government;
- The Centre has been constructed on land leased by the trustee from the Urban Land Authority at a nominal rate; and
- The Government controls the operations of the Centre.

3.31 In conclusion, audit is of the view that as the risks and benefits associated with the financing arrangement remain with the Government and as the distribution payments which the Government subsidises equate to the interest due and payable under the arrangement, the financing arrangement to construct the World Congress Centre is equivalent to a borrowing by the State. Accordingly this amount has been included as part of budget sector indebtedness in Part 5 of this Report.

Management response

The Department of the Treasury fully accepts the need to provide relevant information to the Auditor-General. There has been no intention to deny audit access to information relevant to determining the liabilities and commitments of the Government.

However, the World Congress Centre is financed by a fully privately-owned unit trust and managed by a private company in which the Victorian Government through the Victorian Tourism Commission has a minority shareholding.

Before releasing any commercially confidential details of the financing of the Centre, it was considered necessary for all private sector parties to be consulted. With the consent of these parties, the transaction documents and all departmental files were released to the Auditor-General for review.

The comments in the final sentence of para. 3.5 above are considered incorrect and extravagant. The information paper while providing important background information does not provide the details of individual commercial transactions which were sought by the Auditor-General.

As the Centre is not owned by the Government, the Department of the Treasury does not agree that the financing arrangement is equivalent to borrowing from the Government. The obligations and indemnities under those arrangements are fully detailed in the Finance Statement, at page 205. Even if audit's views were accepted it should be noted that the Centre would then be recorded as a corresponding government asset.

PART 4

BUILDING SOCIETY SUPPORT

KEY FINDINGS

- The aggregate financial obligations of Victorian taxpayers arising from the failure of the Farrow Group of Building Societies is estimated to be $657 million.

  Para. 4.18

- The majority of the above obligations are to be borne by motorists through a special petrol levy introduced by the Government in December 1990.

  Paras 4.19 to 4.23

- The Government expects that the drawings of $150 million at 30 June 1991 under the credit facility established to provide liquidity support to the building society industry will be repaid by the end of 1991.

  Paras 4.24 to 4.26

FARROW GROUP OF BUILDING SOCIETIES

4.1 My *Report on the Treasurer's Statement, 1989-90*, indicated that following the forced closure in June 1990 of the Farrow Group of Building Societies (consisting of the Pyramid, Geelong and Country Wide Building Societies), the Government announced that depositors with the Farrow Group would receive, over time, the principal component of their deposits outstanding at 24 June 1990. Holders of shares within the Farrow Group were not covered by the Government's commitment.

4.2 This section of my Report outlines the financial arrangements established by the Government during 1990-91 to meet the above commitment, which, **on current estimates, will cost Victorian taxpayers $657 million. The majority of this amount will be borne by motorists through a special petrol levy introduced by the Government in December 1990.**

Initial payout to depositors

4.3 In August 1990, the Government entered into an arrangement with the former State Bank of Victoria under which the Bank funded an initial payment to depositors as follows:

- a full payout to those depositors with accounts having balances of less than $100; and
- for all other depositors, 25 per cent of account balances at 24 June 1990.

4.4 To participate in this initial payout, depositors were required to assign their rights to the State Bank for an equivalent distribution by the administrator of the Farrow Group. The Government in turn agreed to indemnify the State Bank against any shortfall between the initial payout to depositors and the amounts ultimately received from the administrator. Furthermore, the Government agreed to meet interest and other costs incurred by the Bank in administering and financing this arrangement.

4.5 **The initial payout to depositors by the State Bank under this arrangement amounted to $362 million. The State incurred a total cost of $40.9 million in 1990-91 in providing this facility, comprising $36.8 million for funding costs and $4.1 million for administrative and associated costs.**

Access to special emergency payments

4.6 In October 1990, the Government announced that depositors suffering extreme hardship because of the Farrow Group's collapse would be given special access to emergency payments. **During 1990-91 emergency payments of $5.9 million were made by the Government.** Stringent eligibility criteria were established for these payments.

4.7 In addition to its strategy of assisting depositors in extreme hardship, the Government decided to pay out all depositors with account balances of less than $100, after the initial 25 per cent payment. **The total amount paid to this category of depositors was $212 000.**

4.8 Both of the above payments were treated as advances against depositors' entitlements and were financed from a special advance provided by the Treasurer under section 15 of the *Public Account Act* 1958. The transactions were recorded in the Trust Fund within an account entitled *Special Purpose Trust Account*. The Government anticipates that the special advance will be repaid during 1991-92 from revenue received under the special petrol levy.

Issue of Victorian Government Security Bonds

4.9 The administrator of the Farrow Group, in an August 1990 interim report, estimated that the shortfall to depositors and investors from a realisation of the Group's assets at that date would be in the order of $250 million. The administrator further estimated that this shortfall would be reduced if an orderly realisation of assets occurred. The administrator followed the interim report with an October 1990 communication to depositors advising that distributions from the realisation of assets was not likely to occur until 1993.

4.10 To give depositors an opportunity to have earlier access to their funds, with greater certainty as to the timing and quantum of returns, the Government decided to offer Victorian Government Security Bonds during December 1990 and January 1991 to all depositors. Some of the features of the bond issue were:

- offer of bonds to a value equal to the balance of deposits, excluding interest credited after 30 June 1989, with acceptance required by April 1991;
- offer conditional upon the assignment to the State of all rights to any future Farrow Group distributions and agreement not to pursue any legal action against the Government or its present and past Ministers;
- provision of a government commitment that no depositor accepting the bond offer would be worse off than awaiting distribution of the Group's assets;
- issue of bonds as transferable securities under new legislation, the *Building Societies (Prudential Standards) Act* 1990;
- progressive payments to bondholders by the Government over a 5 year period beginning in 1991-92;
- participation by the State Bank as agent to process all bond offers and appointment of a company (National Registries Pty Ltd, jointly owned by SECV and Telecom) to distribute bonds, act as Registrar and process annual bond payouts; and
- all associated costs to be met by the Government.

4.11 **The Government bond offer was accepted in respect of 79 per cent of individual depositor accounts, with around 125 000 bonds issued to an aggregate value of $875.2 million.** Table 4A summarises the State's financial obligations to bondholders.

TABLE 4A. STATE'S FINANCIAL OBLIGATIONS TO BONDHOLDERS
($million)

Payment due		*Amount*
August	1991	*(a)*195.0
" "	1992	158.0
" "	1993	183.8
" "	1994	142.9
" "	1995	195.5
Total		**875.2**

(a) Payment made 30 August 1991.

4.12 **Costs of $1.2 million were met by the State during 1990-91 in administering the bond arrangements.**

Status of legal action

4.13 As stated in my October 1990 Report, the Victorian Government Solicitor had advised that a Supreme Court action was pending against the State and 2 members of the Government relating to public representations made in respect of the financial position of the Pyramid Building Society. This action was withdrawn following the plaintiff's acceptance of the Government's bond offer.

4.14 During 1990-91, a new Supreme Court action was initiated against the State and 2 members of the Government by a holder of non-withdrawable shares in Pyramid. This action is currently in progress.

Realisation of Farrow Group assets

4.15 The State's liability in regard to the Government commitment to Farrow Group depositors will be reduced by the extent of its ultimate share of the liquidator's distribution of the Group's assets.

4.16 As previously mentioned, the administrator's August 1990 interim report indicated that a shortfall in the order of $250 million would occur from an immediate realisation of assets, however, this shortfall would be minimised by an orderly disposal of assets.

4.17 The above assessment of the Group's position was updated in a June 1991 report by the appointed liquidator. The Government has examined the Group-wide projections in that report and estimates that distributions totalling $924 million will be received over the next 5 years to help offset payments of $1 243 million that will have been made to depositors by or on behalf of the Government and associated finance and administrative costs, estimated to be a further $338 million.

4.18 Based on these projections a total of $657 million will need to be funded by Victorian taxpayers. Table 4B summarises the position.

TABLE 4B. AGGREGATE FINANCIAL OBLIGATIONS OF VICTORIAN TAXPAYERS FROM FARROW GROUP
($million)

Item	*Amount*	
Initial payout to depositors by State Bank	362	
Associated finance and administrative costs (met from Consolidated Fund) to 30 June 1991	41	403
Special emergency payments		6
Victorian Government Security Bonds	875	
Associated costs (met from Consolidated Fund) to 30 June 1991	1	876
Future estimated financing costs*(a)*		296
Total costs		1 581
Less - Projected distributions from liquidator		924
Estimated shortfall to be met by Victorian taxpayers		**657**

(a) Government estimate of cost of borrowings to meet bond obligations (in advance of receipt of liquidator's distributions) and future financing costs relating to initial payout by State Bank.

Use of petrol levy to finance shortfall

4.19 Table 4B indicates that an amount of $42 million was paid from the Consolidated Fund in 1990-91 to cover certain financing and administrative costs relating to the Farrow Group.

4.20 In December 1990, the Government increased the levy on the wholesale price of motor spirit (petrol), from 7.8 per cent to 11 per cent, as the means of funding its estimated remaining financial obligations of $615 million arising from the Farrow Group.

4.21 The legislative authority for the special petrol levy was an amendment to the *Business Franchise (Petroleum Products) Act* 1979, which requires that all levy revenue be paid into the Consolidated Fund. The Act also provides that, as soon as practical after the end of each financial year, the additional levy proceeds from the previous year be transferred from the Consolidated Fund to the special trust account within the Trust Fund.

4.22 The Government's *1991-92 Budget Papers* indicate that the special petrol levy will cease in 1995-96, the year in which the Government anticipates that all its financial commitments relating to Farrow will be settled. Table 4C shows details of the projected revenue from the special petrol levy.

TABLE 4C. PROJECTED REVENUE BY GOVERNMENT FROM SPECIAL PETROL LEVY *(a)*
($million)

Year	*Amount*
1990-91	*(b)* 64
1991-92	91
1992-93	107
1993-94	111
1994-95	115
1995-96	*(c)* 123
Total	**611**

(a) Projections by Government do not take into account the 1990-91 Special Emergency payments of $6 million.

(b) This amount was received during 1990-91.

(c) Includes Government estimate of end-of-period surplus of $2 million.

4.23 In line with the legislative provisions, the amount of $64 million collected by the State in 1990-91 from the petrol levy formed part of the Consolidated Fund at 30 June 1991. As pointed out in Part 1 of this Report, the legislation does not require this amount to be transferred to the special purpose trust account until the following financial year, therefore it has impacted favourably on the financial position of the Consolidated Fund at 30 June 1991.

BUILDING SOCIETY INDUSTRY LIQUIDITY SUPPORT SCHEME

4.24 My October 1990 Report indicated that the liquidity difficulties and the subsequent forced closure of the Farrow Group of Building Societies in June 1990 resulted in a general lack of community confidence in the building society industry. As a measure to stabilise the industry, the Government in July 1990, established a line of credit for all building societies, with the exception of societies within the Farrow Group.

4.25 Under the arrangements, the credit facility was established through VicFin which was to advance funds as necessary to the Victorian Building Societies Council. The Council would in turn lend funds, at its discretion, to individual building societies to meet liquidity needs. Moneys advanced are subject to a charge over the assets of the relevant building societies and are provided at an interest rate comparable with the commercial cost of funds. **Funds advanced by VicFin under this arrangement are subject to a government indemnity under the Housing Act 1983.**

4.26 The liquidity support scheme was initially introduced for a period of 12 months to 24 July 1991. However, as indicated in the Government's *1991-92 Budget Papers*, this period has been extended to 31 December 1991. The Government expects that, as the building society industry is now stabilised, all drawings **(totalling $150 million at 30 June 1991)** by building societies under the support arrangement will have been repaid by that date.

PART 5

BUDGET SECTOR INDEBTEDNESS

KEY FINDINGS

- Budget sector indebtedness to be funded by general taxpayers exceeds $38.1 billion (30 June 1990, $32.6 billion) which is equivalent to $8 590 per capita. These amounts do not include non-budget sector net debt of $12.8 billion to be funded from revenues raised by public bodies.
Paras 5.3 to 5.4

- The annual cost to the community of servicing public account borrowings increased from $330 per capita in 1989-90 to $381 per capita in 1990-91.
Paras 5.58 to 5.62

- During the year, 19.4 per cent of available revenue was used to meet finance charges, compared with 17 per cent in 1989-90.
Para. 5.60

- Accumulated deficits of $10 billion arising from Consolidated Fund operations over the last decade have been funded from borrowings.
Paras 5.8 to 5.10

- Short-term borrowings to cover cash shortfalls in the Consolidated Fund cost the State $150 million in interest charges compared with $70 million in the previous year.
Paras 5.50 to 5.52

- The extensive use of short-term borrowings rather than obtaining long-term financing was more costly to the State by over $10 million.
Paras 5.53 to 5.57

- Certain of the arrangements entered into by the Government which resulted in the deferral of expenditure of $317 million, in substance, represented borrowings of the Consolidated Fund, given that the Government incurred financing costs associated with these deferrals.
Paras 5.15 to 5.16

- The State has an exposure of around $700 million to the unitholders in the Victorian Equity Trust, which is due for settlement in June 1992.
Paras 5.98 to 5.101

- The Government has guaranteed the repayment of the Melbourne Cricket Club's borrowings of up to $160 million for the redevelopment of the Southern Stand. In addition, any loss incurred by the Club if the cost exceeds $160 million is also indemnified by the Government.
Paras 5.102 to 5.107

AGGREGATE INDEBTEDNESS

5.1 A major focus of my October 1990 Report to the Parliament was the level and impact of budget sector indebtedness. This topic generated considerable parliamentary and community debate, focusing on both the magnitude and the key components of such indebtedness. The debate, in my view, has been highly successful in stimulating discussion on this most important issue.

5.2 **Budget sector indebtedness, as reflected in this Report, represents borrowings and other financial obligations which will need to be met from the Consolidated Fund and, thus, by general taxpayers.**

Total budget sector indebtedness

5.3 **The total budget sector indebtedness at 30 June 1991 was $38.1 billion (30 June 1990, $32.6 billion), which is equivalent to approximately $8 590 per capita (30 June 1990, $7 430 per capita).** Table 5A summarises this indebtedness.

TABLE 5A. TOTAL BUDGET SECTOR INDEBTEDNESS
($billion)

Item		**1990-91**	1989-90
Borrowings		**17.0**	15.0
Employee entitlements -			
Unfunded superannuation liabilities *(a)*	**17.2**		15.6
Accrued leave	**0.7**	**17.9**	0.7
Tricontinental Group		**1.7**	-
Other liabilities *(b)*		**1.5**	1.3
Total budget sector indebtedness		**38.1**	32.6

(a) Based on latest actuarial estimates of unfunded superannuation liabilities.

(b) Includes creditors and accrued interest of departments and net liabilities (to be funded from the Consolidated Fund) of budget sector public bodies.

5.4 The above table **does not include non-budget sector net debt of $12.8 billion** which is detailed within the section entitled "Supplementary Information" in the *Finance Statement.* The majority of this debt relates to the State's major public bodies (including State Electricity Commission, Melbourne and Metropolitan Board of Works and Gas and Fuel Corporation) and is payable from the revenues of those bodies and not by general taxpayers.

5.5 More detailed analysis of borrowings and other financial commitments of the budget sector at 30 June 1991 follows in this Section of the Report:

- *Budget Sector Borrowings* *(paras 5.6 to 5.45)*
- *Finance Charges* *(paras 5.46 to 5.72)*
- *Other Financial Commitments* *(paras 5.73 to 5.92)*
- *Contingent Liabilities* *(paras 5.93 to 5.138)*

BUDGET SECTOR BORROWINGS

Current level of budget sector borrowings

5.6 The budget sector's accumulated borrowings, as determined by audit, at 30 June 1991 amounted to $17 billion which represents an increase of $2 billion since the previous year and $11.1 billion over the last decade.

5.7 Table 5B shows the movements in budget sector borrowings during the year.

TABLE 5B. MOVEMENTS IN BUDGET SECTOR BORROWINGS
($million)

Item			*Amount*
Public Account -			
Consolidated Fund borrowings 1990-91 -			
New borrowings	1 379		
Prior year borrowings transferred from Trust Fund	86		
Borrowings to defer interest payments	115		
Borrowings from sale and lease-back arrangements	101	*(a)*1 681	
Less - Net redemption of debt		(1 102)	
		579	
Add -			
Indexation on loans	11		
Discount and premium on loans	6	17	596
Trust Fund -			
Short-term borrowings		77	
Prior year borrowings transferred to Consolidated Fund		(86)	(9)
New debt items -			
Victorian Government Security Bonds *(b)*		807	
Borrowings to defer expenditure		317	
World Congress Centre debt		149	
Flexible Tariff Management Unit Trust		135	
Centralisation of transport debt		96	
Assumption of Victorian Tourism Commission debt		2	1 506
Net movements in Public Account borrowings for year			2 093
Add - Borrowings at 1 July 1990			14 576
Total Public Account borrowings			16 669
Budget sector statutory authorities -			
Net borrowings in 1990-91			(73)
Borrowings at 1 July 1990			452
Total budget sector statutory authority borrowings			379
Total budget sector borrowings at 30 June 1991*(c)*			**17 048**

(a) The 1990-91 operating deficit of $1 712 million, as stated in Part 1 of this Report, was funded from borrowings of $1 681 million and $31 million of interest expense that was refinanced and is included in the face value of budget sector borrowings disclosed in the *Finance Statement*;

(b) In addition to the $807 million of Victorian Government Security Bonds issued at 30 June 1991, further bonds valued at $68 million were issued in 1991-92 (total value of bonds issued was $875 million); and

(c) The *Finance Statement* discloses gross budget sector borrowings of $15 894 million, however, this amount, in audit opinion, is understated by $1 154 million due the non-inclusion of:

- outstanding borrowings arising from transport sale and lease-back arrangements ($441 million);
- borrowings to defer expenditure ($317 million);
- borrowings involving certain interest swap arrangements ($170 million);
- borrowings relating to World Congress Centre ($149 million); and
- short-term borrowings held in Trust Fund ($77 million).

Management response

The presentation of actual gross public sector borrowings published in the Finance Statement has been prepared on a basis fully consistent with similar estimates presented in previous years and with standards accepted by the Australian Bureau of Statistics and internationally for classification of the components of public debt. There is no "understatement" in the Finance Statement as claimed by audit in footnote (c) of Table 5B, as set out in the Department of the Treasury's comments on paras 1.3 and 1.12 to 1.19 above.

In the Department of the Treasury's view, the additional items identified by audit in Table 5B belong to other categories of liabilities and commitments. Three of them are appropriately reported elsewhere in the Finance Statement, as follows:

- *variations in interest obligations due to swap transactions are reported as interest accrued in Table B.1 of the Finance Statement;*
- *deferrals of other expenditure obligations giving rise to liabilities are disclosed in relevant tables in the Supplementary Section; and*
- *short-term borrowings held in the Trust Fund are invested with other trust fund balances in the Cash Management Account's holdings of short-term financial assets and netted out in the presentation of net public debt in Table B.1 of the Finance Statement.*

Transport sale and leaseback transactions are considered to be operating leases and are fully disclosed in Table 5.12 of Budget Paper No. 2 as leasing "commitments". Consideration will be given in future to disclosing these as leasing commitments in an appropriate table in the Supplementary Section of the Finance Statement.

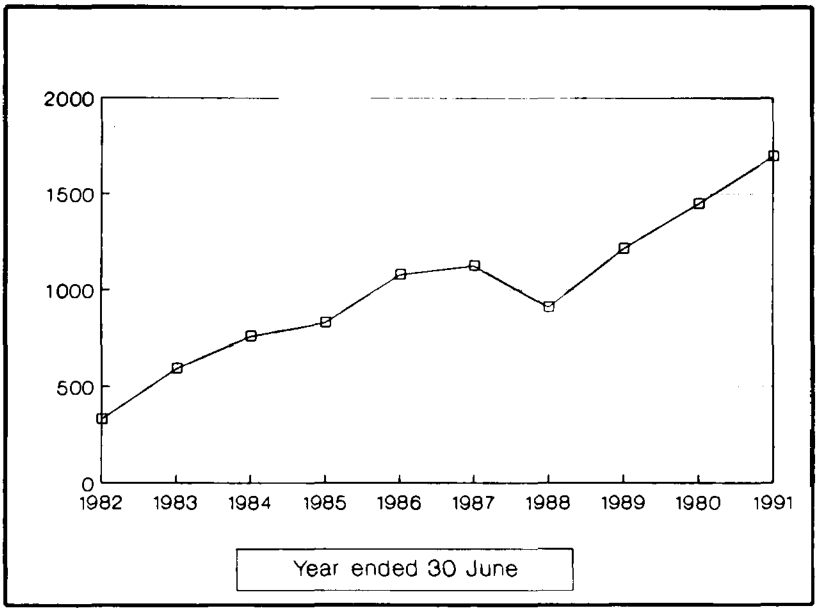
With respect to the World Congress Centre, as previously indicated in Part 3, the Centre is not owned by the Government. The financing arrangements are not borrowings by Government and any obligations and indemnities are fully disclosed in the Finance Statement at page 205.

Borrowings to meet escalating deficits

5.8 My October 1990 Report illustrated the magnitude of Consolidated Fund deficits which had occurred in the 10 year period up to June 1990, and the key causes of such deficits. That Report also drew attention to the adverse impact of escalating deficits on budget sector borrowings and on the State's capacity to meet its future obligations.

5.9 During 1990-91 the pattern of increasing deficits continued and resulted in further reliance on borrowings to finance the year's operations. Charts 5C and 5D illustrate the rate of increase in annual deficits over the last decade and the accompanying impact on the level of borrowings necessary to fund government programs.

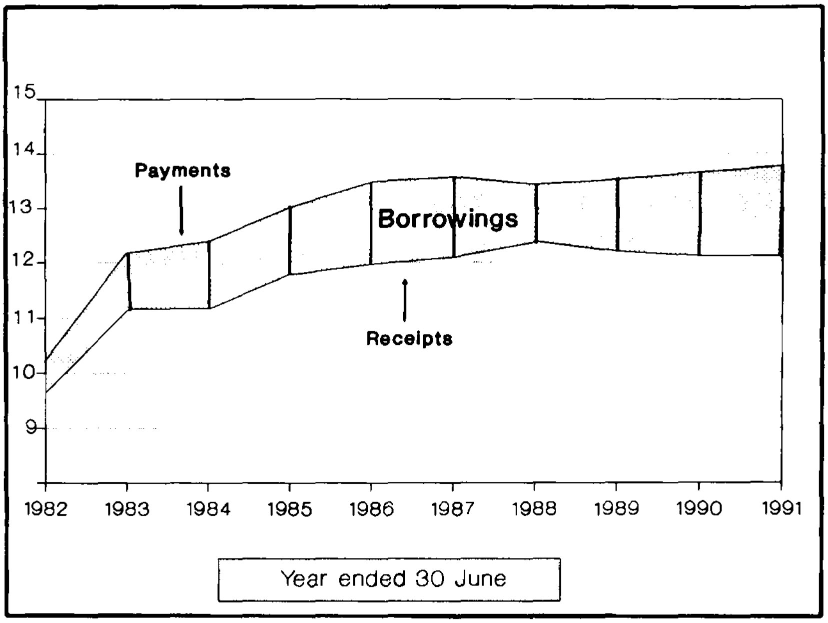
CHART 5C. ANNUAL DEFICITS *(a)(b)*
($million)



(a) In determining the deficit for each period, cash balances from prior years have been excluded.

(b) The annual deficits are referred to in the *Finance Statement* as a shortfall of receipts.

CHART 5D. LEVEL OF BORROWINGS TO FUND GOVERNMENT PROGRAMS
(In constant 1990-91 prices)
($billion)



5.10 Accumulated deficits arising from Consolidated Fund operations over the past decade totalled $10 billion. An audit analysis of the Consolidated Fund's operations over this period indicated that a substantial proportion of borrowings has been used to fund deficits in the Works and Services sector. **However, the analysis also showed that over the same period the aggregate deficit on recurrent operations, funded from borrowings, was $1.1 billion.**

Government strategies to reduce reliance on borrowings

5.11 In recognition of the past reliance that had been placed on borrowings and a consequential need for decisive action, the Government determined that the underlying and fundamental aspect of its 1990-91 Budget would be the introduction of a long-term debt management strategy.

5.12 The key initial objective sought under this strategy was a reduction in the level of net budget sector debt by $139 million in 1990-91. The framework for attainment of this principal target included:

- establishment of a debt retirement fund (to be financed from expected proceeds of $2.6 billion from sale of certain business assets and a $100 million contribution by the Consolidated Fund) to be used to retire debt;

- gradual centralisation of all public account funded debt to either VicFin or the VDF, to enhance the efficiency of debt management; and
- use of financing instruments to facilitate the spreading of interest costs over the next 5 to 6 years.

