VICTORIA

Report of the
AUDITOR-GENERAL
on the
FINANCE STATEMENT

for the year ended
30 June 1993

MELBOURNE
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CONTENTS

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 financial operations of the State's budget sector for the year ended 30 June 1993 and its financial position at that date.

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 my report on the Finance Statement for the year ended 30 June 1992, I gave emphasis to the issues that I hoped the new administration would pursue in order to improve the financial management of the State.

I can now report that prompt action has been taken by the Government during 1992-93 to resolve many matters which had remained outstanding for a number of years. The Government has recognised as liabilities, for the first time, transport sale and lease-back transactions, deferred expenditure arrangements, the Portland Smelter Unit Trust delayed compensation payments and financing arrangements associated with the World Congress Centre and has commenced action to eliminate prior year expenditure deferrals.

It is pleasing that the 1993-94 Budget Papers identify further positive action for the current financial year, including:

- development of an integrated management cycle which provides, among other things, for a medium to long-term planning focus, accountability based on outcomes, and maintenance of appropriate information systems;
- introduction of new financial management legislation to consolidate current financial reporting and accountability requirements;
- reform of public sector superannuation arrangements to reduce associated costs and the level of unfunded liabilities;
- enhanced budgetary flexibility for departments through the provision of global appropriations, annotated allocations and the carry forward of unspent appropriations;
- elimination of further prior year expenditure deferral arrangements; and
- improved differentiation between operating and capital transactions within the budget sector.

The actions taken in 1992-93 and those proposed during the current financial year, allied with the various expenditure reduction measures, indicate a significant commitment to enhancing resource management which, if sustained, should improve the State's financial position.

In my Report on last year's Finance Statement, I advised Parliament that I was not in a position to verify whether the State had borrowed in excess of the Loan Council allocation. It was subsequently confirmed that the State had exceeded the borrowing limit and, in December 1992, the Loan Council approved an additional allocation to the State to formalise these borrowings.

Finally, in previous years, I have advocated a need to improve the level of accountability over Government operations, through the presentation of accrual based financial statements by all Departments. A 3 year program has now been introduced with the aim of achieving this objective by 1995-96. However, accountability over government financial operations would be further enhanced by the presentation to Parliament of an accrual based "whole of government" financial statement.

EXECUTIVE SUMMARY

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

FINANCIAL RESULT

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- The Finance Statement discloses that the overall Consolidated Fund deficit for the year was $3.3 billion. However, after taking into account debt repaid or refinanced and changes in cash and investment holdings of $1.1 billion, the financing transactions of the budget sector totalled $2.2 billion.

Paras 1.7 to 1.12

- The operating deficit for the year (which forms part of the above results), excluding payments made under employee departure programs and the reversal of prior year expenditure deferrals, was $1.1 billion. This compares favourably with the 1991-92 result which was a deficit of $1.2 billion.

Paras 1.13 to 1.21

- The Finance Statement discloses the receipts and payments of the Consolidated Fund and Trust Fund, together with supplementary information relating to certain year-end balances. However, there will not be full accountability to the Parliament until financial information is presented on an accrual basis covering the whole of government.

Paras 1.1 to 1.6

CONSOLIDATED FUND RECEIPTS

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- The Consolidated Fund receipts for the year, excluding borrowings, totalled $13.5 billion, compared with $12.7 billion in 1991-92. Higher Commonwealth grants and contributions from public authorities, and the introduction of various revenue raising initiatives were the key factors contributing to the increase.

Paras 2.1 to 2.4

- The total revenue actually received from the new State Deficit Levy in the year was $173 million.

Paras 2.8 to 2.14

CONSOLIDATED FUND PAYMENTS

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- Consolidated Fund payments for the year totalled $16.8 billion. Debt charges and Health and Community Services, Education and Transport related costs account for 70 per cent of these payments.

  Paras 3.1 to 3.5

- During 1992-93, employee departure programs financed around 20 000 departures from the budget sector workforce at a cost of $772 million.

  Paras 3.8 to 3.26

BUDGET SECTOR ASSETS

Page 55

- While the Government has presented detailed information on budget sector liabilities, there is still a need for more comprehensive reporting of asset holdings.

  Paras 4.1 to 4.5

- A 3 year program has been introduced, requiring all departments to produce accrual accounting financial statements by 1995-96. However, to accelerate the realisation of the benefits arising from such an initiative, consideration should be given to advancing the implementation timetable.

  Paras 4.6 to 4.8

BUDGET SECTOR LIABILITIES AND COMMITMENTS

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- At 30 June 1993, the liabilities of the State were approximately $72 billion (unaudited), of which budget sector liabilities accounted for $42.9 billion.

  Paras 5.6 to 5.7

- Net obligations to be met by the Transport Accident Commission (TAC) in relation to the Farrow Group arrangements were estimated at $561 million at June 1993, which was $249 million more than when the debt was transferred in January 1993.

  Paras 5.41 to 5.50

- In addition to the net obligations to be met by TAC relating to the Farrow Group, $244 million has been met by Victorian taxpayers mainly from the special petrol levy.