5.13 In view of the substantial budgetary difficulties which were experienced **during 1990-91, the key debt reduction objective was not achieved** and the Government has now combined its debt management strategy with a wider 3 year financial management plan for the State. This plan, which was outlined in the June 1991 *Economic Statement*, formed the basis of the Government's 1991-92 Budget and broadly involves:

- setting of budgetary strategies aimed at controlling and reducing real growth in expenditure levels, restraining revenue growth and achieving long-term debt reduction;
- a strong focus on ensuring that government programs and services are delivered in the most economic and efficient manner; and
- increased private sector investment in the provision of public infrastructure.

5.14 The latest government initiatives place greater significance on achieving sustained long-term improvement in the overall financial management of the State. Ensuring real reductions in debt levels will clearly be the most critical task if the important targets embodied in the Government's financial plan are to be attained.

Borrowings to defer expenditure

5.15 Part 1 of this Report referred to strategies pursued by the Government in 1990-91 which led to the deferral of expenditure to future financial periods. **Certain of the deferral arrangements,** for example those involving grants to non-government schools, private bus subsidies and municipal rate concessions and library subsidies, **in substance, represented short-term borrowings of the Consolidated Fund, given that the Government incurred financing costs associated with these deferrals.** Deferrals of this nature entered into by the Government in 1990-91 totalled over **$98 million**.

5.16 My *Report on Ministerial Portfolios, April 1991* referred to an additional **deferral of expenditure from the Consolidated Fund, by way of in substance borrowing,** relating to the Emergency Services Superannuation Scheme. That Scheme has borrowed an amount of **$219 million** to cover amounts due to it from the Consolidated Fund in respect of certain employer contributions. **The Consolidated Fund is progressively making supplementary contributions to the Scheme under a structured financial plan to cover the redemption and servicing of this debt.**

Borrowings relating to the Flexible Tariff Management Unit Trust

5.17 In my October 1990 Report, I commented on the role of the Flexible Tariff Management Unit Trust (FTMUT) in arrangements under which the electricity tariff for the Point Henry and Portland aluminium smelters within the State fluctuates in line with world aluminium prices. That Report indicated that the State Trust Corporation is the trustee of FTMUT and that the Treasurer is FTMUT's sole unitholder.

5.18 In summary, FTMUT is required, under agreements with SECV, Alcoa and Portland Smelter Services Pty Ltd, to make payments to the SECV when aluminium prices fall below a stipulated level. Conversely, the agreements require Alcoa and Portland Smelter Services Pty Ltd to pay certain amounts to FTMUT when prices rise above that level.

5.19 In the previous year, FTMUT made payments to the SECV totalling $50 million which were financed from a $20 million loan facility provided to the State Trust Corporation by the Victorian Development Fund (VDF), and a $30 million purchase of units in FTMUT by the State-owned Portland Smelter Unit Trust. These units were immediately transferred to the Treasurer as part of the dividend due to the Government from the Trust.

5.20 Because of continuing depressed aluminium prices, FTMUT in 1990-91 made further payments to the SECV totalling $113.5 million. These payments together with financing and other costs of $9.4 million were financed as follows:

- a further drawdown of $115 million from the VDF's loan facility, bringing the total amount outstanding (and subject to a government guarantee) at 30 June 1991 to $135 million; and
- a direct government contribution of the balance of $7.9 million.

5.21 The $135 million loan facility held by the State Trust Corporation is reported in the 1990-91 Finance Statement under budget sector borrowings.

5.22 The Government's *1991-92 Budget Papers* indicate that, based on the current level of aluminium prices, further flexible tariff payments will be required to be made by FTMUT during that year.

5.23 In addition to the need for special payments to the SECV under the flexible tariff structure, the depressed aluminium prices have led to a substantial reduction in the level of the Government's dividend from the Portland Aluminium Unit Trust. In this regard, the 1990-91 dividend was only $3.7 million compared with the 1989-90 equivalent of $60.4 million (which comprised cash of $30.4 million and units in FTMUT of $30 million). **The aggregate dividends received by the Government to 30 June 1991 from the Portland Smelter Unit Trust totalled $81.3 million.**

Funding by Housing and Construction Victoria of new rental stocks

5.24 To assist in the funding of new rental stock, Housing and Construction Victoria (HCV), during 1990-91, sold approximately 1 500 mortgages to a company known as Home Opportunity Loans Limited (HOL Ltd) for a consideration of **$69.3 million**. HOL Ltd administers the Home Opportunity Loan Scheme which was developed in 1988 to provide housing finance to low income earners who normally would not have access to traditional sources of housing finance.

5.25 Funds advanced by HOL Ltd for housing finance, which are supported by residential mortgages, are obtained from the Victorian Housing Bonds Limited (VHB Ltd), a company which raises funds from the issue of Victorian housing bonds. All funds raised by VHB Ltd are subject to a government indemnity under the *Housing Act* 1983. **At 30 June 1991, an amount of $778.7 million was subject to this indemnity.**

5.26 All policy decisions by HOL Ltd require government approval which means that the company is effectively controlled by the State.

5.27 Over the years, funds raised by HOL Ltd have not been regarded as part of Loan Council borrowings as all loan recipients have been private home purchasers. This was confirmed by the Federal Treasurer in 1989. However, during 1990-91, funds raised by HOL Ltd totalling $69.3 million, **were applied towards the purchase of HCV mortgages and ultimately used by the Government to finance the purchase or construction of rental stock.** This arrangement therefore constituted a significant change from the application of funds raised by HOL Ltd in previous years.

5.28 Audit therefore considers there is a need to seek clarification as to whether the raising of finance by HOL Ltd for the acquisition of HCV mortgages should fall within Loan Council borrowing requirements.

Management response

The Federal Treasurer has acknowledged in writing that the operation of these housing schemes is outside Loan Council Borrowing arrangements.

Borrowings from sale and lease-back transactions

5.29 As indicated in my October 1990 Report, the Public Transport Corporation, during 1989-90, entered into 4 sale and lease-back arrangements relating to rolling stock assets which included 50 suburban trains, 58 locomotives, 50 articulated light rail vehicles and 60 buses. The assets were sold for $448 million and leased back by the purchaser to the Corporation for terms ranging from 4 to 7 years, with renewable options. The bulk of the total sale proceeds, $347 million, were received and paid into the Consolidated Fund in 1989-90, with the **balance of $101 million received early in 1990-91.**

5.30 After receiving external accounting advice, the Department of the Treasury categorised the leases as operating leases. Accordingly, the transactions were not included in the *1989-90 Treasurer's Statement*, or this year's *Finance Statement* as budget sector borrowings or new borrowings, for Loan Council purposes.

5.31 The audit opinion previously conveyed to the Parliament was that these lease arrangements, in substance, have not substantially transferred the risks and benefits incidental to ownership of the assets to an external party but have committed the State to future financial obligations. **Having regard to the economic substance of the transactions, the leases were considered to be simply another form of borrowing and therefore should have been taken into account for Loan Council purposes and reported as borrowings in the Finance Statement.**

5.32 Due to the complexity of recent financing arrangements involving the leasing of major public sector assets, the Treasurer and myself, in March 1991, made a joint submission to the Australian Accounting Research Foundation recommending that a review of the current accounting standard on leases be undertaken, with a view to clarifying the basis for classification of leases between operating and finance.

Borrowings by the Victorian Development Fund on behalf of the Consolidated Fund

5.33 The Victorian Development Fund (VDF), which comprises the Cash Management Account and the State Development Account and forms part of the Trust Fund within the Public Account, was established in 1982 **to provide efficient management of Victorian public sector liquid cash resources**. In 1989 the VDF's powers were extended to enable, inter alia, the issue of Treasury Bills on acceptance of deposits from public sector authorities and approved institutions. Funds received can be lent to the Consolidated Fund or invested in any manner approved by the Governor-in-Council.

5.34 During 1990-91 the Consolidated Fund borrowed $2.2 billion from the Cash Management Account of the VDF to partly overcome its cash shortfalls. The outstanding borrowings during the course of 1990-91 averaged $371 million compared with $202 million in 1989-90. At 30 June 1991 the Consolidated Fund had outstanding borrowings with the Cash Management Account of $541 million (including $367 million carried forward from 1989-90). **Interest paid by the Consolidated Fund on these borrowings during 1990-91 amounted to $53 million ($38 million, 1989-90).**

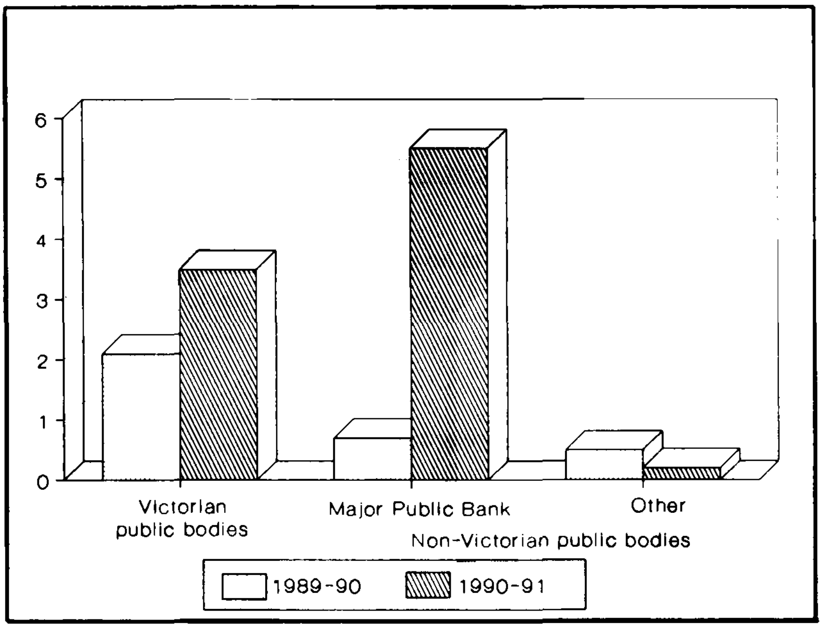
5.35 In the June 1991 *Economic Statement*, the Government announced its intention to combine the operations of the VDF with those of the Victorian Public Authorities Finance Agency (VicFin) into one organisation to be called the Victorian Borrowing Authority. The Government's *1991-92 Budget Papers* indicate that this process is to take place during the current financial year. Given the serious nature of the matters relating to the operations of the VDF raised in my October 1990 *Report on the Treasurer's Statement, 1989-90* (which are outlined in Part 12 of this Report), **I welcome this important government initiative.**

Acceptance of deposits from non-Victorian public bodies

5.36 In my October 1990 Report, I expressed some doubt as to whether the ongoing VDF practice of accepting deposits from non-Victorian public bodies was in accordance with its legislative powers and I urged clarification of the matter.

5.37 While no action was taken to clarify this matter during 1990-91, the volume of VDF transactions involving non-Victorian public bodies increased substantially during the year. Chart 5E illustrates the growth in such transactions during the year.

CHART 5E
VDF DEALINGS WITH VICTORIAN AND NON-VICTORIAN PUBLIC BODIES
($billion)



5.38 As illustrated, Treasury Bills purchased by non-Victorian bodies in 1990-91 amounted to $5.6 billion, an increase of over 350 per cent on the previous year. Given the uncertainty as to the VDF's power to accept deposits from non-Victorian bodies it is hoped that the legislation creating the Victorian Borrowing Authority will clarify this matter.

Victorian Investment Corporation Limited

5.39 In my *Reports on the Treasurer's Statement* for 1988-89 and 1989-90, comment was made on the sale of the Government's equity in the Victorian Investment Corporation Limited (VIC), which cost the State $25.5 million, to a subsidiary of the State Bank of Victoria for a nominal amount of $10. At the date of sale, assets and liabilities held by VIC were both valued at $14 million.

5.40 Prior to the sale, the State purchased VIC's investment shareholdings and certain other assets valued at $51.7 million. As consideration for these assets, the State assumed $51.7 million of VIC's liabilities together with its contingent liabilities which at that time were estimated at $2.5 million.

5.41 **During 1990-91 the Government re-assessed the value of shareholdings acquired by it prior to the sale of VIC, resulting in a write-down in the value of such shareholdings by $22.2 million.** Part of this write-down related to the complete write-off of $11.5 million in shares held in Ramax Ltd, a company which went into liquidation in July 1991. However, the Government estimates that recoveries of $753 000 will be received from liquidator's distributions together with other royalty receipts over a number of years.

5.42 Table 5F indicates the cost to the Consolidated Fund at June 1991 arising from the State's involvement with VIC.

TABLE 5F. ACCUMULATED FINANCIAL IMPACT OF VICTORIA INVESTMENT CORPORATION ON THE CONSOLIDATED FUND
($million)

Item		*Amount*
1988-89 -		
Liabilities assumed	51.7	
Equity transferred at no value	25.5	77.2
Less - Assets assumed*(a)*		(51.7)
		25.5
1989-90 -		
Interest expense	8.3	
Payments made under indemnities	1.2	
Revenue earned	(0.4)	9.1
1990-91 -		
Interest expense	15.0	
Payments made under indemnities	1.9	
Write-down of assets (equity holdings) previously assumed	22.2	39.1
Total cost to Consolidated Fund at 30 June 1991		**73.7**

(a) Based on valuation when transferred in 1988-89.

Impact of collapse of Victorian Economic Development Corporation

5.43 In my October 1990 *Report on the Treasurer's Statement, 1989-90*, I updated the financial impact of the collapse of the Victorian Economic Development Corporation (VEDC) on the Consolidated Fund. Audit estimated that costs of around $86 million had been incurred by the Consolidated Fund up to 30 June 1990 on account of the VEDC's collapse.

5.44 During 1990-91, the additional cost to the Consolidated Fund for interest incurred or income forgone in respect of debt previously assumed, forgiven and converted to equity was estimated by audit to be $8 million, **bringing the total cost to the Consolidated Fund at 30 June 1991 to $94 million.**

5.45 It was also previously reported that, in November 1989, the then Treasurer directed the Rural Finance Corporation of Victoria to acquire certain assets and discharge the liabilities of the VEDC. The position at 30 June 1991 of VEDC loans considered doubtful at the date of transfer, is disclosed in Table 5G.

TABLE 5G. VEDC DOUBTFUL DEBTS
($million)

Item		*Amount*
Doubtful debts at date of transfer		111.7
Add - Adjustments to doubtful debts		
1988-89	18.3	
1989-90	(3.0)	
1990-91	(3.8)	11.5
Less - Recovery of amounts previously written-off		(3.1)
		120.1
Less debts written-off by RFC		62.2
Total doubtful debts at 30 June 1991		57.9

FINANCE CHARGES

5.46 Finance charges represent the direct impact of borrowings on Consolidated Fund operations.

5.47 The *Finance Statement* discloses that finance charges paid in 1990-91 amounted to $1.5 billion (1989-90, $1.4 billion).

5.48 As highlighted in my October 1990 Report, the *Finance Statement* is prepared on a cash basis of accounting and, therefore, the finance charges included in that *Statement* do not reflect interest incurred but not paid in the period. **Interest incurred in 1990-91 (calculated on an accrual basis) was $1.8 billion.** The difference of $303 million between interest paid, as disclosed in the *Finance Statement*, and interest incurred can be explained as follows:

- **the deferral of interest payments to VicFin by up to one month ($96 million);**
- **the Government's policy in 1990-91 and prior years of acquiring debt instruments which enable the structuring of its debt portfolio in a manner which defers the impact of interest payments to future periods ($200 million); and**
- **the increase in the period, 30 June 1990 to 30 June 1991, in interest accrued and not paid ($7 million).**

5.49 Details of interest paid and interest incurred in the period and accrued at year-end are given in Table 5H.

TABLE 5H. INTEREST CHARGES ON PUBLIC ACCOUNT BORROWINGS
(Excludes statutory authority interest payments)
($million)

Item	*Interest incurred but not paid at 1 July 1990*	+	*1990-91 Interest incurred*	-	*1990-91 Interest paid(a)*	=	*Interest incurred but not paid at 30 June 1991*
Charges on borrowings obtained from -							
Commonwealth	161		489		512		138
Capital Works Authority	503		1 021		869		655
Victorian Development Fund -							
Cash Management Account	6		50		53		3
State Development Account*(b)*	41		109		98		52
VicFin	-		97		97		-
Other *(c)*	-		80		60		20
Total interest charges	711		1 846		*(d)*1 689		868
Less portion relating to capital growth of debt	153						172
Accrued interest at 30 June	558						696

(a) The State also made contributions to:
- State Bank Victoria relating to finance costs for initial payout of Farrow Group depositors ($36.8 million); and
- South Eastern Medical Centre ($21.6 million).

(b) Payments on account of State borrowings do not include internal transactions relating to amounts charged to departmental programs in respect of advances under the State Development Program.

(c) Comprises Computer Lease Facility, FTMUT and 1989-90 and 1990-91 drawdowns under transport leases.

(d) Includes $1 543 million interest payments disclosed in the *Finance Statement*, and $146 million of interest payments that were netted-off against the proceeds received from borrowings.

Management response

Full details of budget sector accrued interest have been disclosed both in the 1991-92 Budget Paper No. 2 Table 5.10 and in the Supplementary Information presented in the Finance Statement.

Cost of short-term financing

5.50 As mentioned in my October 1990 Report, the Government has traditionally managed temporary cash shortfalls in the Consolidated Fund through the use of short-term financing. Such shortfalls arise because patterns of revenue collections do not generally coincide with those of payments. The Report drew attention to the increased use and associated cost of short-term financing in recent years.

5.51 In 1990-91, interest on borrowings to cover temporary cash shortfalls cost the Consolidated Fund $150 million, more than double that of the previous year. Consistent with the practice followed in previous years, such financing has been obtained via the Victorian Development Fund (VDF) and the Victorian Public Authorities Finance Agency (VicFin).

5.52 Table 5I highlights the escalating cost to the Consolidated Fund of short-term borrowings over recent years.

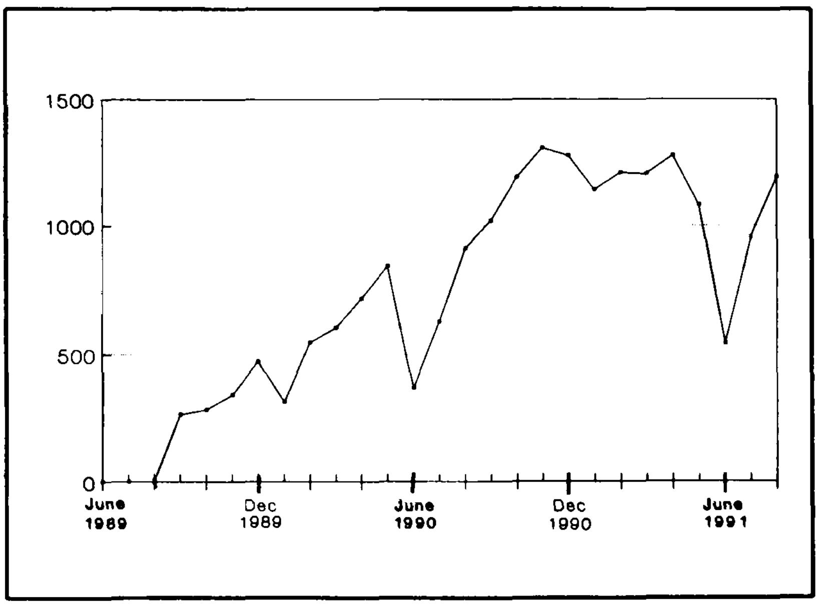
TABLE 5I. COST OF SHORT-TERM BORROWINGS
($million)

Year	*Amount*
1985-86	1
1986-87	14
1987-88	7
1988-89	6
1989-90	*(a)*70
1990-91	***(a)*150**

(a) Includes management fee paid to VDF of $3 million in 1990-91 (1989-90, $2.5 million).

5.53 An audit analysis of the utilisation of short-term borrowing over the past 2 years revealed that **the average level of such financing increased from $430 million in 1989-90 to $1.1 billion in 1990-91**. Chart 5J shows the movements in the level of short-term borrowings by the Consolidated Fund over this period.

CHART 5J. MOVEMENTS IN LEVEL OF SHORT TERM BORROWINGS, 1989-90 AND 1990-91
($million)



5.54 The chart highlights the sharp reduction in the level of short-term borrowings which occurs at the end of each financial year due to the requirement under the Public Account Act that all such borrowings, other than from the VDF, be repaid by 30 June.

5.55 **Given the escalating and virtually continuous use of this form of financing by the Consolidated Fund, one could argue that the borrowings are now more in the nature of a permanent financing facility.**

5.56 **Also, from a debt management perspective, if the average level of borrowings of $1.1 billion in 1990-91 had been raised as long-term financing, costs to the State would have been reduced by around $10.3 million.**

5.57 The Department of the Treasury is of the view that there would be an additional cost of $23.6 million if it had utilised long-term borrowings, due to the fall in interest rates during the year. However, this calculation is not supported by audit as it does not represent the cost differential of borrowing $1.1 billion during 1990-91 on a long-term rather than a short-term basis.

Management response

Short-term financing is arranged pursuant to section 21(2) of the Public Account Act which requires repayment with interest during the financial year in which the temporary advance was obtained. To resort to long-term borrowing as suggested by the Auditor-General would be in breach of the legislation.

If however the Government had the power to undertake long-term borrowings to cover Consolidated Fund shortfalls, and the $1.1 billion had been borrowed long-term in 1990-91, the additional cost on the average borrowings in the 1991-92 financial year would have been approximately $23.65 million consequent on the fall of interests rates during the year. This additional cost would continue for the term of the borrowing.

Impact of servicing the State's Public Account borrowings

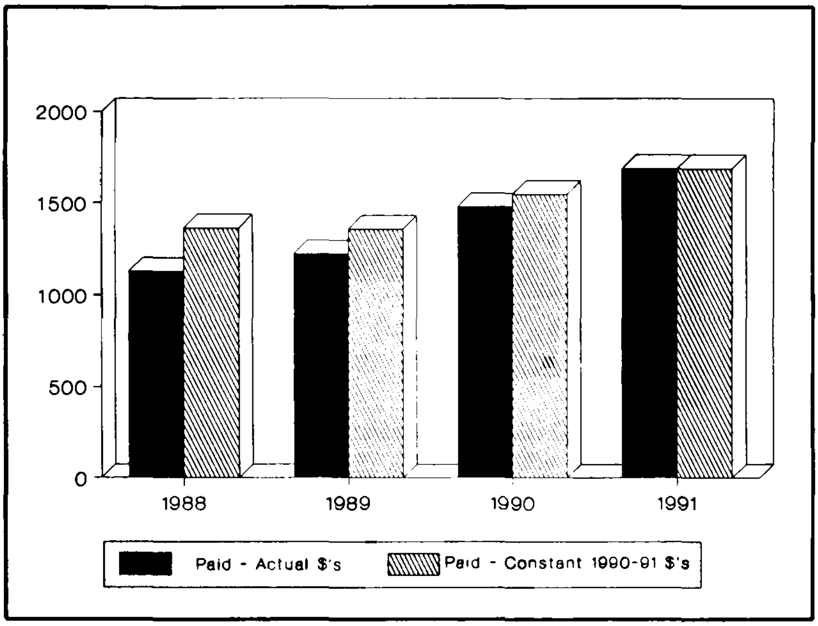
5.58 An audit analysis of Public Account borrowings showed that finance charges have continued to absorb an increasing proportion of the State's revenue base.

5.59 Finance charges paid from the Public Account over the period 1987-88 to 1990-91 **have increased from $1.1 billion in 1987-88 to $1.7 billion in 1990-91,** a 50 per cent increase in actual terms, or a 23.8 per cent increase in constant 1990-91 prices.

5.60 **In 1990-91, 19.4 per cent (1989-90, 17 per cent) of Consolidated Fund revenue available for general application was used to meet finance charges, compared with 15.2 per cent in 1987-88.** Over the same period, **the annual cost to the community to service Public Account borrowings increased from approximately $265 per capita in 1987-88 to around $381 per capita in 1990-91 ($330 per capita in 1989-90).**

5.61 Chart 5K identifies the costs paid by the State in servicing its borrowings for the years 1987-88 to 1990-91.

CHART 5K. FINANCE PAYMENTS TO SERVICE PUBLIC ACCOUNT BORROWINGS*(a)*
($million)



(a) It was not possible to include in the chart finance charges incurred, as this information is not available for the period covered by the chart.

5.62 In its June 1991 *Economic Statement*, the Government announced a 3 year financial plan which would focus on reduction of debt levels and associated finance costs. As part of the plan, the Government established a target for the reduction of interest payments to less than 15.5 per cent of the State's recurrent revenue by 1993-94.

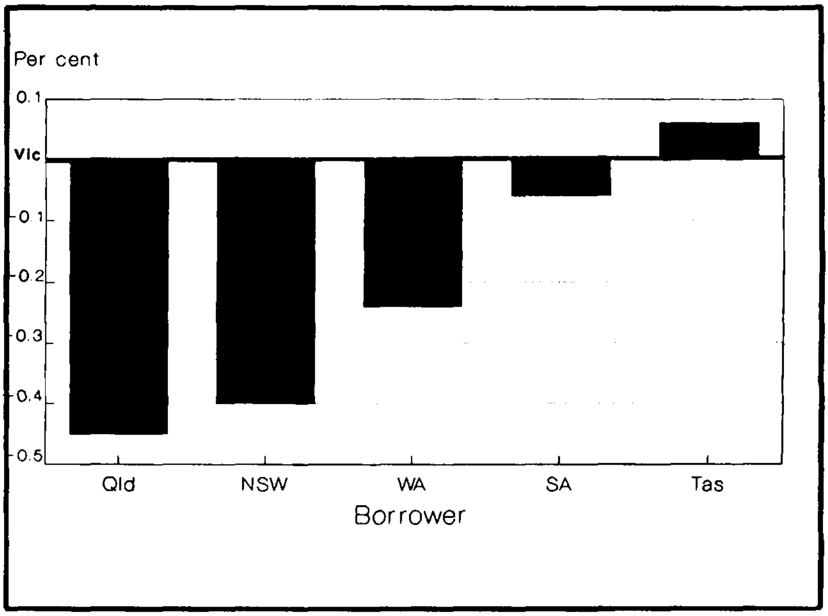
Victoria's cost of borrowing compared with other States

5.63 Borrowing costs vary between States according to the market's perception of the financial standing of each State. The key factors which influence the market perception of individual States include:

- condition of the economy;
- tradeability of debt portfolio;
- size and time profile of debt;
- economic strategies in place; and
- credit rating.

5.64 At 30 June 1991, interest payable by Victoria on new borrowings was the highest of all States, apart from Tasmania. Chart 5L illustrates this position.

CHART 5L. INTEREST RATE DIFFERENTIAL BETWEEN VICTORIA AND OTHER STATES, AT 30 JUNE 1991 *(a)*



(a) Interest differentials based on debt with a 5 year maturity.

Source: Potter Warburg fixed interest daily statistics.

5.65 **A specific factor contributing to the additional financing costs payable by Victoria compared with other States was its lower credit rating.** In June 1990, an international credit rating agency downgraded the State's *Australian dollar denominated debt* from a rating of AAA to a rating of AA1. The rationale for this downgrading was that the agency considered the State had relatively high levels of public sector debt and debt charges as a percentage of revenue and a slightly diminished capacity to address its economic and financial problems.

5.66 In May 1991 the State's credit rating was further reduced from AA1 to AA2 by the same international credit rating agency principally due to the Agency's assessment of the rapid deterioration of the State's finances with a resultant increase in Victoria's debt burden, and poor performances of State-owned enterprises.

5.67 **Audit has estimated that the additional interest costs incurred by the Consolidated Fund as a direct result of the credit downgradings in 1990-91 were approximately $1.8 million and will be in the order of $3.3 million for 1991-92.**

Management response

Government borrowing authorities raise new borrowings across a range of maturities. The borrowing margin between the authorities varies according to the term to maturity. Consequently, the Department of the Treasury believes that it is inappropriate to compare the cost of borrowing on the basis of the cost of a particular term to maturity because the authority can choose between maturities depending on their relevant cost.

Financial market data obtained by the Department of the Treasury from the Bloomburg Financial Market Information System for 30 June 1990-91 indicates that VicFin's cost of funds across all maturities was on average below that of the South Australian Financing Authority. Consequently, the cost of Victorian new borrowings was lower than both South Australia and Tasmania as at 30 June 1991.

Cost implications of delay in retirement of borrowings

5.68 As an integral part of the Government's debt management strategy, the Victorian Debt Retirement Authority was established in December 1990, with the primary purpose of reducing the level of Victorian budget sector debt.

5.69 At 30 June 1991, the Authority held $227 million, representing the balance of the proceeds received from the sale of the State Bank of Victoria in December 1990, which had not been applied towards the reduction of debt.

5.70 While the Government, in its *1991-92 Budget Papers*, has identified that the funds held by the Authority will be utilised in 1991-92 for debt reduction purposes, audit calculated that **use of these funds during 1990-91 to retire part of the State's more expensive debt would have generated a net saving to the State of around $3.8 million.**

Management response

The Victorian Debt Retirement Authority decided not to complete its planned reverse bond tender in 1990-91 because its advisers indicated that accounting, operational and legal requirements were not fully in place to give effect to that tender in 1990-91.

Use of capital funding to meet interest charges

5.71 Previous Auditor-General's Reports to the Parliament have highlighted that the Government's practice of borrowing or selling assets to meet recurrent charges such as interest on borrowings was not consistent with principles of sound financial management. Audit has contended that proceeds from borrowings or asset sales should only be used to finance items which create long-term economic and social benefits to the State, such as assets and infrastructure.

5.72 An audit analysis of funding sources used to meet interest payments disclosed that in 1990-91 approximately $215 million ($197 million, 1989-90) of interest charges were funded from borrowings, sale of assets and works grants.

Management response

There is no established principle or practice on borrowing or selling assets to meet recurrent charges.

Government asset management policy is that tangible assets which have reached the end of their economic life or which are no longer needed or which no longer produce a satisfactory economic and social return should be disposed of, with the proceeds being paid into the Consolidated Fund in the case of agencies whose funds are managed within the Public Account. Along with all other Consolidated Fund revenue the proceeds are made available, by way of appropriation, to meet the full range of Government spending requirements.

In some instances, the allocation of funds to particular capital projects has been made conditional on the planned realisation of proceeds from non-business asset sales. In framing its overall allocation for capital purposes, the Government also takes into account the aggregate funds likely to be available from non-business asset disposals.

OTHER FINANCIAL COMMITMENTS OF THE STATE

5.73 In addition to the budget sector obligations previously commented upon in this Report, the State has entered into a number of arrangements involving significant financial commitments which will impact on its future financial operations.

Victorian Government Accelerated Infrastructure Program

5.74 During 1990-91 the Government announced its Accelerated Infrastructure Program which allows for private equity in the provision of public facilities. Under this Program a special purpose public company was established by a subsidiary of a major bank to finance and commission the construction of police stations, court buildings or other buildings for government use. The amount required for the Program will be at least $200 million and will be financed through the issue of CPI capital indexed bonds over a 3 to 5 year period. The bonds are to be indemnified by the Treasurer of Victoria which will negate any exposure that the company may have in meeting any shortfall on redemption of the bonds (at 30 June 1991 no borrowings had taken place under this Program although a Contract of Indemnity had been signed between the company and the Treasurer). According to the Government, buildings are to be made available to the relevant government entities through long-term property leases for approximately 20 years. Lease rentals payable by the Government from the public account are to be set at a level that will cover interest payments undertaken by the company.

5.75 In February 1991 just over $1 million was paid out of the Consolidated Fund to cover development costs relating to the Program. This payment predominantly covered costs of the development manager, legal costs and expenses associated with the financier, financial manager and the trustee. No construction of public infrastructure or lease arrangements occurred under this Program during 1990-91. As a consequence, there has been no impact on the liabilities of the budget sector at 30 June 1991. However, in relation to the proposals for redevelopment works to commence under this Program in 1991-92, audit understands that the Department of the Treasury, after taking into account external accounting advice, intends to classify the associated leases as *operating leases* and therefore these obligations will not be included in budget sector borrowings or included as new borrowings for Loan Council purposes.

5.76 In audit opinion **the lease arrangements, in substance, will not substantially transfer the risks and benefits incidental to ownership of the assets to an external party, but will commit the State to future financial obligations. In addition, the indemnities to be issued by the Treasurer and the lengthy expected periods of occupancy confirm my opinion that the leases, in substance, will amount to further government borrowings in 1991-92.**

5.77 As stated in paragraph 5.32 of this Report, the Treasurer and myself have made a joint submission to the Australian Accounting Research Foundation recommending that a review of the current accounting standard on leases be undertaken.

Urban Infrastructure Program

5.78 The Government announced, as part of the 1990-91 State Budget, that the provision of adequate urban infrastructure was a major concern and consideration would need to be given for private sector participation in the provision of public infrastructure. In order to address this concern, the Government established an Urban Infrastructure Fund to enable the development of infrastructure works and community services in metropolitan areas. The Government's aim was to fund projects that improve urban living by addressing infrastructure deficiencies and encourage projects which would otherwise face a funding shortfall.

5.79 The Fund was to be administered through the Urban Land Authority which was to provide the Government's 1990-91 commitment of $12 million together with an ongoing contribution in the form of a Public Authority Dividend of 5 per cent of the Authority's total equity. In addition, a task force with private sector representation was established to enhance private sector involvement in the development of infrastructure assets.

5.80 An examination of the processes involved in administering this government initiative revealed that in April 1991 ministerial approval was given for the Urban Land Authority to contribute $8.2 million towards 37 infrastructure projects. The balance of the commitment, $3.8 million, is anticipated to be allocated in 1991-92.

5.81 In broad terms, the 1990-91 funding comprised $2.5 million for projects to be undertaken by community groups, $1.9 million for government department projects and $3.8 million in respect of projects for local government councils. Actual expenditure for the year on infrastructure projects amounted to $390 000.

5.82 **The establishment of the Urban Infrastructure Fund and the mechanism for its funding from Urban Land Authority reserves, provides an avenue for the Government to meet its commitment to urban infrastructure and social justice principles without imposing a funding burden on the Public Account.**

5.83 The Urban Land Authority was established under the *Urban Land Authority Act* 1979. Its objectives are to provide developed land allotments, dispose of surplus lands and assist in the implementation of State urban planning policies and major State projects at the direction of the Minister through the acquisition, development and sale of land.

5.84 Given this charter, the Authority sought legal opinion as to whether it was empowered under its enabling legislation to expend Authority funds on urban infrastructure works and facilities not directly related to Authority estates. Advice subsequently received, which conflicted with legal opinion obtained by the Government, indicated that the Authority could only fund infrastructure works and facilities which were directly related to land it had or was developing.

5.85 In view of the conflicting legal opinions, concerns are raised as to the legality of the mechanism chosen by the Government to fund the provision of urban infrastructure if future infrastructure projects are undertaken outside of the Authority estates.

National Tennis Centre

5.86 Previous Reports of the Auditor-General to the Parliament have commented on the high level of borrowing by the National Tennis Centre Trust and the substantial impact of finance charges on the financial viability of the National Tennis Centre.

5.87 During 1990-91, the Trust entered into further funding arrangements with the Victorian Development Fund to overcome cash liquidity problems. The facility, currently standing at $8 million, has been guaranteed by the Treasurer.

5.88 To assist the Centre in meeting its financial commitments, **the Treasurer has agreed to allocate to the National Tennis Centre Trust an annual grant of up to $12 million for a period of 12 years.** As indicated in the *1991-92 Budget Papers*, the first payment of $12 million is to be made in 1991-92.

Operating lease commitments

5.89 The budget sector's financial commitments include future obligations under operating lease arrangements. **Audit examination revealed budget sector operating lease commitments at 30 June 1991 amounting to $703 million (1989-90, $636 million).** Table 5M provides details of the timing of these commitments.

TABLE 5M. OPERATING LEASE COMMITMENTS
($million)

Year	*Amount*
1991-92	105
1992-93	94
1993-94	89
1994 onwards	415
Total commitments *(a)*	***703***

(a) The *Finance Statement* discloses total commitments of $505 million. The $198 million difference between this figure and commitments as disclosed by audit arises mainly due to the *Finance Statement* only including administrative unit commitments and not those relating to budget sector public bodies.

5.90 The major portion of the increase of $67 million in operating lease commitments in 1990-91 related to the provision of office accommodation.

Capital commitments

5.91 In addition to the budget sector's operating lease commitments, contractual arrangements have been entered into at 30 June 1991 for the acquisition or construction of assets over future years. **An audit review showed that commitments at 30 June 1991 in respect of works not yet carried out under existing contracts were valued at $853 million.** Table 5N provides details of the likely timing of these commitments.

TABLE 5N. CAPITAL COMMITMENTS
($million)

Year	*Amount*
1991-92	655
1992-93	121
1993-94	53
1994 onwards	24
Total commitments	**853**

5.92 The above commitments do not include capital works projects approved at 30 June 1991 for which contracts had not been let at that time.

CONTINGENT LIABILITIES

5.93 Contingent liabilities can be described as potential commitments, the occurrence of which is dependent upon future events or outcomes. These obligations consist of government guarantees, indemnities and other types of support arrangements.

5.94 In attempting to determine and comment on the magnitude of the financial obligations of the State, I requested the Department of the Treasury to provide a complete listing of all financial arrangements current at 30 June 1991 which involve the provision by government to external parties of covenants, indemnities or similarly titled instruments. **This information could not be supplied as sufficient records were apparently not maintained by the Department. Due to the absence of such records I cannot give an assurance as to the full extent of all financial obligations of the State.**

Government guarantees and indemnities

5.95 The State has provided guarantees on the borrowings of various private and public sector organisations and financial institutions. In the event that the various organisations cannot meet their commitments, the State will be required to assume any liability which arises under these guarantees. Indemnities provided by the Treasurer generally impose a primary liability on the Government to protect the indemnified party against loss.

5.96 The *1990-91 Finance Statement* discloses that the estimated contingent liability for government guarantees and indemnities at 30 June 1991 was $21.8 billion.

5.97 Comment on a number of obligations which are also outlined in the *1990-91 Finance Statement,* are detailed in paragraphs 5.98 to 5.120 Obligations identified by audit but not included in the *Finance Statement* are commented on in paragraphs 5.121 to 5.138.

Victorian Equity Trust

5.98 The Victorian Equity Trust (VET) is a publicly listed trust established by the State in 1988 to raise $500 million in equity funding for the Portland Smelter Unit Trust and the State's 3 major statutory authorities, the State Electricity Commission of Victoria, the Gas and Fuel Corporation of Victoria, and the Melbourne and Metropolitan Board of Works. At 30 June 1991, approximately 18 per cent of issued VET units were held by Victorian public sector superannuation funds.

5.99 VET unitholders have the option of selling their units to the now idle Victorian Economic Development Corporation (VEDC) on 1 June 1992 at a set price based on the Australian Stock Exchange All Ordinaries Index at the time, after deducting the value of distributions made up to that date (at 1992 prices). **Under a covenant the Treasurer has undertaken to finance the acquisition of the units.**

5.100 To limit the contingent exposure in the event that the unit holders exercise their option, a hedge arrangement was entered into by the Government with a financial institution in July 1991 which limits the State's exposure to between **$700 - $710 million**, compared with an exposure of approximately $755 million before the hedge.

5.101 As indicated in its *1991-92 Budget Papers* the Government is currently examining a range of strategies concerning its VET exposure, with a preference towards achieving continuation of the VET vehicle.

Melbourne Cricket Club - Southern Stand redevelopment

5.102 The financing arrangement entered into by the Melbourne Cricket Club for the construction of the Southern Stand redevelopment consists of:

- borrowings to a maximum of $160 million from a major private bank; and
- $50 million expected to be raised in late-1992 by the issue of inflation indexed bonds by the Club.

5.103 In both cases interest is to be capitalised in the initial years of the borrowings as cashflow is not expected to meet the commitments.

5.104 Under the financing arrangement it is expected that the issue of the bonds will reduce the facility provided by the bank to approximately $110 million (the bank's long-term advance will only be known once the construction of the Stand has been completed, scheduled for early 1992, and the bonds have been issued). As detailed in the Explanatory Statement to the *Finance Statement,* financial accommodation with a face value of $40.8 million had been drawn down by the Club at 30 June 1991. The Government anticipates the final cost of construction will be in the vicinity of $155 million.

5.105 Due to the Melbourne Cricket Ground being located on Crown land and the significance of the Southern Stand to the Victorian public, **the Government has guaranteed the repayment of the Melbourne Cricket Club's borrowings (including capitalised interest) for the construction of the Stand up to $160 million. In addition, the Treasurer has provided an indemnity to the Club to cover any loss incurred by the Club if the cost of the project (including capitalised interest) exceeds $160 million.**

Accruals indemnity

5.106 In order to offset substantial accounting losses to be incurred by the Melbourne Cricket Club in the early years of the financing arrangement, due to significant non-cash expenses in the form of accrued interest on loans and the amortisation of the Southern Stand having to be recognised for financial reporting purposes, the Treasurer has provided the Melbourne Cricket Club with accrual indemnities which will appear as receivables in the Club's ensuing profit and loss statements.

5.107 According to the indemnity deed the Treasurer will only have an obligation to make payments in respect of any unpaid borrowings, including capitalised interest, at the expiration of the ground lease period of 27 years. The deferred obligations under the accrual indemnity do not extend the Government's financial exposure beyond that provided for in the Guarantee.

Royal Children's Hospital guarantee

5.108 Borrowings of $7 million from the Victorian Development Fund, to assist the Royal Children's Hospital to complete works associated with a building project, were guaranteed by the Treasurer during 1990-91.

N.A. Noulikas Construction Pty Ltd

5.109 N.A. Noulikas Construction Pty Ltd, a major concrete structure contractor, encountered difficulties on private sector construction sites as well as the State Government Remand Centre during the 1985 de-registration of the Builders Labourers' Federation. Financial assistance provided by the Government to the company included a $3.6 million loan from the former Victorian Economic Development Corporation (VEDC) on the basis of third and fourth mortgages over various assets. The loan was secured by a Treasurer's guarantee as secondary security.

5.110 As a result of severe liquidity problems, a liquidator was appointed to all the companies in the Noulikas Group in August 1988. The mortgage security of the VEDC was not substantial and, as such, the only effective security was the Treasurer's Guarantee.

5.111 Non-payment of interest by the company of $1.8 million increased the debt to $5.4 million. This debt was extinguished during 1990-91 by a payment made from the Consolidated Fund.

Melbourne and Metropolitan Board of Works

5.112 Under the *Accident Compensation Act* 1985, the Melbourne and Metropolitan Board of Works, as a self-insurer, is required to have a bank guarantee in favour of the Accident Compensation Commission, guaranteeing payment of amounts not less than the assessed liability in respect of accidents or injuries to the Commission's employees, should the Board fail to meet such liabilities.

5.113 In February 1991, the Treasurer issued a guarantee for up to $10 million covering all amounts payable by the Board in connection with this arrangement.

Newsteel Pty Ltd - Loan underwritten by the Treasurer

5.114 Newsteel Pty Ltd, a steel manufacturer based in Queensland, encountered difficulties with the Builders Labourers' Federation while involved in the construction of the floodlighting towers for the Melbourne Cricket Ground.

5.117 Subsequently, the Corporation requested the Treasurer to meet the shortfall of $127 000 under the underwriting commitment. During 1990-91 this amount was met from the Consolidated Fund.

Sale of St Andrew's Hospital

5.118 In my *Report on the Treasurer's Statement, 1989-90,* comment was made on a government guarantee provided to St Andrew's Hospital in 1977 to cover a number of loans provided by financial institutions to the Hospital, the Hospital's ensuing default on loan repayments and the financial institutions' call on the government guarantee. The Government, having obtained a first mortgage over the Hospital site as security over the guarantee, elected to exercise its powers under the mortgage including the power of sale. Subsequently, in April 1990 the Hospital was sold on an instalment basis to the Peter McCallum Cancer Institute for $32 million.

5.119 During 1990-91 payments under the government guarantee amounting to $1.4 million were met from the Consolidated Fund.

5.120 Amounts outstanding concerning the sale include the repayment in 1993 of a $14 million loan from the State Superannuation Board which is government guaranteed, and in excess of $5 million in relation to wind down costs which are to be met from the Consolidated Fund. The latter amount has not been recognised as a contingent liability by the Government.

Bayside project

Clean-up costs

5.121 As reported in my *Report on Ministerial Portfolios, May 1990,* Sandridge City Development Company Pty Ltd was appointed as the preferred developer of the Port of Melbourne Bayside Development site. Its proposal was for a mixed-use development comprising residential, commercial and tourism-related activities and was projected to cost some $600 million over a period of 7 years. As part of the consolidation of the various land holdings within the site a contract was entered into in December 1986 with a major petroleum company for the purchase of a parcel of land that had been used for the storage and distribution of petroleum products. Under the contract the petroleum company was required to clean-up any residual hydrocarbons on or beneath the land following demolition of storage tanks etc.

5.122 Despite this contractual obligation no action was taken by the petroleum company to commence cleaning operations and it was not until January 1989 that the company agreed to contribute $4.5 million towards the cleaning-up of the site. At May 1990 industrial disputation concerning the cleaning-up operations had prevented the commencement of any cleaning-up works and the initial estimated clean-up cost of $6.7 million had escalated to a projected cost of $19 million which was to be largely borne by the State.

5.123 In order to formalise the obligations of the various parties involved in the project an agreement between the State, the Urban Land Authority and the developer was executed on 26 July 1990. Under the terms of the agreement, any of the parties may give notice of their intention to terminate if certain events were not achieved by the relevant date (originally 31 March 1991 and extended to 30 June 1991).

5.124 According to information supplied to audit, the Authority was unable to complete the clean-up of the contaminated land on the site by the relevant date and the developer served a notice of termination.

5.125 Under the terms of the agreement, once a notice is served both parties have a period of 90 days to reach agreement as to how the project might proceed. As such, **if the parties are unable to reach agreement by 31 October 1991** (extended from the original date of 26 September 1991 by the Minister for Major Projects) **as to the continuance of the project, the agreement provides for the Authority to pay moneys to the developer for the cost of works undertaken to date. Audit was advised that the potential liability regarding this matter is around $7.8 million.**

Contingent liability of the Treasurer in relation to outstanding expenditure

5.126 The Victorian Major Projects Unit (MPU), on behalf of the Urban Land Authority, has funded expenditure relating to the site by way of loans received from the Victorian Public Authorities Finance Agency (VicFin).

5.127 At 30 June 1991 the MPU had borrowed $30.4 million for the project from VicFin on the basis of various Treasurer's approvals and:

- an undertaking from the former Treasurer in June 1988 that at the completion of the project the MPU would be reimbursed from the Consolidated Fund in respect of any outstanding expenditure (shortfall between project income and expenditure for the project); and
- advice from the Treasurer in May 1991 that he had *"... authorised to guarantee the repayment of the approved borrowings and the payment of interest subject to approving the terms and conditions of the borrowing".*

5.128 The audit revealed that the MPU and VicFin accepted letters containing the above information as being in the nature of guarantees and as such constituting an appropriate security to facilitate the raising of funds for the project. However, the Treasurer was of the view that *"... the letters indicate support for the project and provide advice on the appropriate statutory power for the provision of guarantees. In order to obtain the benefit of a guarantee, I require advice that a guarantee is required as well as the terms and conditions for the borrowing. This request is necessary each time a borrowing occurs. On the last two occasions the MPU raised funds for the Project, $1.6 million on 15 July 1991 and $800 000 on 31 July 1991, and following a request, I executed guarantees in favour of VicFin in respect of those borrowings. With regard to the past borrowings for which a guarantee was not requested, I advise that I am not able to execute guarantees on a retrospective basis in favour of VicFin".*

5.129 As guarantees could not be executed on a retrospective basis in favour of VicFin, no security in the form of a government guarantee exists for the repayment of borrowings raised by the MPU of $30.4 million for the Bayside project.

5.130 Audit is of the view that despite the fact that the borrowings of the MPU to 30 June 1991 were not formally guaranteed by the Government, it could be argued that a contingent liability exists for the Government at 30 June 1991 in respect of any shortfall between project income, which will mainly be derived from the proposed sale of the site to the Developer (agreed sale price of $14.4 million), and the costs incurred by the MPU.

Royal Melbourne Institute of Technology

5.131 Citytech Pty Ltd was purchased (under its former title of Kestan Pty Ltd) by the Royal Melbourne Institute of Technology (RMIT) in 1987 as part of a major acquisition of land for a total purchase consideration of $15 million.

5.132 The purchase was funded through financing arrangements entered into between RMIT and the State Bank of Victoria which included RMIT granting the bank a fixed and floating charge over RMIT's assets and undertakings.

5.133 **In addition, the Government, in 1987, confirmed with the bank the intention to support RMIT with respect to these obligations. At 30 June 1991 borrowings for this facility amounted to $12.5 million.**

Directors of National Safety Council of Australia (Victoria) (In Liquidation) - Legal costs indemnities

5.134 The State Bank of Victoria, as a creditor of the National Safety Council of Australia (NSCA), has taken legal action against 11 directors of the Council for recovery of $96.7 million of unpaid debts. It is alleged that the directors were in breach of the Companies Code during the months immediately prior to the collapse of the NSCA by incurring debts which they should have known could not be repaid.

5.135 At the time of its collapse, the NSCA had 3 directors who were employed in the Victorian public sector. Cabinet approved indemnities for the legal costs of these 3 directors.

5.136 The Attorney-General advised the Treasurer that expenditure covered by these indemnities would most likely be between $550 000 and $600 000. The audit disclosed that an amount of $655 000 has been claimed against these indemnities.

Legal indemnity to a government Minister

5.137 Following comments made by a government Minister concerning allegations about a particular individual and that individual's activities with Soccer Pools Australia Pty Ltd, legal action was taken against the Minister.