  Paras 5.44 and 5.51

BUDGET SECTOR LIABILITIES AND COMMITMENTS - *continued.* **Page 61**

- The present value of the State's current exposure under the flexible electricity tariff arrangements associated with the Portland and Point Henry aluminium smelters is estimated to be around $1.7 billion. This is in addition to $563 million already paid under the arrangements.

  Paras 5.68 to 5.75

- The Government has announced major reforms to Superannuation Funds principally operated for budget sector employees, aimed at reducing associated costs and the level of unfunded liabilities which currently stands at $18 billion.

  Paras 5.87 to 5.95

- A major objective of the Government is to restore the State's former AAA credit rating through a budgetary strategy aimed at arresting the growth in debt, with a target to eliminate current account deficits by 1995-96. The Government has implemented various expenditure reduction and revenue raising measures aimed at achieving this target.

  Paras 5.103 to 5.111

- Assurances again cannot be given to the Parliament as to the full extent of the State's contingent liabilities. However, action has commenced to review the processes and records presently utilised to identify, monitor and report on these exposures.

  Paras 5.132 to 5.137

OTHER MATTERS **Page 101**

- Payments totalling $35 million, made in 1989-90 without parliamentary authority, remain unacquitted. However, the Treasurer has advised that it is the Government's intention to validate this expenditure in 1993-94 through the introduction of enabling legislation.

  Para. 6.3

REVIEW OF THE

1992 - 93

FINANCE STATEMENT

PART 1

Financial Result

KEY FINDINGS

FINANCIAL RESULT

- The Finance Statement discloses the receipts and payments of the Consolidated Fund and Trust Fund, together with supplementary information relating to certain year-end balances. However, there will not be full accountability to the Parliament until financial information is presented on an accrual basis covering the whole of government.

  Paras 1.1 to 1.6

- The Finance Statement discloses that the overall Consolidated Fund deficit for the year was $3.3 billion. However, after taking into account Consolidated Fund debt repaid or refinanced and changes in cash and investment holdings of $1.1 billion, the financing transactions of the budget sector totalled $2.2 billion.

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- The operating deficit for the year (which forms part of the above results), excluding payments made under employee departure programs and the reversal of prior year expenditure deferrals, was $1.1 billion. This compares favourably with the 1991-92 result which was a deficit of $1.2 billion.

  Paras 1.13 to 1.21

- The Government has announced that the key focus of its budgetary and debt management strategies is the elimination of operating deficits.

  Para. 1.19

- During 1992-93, the Government eliminated certain previously established arrangements involving the deferral of Consolidated Fund expenditure of $296 million.

  Paras 1.22 to 1.31

Financial accountability framework

1.1 Within the State, accountability over government financial operations is established through a requirement, under the *Audit Act* 1958, for the Minister for Finance to annually prepare and transmit to the Auditor-General a statement of the receipts and payments of the Consolidated Fund and the Trust Fund, commonly known as the Finance Statement. Under the Act, **the Auditor-General is required to prepare a Report which explains in full the Finance Statement, and to transmit the Statement and the Report to the Legislative Assembly of the Parliament**.

1.2 The *Constitution Act* 1975, *Audit Act* 1958 and *Public Account Act* 1958 jointly establish the broad framework relating to the financial operations of government. Under this framework, the *Consolidated Fund* is used as the Government's main operating fund, into which must be paid all moneys forming part of Consolidated Revenue, including State taxes and charges, certain Commonwealth grants and asset sales proceeds. A fundamental principle underlying the framework is that only the Parliament can authorise expenditure from the Consolidated Fund. Accordingly, annual Appropriation Acts are prepared by the Government and sanctioned by the Parliament, providing authority for the expenditure of Consolidated Fund moneys in any financial year. This mechanism provides the key vehicle through which the Parliament exercises control over the public purse.

1.3 The *Trust Fund* comprises various trust accounts created for particular purposes, such as to record the receipt and on-passing of certain Commonwealth grants to third parties, to hold funds in working and suspense accounts for accounting purposes, and to facilitate the receipt and disbursement of funds held in trust.

1.4 Since the establishment of the legislative accountability framework, there have been significant developments in the role and utilisation of financial information presented by government. While, in past years, financial information was predominantly produced for management and Parliamentary accountability purposes, there is now significant demand for information to facilitate, inter alia, inter-governmental comparisons of financial performance and position, and the impact of government operations on the economy.

1.5 Due to the increasing demand for financial information which has a greater economic relevance, the Government in recent years has presented within various budget documents and monthly Niemeyer Statements the result of budget sector operations in the *national accounting format*, which is based on a model developed by the Australian Bureau of Statistics.

1.6 **This Report is prepared in the context of the established financial accountability framework, upon which the Finance Statement is presented.** The Report also outlines the key differences between the Consolidated Fund and *national accounting format* results. However, **it will not be until information is presented on an accrual basis covering the whole of government that there will be adequate accountability to the Parliament over government financial operations.**

Financial result for the year

1.7 The *1992-93 Finance Statement* discloses a balanced position of the Consolidated Fund at 30 June 1993, with the recorded receipts of $16.9 billion, including borrowings, equal to payments. This balanced outcome arises from a requirement of the *Public Account Act* 1958 that payments from the Consolidated Fund in any financial year must not exceed the total receipts paid into the Fund. Where sufficient receipts are not available to meet total payments, the Government borrows to finance Consolidated Fund payments and achieve a balanced financial outcome. However, the Treasurer, in the 1993-94 Budget Papers indicated that this artificial requirement to balance the Consolidated Fund is to be removed during 1993-94 by amending legislation.