5.138 **In October 1990, Cabinet agreed to provide a legal indemnity to the Minister in respect of the writ.**

Management response

Paragraphs 5.74 to 5.77

Independent expert advice from three sources including two leading accounting firms has confirmed that the leases will be correctly treated as operating leases and accordingly are not borrowings, in either substance or form. As operating leases they are appropriately reported as commitments in the Finance Statement. Nevertheless, as reported in paragraph 5.32, the Treasurer and the Auditor-General in March 1991 made a joint submission to the Australian Accounting Research Foundation recommending a review of the current Accounting Standard on leases be undertaken with a view to clarifying the basis for classification of leases between operating and finance.

Paragraphs 5.78 to 5.85

Guidelines for ULA projects were revised to reflect the ULA's legal advice and all projects are required to be either on or related to a ULA development or estate. All funded projects are assessed by the ULA's legal advisers to ensure they are consistent with the objects of the ULA Act.

Paragraphs 5.93 to 5.97

Table B.5 of the Finance Statement contains a complete listing as known to the Department of the Treasury of guarantees and indemnities for which a reasonable estimate of the contingent liability can be provided. Difficulties in quantification were discussed in the Finance Statement.

Audit's comment that indemnities generally impose a primary liability on the Government to protect the indemnified party against loss is consistent with the description given in the Finance Statement (page 194). However, audit does not point out that under guarantees, the Treasurer generally assumes a secondary liability to a creditor for the default of the borrower who remains primarily liable to the creditor.

As noted in the Finance Statement, this requires the lenders to exercise all means available to exhaust their claims against the borrowers in respect of primary securities held before the Government guarantee can be invoked. This reduction in potential exposure needs to be taken into account in assessing the gross figures reported.

Not listed in Table B.5 because it is not practicable to quantify amounts were Letters of Comfort provided by RMIT and MPU. Nor can the legal indemnity to a Government Minister be quantified. In respect of the legal cost of indemnities to National Safety Council of Australia directors employed in the public sector, there were some outstanding claims as at 30 June 1991, but the addition to contingent liabilities could not be accurately quantified.

The Department of the Treasury will give consideration to reporting in narrative form other forms of Government support where quantification is difficult.

Paragraphs 5.118 to 5.120

The $14 million loan to be repaid in 1993 will be financed from the proceeds of the sale. The latest estimate of the Consolidated Fund contribution is $5.2 million.

PART 6

BUDGET SECTOR ASSETS

KEY FINDINGS

- Until comprehensive information on assets is available, Parliament will not be in a position to compare budget sector asset holdings with the sector's indebtedness.

  Paras 6.1 to 6.5

- More than 1 600 properties, approved for sale over the 5 years to June 1991 and with an estimated value of $372 million, were still awaiting sale.

  Paras 6.10 to 6.13

Need for comprehensive information on budget sector assets

6.1 Any assessment of the budget sector's financial position needs to take into account the nature and value of assets held at year-end.

6.2 My October 1990 Report outlined the status of the Government's asset recording and reporting program which had commenced in 1987. The Report identified that this program had extended over several years and emphasised the importance of the Department of the Treasury ensuring that the program was finalised in a timely manner.

6.3 The Government finally completed its accounting policy statement on this subject in August 1991. Under this policy statement, departments have until 30 June 1992 to finalise identification and valuation of all assets, other than heritage holdings and land and buildings. Valuation of heritage assets has been deferred pending the development of an appropriate valuation basis. In addition, complete information on budget sector land and buildings will not be available until 30 June 1996 as a 5 year program involving valuations by the Valuer-General has been put in place by the Government.

6.4 To facilitate a meaningful appraisal of the budget sector's financial position, ideally, the following specific information on assets should also be available:

- distinction between income producing and community assets; and
- particulars of assets surplus to requirements.

6.5 Until comprehensive information on assets is available, Parliament will not be in a position to compare budget sector asset holdings with the sector's indebtedness.

Distinction between income producing and community assets

6.6 For effective decision-making and analysis, it is necessary to distinguish between budget sector assets with an income producing capability and those community assets which do not have this capability. Assets which fall within the former category include public transport infrastructure and hospitals, while non-income producing assets of a community nature include the State's primary and secondary schools, parks and gardens and heritage collections.

6.7 The availability of this type of information, together with details of the level of budget sector borrowings, would facilitate periodic monitoring of the extent to which acquired assets will contribute towards financing debt repayments and the portion of such repayments to be met by general taxpayers.

6.8 The Government's accounting policy statement requires assets to be valued at their written-down current cost, using current market buying price, reproduction cost or replacement cost.

6.9 An important principle embodied in Australian Accounting Standards is a requirement that assets should be recorded at amounts which will be recovered through continued use and, where applicable, disposal. It is my view that this condition can only be satisfied through use of current market buying prices for assets subject to valuation. **Because of the subjective nature of both reproduction and replacement cost valuation bases, difficulty is likely to be experienced by users of financial statements in determining whether such values assigned to budget sector assets could be recovered.** These views have been communicated to the Department of the Treasury.

Assets surplus to requirements

6.10 Since 1986-87, the Government has operated an assets renewal program which has been aimed at identifying and selling surplus and under-utilised assets (other than business assets). While actual asset sales in the 5 years to June 1991 have realised over $840 million, **more than 1 600 properties approved for sale over the same period and with an estimated total value of $372 million, were still awaiting sale.**

6.11 Table 6A provides a summary of assets awaiting sale at 30 June 1991.

TABLE 6A
ASSETS AWAITING SALE, AT 30 JUNE 1991
($million)

Year approved for sale	*Estimated value*
1986-87	*(a)*55.3
1987-88	*(b)*44.3
1988-89	*(c)*58.0
1989-90	13.6
1990-91	201.0
Total	**372.2**

(a) 16 properties, including the Prince Henry's Hospital site ($30 million) and Cathedral Place site ($9.5 million);

(b) 65 properties, including two sites each with an estimated value of $7.5 million; and

(c) 72 properties, including the Queen Victoria Hospital site ($36 million).

6.12 The Ministry for Finance advised audit that the main reasons for the above delays in the sale of assets were:

- downturn in the property market;
- planning and zoning restrictions; and
- poor marketability of certain properties.

Queen Victoria Hospital site, awaiting sale since August 1988.

6.13 The fact that substantial delays in the disposal of surplus properties give rise to significant opportunity costs to the State, particularly in the case of idle or non-income producing properties, reinforces the need for such information to be periodically available for Parliamentary scrutiny.

Victoria's Public Balance Sheet

6.14 An important Government initiative occurred in June 1991 with the release of Victoria's Public Balance Sheet, which presents a provisional consolidated statement of assets and liabilities together with additional supplementary information as at **30 June 1990.**

6.15 Because of the absence of adequate asset records within departments, the preliminary values assigned to budget sector assets included in that document were derived from the application of an economic model.

6.16 At the time of the release of the document I commented as follows:

> *"As an initial move along the reporting spectrum and to enhance the financial information provided to users, the Victorian Government, in consultation with the accounting profession, has prepared a "whole of government" Statement of Assets and Liabilities. This development in the standard of disclosure traditionally provided by governments in the past is a commendable step and one which has my full support.*
>
> *"I recognise that there will be further developmental work required including substantial improvements in the standard of asset recording in the budget sector before the Statement of Assets and Liabilities is in an auditable state but the Statement is a further step in the continuing evolution of an improvement in financial reporting by the Victorian Government."*

Management response

Paragraphs 6.1 to 6.5

Substantial progress has been made in providing enhanced information on government asset holdings. The need for continuing development of this information is clearly recognised as outlined by the timetable detailed in para. 6.3 above.

Paragraphs 6.10 to 6.13

The sale of surplus assets to obtain the maximum return is a complex process. It involves the assessment of whether such land should be retained in public ownership and significant consultation with local government and the community, and other affected agencies. A consistent process while time consuming is considered essential.

Since 1986, the process had been continually reviewed. Further modifications were made in May 1991 to ensure that procedures are more flexible, public and timely. In addition, the sale of a number of development projects has been deferred because of adverse market conditions.

PART 7

ANALYSIS OF CONSOLIDATED FUND PAYMENTS

KEY FINDINGS

- Payments for the year, as determined by audit, were $44 million below budget.

  Paras 7.1 to 7.4

- Operating expenditure of $398 million (1989-90, $300 million) was classified as *"works and services"* expenditure and funded from capital receipts including borrowings.

  Paras 7.5 to 7.9

- A proper classification of budget sector expenditures into operating and capital items would improve the value of the *Finance Statement* as a source of information on the State's finances and facilitate enhanced economic decision-making.

  Paras 7.5 to 7.6

Summary of financial transactions

7.1 In the Government's *1990-91 Budget Papers*, it was estimated that the total payments of the Consolidated Fund (excluding transactions relating to the sale of business assets) would be $13.9 billion, comprising $11.8 billion for annual appropriations and $2.1 billion for special appropriations. **Actual payments for the year, as determined by audit, were in total $44 million below budget.** Table 7A summarises the year's payments.

TABLE 7A. BUDGETED AND ACTUAL PAYMENTS
($million)

Item	*1989-90 Actual*	**1990-91 Actual**	*1990-91 Budget*	**1990-91 Variance**
Recurrent -				
Annual appropriations	9 199	*(a)***9 794**	9 767	**(27)**
Special appropriations	1 896	**2 016**	1 993	**(23)**
Total recurrent	11 095	**11 810**	11 760	**(50)**
Works and services -				
Annual appropriations	1 920	**1 964**	2 016	**52**
Special appropriations	16	**48**	90	**42**
Total works and services	1 936	**2 012**	2 106	**94**
Total payments	13 031	*(b)***13 822**	13 866	**44**

(a) Includes $146 million expenditure on finance charges which, as explained in Part 1 of this Report, was netted-off outside the Consolidated Fund.

(b) Excludes transactions of $2 054 million recorded by the Government within the Consolidated Fund relating to the sale of the State Bank of Victoria which were not specified in the Government's *1990-91 Budget Paper No. 2* (refer to Part 2 of this Report for specific comments relating to the State Bank sale).

Major budget variances

7.2 The *Finance Statement* reports under-expenditure against budget of $190 million, which does not take into account the netting-off of finance charges of $146 million. As indicated above, this amount has been regarded by audit as expenditure for the year in arriving at a variance against budget of $44 million.

7.3 The main factors contributing to the under-expenditure of $190 million reported in the *Finance Statement* were:

- an appropriation of $100 million to the Debt Retirement Authority for the retirement of State debt not utilised during the year;
- deferral to 1991-92 of repayment of bridging finance of $59 million owed to the Victorian Development Fund;
- expenditure under the Treasurer's micro-economic reform package for staff redundancies lower than anticipated by $28 million; and
- reduced level of grants and loans provided by the Department of the Treasury.

7.4 The Explanatory Notes in the *Finance Statement* provide more details on expenditure variations against budget.

Lack of clear distinction between operating and capital expenditure

7.5 As identified in previous Auditor-General's Reports to the Parliament, the *Finance Statement* distinguishes between recurrent and works and services expenditure, however, this classification basis does not provide a satisfactory segregation between operating and capital transactions. Accordingly, recurrent expenditure includes a number of capital items and conversely works and services expenditure includes significant operating costs.

7.6 Audit has consistently stressed the importance of a proper classification of budget sector expenditures into operating and capital items to improve the value of the *Finance Statement* as a source of useful information on the State's finances and to facilitate enhanced economic decision-making.

7.7 **Audit has identified that, in 1990-91, operating expenditure of approximately $398 million (1989-90, $300 million) has been classified in 1990-91 as "works and services" expenditure.** Table 7B sets out the categories and levels of such expenditure.

TABLE 7B. OPERATING COSTS RECORDED UNDER WORKS AND SERVICES EXPENDITURE
($million)

Category	*Amount*
Repairs and maintenance	151
Housing rental assistance	81
Micro-economic reform program	72
Finance charges	69
Timber industry strategy and fire suppression	25
Total	**398**

7.8 In the previous year, the Government indicated that the classification of transactions between operating and capital within the Consolidated Fund would be examined. However, at the date of preparation of this Report, little progress had been made on the issue.

7.9 An encouraging development on this subject occurred at the May 1991 Premier's Conference, at which the Commonwealth and all States were represented. That Conference endorsed a proposal for all governments to publish by 1992-93 uniform financial data which, inter alia, will distinguish between capital and operating expenditure transactions.

Payments to Portland Smelter Unit Trust

7.10 To secure the construction and commissioning of the Portland Aluminium Smelter, the Portland Smelter Unit Trust, which holds the Government's ownership interest in the Smelter, was directed to make a $180 million payment to the State Electricity Commission of Victoria (SECV) in 1984 as compensation for lost revenue due to delays in the commissioning of the smelter.

7.11 The *1990-91 Finance Statement* discloses that the Government has now agreed, as a post-budget decision, to provide a grant of $6 million to the Portland Smelter Unit Trust in 1991-92 to partly compensate the Trust for the earlier payment. The *Finance Statement* also signals the Government's intention to provide a similar grant to the Trust in 1992-93 and to review this arrangement annually .

7.12 **In audit view, progressive compensatory payments by the Government to the Portland Smelter Unit Trust represent assumption and realisation of an equivalent portion of the initial compensation payment.**

Staff redundancy payments

7.13 As a part of its overall strategy to reduce public sector expenditure the Treasurer announced in the 1990-91 budget that it was intended to reduce the number of budget sector positions by over 8 000. Mechanisms to achieve these reductions were attrition, redeployment and voluntary redundancy. An amount of $100 million was provided to meet voluntary redundancy payments, however, actual payments amounted to $71.1 million. The following table provides details:

TABLE 7C. STAFF REDUCTIONS, 1990-91

Agency	*Reduction in positions* Budget	*Actual attrition*	*Actual redund-ancies(a)*	*Total actual(b)*	*Cost of redund-ancies*	*Average cost*	*Estimated annual payroll savings(c)*
					($m)	*$*	*($m)*
Attorney-General	*(d)*-	151	46	**197**	2.3	50 000	4.5
Agriculture	**100**	109	55	**164**	2.3	45 500	4.5
Health	**1 695**	1 341	194	**1 535**	4.9	26 800	13.5
Finance	**176**	133	76	**209**	2.7	38 200	21.5
Conservation	**205**	258	63	**321**	2.8	46 000	6.1
Education*(e)*	**3 628**	1 477	355	**1 832**	17.0	48 500	31.3
Transport	**1 890**	632	685	*(f)***1 317**	37.3	54 500	42.5
Other	**870**	587	68	**655**	1.8	26 500	35.9
	*(g)***8 564**	4 688	1 542	**6 230**	71.1	47 200	159.8

(a) Figures obtained from agencies.

(b) Information obtained from Public Sector Employment returns and calculated on the basis of effective full-time equivalents.

(c) Estimated annual payroll savings as calculated by government agencies.

(d) Included in other as individual amount not available.

(e) Adjusted to take account of 1 600 positions previously employed by school councils but now employed by the Department.

(f) Includes 149 first year apprentice intake and excludes 225 contract/temporary employees not paid through the payroll system.

(g) Figure obtained from Department of the Treasury internal budget papers.

7.14 The Government has estimated that a further reduction in the order of 10 000 budget sector positions will occur during 1991-92. A central component of the budget strategy to achieve this result is the Enhanced Resignation Package which provides for payments and entitlements associated with voluntary redundancy. Certain categories of budget sector employees will be able to apply for redundancy payments under this Package and an amount of $300 million has been provided for these payments in 1991-92.

Management response

Paragraphs 7.5 to 7.9

In common with the Commonwealth Government and most other States, Victoria has adopted a national accounting form of presentation of the transactions and balances of the State budget and non-budget sectors based on the Australian Bureau of Statistics system of national accounts and its government financial statistics classification scheme. This presentation in the Budget Papers effectively distinguishes between current and capital outlays, and is being further refined as the States and the Commonwealth continue their collaborative effort to standardise budgetary reporting.

PART 8

ANALYSIS OF CONSOLIDATED FUND RECEIPTS

KEY FINDINGS

- Receipts excluding borrowings for the year were $593 million below budget, principally due to a $444 million shortfall in State taxation receipts.

  Paras 8.1 to 8.2

- Delays in finalising negotiations contributed to the sale in June 1991 of a property in Port Melbourne for $29.5 million, which was $15.5 million below a previous valuation.

  Paras 8.7 to 8.10

Summary of financial transactions

8.1 The Consolidated Fund receipts for the year, excluding borrowings and the proceeds from sale of business assets (not specified in the Government's *1990-91 Budget Paper No. 3*) totalled $12.1 billion, which was $593 million below budget. The major shortfalls in receipts were in the areas of taxation ($444 million) and general asset sales ($111 million).

8.2 Table 8A provides a summary of the receipts of the Consolidated Fund for the year.

TABLE 8A. BUDGETED AND ACTUAL CONSOLIDATED FUND RECEIPTS
($million)

Item	*1989-90 Actual*	**1990-91 Actual**	*1990-91 Budget*	**1990-91 Variance**
Recurrent -				
Taxation	4 796	**5 143**	5 587	**(444)**
Commonwealth	3 896	**4 018**	4 054	**(36)**
Other	1 971	**2 081**	2 119	**(38)**
Total recurrent	10 663	**11 242**	11 760	**(518)**
Works and services -				
Commonwealth	701	**764**	735	**29**
Sale of assets *(a)*	199	**123**	234	**(111)**
Other	22	**18**	11	**7**
Total works and services	922	**905**	980	**(75)**
Total receipts*(a)*	11 585	**12 147**	12 740	**(593)**

(a) Excludes all transactions relating to the sale of the State Bank of Victoria of $2 017 million recorded by the Government within the Consolidated Fund and all borrowings. Transactions in respect of the State Bank sale were not specified in the Government's *1990-91 Budget Paper No. 3* (refer to Part 2 of this Report for specific comments relating to the State Bank sale).

Asset sales

8.3 The Government indicated in its *1990-91 Budget Papers* that it expected to generate revenue of $2.8 billion from the sale of assets during 1990-91. However, budget shortfalls were experienced in 1990-91 from both business assets and property sales. Table 8B compares the projected and actual position on an agency basis.

TABLE 8B. PROJECTED SALES AND ACTUAL SALES BY AGENCY, 1990-91
($million)

Agency	*Projected sales*	*Actual sales*	*Variance*
Business assets -			
Department of the Treasury	*(a)*2 600	*(b)*2 017	(583)
Property -			
Department of the Treasury	90	31	(59)
Transport authorities*(c)*	45	33	(12)
Ministry of Finance	44	47	3
Ministry of Education	44	9	(35)
Major Projects Unit	10	1	(9)
Other	1	2	1
	234	123	(111)
Total	**2 834**	**2 140**	**(694)**

(a) Amount not specified in the Government's *1990-91 Budget Paper No. 3.*
(b) Amounts as recorded by the Government in relation to the State Bank sale.
(c) Sale and lease-back transactions not included.

8.4 The difference of $583 million between projected and actual sales of business assets resulted from:

- the non-passage through the Legislative Council of legislation dealing with the proposed sale of the State Insurance Office; and
- decisions taken by the Government not to proceed with disposal of softwood plantations and its share in the Portland Aluminium Smelter, in view of the current economic climate.

8.5 The explanatory notes within the *Finance Statement* indicate the 1990-91 budget shortfall of $111 million in property sales was principally due to the depressed state of the property market during the year.

8.6 Part 6 of this Report provides information on assets that have been earmarked for sale but were awaiting sale at 30 June 1991.

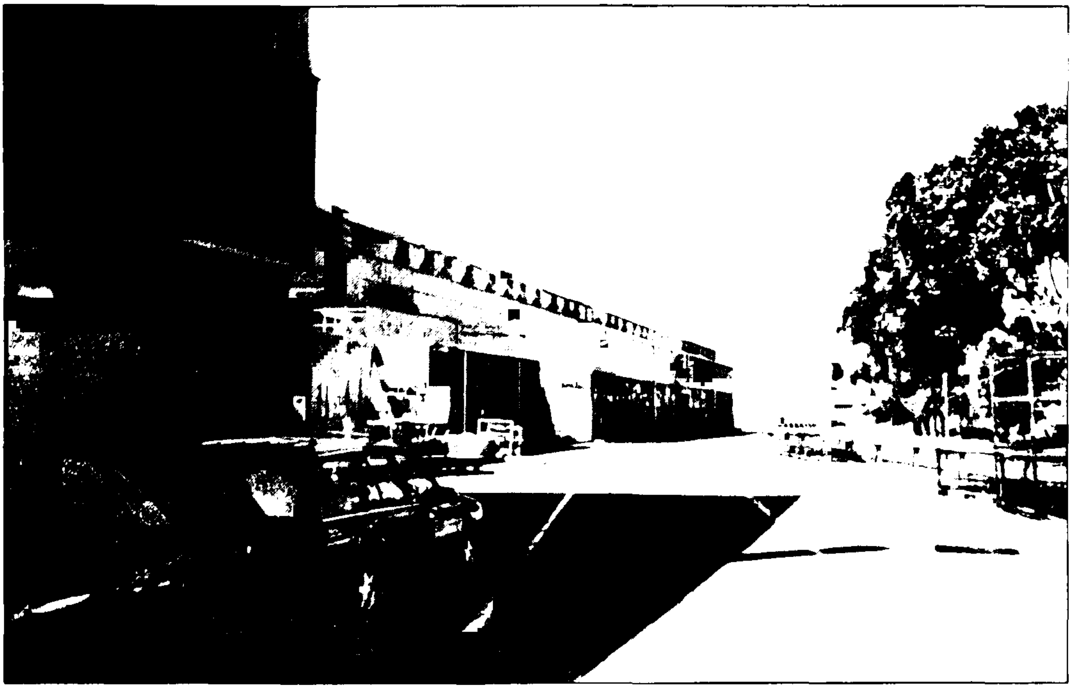
Property Sale - Port Melbourne

8.7 In 1986, the Government approved the sale of 30 hectares of Crown land located in Port Melbourne, which had been leased under long-standing arrangements to a private sector company involved in the motor vehicle industry. The Government decision provided for the lessee to be given a *first option* to purchase the property.

8.8 Although approval for the sale of the property was given in 1986, the Government determined to defer any sale action because of the poor state of the motor vehicle industry at the time.

8.9 The first offer to the lessee to purchase the property was not made until February 1989. After extensive negotiations with the lessee, who expressed an unwillingness to purchase, the Government further deferred sale action and, in January 1990, after obtaining a Valuer-General's valuation of the property at $45 million, a second offer to purchase was made to the lessee. This offer was also refused.

8.10 Negotiations between the parties continued up to June 1991 when the property was finally sold to the lessee for $29.5 million, which approximated a value determined at the time by the Valuer-General. The price achieved for the sale was $15.5 million below the valuation obtained in January 1990.



Part of the Port Melbourne site subject to the sale.

Forgiveness of water board debt

8.11 During 1990-91 the Cabinet approved in principle the forgiveness of debt amounting to $16 million owed by certain water boards to the Consolidated Fund. The rationale provided for this forgiveness of debt was that it would enable the restructure of certain non-viable water authorities and the cessation of annual revenue subsidies from the Consolidated Fund.

8.12 To 30 June 1991, the Treasurer had approved the specific forgiveness of debt totalling $10.5 million.

Management response

Paragraphs 8.7 to 8.10

The sale of the property involved complex negotiations over 2 years commencing at the peak of the property boom. With prices falling in the real estate sector through 1990 and 1991 it was necessary to undertake a number of reassessments of the market value of the property before price acceptance and settlement was achieved in June 1991. The sale price of $29.5 million reflected value in exchange at May 1991 and was supported by the Valuer-General, 2 independent valuations and approved by the Land Monitor.

Comparison between valuation advices provided in June 1990 and May/June 1991 reflects market fluctuations and does not provide useful or relevant information in this context.

PART 9

STATE TAXATION

KEY FINDINGS

- Substantial efficiencies could be achieved if the operations of the State's 2 major collection agencies were amalgamated.

  Para. 9.9

- The lenient and inconsistent approach of the Stamp Duties Office to the imposition of penalties has not encouraged the timely payment of fees and duties by taxpayers.

  Paras 9.32 to 9.35

- Penalties imposed in 1990-91 represented on average only 2.5 per cent of the maximum amount provided for in legislation.

  Para. 9.34

- Audit estimates that between $24 million and $34 million in stamp duty on motor vehicle transactions was forgone in 1990-91.

  Paras 9.40 to 9.58

- Evasionary activity contributed to a decrease in tobacco franchise fees equating to $51 million a year.

  Paras 9.60 to 9.67

- Subsequent to the commencement of the first full-scale audit of a major bank since the introduction of the Financial Institutions Duty in 1982, voluntary disclosures amounting to $9.3 million were made by major banks.

  Paras 9.86 to 9.93

- The coverage of the tax base through investigations conducted by the Stamp Duties Office is inadequate to identify the substantial revenue forgone through avoidance and evasion activity.

  Paras 9.94 to 9.108

- The voluntary disclosure of $23.4 million by one large petroleum wholesaler demonstrates the importance of regular investigations by the Stamp Duties Office.

  Paras 9.69 to 9.71

- The more timely follow-up of outstanding payroll tax returns and the stricter enforcement of penalty provisions by the State Taxation Office has increased the proportion of duty paid by the due date.

  Para. 9.123

- An expansion of investigation functions of the State Taxation Office identified additional net revenue of $23 million in 1990-91.

  Paras 9.136 to 9.137

TAXATION REVENUE

9.1 Taxation receipts are the largest source of State Government revenue, representing 45 per cent of total recurrent receipts in 1990-91. By way of contrast these receipts represented 39 per cent of all 1980-81 recurrent receipts.

9.2 The State's reliance on taxation receipts for the funding of Consolidated Fund operations has increased over the past decade. However, as taxation receipts are significantly affected by the level of economic activity and employment, the State's vulnerability to revenue shortfalls due to adverse conditions has also significantly increased. As previously indicated in Part 8 of this Report, **receipts in 1990-91 from this source amounted to $5.1 billion, which was $444 million below the budget estimate of $5.6 billion.** Details of the shortfall are shown in Table 9A.

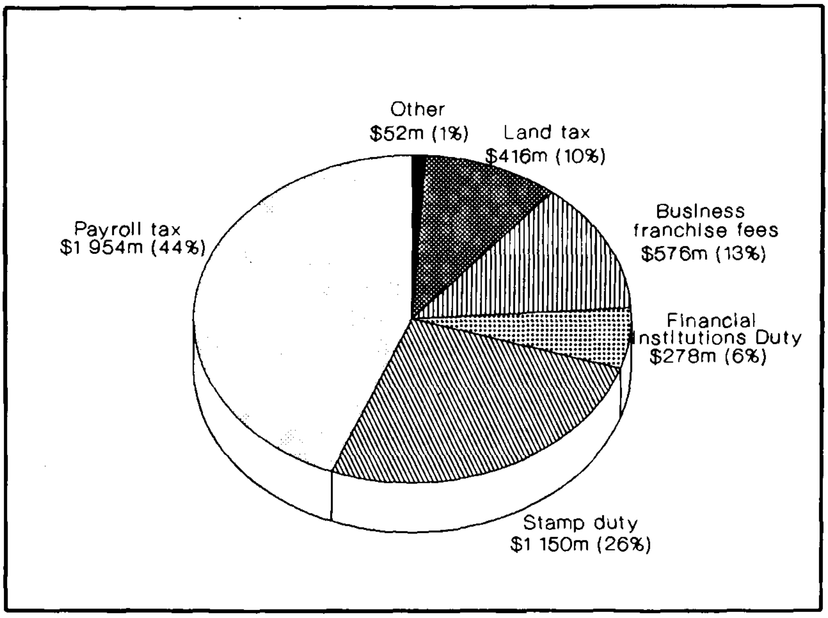
TABLE 9A
TAXATION REVENUE SHORTFALLS, 1990-91
($million)

Revenue source	*Shortfall*
Stamp duty	285
Payroll tax	90
Financial Institutions Duty	37
Tobacco franchise fees	32

9.3 The responsibility for the collection of 86 per cent of Victorian taxes is assigned to 2 collection agencies operating as separate administrations within the Department of the Treasury. While the State Taxation Office, administered by the Commission of Taxation (the Commissioner), has responsibility for the collection of payroll tax and land tax, the Stamp Duties Office, administered by the Comptroller of Stamps (the Comptroller), collects a range of duties, fees and levies including stamp duty, Financial Institutions Duty and business franchise fees. The Land Titles Office and the Roads Corporation also collect stamp duty on behalf of the Comptroller.

9.4 Chart 9B illustrates in percentage terms the 1990-91 collections of these agencies which amounted to $4.4 billion.

CHART 9B. STATE TAXATION, 1990-91



9.5 An audit review of the 2 collection agencies was commenced during 1989 with a view to evaluating the efficiency of systems and procedures in place to administer State taxation legislation and minimise the incidence of tax avoidance and evasion. As disclosed in my *Report on the Treasurer's Statement, September 1989* the denial of audit access to certain records and documents maintained by the Comptroller and the Commissioner prevented the completion of the review. As examinations were substantially completed at the State Taxation Office prior to the review being deferred, certain findings were reported at that time on the efficiency of the collection of payroll tax and land tax.

9.6 In 1990, amendments to audit legislation were enacted which clarified the situation concerning access to information. The review of the Stamp Duties Office and a follow-up of matters raised in relation to the State Taxation Office were subsequently conducted during 1991.

9.7 The overall conclusion of these examinations and specific matters relating to each collection agency are set out in the following sections.

Overall conclusions

9.8 Unlike most other States which have a single agency responsible for the collection of taxation and stamp duty, Victoria has traditionally maintained a separate Office to administer each function.

9.9 The reviews undertaken by audit in 1989 (taxation) and 1991 (stamp duties) suggest **substantial efficiencies could be achieved by the State if the operations of the 2 Offices were amalgamated.** Audit has recently been advised that the costs and benefits of possible amalgamation of the 2 Offices are currently under examination and that the Treasurer has established a task force to report to him by 30 November 1991.

9.10 Although the functions of each Office are similar, **each agency has adopted a different approach to the development of revenue collection strategies** as can be seen from the following comparisons:

- The State Taxation Office has recently entered into a $21 million agreement with a computer consulting firm for the development and implementation of a generic computer system to meet current revenue collection needs and to give flexibility to enable adaption to any future forms of government taxation. The Stamp Duties Office on the other hand has for a number of years been in the process of developing systems in-house at an estimated cost of $6.6 million;
- The Stamp Duties Office has continued to adopt the practice of imposing and subsequently granting substantial reductions or remissions of penalties while the State Taxation Office has significantly strengthened its approach to the imposition of penalties since the 1989 audit review. By way of comparison, the Stamp Duties Office has imposed penalties, on average, of 2.5 per cent of the maximum provided in legislation compared with penalties of 30 per cent generally applied by the State Taxation Office. A substantially higher rate of penalty imposition has been achieved at the State Taxation Office even though the tax base of that Office is more susceptible, especially in the short-term, than that of the Stamp Duties Office to erosion through businesses ceasing or being wound-up. Duties collected at the Stamp Duties Office are much more consumer dependent and while it is accepted that economic conditions have a major impact on the tax base of that Office it is most unlikely that the volume of activity, e.g. motor vehicle, land or share sales will vary greatly if there are less dealers or agents in the market;
- An increase in funds allocated to the investigation function has significantly increased the detection of unpaid payroll tax by the State Taxation Office in 1990-91. However, resources available for investigations conducted by the Stamp Duties Office have been contained in recent years; and
- The operations of the Stamp Duties Office are structured on the basis of each revenue type, whereas the State Taxation Office moved from such a structure in 1986 to one based on various operational functions. This major organisational change was undertaken after a study conducted by the Department of the Treasury to identify improvements needed to effectively meet the revenue collection roles and objectives of the State Taxation Office.

Management response

The new computer system at the State Taxation Office will replace substantial, but outmoded, existing computer systems. The computer developments at the Stamp Duties Office have been largely replacing manual systems. The Stamp Duties Office system is also "generic" in that it brings together all the common components of the revenue collection system (known as the Corporate Data System) and has the flexibility to incorporate additional tax bases.

Increased funds were made available to the Stamp Duties Office for investigations in 1990-91 but recruitment difficulties constrained the operation.

The organisational structure of the Stamp Duties Office reflects a major review by the Public Service Board undertaken just before the review (cited by audit) of the State Taxation Office.

STAMP DUTIES OFFICE

Key conclusions

9.11 The audit review found that the Stamp Duties Office (SDO) had generally actioned the large volume of documents for which it had responsibility in a timely manner and promptly banked its revenue collections in the Public Account.

9.12 However, many of the problems disclosed in relation to the State Taxation Office in 1989 were found to also exist within the SDO.

9.13 Significant amounts of revenue have been forgone as a result of avoidance and evasion activity by taxpayers and from delays in the follow-up and subsequent collection of outstanding revenue by the SDO.

9.14 Also, the lenient and inconsistent approach of the SDO to the imposition of penalties has not encouraged the timely payment of fees and duty by taxpayers.

9.15 Audit concluded that the efficiency and effectiveness of the SDO in promptly identifying and collecting all revenue due would be greatly enhanced by:

- expansion of its investigation activity;
- substantial improvements to information systems and reporting processes; and
- a more effective allocation of available resources to high risk areas.

9.16 For these changes to be achieved there needs to be a greater focus on maximising the net benefits to the State through improvements to revenue raising strategies rather than the current trend of containing the costs of the SDO.

Management response

The recent audit of the SDO by the Auditor-General's Office (audit) recognises general efficiencies of the SDO in processing and banking. It has identified administrative difficulties associated with limited resources, recognised the prevalence of tax evasion and pointed out some administrative shortcomings which have been, or are now being, addressed.

There are, however, a number of significant points on which the audit conclusions are not accepted.

Legislative responsibilities

9.17 The Comptroller is responsible for the administration of the following legislation:

- *Stamps Act* 1958;
- *Business Franchise (Tobacco) Act* 1974;
- *Business Franchise (Petroleum Products) Act* 1979;
- *Financial Institutions Duty Act* 1982;
- *Energy Consumption Levy Act* 1982; and
- *Debits Tax Act* 1990.

9.18 The *Stamps Act* 1958 provides for the payment of duty on a range of documents such as land transfers, mortgages, deeds, commercial leases, and motor vehicle registrations and transfers. During 1990-91, over 400 000 dutiable documents were lodged at the Stamp Duties Office (SDO), 300 000 at the Roads Corporation and 35 000 at the Land Titles Office.

9.19 In certain other cases, stamp duty and Financial Institutions Duty is paid by regular remittances accompanying returns or statements from registered taxpayers. Such taxpayers include financial institutions, used car dealers, insurance companies, sharebrokers, rental businesses and bookmakers. In accordance with the Business Franchise Acts, tobacco and petroleum merchants are also licensed by the SDO on payment of prescribed fees. At 30 June 1991, approximately 5 400 registered taxpayers and around 12 000 petroleum and tobacco merchants were recorded at the SDO.

9.20 SDO expenditure in 1990-91 amounted to $10.1 million, including the salary costs of 240 staff. **However, the total cost of collecting revenue due in accordance with legislation administered by the Comptroller, including the cost of collections at the Land Titles Office and Roads Corporation, has not been quantified by SDO.** Consequently, the Comptroller is not in a position to make informed decisions regarding the full impact of various collection strategies.

Management response

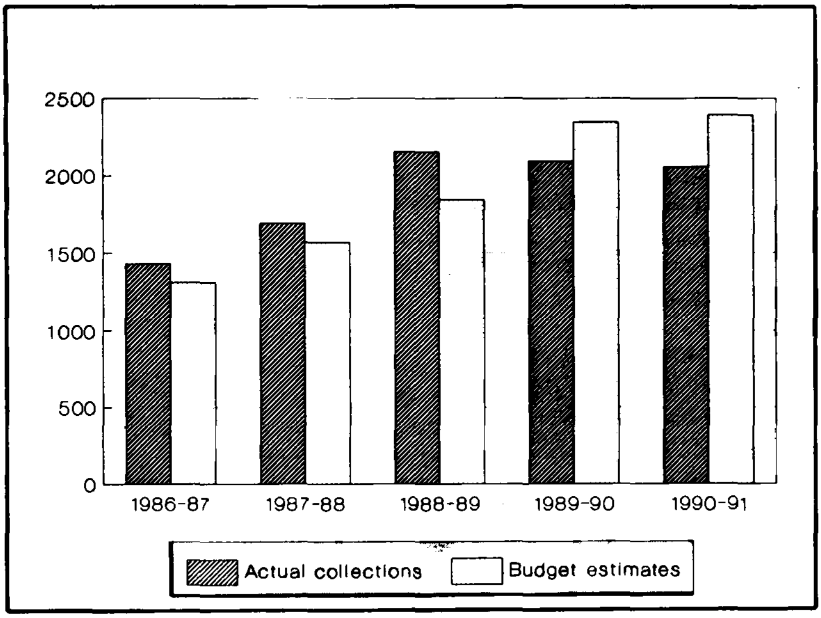
The SDO cannot, and is not responsible to, quantify costs of collection incurred by the Land Titles Office and the Roads Corporation. It does quantify in detail its own costs of collection which have been under 0.6 cents in the dollar for many years.

Revenue collections

9.21 Estimates for each revenue type are prepared annually by the SDO on the basis of past receipt patterns, a knowledge of relevant market factors, and various economic and financial indicators. These estimates are supplied to the Department of the Treasury which has responsibility for the development of revenue estimates included in the State's annual budget. Various financial modelling systems and economic indicators are also used by the Department in arriving at final budget predictions.

9.22 Comparisons of actual collections with budget estimates for the last 5 years are illustrated in Chart 9C.

CHART 9C
COMPARISON OF REVENUE ESTIMATES AND COLLECTIONS
($million)



9.23 Collections in 1990-91 were approximately $37 million less than revenue raised during the previous year and $361 million less than the relevant revenue estimates contained in the Government's 1990-91 Budget Papers (excluding debits tax collections for which no estimate was included). Table 9D shows comparisons for specific revenue sources.

TABLE 9D. REVENUE ESTIMATES AND COLLECTIONS
($ million)

Revenue source	*Actual 1989-90*	*Budget estimate 1990-91*	**Actual 1990-91**
Stamp duty -			
Land transfers	751	711	**535**
Motor vehicles	248	267	**206**
Non-life insurance business	131	141	**136**
Marketable securities	108	113	**95**
Betting instruments	14	15	**12**
Mortgages	81	77	**66**
Leases	31	35	**28**
Rental business	37	42	**34**
Other stamp duty	33	34	**38**
Total stamp duty	1 434	1 435	**1 150**
Financial Institutions Duty	183	315	**278**
Petroleum franchise fees	295	356	**352**
Tobacco franchise fees	174	256	**224**
Energy consumption levy	7	8	**5**
Debits Tax	*(a)*	*(a)*	**47**
Total revenue	**2 093**	**2 370**	**2 056**

(a) Debits Tax revenue was transferred from the Commonwealth to the State in January 1991.

9.24 In the majority of areas, collections for 1990-91 were significantly less than projected. The SDO has indicated that these outcomes were a reflection of the continuing unfavourable economic conditions. Audit analysis of collections highlighted the following:

- *Duty on land transfers.* The reduction in the number of land transfers processed at the SDO from 110 000 in 1989-90 to 88 000 in 1990-91 and a decline in the average property selling price, as recorded at the Valuer-General's Office, from $144 000 in 1989 to $136 000 in 1990 contributed to the decrease in stamp duty. These factors which impacted on duty raised on land transfers have had a similar effect on the amount of duty collected on mortgages;
- *Duty on motor vehicle transactions.* A decline of 17 per cent in collections represents the first reduction in revenue from this source in at least 10 years. Bureau of Statistics information indicated that the number of new vehicle registrations in Victoria decreased by 25 per cent in 1990-91. However, audit found that the number of second hand private vehicle transfers had increased significantly over the period. This change in the nature of transactions, coupled with falls in average car prices as disclosed by industry sources, has contributed to a reduction in the average duty paid per dutiable transaction, at the Roads Corporation, from $487 in 1989-90 to $364 in 1990-91;

- *Duty on marketable securities.* A decrease in the volume of securities traded and a downturn in security prices during the year has contributed to a reduction in revenue received on the transfer of shares and other securities;
- *Financial Institutions Duty.* A rate increase from .03 per cent to .06 per cent from 1 November 1990 was anticipated to increase revenue in the 1990-91 year by $102 million. However, the actual increase as a consequence of the rate change was only $78.7 million. The SDO has estimated that, excluding the effect of the rate increase and additional revenue of around $10 million resulting from investigation activities, a growth of only 3.5 per cent has occurred on 1989-90 collections compared with an expected growth of around 10.5 per cent; and
- *Tobacco franchise fees.* A 43 per cent increase in the rate for these fees was predicted in the Government's *1990-91 Budget Papers* to increase revenue in the year by $60 million. However, the SDO has estimated that the increase resulted in additional revenue of only $41 million.

9.25 While it was apparent to audit that a reduction in the volume and value of various dutiable transactions had a substantial impact on SDO receipts during 1990-91, the following factors have, to a lesser extent, also affected the level and timing of collections during the period:

- **an increase in the number of registered taxpayers ceasing trading or becoming insolvent; and**
- **a higher number of returns from taxpayers outstanding at 30 June 1991 in certain areas than at the same time in the previous year.**

9.26 Indicators in a number of areas also suggested that continued, and in certain instances increased, avoidance and evasion resulted in a substantial loss of revenue during 1990-91.

Outstanding revenue

Follow-up of defaulting taxpayers

9.27 In accordance with the *Stamps Act* 1958 and the *Financial Institutions Duty Act* 1982, registered taxpayers are required to forward regular returns or statements to the SDO, together with duty due, by certain specified dates. Similarly, licensed petroleum and tobacco wholesalers are required to pay licence fees at the end of each month and petroleum and tobacco retailers are required to be licensed annually in accordance with the Business Franchise Acts. **During 1990-91, over $1.2 billion was collected on the basis of these periodic remittances.**

9.28 In cases where duty or fees are not lodged by the due date, the Comptroller may issue an assessment of amounts due. Assessments are also issued in circumstances where an opinion of the Comptroller is required regarding the amount of duty due on documents lodged by taxpayers. Assessments are generally payable within 30 days of issue. Where documents or returns are not lodged or assessments are not paid by the due date, various penalties may be imposed by the Comptroller.

9.29 A review of practices adopted within the SDO regarding the follow-up of outstanding amounts **highlighted a number of deficiencies which delayed the collection of revenue and consequently increased the State's interest costs,** namely:

- manual systems and procedures in place were not conducive to the prompt identification and follow-up of outstanding revenue;
- in some instances, assessments were not issued despite returns or fees remaining outstanding for a number of months;
- several reminder letters were often sent to defaulting taxpayers before an assessment was issued or legal action taken. In some cases, this process was followed even where taxpayers were regularly slow in forwarding returns; and
- a lenient approach was taken to the imposition of penalties.

Management response

Audit has been advised that the problems of the current manual systems are being rectified through the progressive implementation of the 3 year EDP strategic plan.

Debtors recording systems

9.30 In the absence of comprehensive debtors systems at the SDO, **the total value of amounts outstanding at 30 June 1991 cannot be established.** The debtors recorded in the systems in place, which were limited to the areas of business franchise fees and the Energy Consumption Levy, amounted to **$19.6 million** at 30 June 1991. However, audit findings indicate that **the total value of amounts receivable at that date was significantly higher than the reported figure**. For example:

- revenue amounting to at least $7.2 million detected through investigations activities during 1990-91 was still pending collection at 1 August 1991;
- legal action had commenced in relation to outstanding amounts totalling $2.2 million;
- approximately 1 200 returns from taxpayers were outstanding; and
- over 1 200 tobacco retailers recorded at the SDO had not paid annual licence fees due by 30 June 1991.

9.31 **The establishment of appropriate systems to record the value and age of amounts outstanding would assist the management of the SDO in identifying changes in collection patterns from period to period and in effectively assessing the adequacy of follow-up procedures relating to outstanding revenue.**

Management response

Computer systems are currently being implemented by the SDO to provide debtors recording systems for all returns based areas within the next year.

Imposition of penalties

9.32 A range of penalties may be imposed by the Comptroller where amounts are not paid in accordance with the timeframes specified in legislation. These penalties are summarised in Table 9E.

TABLE 9E. PENALTY PROVISIONS

Type of duty/fee	*Type of non-compliance*	*Maximum legislative penalty*
Stamp duty • Registered used car dealers and rental businesses	Failure to lodge a return and pay duty by the due date.	100% of the duty due plus 20% a year from the due date or $25, whichever is the greater.
• Sharebrokers	Failure to lodge a return and pay duty in accordance with requirements.	200% of the duty payable.
• Marketable securities, land transfers, mortgages	Payment of duty not made within 3 months of execution of the document.	200% of the duty unpaid or $20, whichever is the greater, plus 20% a year from the date of execution of the document.
• General insurance businesses	Failure to lodge a return and pay duty by the due date.	10% of the duty due.
• Life insurance businesses	Failure to lodge a return and pay duty by the due date.	No penalty.
Financial Institutions Duty	Failure to lodge a return and pay duty.	Additional duty on the amount unpaid from the due date at the rate approved by the Australian Loan Council for long-term borrowing for new public securities issued by semi-government authorities at the due date or 20% a year, whichever is the greater.
Business franchise fees (tobacco and petroleum)	Carrying on the business of tobacco or petroleum retailing without having applied for the appropriate licence.	100% of the licence fee due.

9.33 Provision is also made within the legislation for the Comptroller to reduce or remit penalties. Discussions with the Comptroller indicated that in the administration of the legislation, the aim of the SDO is to impose penalties in an equitable manner, encourage prompt payment and maintain the revenue base in the long-term. Penalties are generally assessed on the basis of the past record of the taxpayer. A review of practices adopted during 1990-91, revealed that the penalties assessed by the SDO were substantially below the maximum provided for in the legislation and in numerous instances were later reduced or totally remitted by the Comptroller. Table 9F highlights this situation.

TABLE 9F. PENALTIES IMPOSED AND AMOUNTS COLLECTED IN 1990-91 ($'000)

Revenue type	*Maximum penalty in accordance with legislation*	*Penalties assessed*	*Penalty imposed after reductions or remissions*	*Penalty collected at 30 June 1991*
Stamp duty -				
Land transfers	3 193	3 193	140	140
Mortgages	1 027	1 027	93	91
Leases	122	122	8	7
General insurance business	294	294	4	4
Rental businesses	*(a)*6 082	*(a)*608	51	36
Sharebrokers	3 397	nil	nil	nil
Registered used car dealers	2 024	233	104	60
Financial Institutions Duty	16	16	8	4
Business franchise retailers	5	5	5	*(b)*
Total	**16 160**	**5 498**	**413**	**342**

(a) Audit estimate.
(b) Not available.

9.34 While audit recognises the discretionary powers of the Comptroller in this area, a number of matters regarding present practices were highlighted which do not result in the equitable administration of penalty provisions or encourage the timely payment by taxpayers of stamp duty and fees. In summary, audit found that:

- penalties imposed were on average 2.5 per cent of the maximum provided in legislation;
- sharebrokers had not been penalised for late payment of duty for several years due to (as advised by the SDO) an administrative oversight;
- inconsistencies existed in the approach to imposing penalties both within and between various sections of the SDO;
- guidelines developed by the SDO to assist in the administration of penalty provisions were not always followed;

- insufficient explanation was provided by some taxpayers to justify the reduction or remission of penalties; and
- the process of administering the penalties was time consuming and cumbersome.

9.35 **It was also evident to audit that in some cases, the penalties imposed did not compensate for the interest forgone through late payment and the costs involved in administering the penalty provisions.**

Management response

The discretion provided by Parliament to remit or reduce penalties is exercised in accordance with the seriousness of the taxpayer's omission to pay on time. This principle has longstanding judicial approval and is applied when Courts are required to adjudicate on the merits of the imposition of a particular penalty.

The SDO approach encourages voluntary disclosures which ensure unpaid revenue is recovered and increased payments are thereafter maintained in the revenue base.

Specific points raised by audit will be addressed.

Undetected revenue

9.36 An objective of the Department of the Treasury in the management of budget sector resources is to ensure that all revenue prescribed in relevant legislation is collected in an efficient and effective manner. In this regard, the SDO has responsibility for ensuring compliance with a range of legislation, identifying weaknesses or anomalies in such legislation and interpreting and advising taxpayers of their legislative responsibilities.

9.37 The Government at various times has also indicated that it considers that a strong attack on avoidance and evasion activities is central to enforcing revenue legislation and ensuring the elimination of unfair practices which shift the tax burden to honest taxpayers.

9.38 Over a number of years the SDO has initiated actions aimed at minimising avoidance and evasion through tightening of legislation, undertaking investigations of taxpayers and establishing communication links with other States and the Commonwealth.

9.39 **Notwithstanding these actions, audit is of the opinion that substantial revenue payable in accordance with legislation administered by the SDO still remains undetected as a result of insufficient investigation activity, weaknesses in the legislation and deficiencies in systems and processes at the SDO or other agencies responsible for the collection of stamp duty on behalf of the Comptroller.**

Management response

The matters raised by audit will be addressed.

Stamp duty on motor vehicles

9.40 Stamp duty is paid directly to the Roads Corporation, in its capacity as agent for the SDO, in relation to all new and second-hand vehicle registrations and vehicle transfers between private persons. Registered used car dealers are required to lodge a monthly statement in respect of the previous month's dutiable sales, along with the remittance of stamp duty relating thereto, directly to the SDO.