1.8 The Finance Statement discloses that **borrowings of $3.3 billion were paid into the Consolidated Fund during 1992-93 to enable a balanced outcome to be achieved. These borrowings represent the Consolidated Fund deficit for the year** (described in Table A.2 on page xv of the Finance Statement as the *amount required to be funded*). During 1992-93, $1.2 billion (1991-92, $580 million) was paid out of the Consolidated Fund to repay borrowings.

1.9 However, the *national accounting format* result, as represented by the **budget sector financing transactions, in 1992-93 totalled $2.2 billion** (1991-92, $1.7 billion). This format takes into account the transactions of the Consolidated Fund, Trust Fund and those public bodies subject to substantial central budgetary control. The difference between this outcome and the Consolidated Fund deficit of $3.3 billion is outlined in Tables 1A and 1B.

1.10 The Consolidated Fund result for the year, together with the budget sector financing transactions calculated on the basis of the *national accounting format*, are presented in Table 1A.

TABLE 1A
FINANCIAL RESULT FOR THE YEAR
($million)

Item	*Actual 1991-92*	**Actual 1992-93**	*Budget 1992-93*	**Variation from Budget**
Recurrent -				
Receipts excluding borrowings	11 848	**12 497**	12 760	**(263)**
Payments	12 729	*(a)* **13 561**	13 931	**370**
Recurrent deficit for year	(881)	**(1 064)**	(1 171)	**107**
Works and services -				
Receipts excluding borrowings	891	**997**	1 001	**(4)**
Payments	2 179	**3 262**	2 732	**(530)**
Works and services deficit for year	(1 288)	**(2 265)**	(1 731)	**(534)**
Overall Consolidated Fund deficit for year (funded from borrowings)	(2 169)	**(3 329)**	(2 902)	**(427)**
Less - Reconciling items (refer to Table 1B of this Report)	510	**1 156**		
Financing transactions (national accounting format)	(1 659)	**2 173**		

(a) Does not include a payment of $95 million relating to the refinancing of Cash Management Account borrowings with medium-term borrowings.

Difference between Consolidated Fund and National Accounting format results

1.11 As previously highlighted, different results arise from the use of the Consolidated Fund and *national accounting* reporting formats. Table 1B presents a summary of the key differences arising between these results for the year.

TABLE 1B
RECONCILIATION OF 1992-93 CONSOLIDATED FUND DEFICIT WITH FINANCING TRANSACTIONS
($million)

Item			*Amount*
Consolidated Fund deficit			**3 329**
(as per Table A.2 of the Finance Statement)			
Less -			
Appropriations for repayment of borrowings -			
Farrow Group bond holders	107		
Debt Retirement Fund	40		
Capital Works Authority	203		
State Development Account	585		
Cash Management Account	59		
Commonwealth debt	75		
Computer lease facility	19	*(a)* 1 088	
Borrowing repayments outside the Consolidated Fund -			
Victorian Debt Retirement Fund	100		
Commonwealth Government	9		
Trust Fund (in respect of Farrow bond holders)	51		
Department of Planning and Development	39		
Other	2	201	
		1 289	
Capital injection by the Consolidated Fund into the Treasury Corporation of Victoria		30	
Net effect of other items (mainly changes in cash, investments and other items)		(163)	
Total reconciling items			**1 156**
Financing transactions (national accounting format)			**2 173**

(a) The difference between this amount and the $1.2 billion disclosed in paragraph 1.8 relates to principal repayments on *swap transactions* which are not regarded by the Department of the Treasury as repayments of borrowings but disclosed as finance charges.

1.12 As indicated in the above table, the difference of $1.1 billion, between the 2 alternative reporting formats largely relates to Consolidated Fund debt repaid or refinanced in the year, which has been partly off-set by a reduction in cash and investment holdings.

Re-statement of Consolidated Fund result by audit

1.13 Reports of the Auditor-General to the Parliament over a number of years have drawn attention to the absence of a clear differentiation between operating and capital transactions, which precludes the meaningful assessment of the Consolidated Fund result. The classification basis adopted for the *Finance Statement*, consistent with parliamentary appropriations, segments all transactions between the recurrent and works and services sectors. However, the recurrent sector includes a number of capital items, such as borrowing repayments, and conversely the works and services sector includes significant operating costs. Accordingly, users of the Finance Statement cannot readily ascertain or assess the Consolidated Fund operating result for the year.

1.14 Table 1C presents the Consolidated Fund result for the year, segmented according to operating and capital transactions.