9.41 Total stamp duty revenue collected during 1989-90 and 1990-91 on motor vehicle transactions is set out in Table 9G.

TABLE 9G. STAMP DUTY ON MOTOR VEHICLES
($million)

Revenue collection	*1989-90*	**1990-91**
Stamp duty collected at -		
Roads Corporation	154.4	**122.3**
Stamp Duties Office	93.7	**83.3**
Total stamp duty on motor vehicles	248.1	**205.6**

9.42 Specific details of deficiencies in the collection of revenue in this area are set out in the following paragraphs.

Definition of market value

9.43 The *Stamps Act* 1958 requires stamp duty to be paid on vehicle registrations and transfers on the basis of market value which is defined as the price at which a vehicle might reasonably have been sold free from encumbrances in the open market. Where the purchase or transfer price of the vehicle is greater than the market value, that price is to be used as the basis of calculating stamp duty.

9.44 Within the motor vehicle industry, the term *market value* has a range of definitions including wholesale value, trade value, retail value or special market values such as those applying to public auctions, fleet operators and markets where discounts apply. Values of second-hand cars are obviously also dependent on the physical condition of the individual vehicle.

9.45 Audit was advised that **in practice all of the definitions of market value outlined above are acceptable to the SDO**, given the particular circumstances, which presents difficulties in verifying declared market values for stamp duty purposes.

9.46 Stamp duty is levied on the basis of various specified rates for every $200 of a vehicle's value. Although the rates of duty have progressively increased since the introduction of the duty in 1964, the $200 band on which duty is calculated has not changed since that time. The increase in the past 27 years in the price of vehicles and the range of makes, models and accessories has therefore increased the scope for manipulation of declared market values by taxpayers and made the process of detecting understatement even more difficult.

Evaluation of market values at Roads Corporation

9.47 Guidelines developed by the SDO during 1990-91 define the term *"open market"* as the *open retail market as supported by various dealers' guides*. The guidelines, however, acknowledge that there are certain markets that consistently reflect a lower than retail price. The guidelines are provided to staff at Roads Corporation to assist them in making an assessment of the reasonableness of declared market values on registration and transfer documents lodged.

9.48 It was evident to audit that a great deal of reliance is placed on the judgement of Roads Corporation counter staff in determining whether the market value declared by the taxpayer is reasonable and reporting any concerns regarding values to the SDO. An audit review of duty payable on vehicle registrations and transfers disclosed significant variances between the declared market values upon which the duty was calculated and the values contained in dealers' guides. However, reports provided to the SDO by the Roads Corporation did not include many of these variances indicating that **the current processes for evaluating and investigating market values are largely ineffective**.

Statements provided by dealers

9.49 Stamp duty on transfers of vehicles submitted at the Roads Corporation by a registered used car dealer is not required to be paid at the time of transfer, provided a valid dealer number is quoted. Monthly statements of the previous month's dutiable sales are forwarded directly to the SDO by dealers along with the stamp duty due.

9.50 Dealers are not required to provide details to the SDO of specific transactions making up the amount of monthly stamp duty (e.g. registration numbers, market values, stamp duty). Consequently, the accuracy of the stamp duty paid cannot be matched with the transactions processed at the Roads Corporation during the period and verification can only be achieved through individual investigations by the SDO of dealers' records.

9.51 During 1990-91, only 5 per cent of dealers were investigated by the SDO. In addition, since the introduction in 1984 of the present returns-based system for used car dealers, many dealers have not yet been subject to investigation. On average, around $680 000 per year has been detected by the SDO as a result of investigations conducted in this area since 1984.

Records maintained by dealers

9.52 While registered used car dealers are required under existing stamp duty legislation to keep and retain books and records for a period of 5 years, the legislation does not prescribe the form of such records. This situation has impacted adversely on the investigation processes as dealers are not obliged to provide any records and, in some cases, obstruct the investigation process. The SDO usually reviews records required to be maintained by dealers under other legislation such as the *Motor Car Traders Act* 1986. These records do not always provide sufficient information to enable the detection of stamp duty avoided or evaded.

9.53 Under the current legislative provisions, administrative procedures and level of investigative activity, loss of stamp duty as a result of the understatement of the number or value of motor vehicle transactions may remain undetected.

Audit estimate of stamp duty forgone

9.54 An audit analysis of various vehicle registration and transfer documents lodged at the Roads Corporation during 1990-91 was undertaken with the aim of estimating the effect on revenue collection of current weaknesses. In particular, emphasis was placed on examining the possibility of vehicle values being mis-stated for stamp duty purposes. Testing was undertaken on the basis of selecting a random sample of documents lodged and comparing the value declared by the taxpayer with the most conservative retail values contained in an industry dealers' guide for the type of vehicle.

9.55 Audit found that the variances between the stamp duty on the declared value and the duty applicable to values contained in the guide were as follows:

- For new vehicle registrations the average variance was $94 per vehicle (excluding fleet purchases which are generally subject to bulk discounts) representing a total of **$10.6 million** over the total number of new vehicle registrations during the year. In the case of a number of luxury cars included in the sample the declared values were between $8 500 and $15 000 lower than the value stated in the dealers' guide;
- For second-hand vehicle re-registrations the average variance was $120, equating to a total of **$5.9 million** over the total number of re-registrations during the year. The selected sample excluded auction sales as vehicles sold in this market generally return lower than retail prices; and
- For private vehicle sales the average variance was $121 per vehicle corresponding to a total value of **$18.2 million** for all such transactions during the year.

9.56 It is recognised that the actual value of individual cars will vary depending on the condition of the vehicle and incentives or discounts offered in the particular market. Notwithstanding this factor, and the possible overstatement due to the exclusion from the samples of fleet purchases and auction sales, **audit estimates that between $24 million and $34 million in stamp duty was forgone during 1990-91 as a result of mis-statement of vehicle values on documents processed at the Roads Corporation.**

9.57 The SDO performed an analysis of **sales for one week in April 1991** on the basis of a sample of advertisements in local newspapers. The **SDO estimated from the results of this analysis that total evasion in the private sales area was $14.7 million in 1990-91 (compared with the audit estimate of $18.2 million).** In addition, the SDO has indicated that of re-registration cases referred to the SDO by the Roads Corporation where declared market values were deemed to be unreasonable, additional stamp duty collected equated to $76 per case referred.

9.58 **Audit is of the view that a simplified system of imposing duty, such as the use of broader bands for the calculation of the duty or fixed rates of duty for various categories of vehicles, would assist in the administration of the legislation especially in terms of identifying understatement of values. In developing such a system, consideration would also need to be given to protecting the existing tax base.**

Management response

Audit's estimates of evasion of motor vehicle duty are crude and in some cases fallaciously apply variances established for one category vehicle to sales of different categories. The SDO is conducting a further survey of samples of new and used motor vehicle sales as audit estimates greatly exceed SDO investigation indicators.

Business franchise fees

9.59 The Business Franchise Acts provide for the voluntary licensing of tobacco and petroleum wholesalers and the compulsory licensing of tobacco and petroleum retailers. The Acts also provide for the collection of licence fees as follows:

- Wholesalers are required to pay a monthly licence fee consisting of $50 plus 50 per cent (tobacco) or 11 per cent (petroleum) of the value of products sold, for re-sale or consumption in Victoria. The fee is not payable on sales of tobacco or petroleum products between licensed wholesalers nor on the sale of diesel fuel sold for off-road use; and
- Retailers are required to pay an annual licence fee of $50. However, if the retailer buys tobacco or petroleum from an unlicensed wholesaler, the fee payable is $50 plus 50 per cent (tobacco) or 11 per cent (petroleum) of the value of products purchased from the unlicensed wholesaler which is for re-sale or consumption in Victoria.

Tobacco fees

9.60 As the rates of taxation on tobacco products vary between the States and Territories, a substantial financial incentive encourages the purchase by retailers of tobacco originating interstate. **The major form of evasion in this area has therefore related to retailers purchasing tobacco products from unlicensed wholesalers and failing to pay the additional licence fee due in such cases.** Table 9H sets out details of the rates applicable in each State at 30 June 1991.

TABLE 9H.
RATES OF TAXATION ON TOBACCO PRODUCTS, 30 JUNE 1991

State	*Per cent*
Australian Capital Territory	*(a)*35
New South Wales	*(a)*35
Northern Territory	50
Queensland	30
South Australia	50
Tasmania	50
Victoria	**50**
Western Australia	50

(a) The taxation rates in New South Wales and the Australian Capital Territory were increased to 50 per cent in August 1991.

9.61 The SDO has indicated that in the past, changes in the tobacco tax rates in other States have impacted on tobacco franchise fees collected in Victoria. For example, a significant increase in Victorian tobacco tax receipts occurred in early 1989 following the introduction of a Queensland tobacco tax. This increase indicated that the introduction of the tax temporarily curtailed evasionary activity in Victoria which had previously been present when a tax did not apply in Queensland.

9.62 From December 1990, the Victorian fee was increased from 35 per cent to 50 per cent. **The SDO has indicated that evasion has escalated since that time** with the vast majority of tobacco products, which have been purchased by Victorian retailers from unlicensed wholesalers for the purpose of evading tobacco taxes, originating in Queensland and New South Wales.

9.63 Audit analysis of the average reported monthly tobacco sales by licensed wholesalers in 1989-90 and 1990-91 indicated that:

- between October 1989 and the end of November 1990 the average reported monthly tobacco sales were approximately $51.2 million; and
- between December 1990 and July 1991 the average reported monthly tobacco sales fell to approximately $42.7 million.

9.64 The decline in reported sales since the tax rate increase in December 1990 translates to a reduction of $51 million per year in business franchise fees. Audit considers that evasionary activity has contributed significantly to this decrease.

9.65 To a lesser extent, the decline during the period may also be attributed to the following factors:

- the effect of a price increase in cigarettes on the consumption of tobacco;
- the effect of the economic recession on the disposable income of consumers of tobacco products;

- the effect on consumption of the *Quit* campaigns and government and private sector workplace smoking policies; and
- the effect of stockpiling by tobacco retailers when they became aware of the impending tax rise in Victoria in December 1990. It was found that in August 1990 the reported tobacco sales escalated to $75 million.

9.66 The SDO has estimated that **schemes of evasion which were operating in the May 1991 to July 1991 period would be generating approximately $20 million in income a year. This translates to $10 million a year in evasion of business franchise licence fees**.

9.67 The Investigations Branch of the SDO has expended a significant amount of time and resources in an attempt to curtail the evasion. During 1990-91, investigations in this area detected unpaid fees amounting to $3.5 million.

Petroleum fees

9.68 Although the variance in the rate of State taxes in the petroleum area provides opportunity for evasion, the SDO has indicated that such activity is not as prevalent as in the area of tobacco products with evasion generally concentrated in Victoria's border areas due to the following factors:

- the unlicensed wholesalers require large capital investment to enable the purchase of petroleum tanker trucks for transportation;
- petroleum by its very nature is difficult to transport in a manner which will defy surveillance activities; and
- the margins between the various State's licence fees on petroleum products are not as great as exist in some instances in tobacco licence fees.

Standard audits of licensed tobacco and petroleum wholesalers

9.69 The SDO has a standard procedure whereby **licensed tobacco and petroleum wholesalers are to be visited once every 12 months** for the purposes of examining their systems for collecting, recording, and reporting business franchise licence fees. These audits are considered necessary to ensure that systems are operating correctly and that any changes to systems have not resulted in an underpayment of licence fees.

9.70 **The importance of this type of regular investigation was demonstrated in March 1990 when one large petroleum wholesaler made a voluntary disclosure and paid the SDO $23.4 million** in underpaid licence fees. The underpayments had arisen due to a computer programing deficiency.

9.71 Audit found that **annual investigations of wholesalers by SDO had fallen well behind schedule.** In summary, around half of the licensed tobacco wholesalers recorded at the SDO had not been subject to an examination of their systems for over 3 years. Of the 5 licensed petroleum wholesalers, 3 had not been subject to an examination for around 2 years.

Unlicensed tobacco retailers

9.72 The fee for an annual tobacco retail licence is generally $50. A person trading without a licence is liable to a fine of $2 000 if convicted of this offence. The court can also impose an additional penalty of double any amount which it is satisfied should have been paid to the Comptroller by way of a licence fee.

9.73 In 1988, the SDO obtained customer listings from all licensed tobacco wholesalers in Victoria in order to compare the listings with its records of licensed tobacco retailers. Subsequently, 17 500 letters were issued in July 1988 to persons suspected of trading without a licence. There were approximately 10 000 licensed tobacco retailers in Victoria at that time.

9.74 Only around 1 500 replies to the letter were received from persons wishing to apply for a tobacco retailer's licence. The SDO also attempted to identify unlicensed tobacco retailers in 3 inner-Melbourne suburbs in 1989. Since that time, the SDO has taken no significant additional steps to identify unlicensed tobacco retailers in Victoria or follow-up the 16 000 retailers who did not respond to the letter issued in 1988 advising of the legislative requirement to be licenced.

Diesel fuel exemptions

9.75 Purchasers of diesel fuel used for off-road purposes may apply to the SDO for a certificate to enable an exemption from the business franchise fee. The certificate permits the holder to purchase diesel fuel at a reduced rate as long as the fuel is used only for off-road purposes. Approximately 72 000 certificates have been granted by the SDO. Petroleum wholesalers are required to forward a schedule of such sales to the SDO on a monthly basis. From returns received, the SDO estimates that up to 50 per cent of diesel fuel sales amounting to **approximately $30 million a year are claimed as being for off-road use.**

9.76 Audit found that the control and monitoring of the exemption system is inadequate in that:

- Certificates are automatically issued to persons or bodies who complete a statutory declaration indicating that the fuel for which an exemption is given will be used for off-road purposes only. These certificates are held indefinitely unless the holder informs the SDO of any changes in circumstances or the SDO investigates the holder as a result of a complaint or related investigation; and
- Schedules of certificates submitted by petroleum wholesalers to support claims of exempt diesel sales are not regularly reviewed by the SDO for accuracy, completeness or validity of the certificate numbers.

9.77 Under present procedures, **the SDO has no assurance that amounts claimed as exemptions are in fact for off-road use or that the reduced rate applying to off-road diesel sales has been passed on by petroleum wholesalers and retailers to the certificate holders.**

Land transfers

9.78 Stamp duty payable on a transfer of land is calculated, using a progressive scale of percentage rates, as a proportion of the value of the property being transferred. The value of the property is defined in the *Stamps Act* 1958 as the purchase price or the amount for which the property might reasonably have been sold in the open market on the date of the sale, whichever is the greater.

9.79 In the majority of land transfers of an arm's length nature, little doubt exists regarding the price paid for the property as lodging parties are required to provide the contract of sale with the transfer documents. However, in circumstances where a transfer occurs between related parties and in instances where no consideration is involved, uncertainty may exist regarding the value to be assigned to the property for the purpose of calculating stamp duty payable. This issue is addressed in the *Stamps Act 1958* which provides for the Comptroller to express an opinion on whether a transfer of land is dutiable and to determine the amount of duty payable.

9.80 Transfers of land are to be submitted for opinion where they have any of the following characteristics:

- the transfer involves no financial consideration;
- a sale is between related parties;
- a sale is of a fractional interest in a property;
- a sale involves a licensed premises (involving goodwill);
- the transfer is associated with the winding-up of a company;
- certain transfers where the parties are claiming an exemption from stamp duty; and
- transfers resulting from the partition of property.

9.81 In certain cases, documents submitted for assessment are referred by the Comptroller to the Valuer-General for valuation. In the 7 financial years to 1990-91, the Comptroller has referred approximately 19 000 properties for valuation. **The Valuer-General's valuation for these properties exceeded their declared values by in excess of $391 million resulting in the imposition of approximately $13 million in additional stamp duty. The average increase in duty for all referrals during 1990-91 was $495 representing a return of around $5 for every $1 of valuation costs.**

9.82 Despite these positive results, the number of properties referred by the Comptroller has declined by over 50 per cent since 1984-85. Funding provided to this function has been further reduced in the 1991-92 budget by $80 000. Based on the outcomes in 1990-91, audit estimates that the latest budget reduction will reduce the number of referrals by approximately 830 and result in a net loss to the Consolidated Fund of approximately $332 000.

9.83 In addition, the criteria currently being applied by the Comptroller in selecting properties for referral to the Valuer-General are considered by audit to be deficient in the following aspects:

- Properties are to be referred where the declared value of the property is less than 40 per cent higher than the municipal capital improved value in the case of Melbourne central business district properties or 20 per cent higher for properties in other locations. Audit inquiries revealed that municipal values for Melbourne metropolitan municipalities were set between 1986 and 1988 and have not been adjusted since that time. Data obtained from the Valuer-General's Office at December 1990 indicated that the average increase in the price of dwellings across the State since 1986 was approximately 57.6 per cent with an average increase of over 200 per cent in Melbourne central business district prices; and
- There is no systematic reference to external data on property values when assessing the reasonableness of declared values of properties. Audit investigations revealed that such data on property values is available on a periodic basis from the Valuer-General's Office at minimal cost.

9.84 A random sample of land transfer documents lodged for assessment during 1990-91 was selected by audit for comparison with data obtained from the Valuer-General's Office on the average property value for the relevant localities at the time of transfer. The comparison revealed that 65 per cent of the declared values were under the value provided by the Valuer-General.

9.85 On the basis of the results of referrals in 1990-91, audit estimates that additional duty of around $3.4 million could have been identified at a cost of around $672 000 if documents for referral had been selected on the basis of data available from the Valuer-General.

Management response

Because of the careful culling of cases referred to the Valuer-General it does not follow that additional references would generate the same revenue as those cases referred.

The SDO has already taken steps to obtain the valuation data from the Valuer-General's Office on a regular basis.

Financial Institutions Duty

9.86 The *Financial Institutions Act* 1982 imposes duty on certain receipts of financial institutions and short-term money market operators. While the financial institutions are liable to pay the duty, in practice it is generally passed on to their customers.

9.87 The Act requires certain institutions or persons to be registered with the SDO and to furnish a monthly return within 21 days after the end of each month together with the duty due. Each return is to detail the total value of dutiable receipts in the month and the total number of individual dutiable receipts of, or exceeding, $2 million. The duty payable is calculated at the rates of 0.06 per cent on dutiable receipts less than $2 million and $1 200 per receipt of $2 million or more. A registered short-term money market operator is required to return details of the daily liability of short-term dealings for the month and the duty payable on this figure at the rate of 0.005 per cent.

9.88 The SDO estimates that receipts from the 4 major trading banks constitute 90 per cent of total Financial Institutions Duty (FID) collections.

9.89 Collections are based on a system of self-assessment and information provided on returns is accepted at face value although some arithmetic checking is performed by the SDO. No detailed analysis or research has been undertaken by the SDO of the estimated level of avoidance or evasion which may exist in the FID area and details of the turnover of receipts in the State's financial markets are not monitored on a regular basis. The SDO is therefore very dependent on individual investigations to detect unpaid duty.

9.90 Although some minor investigations have been undertaken in the 4 major trading banks, in past years investigations have concentrated on other FID taxpayers. In June 1990, the SDO initiated its first full-scale audit of a major trading bank since the introduction of the duty in 1982. The investigation was initially intended to examine all aspects of FID with completion in approximately 2 months. However, difficulties experienced during the review, as a result of delays caused by the bank, considerably extended the time involved and the review is still continuing.

9.91 As a result of investigation activity in 1990, voluntary disclosures amounting to $9.3 million were made by major banks. Of these disclosures, over 80 per cent related to duty on receipts of private foreign currency accounts and foreign currency short-term dealings. Audit was advised that while such material disclosures are usually reviewed by the SDO for accuracy and completeness no such review was undertaken in these cases.

9.92 Details of the results of investigations in the FID area during the last 4 years, including the voluntary disclosures, are set out in Table 9I.

TABLE 9I. FID INVESTIGATIONS

Item	*1987-88*	*1988-89*	*1989-90*	*1990-91*
Number of investigations completed	93	126	102	111
Revenue detected ($'000)	110	1 950	2 600	12 590

9.93 On the basis of the results of investigations and level of voluntary disclosure in the area of FID during 1990-91, there is strong evidence to suggest that all duty due is not being collected.

Management response

There have been in past years a number of substantive investigations involving the major banks.

Investigations procedures

9.94 The self-assessing nature of many of the revenue collection areas of the SDO results in investigation processes forming a key element in detecting unpaid revenue and in encouraging legislative compliance.

9.95 The key objectives of the Investigations Branch of the SDO are to:

- conduct inspections and investigations of taxpayers' affairs and records to determine compliance with relevant legislation, identify avoidance or evasion schemes and ensure that the correct amount of duty has been paid;
- ensure that legitimate taxpayers are not undermined by their tax evading competitors; and
- ensure that the public are made aware of the relevant legislation and their liabilities under the relevant Acts.

9.96 Table 9J discloses the results of investigation activity during the past 3 years.

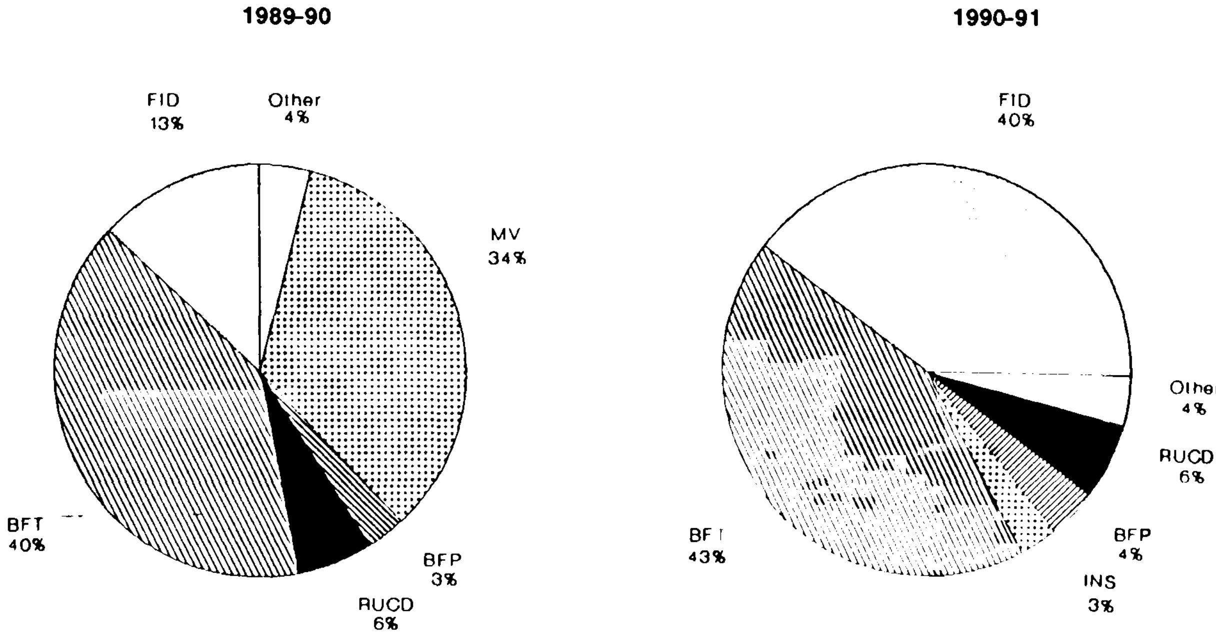
TABLE 9J. INVESTIGATION RESULTS

Item	*1988-89*	*1989-90*	*1990-91*
Additional revenue -			
Revenue detected ($millions)	18.4	20.7	8.3
Voluntary disclosures ($millions)	-	23.4	13.3
Total	18.4	44.1	21.6
Number of investigations	681	677	494
Expenditure ($millions)*(a)*	1.2	1.3	1.2

(a) Direct salary costs.

9.97 Chart 9K highlights that, **excluding voluntary disclosures**, a substantial proportion of the unpaid revenue detected in the past 2 years related to FID and tobacco franchise fees.

CHART 9K. DETECTED REVENUE



KEY

FID	-	Financial Institutions Duty	RUCD	-	Registered used car dealers
BFT	-	Business franchise - Tobacco	MV	-	Motor vehicle manufacturers
BFP	-	Business franchise - Petroleum	INS	-	Insurance companies

9.98 The audit review found that **the current resource levels and systems and procedures of the Investigations Branch are inadequate to ensure all areas of potential risk are effectively covered.** Specific details follow.

Forward planning and overall strategies

9.99 Insufficient attention has been given to regularly analysing the various areas of the tax base and developing strategic plans on the basis of risks identified. In particular:

- Very little forward planning has been conducted. Planning has not been considered by management to be feasible due to present resource constraints and the need for flexibility to cater for unpredictable problems which arise;
- A formal methodology, including criteria for assessing risks and materiality, is not in place to assist in the prioritisation process; and
- Regular research into, and assessments of, possible avoidance and evasion areas (in each tax base) has not been undertaken.

Coverage of the tax base

9.100 Statistics are maintained by the SDO on the number of investigations conducted in each category of taxpayer. **However, information is not available within SDO to analyse the proportion of the tax base covered in dollar terms or determine the detection cost in each segment of the tax base.**

9.101 An analysis of available information highlighted that while the SDO has attempted to protect the tax base by maintaining a presence in most collection areas, the coverage has varied significantly between categories of taxpayers with little or no coverage in some areas. **There was evidence to indicate that the level of coverage in some areas was not commensurate with the risk of avoidance or evasion or the size of the tax base.** It appeared to audit that a more appropriate allocation of resources was necessary. For example, over 12 per cent of the total collections of the Office during 1990-91 related to receipts from the 4 major banks in the form of FID. However, as indicated previously in this Report **only one full-scale audit had been initiated of a major bank since the FID legislation was enacted in 1982.**

9.102 Similarly, the level of investigation activity was not in line with past detection results. While 38 per cent of investigator hours were allocated to investigations of registered used car dealers, detection in this area represented only 6 per cent of the total detections in 1990-91. In addition, collections from dealers were only 4 per cent of the total SDO collections for the year.

Resourcing of Investigations Branch

9.103 The Investigations Branch has a total staff establishment of 51 positions of which between 12 and 15 have been vacant for the past 3 years.

9.104 In recent years, the Branch has provided resource assistance to a number of task forces established in conjunction with law enforcement agencies. These projects, which have included investigations of car dealers and surveillance within the tobacco industry, have been considered by the SDO to be of assistance in detecting State revenue and protecting the revenue base from future evasion. Nevertheless, they have directed resources away from the Office's ongoing routine investigations.

9.105 Available resources are primarily directed to investigating matters referred to the Branch from within the SDO or as a result of information from external parties. In recent years, the Branch has not had sufficient resources to investigate many of the cases referred. Consequently, 820 taxpayer files referred to the Branch were pending at 30 June 1991 of which 27 had been assigned a high priority.

9.106 In May 1990, the SDO prepared a submission to the Department of the Treasury requesting funding to fill all vacant positions. The submission indicated that approximately $1.5 million would be required to fill the positions and that expected revenue of between $7 and $20 million could result from increased investigation activity, particularly in the FID and tobacco franchise areas.

9.107 Subsequent to the submissions, the SDO was given approval to advertise the vacant positions and recommendations for appointments were made. However, delays resulting from public sector workforce management practices and recent budget cuts have resulted in the appointments not proceeding.

9.108 The current vacancy levels of the Branch have placed substantial strain on resources and have limited the coverage of the tax base. The results obtained with the current level of activity, in addition to the potential undetected revenue disclosed in this Report, highlight the need to carefully assess the resource requirements of the Investigations Branch of the SDO.

Management response

Allocation of investigative priorities does not turn simply on the size of a revenue base. It is agreed that substantial scope exists to increase revenue through investigations. The matter is being addressed.

Information systems and management reporting processes

9.109 The systems currently in place in many revenue collection areas of the SDO are antiquated manual systems which are inadequate for the information needs of management and in many cases contribute to delays in the identification and subsequent collection of outstanding amounts. Systems are also time consuming to operate and cumbersome to maintain. Major deficiencies in the present systems and reporting processes include the following:

- Statistical information such as the number of various types of documents processed, the number of taxpayers in each tax base, the number and age of outstanding revenue in each area and information on the number of matters referred to the investigation or legal sections is not reported and analysed on a regular basis. During the examination, audit was provided with 3 different sets of figures on the number of taxpayers in the tax base;
- Formal reports provided to senior management are generally limited to analyses of actual revenue collections compared with estimates;
- Information on the total costs of activities such as collecting each type of duty, undertaking individual investigations and developing computer applications cannot be readily determined and monitored;
- Information provided to the SDO from the Roads Corporation is inadequate to enable satisfactory monitoring of dutiable motor vehicle transactions;

- Insufficient statistical information from external sources such as the Valuer-General's Office, the Australian Stock Exchange and the Reserve Bank is maintained by the SDO. Such information would assist in the analysis of revenue data and the identification of possible trends in tax avoidance or evasion activities; and
- The recording systems in many areas of revenue collection are manually maintained requiring several cards for each taxpayer to be updated for each transaction. Many calculations, or re-calculations, of financial data are also performed manually. The nature of these processes contributes to delays in the update of records and inaccuracies resulting from human error.

9.110 The absence of suitable computerised systems for processing transactions and providing timely reliable data on the operations of the Office has inhibited the efficient and effective collection of revenue for many years. In view of the major contribution SDO revenue collections make to the State's finances, audit considers the current systems and reporting processes are totally inadequate.

9.111 The need for improvements in systems has been recognised by the SDO for a number of years.

9.112 Approval for funding of an EDP Strategic Plan covering the 1987-88 to 1989-90 period was obtained in November 1988. The strategy was to involve the acquisition of additional computer hardware, the expansion and restructure of the Information Services Branch of the SDO and the development of various applications suitable for the revenue collection and administrative support areas of the Office. Funding of $6.6 million was to be provided over a 5 year period. Increases in revenue as a direct result of computer systems installation was conservatively estimated by the SDO in November 1987 to be $6.8 million over a 3 year period. It was envisaged that the systems would primarily be developed or upgraded within the SDO by small project teams consisting of in-house staff and, where necessary, external consultants.

9.113 Hardware costs to date have amounted to $1.5 million. However, a comprehensive analysis of the total costs of systems development and implementation, including in-house resource costs, have not been undertaken by the SDO and actual and updated estimates of revenue increases and/or cost savings resulting from systems implementation have not been quantified.

9.114 Audit found that delays have occurred in the implementation process with the development of several systems not yet commenced. A number of factors have contributed to these delays, namely:

- The computer site was not completed to a stage where hardware could be installed until January 1990. This was over 6 months after the equipment was selected;
- The approval of funding of the strategy was delayed;

- The time required to develop a number of systems was underestimated by the SDO; and
- Systems development was deferred in some cases as a result of delays in the commencement of consultants required to assist in the project. Insufficient staff resources to manage the consultants and insufficient space to locate them contributed to this position.

Management response

It is a gross overstatement to say that current systems and reporting processes are totally inadequate. The manual system, (the unappropriated moneys account) which did fall into this category had long since been replaced by an efficient EDP system by the time the recent audit was conducted. Some other systems have already been converted to efficient EDP-based systems, and while there is room for improvement in the remaining manual systems those deficiencies are being addressed

Management has a commitment to redress information system deficiencies and to maintain the EDP implementation timetable despite some set backs, and substantial progress has been made to date which accords with that timetable.

Relationship between the SDO and external agencies

9.115 Substantial revenue has been collected on behalf of the Comptroller at the Land Titles Office and Roads Corporation. **The rights, responsibilities and reporting requirements of each party in the arrangement have not been clearly defined.** In addition, costs of the functions performed at the Roads Corporation and the Land Titles Office on behalf of the Comptroller have not been quantified.

Management response

The reporting processes between the SDO and the Roads Corporation have for over 12 months been the subject of a substantive review, and appropriate changes are being progressively made.

It is agreed that additional documentation of the roles of the interacting agencies would be helpful.

Land Titles Office - One Stop Shop

9.116 In November 1985, at the instigation of its members, the Law Institute of Victoria wrote to the Treasurer suggesting that stamping and lodgement of documents relating to land transfers and mortgages be streamlined. It was found that the system in place at the time which involved up to 2 visits to the SDO and one visit to the Land Titles Office for lodgement and registration, was "archaic in an age of computerisation". The Institute suggested a process whereby moneys and documents associated with registration and stamping be simultaneously lodged to achieve a more efficient and effective system of collection. A One Stop Shop was subsequently established within the Land Titles Office.

9.117 When first established, the principal role of the One Stop Shop was to provide a point of simultaneous lodgement **and to service the vast majority of land transfer and mortgage transactions**. It was estimated that the value of dealings would be around $115 million in 1988-89 and that savings to government resulting from elimination of double handling of documents would be $6 million a year.

9.118 The One Stop Shop has now been in operation for 3 years. However, discussions with the SDO and an analysis of results to date suggest that its objective of making conveyancing in Victoria cheaper and more simple have not been achieved.

9.119 A study undertaken by the Land Titles Office to identify its most frequent users disclosed that the major banks accounted for approximately 45 per cent of all lodgements. Lodging agents and large firms of solicitors were also identified as major users. However, it was found that **these parties** after initially trying the One Stop Shop **found it to be inefficient and time consuming** and subsequently reverted to the previous system whereby the documents were lodged for assessment overnight at SDO with the duty paid and documents collected the next day.

9.120 Table 9L shows the proportion of total stamp duty revenue relating to land transfers and mortgages collected at the One Stop Shop in 1990-91.

TABLE 9L. LAND TRANSFER AND MORTGAGE COLLECTIONS, 1990-91

Document type	*One Stop Shop collections*	*Total collections*	*Proportion of collections at the One Stop Shop*
	($m)	*($m)*	*per cent*
Land transfers	102	535	19
Mortgages	3	66	5

9.121 An average of around 160 documents a day (compared with an original estimate of 1 000) have been processed at the One Stop Shop representing approximately 10 per cent of all document lodgements. In the early months of operation it was recognised that the Land Titles Office computer systems had difficulty coping with even 250 lodgements a day.

9.122 Simultaneous lodgement at the One Stop Shop services only a minority of users and consequently it is unlikely that expected savings have eventuated. Audit estimates that the cost to SDO of locating staff at the One Stop Shop is in excess of $100 000 a year. However, the total costs and savings to the Government, the SDO, the Land Titles Office or the community resulting from its operation have not been quantified.

Management response

It is agreed "the objectives of the One Stop Shop of making conveyancing in Victoria cheaper and more simple have not been achieved". At the direction of the Treasurer, the SDO announced on 11 September 1991 that the One Stop Shop facility will cease on 30 September 1991.

STATE TAXATION OFFICE

Key conclusions

9.123 It was pleasing to find that many of the matters highlighted in the 1989 audit review concerning the collection of payroll tax and land tax are in the process of being addressed by the State Taxation Office (STO). The more timely follow-up of outstanding payroll tax returns, an expansion of investigation activities and a more stringent approach to the imposition of penalties **has significantly improved the timeliness of collections in the past 2 years and increased the detection by the STO of unpaid payroll tax.**

9.124 The primary function of the STO is the collection of payroll tax and land tax. Collections of the STO in 1990-91 amounted to $2.4 billion. Specific comments on the follow-up of matters previously raised by audit on payroll tax and land tax collections are set out in the following paragraphs.

Outstanding collections

9.125 Outstanding amounts due to the STO in relation to payroll and land tax have increased from $74.6 million in 1988-89 to $150 million in 1990-91, thus contributing to the liquidity difficulties experienced by the Consolidated Fund over the period.

9.126 Audit was advised that the key factors contributing to the increased debtor levels have been:

- The significant increase in the tax base over the period (90 per cent land tax, 24 per cent payroll tax);
- The increase in the payroll tax rate from 6 to 7 per cent in 1990-91;
- The earlier issue of default assessments, resulting in the earlier recognition of debtors;
- Increased investigatory activity in 1990-91 resulting in the raising of additional assessments on account of underpaid tax during the year; and
- The impact of the current economic downturn on taxpayers' ability to pay and on business insolvencies. The gross debt in the insolvency area has increased from $21.3 million to $31.6 million in the last 12 months. In addition, debts amounting to $19.6 million were written off during the period.

Management response

STO disputes that the outstanding amounts due have increased by $75.4 million over the past 2 years and maintains that the increase is only $36 million. The figures used by audit are not properly comparable. If each figure is calculated using the same method, the 1988-89 figure becomes $102.3 million and the 1990-91 figure $138.2 million.

The original 1988-89 figure of $74.6 million did not include estimated amounts owing by employers who had not lodged returns and who had yet to receive default assessments, nor did it include estimated amounts owing by those insolvent employers whose payroll tax debt was unknown. The original 1990-91 figure included both of these amounts and also included estimated amounts owing by insolvent taxpayers at an inflated figure.

The STO agrees with the key factors listed in paragraph 9.126 but points out that the major factor has been the 90 per cent increase in the land tax base over the period. This, coupled with the economic downturn and the issue of many assessments shortly before 30 June (leaving insufficient time to take stringent recovery action before 30 June), has led to an increase in the amount of outstanding land tax at the end of the financial year.

STO contends that the level of outstanding payroll tax has been well contained in all the circumstances.

Payroll tax

9.127 The *Payroll Tax Act* 1971 provides for payroll tax to be levied on salaries, wages and other benefits paid by employers in cash or kind. In 1990-91, the tax was generally applied to employers with payrolls over $410 000 a year at the rate of 7 per cent on wages in excess of that amount.

9.128 Employers liable for payroll tax are in the main required to lodge a monthly return of wages, together with the payment of due tax, within 7 days of the close of each month.

Follow-up of outstanding returns

9.129 In circumstances where employers fail to lodge a return, the STO issues a tax assessment to the employer for the payroll tax liability estimated on the basis of past wage details. Audit found that the delays of up to 3 months in issuing assessments which existed in 1989 have been reduced. Assessments are now issued within 6 to 7 weeks after an employer has defaulted. The STO has advised that these measures have contributed to a decrease in the average number of outstanding returns per defaulting employer from 2.25 in 1989-90 to 1.92 in 1990-91.

Imposition of penalties

9.130 The legislation provides for additional tax of double the amount of assessed payroll tax to be levied where a taxpayer fails to lodge a return by the due date. Investigations undertaken by audit during 1988-89 disclosed that penalties of up to 50 per cent of the tax due were generally imposed. However, the penalties were frequently reduced to 20 per cent a year when the outstanding returns were received or on the application of the taxpayer.

9.131 In addition, penalties were not imposed at that time where amounts were received after the due date but within the month. Audit questioned the equity or effectiveness of these practices which favoured defaulting taxpayers while not rewarding taxpayers for prompt payment.

9.132 The enhancement of computer systems to enable the automatic issue of penalty assessment notices was completed in April 1991. The STO has advised that since that time penalties have been imposed where payroll tax is received on or after the 10th day of the month in which it is due.

9.133 Guidelines developed early in 1990 by the STO regarding the imposition of penalties set out the flat rates of additional tax to be applied to default assessments based on the number of periods which are outstanding. The penalty, ranging from 30 to 50 per cent, escalates in accordance with the increased delinquency of the employer. In practice it is now very uncommon for penalties to be reduced from a flat rate to 20 per cent a year. **The more timely follow-up of outstanding returns and the stricter enforcement of penalty provisions has contributed to increasing the amount of payroll tax collected by the due date from 40 per cent in 1988-89 to around 70 per cent in 1990-91.**

Arrangements for payment by instalment

9.134 The Commissioner may permit the payment of payroll tax to be made by instalments. Additional tax is payable in these cases at an annual rate of 20 per cent of the amount of tax unpaid.

9.135 The Commissioner has advised that the number of applications for arrangements increased markedly throughout 1990-91 reflecting the economic downturn and an increase in the number of under-declarations detected during inspection or education activities. Consequently, **amounts due under the arrangements has increased from $4 million at 30 June 1990 to $5 million at 30 June 1991.**

Investigations

9.136 The Investigations Branch of the STO has for a number of years been involved in the inspection of various taxpayers with the aim of identifying unpaid tax. The Office has also more recently embarked on a Compliance Assistance Program designed to increase the level of compliance by taxpayers through education. Resources for these activities were increased in 1990-91 on the basis of their application to a number of specific projects. It was pleasing to find that the increase in revenue collections of the State which were expected by both audit and the STO to result from greater prominence to tax avoidance and evasion has been achieved. The results of investigations over the past 3 years are set out below.

TABLE 9M. INVESTIGATION RESULTS

Item	*1988-89*	*1989-90*	*1990-91*
Additional revenue -			
Payroll tax detected ($million) -			
Recurring activities	5.0	7.0	5.5
Special projects	-	-	9.4
Compliance Assistance Program	-	-	10.5
Total	5.0	7.0	25.4
Number of investigations	428	346	803
Expenditure ($millions)*(a)*	0.7	0.9	1.6

(a) Direct salary costs.

9.137 As highlighted, **the expansion of the investigation and education functions has identified additional net revenue of over $23 million in 1990-91** of which $11.5 million has been realised. These programs are to continue in 1991-92.

Land tax

9.138 Land tax is an annual tax imposed on the unimproved value of all taxable land held by the taxpayer, at the preceding 31 December, where the taxpayer's holdings reach or exceed a threshold value. The threshold has increased from $84 000 which applied for 1988 assessments to $150 000 for those issued in 1991. In 1988, approximately 75 000 landholders were liable to land tax compared with 70 000 in 1991.

9.139 Comment was previously made by audit regarding the longstanding procedure of the STO of issuing assessments to landowners progressively throughout each assessment year. Audit estimated that if all assessments had been issued within the first quarter of the 1988 assessment year and payment was received by the due date, between $9 million and $14 million in additional interest could have accrued to the State.

9.140 Since that time, the practice of progressively issuing assessments has continued at the STO. However, **the proportion of assessment issued in the first quarter of the year has increased from only 2 per cent in 1989 to 47 per cent in 1991.**

9.141 A 1991 report resulting from a comprehensive review of land tax in Victoria undertaken at the request of the Government by the Hon. Robert Fordham M.P. made a number of recommendations for changes in the land tax system. The Government has subsequently accepted the majority of these recommendations including a change in the timing of issuing assessments. **In future, it is proposed to issue all assessments by the end of the first quarter of the land tax year.**

Information systems

9.142 For a number of years, audit comment has been made on serious deficiencies in information systems in place within the STO and on the restrictions of the systems on the identification and timely recovery of all tax due. Long-term strategies aimed at addressing systems deficiencies were in the process of being developed by the STO at the time of the 1989 review. Funding of the strategies over a 5 year period was subsequently approved and in April 1991, a contract was entered into with a computer consulting firm for the development and implementation of a generic revenue collection system to facilitate payroll tax and land tax processing and to cater for any changes in revenue collection strategies of the State. **The system, estimated to cost around $21 million, is expected to be fully implemented over the next 3 years with the new payroll tax system expected to be available in 1992.**

PART 10

OTHER MATTERS RELATING TO THE FINANCE STATEMENT

KEY FINDING

- During 1991 the Government unsuccessfully sought parliamentary approval to authorise expenditure of $35 million which was incurred without parliamentary authority in 1989-90.

Paras 10.3 to 10.4

Treasurer's Acquittance

10.1 Section 34 of the *Audit Act* 1958 requires the Auditor-General to acquit the Minister for Finance for the amount of the public moneys spent which has been ascertained to have been duly and properly expended. This section excludes from the acquittance expenditure which is *"... the subject of query or observation or of show cause action or of disallowance or surcharge".*

10.2 All moneys disbursed from the Public Account in 1990-91 were acquitted to the Minister for Finance except for the value of advances totalling $10.5 million held by departments at 30 June 1991.

Unacquitted 1989-90 Expenditure

10.3 My *Report on the Treasurer's Statement, 1989-90,* referred to an amount of $35 million, representing interest charges that were paid from the Consolidated Fund without parliamentary authority, which was not acquitted.

10.4 Following an inquiry by the parliamentary Economic and Budget Review Committee into this matter, the Government introduced legislation into the Parliament to validate the unauthorised expenditure. **This legislation was subsequently rejected by the Legislative Council and, therefore, the $35 million unauthorised expenditure remains unacquitted.**

Trust Fund

10.5 The Trust Fund, which is separate from the Consolidated Fund, records transactions relating to:

- various suspense and clearing accounts which have been established to facilitate accounting procedures and to improve cash management;
- the Works and Services Account;
- the Victorian Development Fund, encompassing the Cash Management Account and the State Development Account;
- several Commonwealth and joint Commonwealth/State trust accounts used for passing specific Commonwealth Grants etc. to educational institutions, housing and transport authorities;
- specific State trust accounts established by legislation for specific purposes, e.g. Hospitals and Charities Fund; and
- accounts established to manage bequests, scholarships etc.

10.6 Summaries of the transactions and balances of the various trust accounts comprising the Trust Fund are given in the *Finance Statement.*

10.7 The *Public Account Act* 1958 allows the Minister for Finance to establish new trust accounts and indicate the purpose for which they were established. Details of new accounts opened within the Trust Fund during 1990-91 and their specified purpose are set out in Table 10A.

TABLE 10A. NEW TRUST ACCOUNTS

Account or Fund	*Purpose for which established*
Archival Heritage Program Trust Account	To record the receipt, investment and disbursement of sponsorship funds received by the Ministry of Arts for Archival Heritage projects.
Cash Suspense Accounts - Ministry for the Arts, Office of the Auditor-General	To facilitate the drawing by the agencies of their own cheques and the drawdown of funds from the Public Account to meet such cheques.
Debt Retirement Trust Account	To receive from the Consolidated Fund net proceeds from the sale of certain designated assets and to pay those proceeds to the Victorian Debt Retirement Authority.
Environment Protection Fund	To receive and invest moneys provided by the Parliament, which may be paid at the direction of the Treasurer as grants or advances to meet the cost of carrying out any necessary works for treatment or disposal of wastes.
Mental Health Research Institute Trust Account	To record the receipt and payment of funds associated with the operation of the Institute.
Ministry of Finance Revenue Suspense Account	To aid improved cash management procedures.
Rental Accommodation Trust Account	To record the receipts from Departments and subsequent payments of rental accommodation funds.
Special Purpose Trust Account	To receive a special advance and special appropriations funded from a special motor spirit levy and make payments to Farrow Group Building Society depositors together with associated costs, and to retire State debt.
Urban Infrastructure Trust Fund	To record the receipt and disbursement of funds for service co-ordination and integration projects.

TABLE 10A. NEW TRUST ACCOUNTS - *continued*

Account or Fund	*Purpose for which established*
Working Accounts - Rural Water Commission	To record appropriations equivalent to revenue paid by the Commission to the Consolidated Fund and to provide a facility for funding the cash flow requirements of the Commission.
State Government Vehicle Pool	To record the transactions of the vehicle pool including the direct charging of all purchases and operating expenses.

10.8 The following accounts were closed during 1990-91:

- Youth Guarantee Program Trust Account; and
- Victorian Conservation Trust Account.

Balances of the Public Account

10.9 The transactions recorded in the Public Account for the past 2 years and the investment of the resulting balances are summarised in Table 10B.

TABLE 10B. RECEIPTS AND PAYMENTS OF THE PUBLIC ACCOUNT
($million)

Item	*1990-91*	*1989-90*
Balance 1 July	407	436
Receipts -		
Consolidated Fund	15 730	12 910
Trust Fund -		
Works and Services Account	1 024	519
Other	80 632	66 391
	97 793	80 256
Payments -		
Consolidated Fund	15 730	12 965
Trust Fund -		
Works and Services Account	1 110	474
Other	80 552	66 410
	97 392	79 849
Balance 30 June	**401**	**407**
Represented by the following investments -		
Trust Fund -		
Cash at bank	22	(5)
Fixed deposit accounts	9	10
State Bank equity contribution	-	45
Stocks and securities	3	3
Investment with the Victorian Development Fund	334	262
Advances -		
Consolidated Fund *(a)*	22	22
Departments and other purposes	11	70
Total Trust Fund	401	407
Consolidated Fund	nil	nil
Total investments at 30 June	**401**	**407**

(a) Previous Reports of the Auditor-General have referred to the fact that the balance of Consolidated Fund deficits of $22 million to 30 June 1970, which was financed by way of advances from moneys standing to the credit of the Trust Fund, was still unfunded. These deficits were incurred prior to amendments to the Public Account Act in 1970 which now precludes the Consolidated Fund from going into deficit.

10.10 As previously mentioned in Part 1 of this Report, the balanced receipts and payments position of the Consolidated Fund at year-end is arrived at after inclusion of borrowings.

10.11 The net effect of the year's transactions was a decrease of $6 million in the total balances of the Public Account, brought about by an equivalent decrease in the balance of the Trust Fund.

Transfer of Appropriations

10.12 The *Audit Act* 1958 provides that I summarise in my Report approvals given by the Governor-in-Council for the transfer of appropriations between items within programs. These transfers do not vary the upper limit of the parliamentary authority for expenditure of funds under each program.

10.13 Total transfers under section 25 of the *Audit Act* 1958 for 1990-91 are summarised in Table 10C.

TABLE 10C. TRANSFERS UNDER SECTION 25 OF THE AUDIT ACT 1958 ($'000)

Entity (a)	*Total transfers approved*
Agriculture and Rural Affairs	1 127
Arts	331
Attorney-General	32
Community Services	1 411
Conservation and Environment	1 467
Corrections	1 564
Education and Training	15 823
Ethnic, Municipal and Community Affairs	228
Finance	438
Health	584
Parliament	221
Planning and Housing	981
Premier	443
Sport and Recreation	10
Transport	41
Treasurer	4 529

(a) In accordance with program titles within the *Appropriation (1990-91, No. 1) Act* 1990.

10.14 In previous years details of section 25 transfers were not detailed within the *Finance Statement*. However, the Economic and Budget Review Committee, in its March 1991 report to the Parliament, recommended that these transfers be reported within the *Finance Statement* to enhance the accountability of the Executive Government to the Parliament. It was pleasing to note that the Committee's recommendation has been adopted by the Government and all section 25 transfers for 1990-91 are recorded in Appendix 2 to the *Finance Statement*.