TABLE 1C
AUDIT RE-STATEMENT OF CONSOLIDATED FUND DEFICIT FOR YEAR *(a)*
($million)

Item	**1992-93**	*1991-92*
Operating transactions -		
Receipts	12 262	11 675
Payments, excluding employee departure programs and reversals of prior year deferrals	13 385	12 883
Operating deficit prior to employee departure programs and reversals of prior year deferrals	**(1 123)**	**(1 208)**
Add - Employee departure program payments and reversals of prior year deferrals	*(b)* 1 048	240
Operating deficit for the year	**(2 171)**	**(1 448)**
Capital transactions -		
Receipts not including borrowings	*(c)* 1 232	1 064
Payments excluding repayments of borrowings	1 214	1 205
Capital surplus/(deficit) prior to borrowing repayments	**18**	**(141)**
Less - Borrowing repayments	1 176	580
Capital deficit for year	**(1 158)**	**(721)**
Overall Consolidated Fund deficit for year (funded from borrowings)	**(3 329)**	**(2 169)**
Less - Reconciling items (refer to Table 1B of this Report)	1 156	510
Financing transactions (national accounting format)	**(2 173)**	**(1 659)**

(a) Table 1D provides a summary of inappropriately classified receipts and payments, as identified by audit.

(b) Includes VDP payments of $773 million ($200 million, 1991-92) and the reversal of prior year deferrals of an operating nature of $275 million ($40 million, 1991-92).

(c) Includes $164 million initially provided by public bodies in relation to the repayment of Victorian Equity Trust (VET) equity, which was utilised to repay borrowings.

1.15 While the *Finance Statement* indicates that in 1992-93 borrowings of $1.1 billion (1991-92, $881 million) were used to finance Consolidated Fund expenditure incurred for recurrent purposes, the audit analysis of revenue and expenditure transactions (as presented in Table 1C) indicates that the actual level of operating expenses funded from borrowings in 1992-93 was $2.2 billion (1991-92, $1.4 billion).

1.16 However, a significant factor contributing to the increased utilisation of borrowings in the year, for operating purposes, was the increased expenditure relating to employee departure programs, which the Government anticipates will contribute to significant future budgetary savings through a reduced budget sector workforce, and the elimination of a number of prior year arrangements for the deferral of expenditure. **The operating deficit for the year, excluding payments made under employee departure programs and the reversal of prior year expenditure deferrals, was $1.1 billion, compared to $1.2 billion in 1991-92.**

1.17 The table also shows that the deficit arising from Consolidated Fund capital transactions in 1992-93 was $1.2 billion ($721 million, 1991-92). However, this result was significantly affected by the higher level of debt repayments in the year. **The capital sector result prior to debt repayment transactions was a surplus of $18 million, compared to a deficit of $141 million in the previous year**.

1.18 Over a number of years I have expressed concern regarding the practice of funding operating costs from borrowings, which is not consistent with the principles of sound financial management. My concern regarding this practice was more recently echoed in the May 1993 *Report of the Victorian Commission of Audit* into the State's finances. In that Report it was highlighted that "*persistent operating deficits represent the antithesis of sound financial management .... a situation which is as unsustainable for the State as it is for any household*".

1.19 **It is pleasing that, in recognition of the significant adverse impact of the practice of borrowing to meet operating costs on the State's finances, the Government in October 1992 announced that the key focus of its budgetary and debt management strategies would be the elimination of current account deficits by the end of its first term**. This commitment was further reinforced in the Government's April 1993 and September 1993 Budget Papers.

Re-classified transactions

1.20 In Table 1C, audit has presented a re-statement of the Consolidated Fund result, which differentiates between operating and capital transactions. Table 1D below details those transactions re-classified.

TABLE 1D
RE-CLASSIFIED CONSOLIDATED FUND TRANSACTIONS
($million)

Item	**1992-93**	*1991-92*
Receipts		
Capital receipts classified as recurrent:		
Repayment of Victorian Equity Trust (VET) equity	164	-
Repayment of advances (principal)	71	173
Re-classified receipts	**235**	**173**
Payments		
Operating payments classified as works and services:		
Employee departure programs	773	200
Repairs and maintenance *(a)*	348	347
Planning and development programs	186	162
Timber industry strategy and fire suppression	30	23
Finance charges	19	34
Other	31	18
	1 387	784
Less - Capital payments classified as recurrent:		
Repayment of borrowings (principal)	476	367
Other	39	23
	(515)	(390)
Re-classified payments (net)	**872**	**394**

(a) Based on information provided by the Department of the Treasury

1.21 As a first step towards the clearer differentiation between operating and capital items, the Government has moved to fund repairs and maintenance expenditure from the recurrent sector in 1993-94. In addition, the Government in its 1993-94 Budget Papers has indicated an intention to undertake a more comprehensive review of budget sector outlays to ensure a more appropriate classification of expenditure in future years.

Action taken to eliminate prior-year expenditure deferrals

1.22 My previous Reports on the Finance Statement have highlighted various strategies implemented by the former Government to defer Consolidated Fund payments to future years, advance revenue collections and conduct transactions involving State financial obligations outside the Consolidated Fund. While a healthier cash-based Consolidated Fund result was reported in previous years by implementing these strategies, substantial financial obligations were transferred to future periods.