PART 11

COMPANIES, TRUSTS, JOINT VENTURES AND INCORPORATED ASSOCIATIONS

KEY FINDINGS

- The growing practice of using companies, trusts, joint ventures and incorporated associations to conduct a widening range of activities on behalf of public bodies and government agencies has reduced the effectiveness of the traditional accountability framework to the Parliament and the taxpayer.

  Paras 11.12 to 11.15

- Due to deficiencies in the existing guidelines, and the failure of the central agency and many public bodies to comply with the guidelines, audit concluded that the framework established by the Government to monitor and control the operations of public sector subsidiaries has not been effectively implemented.

  Paras 11.16 to 11.24

Previous reviews

11.1 My *Second Report for 1985-86* reported on the extent of involvement by public bodies and government agencies in companies, trusts and joint ventures. That Report disclosed that the principal reasons for investment in such entities were to provide greater financial and operating flexibility to the management of government-owned and controlled entities, and to encourage private sector participation in public sector ventures of a commercial nature.

11.2 Audit reported a lack of appropriate accountability mechanisms for such investments and recommended that significant improvements be initiated to increase the degree of reporting to both the Government and the Parliament.

11.3 The Government, through the Department of the Treasury, responded positively to the audit recommendations by issuing the *Guidelines for Companies, Joint Ventures and Trusts* in October 1987 which were to be applicable to Victorian public sector entities. These guidelines require that details regarding all controlling interests in companies, trusts and joint ventures be given by agencies to the Department of the Treasury. **The Department, in turn, established and undertook to maintain a central register of all such investments, a responsibility which has since been assumed by the Ministry of Finance.**

11.4 The April 1991 Auditor-General's *Report on Ministerial Portfolios* also commented on the nature and extent of private practice trust arrangements for full-time medical practitioners in public hospitals. **This matter is presently being considered by the Parliament's Economic and Budget Review Committee.**

11.5 My Office has been advised that the Department of the Premier and Cabinet recently undertook a review which focused on examining the nature, extent and appropriateness of companies, trusts and joint ventures directly established by departments. **The results of the review were recently considered by the Cabinet.**

Current audit review

11.6 In 1991 audit undertook a further review of all companies, trusts, joint ventures and incorporated associations in which controlling interests were held by public bodies and government agencies to determine whether the accountability framework established by the Government in 1987 had been effectively implemented. The data used in this review was sought as at 30 June 1991 from the majority of public bodies and agencies subject to audit by the Auditor-General.

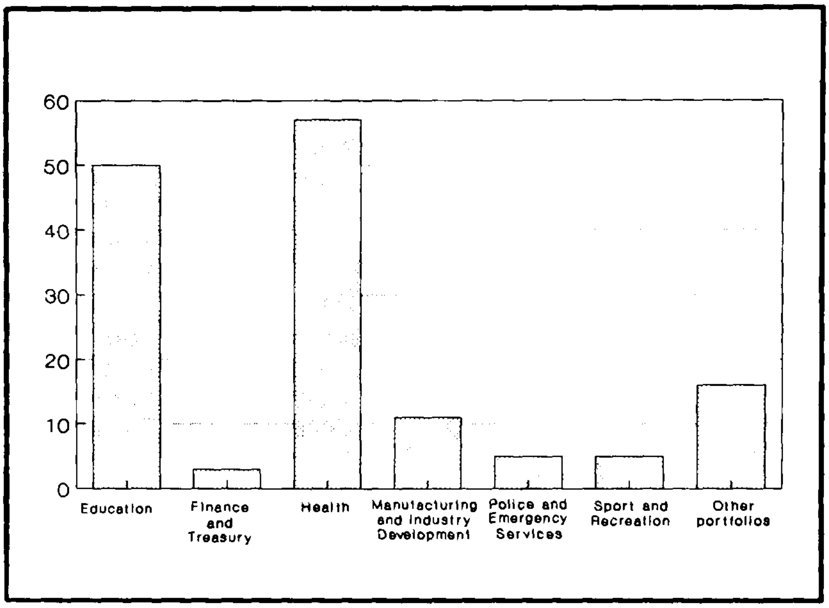
11.7 It is disappointing that 26 public bodies and agencies did not respond to the audit request for financial information in relation to 44 subsidiaries which came under their control. The entities concerned consisted of:

- 11 post-secondary educational institutions;
- 5 public hospitals;
- 3 departments; and
- 7 public bodies.

Extent of public sector involvement

11.8 The number of public sector subsidiaries in the form of companies, trusts, joint ventures and incorporated associations at 30 June 1991, is highlighted in Chart 11A. The information depicted in this chart, which is classified on a ministerial portfolio basis, **indicates that at 30 June 1991 there were in existence 147 subsidiaries, which comprised 69 companies, 69 trusts, 4 joint ventures and 5 incorporated associations.**

CHART 11A. PUBLIC SECTOR SUBSIDIARIES BY MINISTERIAL PORTFOLIO, AT 30 JUNE 1991



11.9 Information in the latest annual reports in respect of 103 of the 147 subsidiaries indicated that they collectively:

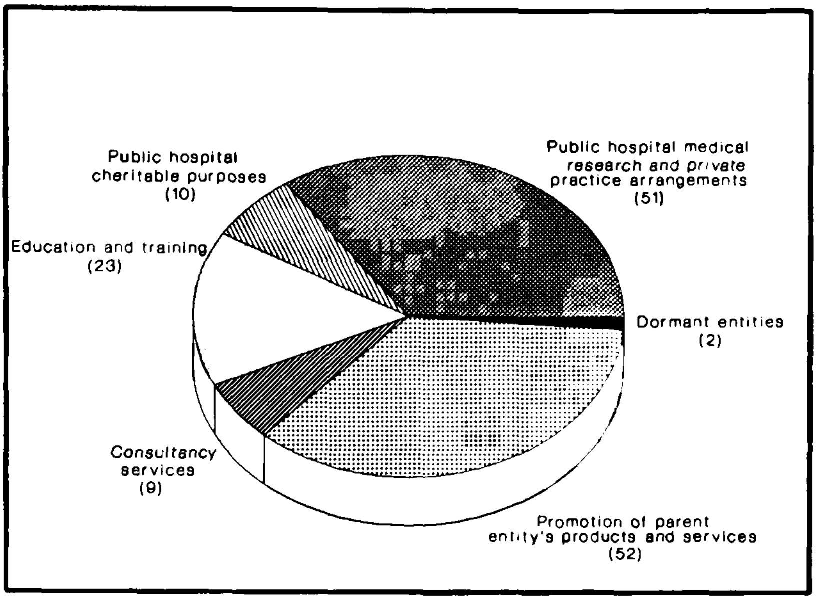
- owned or controlled assets of $347.1 million; and
- incurred liabilities of $341.9 million.

11.10 Further analysis by audit revealed that:

- 16 subsidiaries reported losses totalling $89.4 million;
- 74 subsidiaries reported profits totalling $23.3 million, (of which 48 entities were in the health sector, with profits totalling $13.6 million); and
- 13 subsidiaries reported a "break-even" operating result.

11.11 The principal activities of the 147 subsidiaries are shown in Chart 11B.

CHART 11B
PRINCIPAL ACTIVITIES OF PUBLIC SECTOR SUBSIDIARIES, AT 30 JUNE 1991



Level of public accountability

11.12 To achieve an adequate level of public accountability, parent bodies need to report to their responsible Ministers, the Parliament and the public on all aspects of their subsidiaries' operations. **Such a requirement is warranted when one considers that the taxpayer may ultimately be required to contribute to any residual losses and liabilities incurred by these subsidiaries.**

11.13 The audit review highlighted that of the 69 companies identified:

- 30 were proprietary companies, with 27 of these maintaining *exempt proprietary* status;
- 34 were public companies *limited by guarantee*; and
- 5 were other public companies.

11.14 Companies which are *limited by guarantee* are not required to lodge financial statements nor an annual return with the Australian Securities Commission. Furthermore, *exempt proprietary* companies, in addition to having reduced reporting requirements, are not obliged to submit their annual financial statements to the Commission, if such statements have been audited.

11.15 Given the limited reporting requirements of exempt proprietary companies and companies limited by guarantee, it is questionable whether these reporting mechanisms ensure a proper level of public accountability by companies controlled by public sector entities.

Central guidelines

Substantial non-compliance

11.16 The need for the Ministry of Finance to ensure adherence to the Government's guidelines issued in 1987 has been reinforced by the current findings, which disclose that the majority of public bodies and government agencies had failed to comply with the guidelines.

11.17 Of the 147 subsidiaries identified, in only 17 instances had public bodies and agencies complied with the guidelines in full. The principal reason given for non-compliance was a lack of awareness of the applicability of the guidelines, which was compounded by the lack of effective enforcement by the Ministry of Finance.

11.18 Specific areas of non-compliance included:

- 109 instances where the required ministerial or Treasurer's approval **was not** obtained for the establishment or acquisition of a controlling interest;
- 3 instances where approval was obtained **after** the creation or acquisition of a controlling interest by the public bodies and agencies;
- Only 27 instances where the required *statement of objects* was prepared;
- 9 instances where there was a failure to appoint an auditor; and
- Only 4 instances where subsidiaries had their annual report separately tabled in the Parliament. Of the remainder, very few had tabled their annual report in the Parliament as part of the annual report of their controlling body.

11.19 Given the large cumulative holdings of these subsidiaries, it is of considerable concern that most public bodies and government agencies disregarded the Government's guidelines.

Deficiencies in guidelines

11.20 In addition to the instances of non-compliance referred to above, audit found that the existing guidelines were deficient in that the following provisions were not included:

- the powers of subsidiaries not to exceed the powers of their parent entities, unless expressly permitted by legislation;
- the annual reports of public bodies and government agencies to identify the names and activities of all subsidiaries;
- the financial statements of subsidiaries to be consolidated in line with Australian Accounting Standards where a controlling interest exists; and
- indemnities and guarantees granted to subsidiaries to be disclosed in the annual report of parent bodies.

11.21 Amendments to the guidelines, to incorporate the above matters, would provide an enhanced basis for government monitoring and decision-making in relation to the operations of public sector subsidiaries.

Inadequate central monitoring

11.22 As referred to previously, a central register of investments by government agencies and public bodies in companies, trusts and joint ventures is maintained by the Ministry of Finance. However, examination of this register disclosed that it is substantially incomplete. **At 30 June 1991, details of only 40 public sector subsidiaries were entered in the register. This represented only 27 per cent of the 147 subsidiaries identified.**

11.23 The Ministry of Finance needs to ensure that the register is complete and regularly maintained and monitored. **Without a properly maintained register the Government and the Parliament may be unaware of the existence or the nature of many public sector subsidiaries.**

Overall audit conclusion

11.24 Due to the deficiencies in the existing guidelines and the failure of the central agency and many public bodies to comply with the guidelines, **audit concluded that the framework established by the Government to monitor and control the operation of public sector subsidiaries has not been effectively implemented.**

11.25 **In addition, the growing practice of using companies, trusts, joint ventures and incorporated associations to conduct a widening range of activities, on behalf of public bodies and government agencies, has reduced the effectiveness of the traditional accountability framework to the Parliament and the taxpayer.**

Management response

The Ministry of Finance notes that the majority of the companies, joint ventures and trusts identified by audit and not identified in the register are companies and trusts established within universities, colleges and hospitals. Consideration will be given to the appropriate control arrangements for such bodies and directives will be re-issued.

The Ministry of Finance agrees in principle to the need to ensure compliance and monitor the guidelines and strengthen the accountability requirements through new policy directives.

A number of actions has been taken to ensure compliance with the guidelines in:

- *August 1990 where agencies with identified companies, joint ventures and trusts were required to update the central register;*
- *October 1990 where all agencies were required to update the central register; and*
- *November 1990 where the Department of Health and the Ministry of Education were requested to update the central register.*

Further to the review undertaken by the Department of the Premier and Cabinet, Cabinet has now agreed to:

- *the principles of a general legislative framework to govern wholly-owned government companies;*
- *the development of necessary legislation; and*
- *the endorsement of general principles for the formation and operation of government companies, for issue to all government agencies pending any legislative action.*

In addition the Ministry of Finance will:

- *monitor actions taken on individual companies, joint ventures and trusts in accordance with the recommendations of the Department of the Premier and Cabinet review;*
- *monitor compliance with the guidelines through the central "control" register; and*
- *facilitate the implementation of guidelines.*

PART 12

STATUS OF MATTERS RAISED IN PREVIOUS REPORTS ON THE FINANCE STATEMENT

12.1 Previous *Reports of the Auditor-General on the Finance Statement* have contained comments and recommendations on a number of issues relating to public sector resource management, and compliance with legislation and other directions. The current status of action taken to address matters raised in previous years by the Auditor-General is presented in Table 12A.

TABLE 12A. STATUS OF MATTERS RAISED IN PREVIOUS REPORTS ON THE FINANCE STATEMENT

Report	*Subject*	*Status at date of preparation of this Report*
	—— MATTERS RESOLVED ——	
ABSENCE OF INDEPENDENT SUPERVISION		
1989-90	The absence of independent supervision of the Victorian Development Fund's (VDF) operations could expose the State to substantial financial risk.	Additional senior officers of the Department of the Treasury and an independent advisor have been appointed to the VDF's Committee of Management. A private accounting firm has also been engaged as internal auditor.
ILLEGAL ISSUE OF TREASURY BILLS		
1989-90	The VDF illegally issued 76 Treasury Bills amounting to $316 million direct to private sector fund managers.	Action has been taken by the VDF to prevent the further illegal issue of Treasury Bills.
FLEXIBLE TARIFF MANAGEMENT UNIT TRUST		
1989-90	The acquisition by the Government of additional equity in the Flexible Tariff Management Unit Trust was not funded from the Consolidated Fund and therefore was not subject to parliamentary scrutiny.	No additional units were acquired by the Government during 1990-91.
IMPLEMENTATION OF DISPATCH SYSTEM AT METROPOLITAN AMBULANCE SERVICE		
1989-90	Serious shortcomings were identified in the implementation of a major dispatch and information system at the Metropolitan Ambulance Service.	The Service has terminated the supplier's contract and received $3.9 million as compensation. The Service also retained certain hardware and software supplied by the contractor valued at $2 million as part of the settlement. The Service has submitted a proposal to the Minister for Health for the development of a revised dispatch system.

TABLE 12A. STATUS OF MATTERS RAISED IN PREVIOUS REPORTS ON THE FINANCE STATEMENT - *continued*

Report	*Subject*	*Status at date of preparation of this Report*
	—— ACTION COMMENCED ——	
COLLECTION OF STATE TAXATION		
1988-89 1989-90	State budget strategies for major revenue raising agencies need to focus on enhancing revenue collection as well as reducing costs to ensure maximum benefits accrue to the State.	Some action along the lines recommended by audit has been taken in relation to payroll tax, however, there is a continuing need for a greater focus on enhancing revenue management for other State taxation. Further comment is contained in Part 9 of this Report.
	Penalties relating to payroll tax receipts are not imposed on amounts received after the due date but received within that month.	Action has been taken to substantially resolve this issue. Further comment is contained in Part 9 of this Report.
	Excessive delays occurred in issuing payroll tax assessments and the follow-up of outstanding debts from defaulting taxpayers.	Assessments now issued in a more timely manner. Further comment is contained in Part 9 of this Report.
	More stringent monitoring and follow-up may have resulted in a more timely collection of revenue due under arrangements.	Further comment is contained in Part 9 of this Report.
	More timely issue of payroll tax assessments and prompt follow-up of outstanding debts may have reduced the incidence of debts from companies now in liquidation.	Assessments are now issued in a more timely manner. However, in the last 12 months the gross debt in the insolvency area has increased. Further comment is contained in Part 9 of this Report.
	Significant delays occurred in processing annual adjustments and issuing assessments and refunds to taxpayers.	The timeliness of processing annual adjustments has improved.
	More timely issuing of land tax assessments would result in a substantial increase in revenue to the State.	There has been improvement in the timeliness of issue of assessments. Further comment is contained in Part 9 of this Report.
	Need for the State Taxation Office to take decisive action to improve the accuracy of ownership details in its land tax system.	An arrangement for the central lodgement of change of ownership notices within the Land Titles Office is expected to be implemented shortly. It is anticipated that the proposed system will aid the State Taxation Office in maintaining accurate and up-to-date ownership details and consequently result in more timely collection of land tax.
	Substantial scope to further increase the revenue of the State if greater prominence was directed towards the detection of tax avoidance and evasion.	Additional funds were allocated in the 1990-91 Budget for specific investigation projects. These projects have been successful in increasing revenue collections. Further comment is contained in Part 9 of this Report.

TABLE 12A. STATUS OF MATTERS RAISED IN PREVIOUS REPORTS ON THE FINANCE STATEMENT - *continued*

Report	*Subject*	*Status at date of preparation of this Report*
	—— ACTION COMMENCED - *continued* ——	
COLLECTION OF STATE TAXATION - *continued*		
	Weaknesses in information systems restricted the ability of the State Taxation Office to identify all tax due to the State. The State Taxation Office estimated that a gain of $11 million a year would result from increased revenue and reduced operating costs following the implementation of a new computerised system.	A contract was signed in April 1991 to commence development and implementation of the new information system. Further comment is contained in Part 9 of this Report.
DEPARTMENTAL PHYSICAL ASSETS		
1985-86 1986-87 1989-90	Improvements are needed in the recording, control and reporting of departmental physical assets.	The Government has recently issued its accounting policy statement on asset recording and reporting. Further comment is contained in Part 6 of this Report.
DUTIES AND RESPONSIBILITIES OF BOARD MEMBERS/DIRECTORS OF PUBLIC BODIES		
1987-88 1988-89 1989-90	There is a need for the establishment of criteria for the selection of board members/directors and for a code of conduct to be developed to cover the duties, responsibilities and accountability of persons appointed to public sector boards.	Draft guidelines for members of public sector boards have not yet been finalised by the Department of the Treasury. The Department anticipates that these guidelines will be issued during October 1991.
ENGAGEMENT OF CONSULTANTS		
1987-88	Effectiveness Review Committee guidelines on the submission of post-project evaluation reports need to be adhered to by public sector bodies.	The Committee has undertaken follow-up of outstanding post-project evaluation reports, however, delays continued to occur in the submission of these evaluation reports.
LIABILITIES OF THE STATE		
1987-88	There is a need for development of a strategic plan to identify the State's aggregate liabilities and for reporting this information as part of consolidated financial statements.	In June 1991 the Government released a provisional consolidated statement of assets and liabilities of the State. Further comment is contained in Part 6 of this Report.

TABLE 12A. STATUS OF MATTERS RAISED IN PREVIOUS REPORTS ON THE FINANCE STATEMENT - *continued*

Report	*Subject*	*Status at date of preparation of this Report*
	—— ACTION COMMENCED - *continued* **——**	
PROGRAM BUDGETING		
1988-89 1989-90	Formalised mechanisms for reporting by departments on program performance are necessary if benefits offered by program budgeting are to be fully realised.	Report by the Parliamentary Economic Budget and Review Committee on its inquiry into program budgeting was tabled in Parliament in April 1990. The Committee recommended that legislation be enacted to require public sector agencies to report selected performance indicators. However, the Government, in its response to the Committee's report, tabled in Parliament in May 1991, did not accept the Committee's recommendation. The Ministry of Finance intends to publish a consolidated statement of key performance indicators for public sector agencies by November 1991.
RESOURCE MANAGEMENT AND ACCOUNTABILITY LEGISLATION		
1985-86 1986-87 1988-89 1989-90	Modern resource management and accountability legislation is required to replace the outmoded provisions of the Audit Act and other associated Acts.	Amendments to the Audit Act and the Public Account Act have been approved by Cabinet but draft legislation has not yet been finalised.
MINISTRY OF FINANCE/DEPARTMENTAL RECONCILIATION PROCEDURES		
1986-87	Need for the Ministry of Finance, in conjunction with departments, to review existing reconciliation procedures and the adequacy of existing financial information systems.	Some departments still have difficulty in effecting year-end reconciliations with the Ministry of Finance within the required timeframe. A project is currently being undertaken to strengthen and consolidate the central financial reporting systems.
EXPENDITURE INCURRED WITHOUT PARLIAMENTARY AUTHORITY		
1989-90	Expenditure of $100 million on finance charges was incurred without parliamentary authority as a result of netting-off of borrowings against finance charges.	During 1990-91, borrowings of $146 million were netted-off outside the Consolidated Fund against interest payments due from the Fund. Further comment on this issue is contained in Part 1 of this Report.
WORKS AND SERVICES EXPENDITURE		
1989-90	Significant operating expenditure was classified as Works and Services expenditure and funded from capital receipts including borrowings. The absence of proper segregation between operating and capital transactions precludes meaningful analysis by users of the *Finance Statement*.	The Government has indicated that the classification of transactions between operating and capital within the Consolidated Fund will be examined. However, to date, little progress has been made on the issue. Further comment is contained in Part 7 of this Report.

TABLE 12A. STATUS OF MATTERS RAISED IN PREVIOUS REPORTS ON THE FINANCE STATEMENT - *continued*

Report	*Subject*	*Status at date of preparation of this Report*
	—— ACTION COMMENCED - *continued* **——**	
ARTIFICIAL ARRANGEMENT TO OBTAIN FUNDS FROM PRIVATE SECTOR FUND MANAGERS		
1989-90	An artificial arrangement, involving the Melbourne and Metropolitan Board of Works, was used by the VDF to obtain funds from private sector fund managers amounting to $870 million.	The raising of funds by use of the previously identified artificial arrangement ceased subsequent to the *Report on the Finance Statement, 1989-90*. However, for the remainder of 1990-91, the VDF established alternative arrangements under which Treasury Bills were issued to a major public bank for immediate on-selling to private sector fund managers. These arrangements were based on continual VDF assessments of fund managers' demand for Treasury Bills.
UNACQUITTED EXPENDITURE		
1989-90	Finance charges of $35 million, paid from the Consolidated Fund without parliamentary authority, were not acquitted.	During 1990-91, the Government unsuccessfully sought parliamentary approval to authorise this expenditure.
NEED FOR ACCRUAL ACCOUNTING		
1985-86 1986-87 1989-90	Adoption of accrual accounting within the budget sector will provide opportunities for improvement in management decision-making and financial reporting, and enhance the standard of accountability.	Position unchanged for 1990-91. However, the Government has indicated an intention to reform the legislative provisions relating to the Public ledger to facilitate the recording of transactions on an accrual basis.
FUNDING OF VICTORIAN PUBLIC HOSPITALS		
1989-90	Victoria incurred a reduction in Commonwealth funding available to public hospitals of approximately $32 million in the period 1988 to 1990 due to the failure of hospitals to treat the specified levels of Medicare patients.	During 1990-91, an increased number of Medicare patients were treated in public hospitals, resulting in a reduction in the level of Commonwealth funding forgone from $17 million in 1989-90 to $5 million in 1990-91.
	—— NO ACTION TAKEN ——	
CONSOLIDATED FUND DEFICITS		
1978-79 1979-80	A Consolidated Fund deficit of $22 million at 30 June 1970 is still unfunded and temporarily financed from the Trust Fund.	Position unchanged.

TABLE 12A. STATUS OF MATTERS RAISED IN PREVIOUS REPORTS ON THE FINANCE STATEMENT - *continued*

Report	*Subject*	*Status at date of preparation of this Report*
	—— NO ACTION TAKEN - *continued* **——**	
ACCEPTANCE OF DEPOSITS FROM NON-VICTORIAN BODIES		
1989-90	Doubt exists as to the authority of the VDF to raise funds from non-Victorian public authorities.	Position unchanged. Further comment is contained in Part 5 of this Report.
EMPLOYER SUPERANNUATION CONTRIBUTIONS		
1989-90	Non-budget sector agency employer contributions to the State Superannuation Fund were being utilised to finance Consolidated Fund operations.	Position unchanged. Further comment is contained in Part 1 of this Report.
INTERNAL AUDIT IN THE BUDGET SECTOR		
1987-88 1989-90	Government policy required the implementation of an adequate internal audit function in departments.	Deficiencies still exist in the internal audit coverage of EDP systems. There is also inadequate commitment given by management to resourcing internal audit units and providing adequate training to staff. Further, there has been minimal use of private accounting firms in resourcing reviews of computerised systems.
1989-90	Bureau of Internal Audit has not effectively carried-out its responsibilities.	Position unchanged. The responsibility for the provision of training to internal auditors within the public sector has been transferred from the Bureau to another unit within the Ministry of Finance.
1989-90	Few public hospitals have established effective internal audit units.	Position unchanged. The majority of hospitals have not established effective internal audit units.
1989-90	There has been limited use made of audit committees within government departments.	Position unchanged. The majority of departments have not established audit committees, thereby restricting the effectiveness of internal audit.

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