1.23 It is pleasing to report that, during 1992-93, the Government commenced action to eliminate certain previously established arrangements involving the deferral of Consolidated Fund expenditure. While the collective impact of this action was to increase the Consolidated Fund deficit by $296 million in 1992-93, the initiative will result in the reporting in future years of financial obligations in the period that they fall due.

1.24 Table 1E summarises the expenditure deferral arrangements that were eliminated by the Government in 1992-93.

TABLE 1E
PRIOR YEAR EXPENDITURE DEFERRALS ELIMINATED IN 1992-93
($million)

Item		*Amount*
Operating transactions		
Flexible Tariff Management Unit Trust (FTMUT) obligations	208	
Debt charges on borrowings from the Commonwealth (interest)	67	
		275
Capital transactions		
Debt charges on borrowings from the Commonwealth (principal)		21
Total deferrals eliminated in the year		**296**

1.25 The Government has indicated, in its 1993-94 Budget Papers, an intention to eliminate certain other expenditure deferral arrangements relating to the payment of grants to non-government schools and municipal libraries, the payment of interest and the repayment of the accumulated borrowings of the Flexible Tariff Management Unit Trust (FTMUT).

1.26 Comment on the prior year expenditure deferrals eliminated in 1992-93 is provided in the following paragraphs.

FTMUT obligations

1.27 My previous Reports on the Finance Statement have commented on the funding of the Government's obligations, under flexible electricity tariff arrangements established in 1984 in relation to the Point Henry and Portland Aluminium Smelters, by FTMUT. Prior to 1992-93, flexible electricity tariff payments to the State Electricity Commission of Victoria (SECV) under the arrangements were mainly funded from borrowings raised by FTMUT. In 1991-92, the Government provided a $57.3 million contribution from the Consolidated Fund to FTMUT, which was applied towards a $40 million reduction in outstanding borrowings and $17.3 million for interest and administrative costs.

1.28 In 1992-93, specific budgetary allocation was made to finance the State's flexible electricity tariff obligations to the SECV as they were incurred, rather than FTMUT funding these payments from borrowings. Accordingly, payments totalling $236 million were made by the Consolidated Fund in the year, comprising **$208 million** relating to tariff payments (including an amount of $16 million paid in June 1993 which under previous arrangements was not payable by FTMUT until July 1993) and $28 million relating to FTMUT interest and administrative costs.

1.29 Further comment on the FTMUT arrangements is provided in Part 5 of this Report.

Debt charges on borrowings from the Commonwealth

1.30 My October 1991 Report on the Finance Statement commented on an arrangement, established in 1990-91 between the Government and the former Victorian Public Authorities Finance Agency (VicFin), under which VicFin assumed responsibility for initially meeting debt payments, on behalf of the State, to the Commonwealth. The State in turn agreed to re-imburse these payments to VicFin in the month following payment. In simple terms, the arrangement enabled the deferral by the Consolidated Fund of associated debt payments by up to one month.

1.31 In June 1993, payments totalling **$88.3 million** were made from the Consolidated Fund to meet certain debt charges that were due and payable to the Commonwealth Government which, in previous years, would not have been paid until the following financial year.

PART 2

Consolidated Fund Receipts

KEY FINDINGS

CONSOLIDATED FUND RECEIPTS

- The Consolidated Fund receipts for the year, excluding borrowings, totalled $13.5 billion, compared with $12.7 billion in 1991-92.

  Paras 2.1 to 2.4

- The key factors contributing to the increased level of receipts in the year were a higher level of Commonwealth grants, contributions from public authorities relating to the wind-up of the Victorian Equity Trust, and the introduction of various revenue raising initiatives, such as the State Deficit Levy.

  Paras 2.1 to 2.4

- The total revenue actually received from the new State Deficit Levy in the year was $173 million.

  Paras 2.8 to 2.14

- The final outcome from the sale of State Insurance Office businesses is now expected to be a book loss of $2.1 million. However, costs of $8.7 million are expected to be incurred relating to surplus employees and former staff who return from GIO.

  Paras 2.35 to 2.48

Summary of Financial Transactions

2.1 **The Consolidated Fund receipts for the year, excluding borrowings, totalled $13.5 billion, compared to $12.7 billion in 1991-92.** The key factors contributing to the increased level of receipts in the year were a higher level of Commonwealth grants, contributions from public authorities relating to the wind-up of the Victorian Equity Trust (VET), and the introduction of various revenue raising initiatives by the Government as part of its medium-term financial management strategy which aims to eliminate the current account deficit by the 1994-95 financial year. The major revenue initiatives contributing to the higher level of receipts were:

- imposition of special dividends on public bodies ($189 million);
- introduction of a State Deficit Levy ($173 million);
- increase in vehicle registration fees ($56 million);
- growth in the level of tobacco franchise fees ($39 million); and
- increase in stamp duty on general insurance transactions ($26 million).

2.2 While total receipts in the year were $755 million higher than those collected in the previous financial year, they were $267 million below budget expectations. The major shortfalls in receipts, compared to budget, were in the areas of contributions from public authorities ($382 million), fees and charges for departmental services ($21 million) and liquidator distributions relating to the Farrow Group ($24 million). However, these shortfalls were partly off-set by higher than expected collections in the areas of taxation ($122 million), Commonwealth grants ($42 million) and asset sales ($19 million).

2.3 The significant shortfall in the contributions from public authorities was caused mainly by unexpected delays in the conclusion of negotiations between the Government and 2 public bodies (State Electricity Commission of Victoria and Portland Smelter Unit Trust) regarding the amount payable by these bodies to the Victorian Equity Trust (VET), and ultimately to the Consolidated Fund, for the repurchase of equity units held by the VET in these bodies. While these delays resulted in a substantial shortfall in receipts ($373 million), this deficiency was offset by an equivalent reduction in related debt repayments and therefore there was no significant impact on the Consolidated Fund result for the year.

2.4 Table 2A provides a summary of the receipts (excluding borrowings) of the Consolidated Fund for the year.

TABLE 2A
BUDGETED AND ACTUAL CONSOLIDATED FUND RECEIPTS
($million)

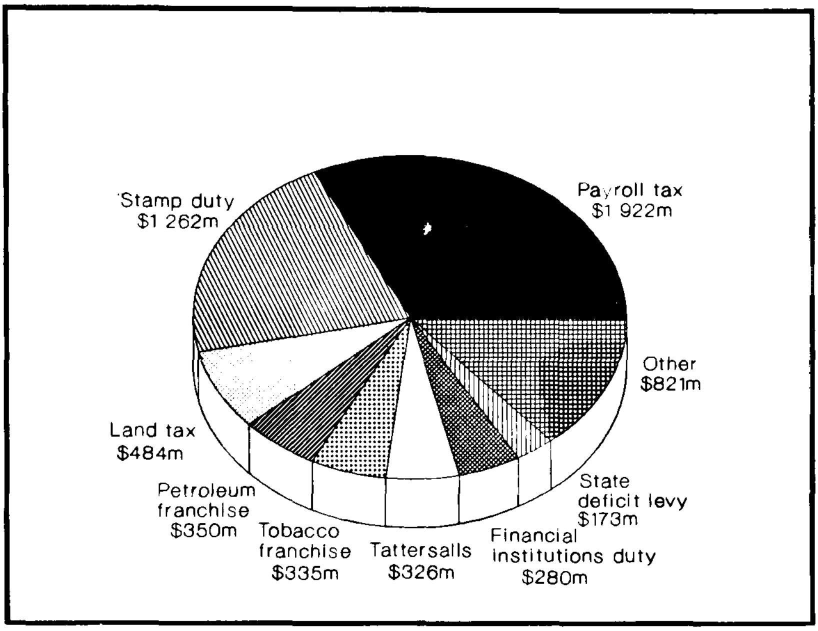
Item	*1991-92 Actual*	**1992-93 Actual**	*1992-93 (a)Budget*	**1992-93 Variance**
Recurrent -				
Taxation	5 450	**5 953**	5 831	**122**
Commonwealth	4 229	**4 406**	4 367	**39**
Other	2 169	**2 138**	2 562	**(424)**
Total recurrent	11 848	**12 497**	12 760	**(263)**
Works and services -				
Commonwealth	749	**864**	861	**3**
Sale of assets	92	**119**	100	**19**
Other	50	**14**	40	**(26)**
Total works and services	891	**997**	1 001	**(4)**
Total receipts (excluding borrowings)	12 739	**13 494**	13 761	**(267)**

(a) Government April 1993 Budget.

Taxation Revenue

2.5 Taxation receipts represent the State's largest revenue source and principally comprise payroll tax, stamp duty, land tax, franchise fees and gambling revenues. In 1992-93, receipts from this source totalled around $6 billion ($5.5 billion, 1991-92) and accounted for approximately 44 per cent of total Consolidated Fund receipts (excluding borrowings). Chart 2B illustrates the contribution to State revenues in the year of key taxation sources.

CHART 2B
MAJOR TAXATION SOURCES
($million)



Variances from budget

2.6 As indicated previously, **in 1992-93, taxation receipts were $122 million above the budget estimate.** Table 2C details the key components contributing to this favourable outcome.

TABLE 2C
MAJOR TAXATION REVENUE VARIATIONS, 1992-93
($million)

Revenue sources	*Budget*	*Actual*	**Variation**
Tobacco franchise fees	290	335	**45**
Stamp duty	1 221	1 262	**41**
State deficit levy	157	173	**16**
Payroll tax	1 912	1 922	**10**
Petroleum franchise fees	345	350	**5**
Debits tax	125	130	**5**
Electronic gaming	90	95	**5**
Tattersalls duty	322	326	**4**
Other taxation items	874	876	**2**
Land tax	495	484	**(11)**
	5 831	**5 953**	**122**

2.7 The key factors underlying the major revenue variations, as advised by the Department of the Treasury, were as follows:

- *Tobacco franchise fees* greater than expected ($45 million) mainly due to tobacco stockpiling and lower than anticipated impact on consumption of a February 1993 fee increase (from 50 per cent to 75 per cent on sales by wholesalers). This was assisted by a reduction in tax evasion resulting from the harmonisation of franchise fees across all States (except for South Australia which levies higher fees than other States);
- *Stamp duties* higher than expected ($41 million) due to increased levels of commercial and industrial property transfers, share market activity and motor vehicle prices;
- *State deficit levy* proceeds above expectations, and lower than anticipated levels of levy refunds for concessions and exemptions ($16 million);
- *Payroll tax* refunds to employers lower than expected ($10 million); and
- *Land tax* below expectations ($11 million) due to delays in tax collections from a number of State public bodies.

State Deficit Levy

2.8 A significant new revenue raising measure introduced by the Government in 1992-93, to assist in the elimination of budget sector operating deficits, was the State Deficit Levy. The Government anticipated that this measure would contribute around $157 million to State revenue in the year.

2.9 The *State Deficit Levy Act* 1992 established a $100 annual levy and provided for its collection by municipal councils, on behalf of the Government, in respect of all rateable properties within the State, except for the following which are treated for the purposes of the Act as a single property:

- single farm enterprises;
- specified health services, such as hostels and nursing homes; and
- land parcels having one title but which are within 2 municipalities.

2.10 Under the Act, where properties attract municipal rates of less than $200 in any particular year, a reduced levy equal to half of the municipal rates is payable. Where Councils have waived part of the municipal rates payable by individuals, on account of pensioner concessions or hardship, the same proportion of the levy is also waived. The legislation provides ratepayers with a choice of 2 payment options for the levy, namely:

- 1 payment on the date that the rates are due; or
- 2 equal instalments, due on the dates fixed for the payment of the second and third instalment of Council rates (February and May respectively).

2.11 Councils are required to forward the levy to the Commissioner of State Revenue within 28 days from when it becomes due or, if payment is to be received by instalments, within 14 days of the due date of the second instalment of the levy. **In cases where the levy has not been paid but municipal rates have been collected, Councils are required to forward to the State an amount equal to the uncollected levy.**

2.12 As the Government anticipated that the majority of levy payments would be made by the due date, the utilisation of these funds in the period between the collection of the levy and its remittance to the State was seen by the Government as compensation to the Councils for the costs incurred in the administration and collection of the levy. However, due to the concerns raised by Councils as to the adequacy of this compensation, in January 1993, the Government agreed to provide Councils with a one-off payment, equivalent to 50 cents per levy assessment notice issued to ratepayers, at an aggregate cost to the Consolidated Fund of $1 million.

2.13 As indicated previously, **the total revenue actually received from the levy in 1992-93 amounted to $173 million**, which was $16 million above Budget projections.

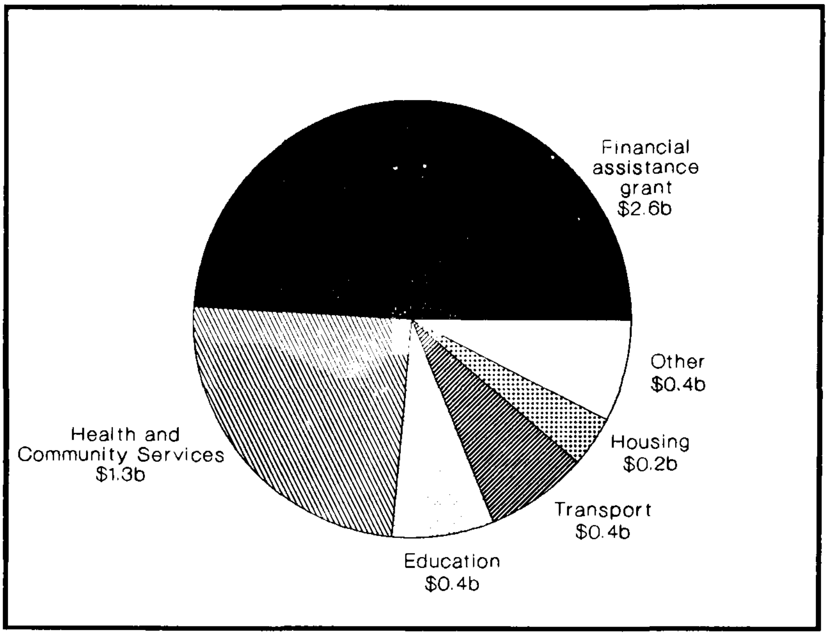
2.14 Audit was advised that information was not readily available within government identifying the amount collected by the State that was sourced from Council rate revenues, due to the non-payment of the levy by ratepayers. However, a July 1993 Report by the Municipal Association of Victoria into *the Economic Impact on Local Government of the State Deficit Levy*, concluded that:

> *"As a result of the number of defaults ... it is estimated that councils may have had to outlay approximately $4.2 million to meet the State Government's "first call" provision. The total outlay of funds by councils from their own source to meet the "first call" provision is expected to amount to $1.5 million (and not $4.2 million) because a significant proportion of the outlay by councils could be recouped by further instalment payments within the local government financial year".*

Commonwealth receipts

2.15 Commonwealth receipts represent the State's second largest source of revenue. Such receipts mainly comprise annual grants relating to general financial assistance, health funding and other specific funding for education, transport and housing programs. **In 1992-93, receipts from this source totalled $5.3 billion ($5 billion, 1991-92) and accounted for approximately 39 per cent of total Consolidated Fund revenues**, not including borrowings. Chart 2D outlines the key components of Commonwealth receipts in the year.

CHART 2D
COMMONWEALTH RECEIPTS, 1992-93
($billion)



2.16 The annual financial assistance grant to the State accounted for around 50 per cent of the total 1992-93 Consolidated Fund receipts from Commonwealth sources, with grants to fund health and community services programs being the next largest component, representing around 24 per cent. Of the Commonwealth receipts in the year, $2.5 billion (47 per cent) represented grants provided for specific purposes.

2.17 As previously stated, Commonwealth receipts in 1992-93 were $42 million above budget expectations due to a higher than expected health grant entitlement ($21 million), and increased Commonwealth funding for education and transport purposes.

Property asset sales

2.18 In 1992-93, proceeds of $119 million received by the Consolidated Fund from the sale of surplus or underutilised properties were $19 million above the budget projection of $100 million. Table 2E provides a summary of property sales, on an agency basis, for the past 2 years.

TABLE 2E
PROPERTY SALES BY AGENCY, 1991-92 AND 1992-93
($million)

Agency	*1991-92*	**1992-93**
Department of Finance	60	**70**
Department of Education	15	**24**
Transport authorities	10	**12**
Office of Major Projects	6	**9**
Other	1	**4**
Total	92	**119**

2.19 The key factors contributing to increased asset sales in 1992-93, as advised by the Department of Finance, were:

- amendments to the *Land Act* 1958 during 1992-93 which, for the first time, enabled the direct sale to the public of Crown land subject to conditions, one of which is that it must be sold for a price not less than the value assigned by the Valuer-General. Prior to these legislative amendments, such properties could only be sold either by auction, tender or (where leased) to the current occupant, which contributed to delays in the finalisation of sales; and
- implementation of various initiatives by the Department to improve the sale potential of properties, including the provision of advice to prospective buyers regarding possible development opportunities for the properties and the provision of assistance on re-zoning.

2.20 Following an examination of major property sales in the year, audit concluded that the prices achieved from these sales were consistent with market valuations provided by the Valuer-General.

Sale of school sites

2.21 During 1992-93, the Department of Education realised a total of $37 million from the sale of various properties, mainly comprising school sites considered surplus to requirements. Of this amount, $24 million was received and paid into the Consolidated Fund in the year. While the balance of $13 million was received by the Department on 30 June 1993, it was not paid to the Fund until 1 July 1993.

2.22 The latter amount ($13 million) related to the sale of 7 school sites to the Urban Land Authority (ULA), including 2 properties which were sold for $4.7 million and were subject to lease-back arrangements. These arrangements were established to facilitate the sub-division and retention by the Department of part of the sites for school purposes.

Eastside development

2.23 My October 1992 Report on the 1991-92 Finance Statement commented on the arrangements entered into between the Government and a private developer in January 1992, relating to the sale and development for residential and commercial purposes of the Eastside property located in East Melbourne. This property formed part of the Public Transport Corporation's rail yards. In summary, the arrangements involved:

- the sale of a 1.5 hectare land parcel (Stage 1) for $5.6 million, with the purchase price plus interest to be paid in 3 yearly instalments ending in June 1994;
- an option for the developer to purchase 2 further sites within the Eastside property, subsequent to June 1994 and June 1996 respectively, subject to satisfactory performance by the developer;
- the Government to offer a fourth site to the developer (on a right of first refusal basis), if a decision is made to sell the site on or before 31 January 2007 and if the developer has commenced construction on the previously acquired sites; and
- the Government to undertake certain works (estimated to cost $6.9 million) mainly relating to the relocation of existing railway facilities and landscaping, to enable the sale of the remaining 3 sites.

2.24 These arrangements were ratified by the new Government in July 1993. Minor amendments were made to the site boundaries of the previously sold property and, as a consequence, the sale price was increased by approximately $200 000.

2.25 The development of Stage 1 is progressing ahead of schedule. Given the success of the development, the Office of Major Projects has advanced the planned completion of the relocation of existing railway facilities and certain minor landscaping works (now estimated to cost $6.2 million) from June 1996 to September 1994, to facilitate the sale of all remaining sites. A budget allocation of $2.4 million has been approved for these purposes in 1993-94, with the balance to be funded in 1994-95.

2.26 In accordance with the sale arrangements, **$1.5 million ($2.1 million, 1991-92) was received by the Consolidated Fund from the developer during 1992-93 in respect of this property.** In September 1993, the developer purchased a part of a second site within the Eastside property for a consideration of $2 million, with a deposit of $200 000 payable on that date and the balance due in January 1994. Consistent with the established arrangements, the developer has an option to purchase the remaining sites.

Queen Victoria Hospital site

2.27 My October 1992 Report commented on the agreements entered into by the Government in March 1992 for the sale of the Queen Victoria Hospital site to a private developer, for a price of $24.2 million payable as follows:

- an initial deposit of $100 000 payable at the date of sale;
- $1.1 million payable in July 1992;
- $1.2 million payable in December 1992; and
- $21.8 million payable in June 1999.

2.28 Under the arrangements, the title for the property will not transfer to the developer until an unconditional bank guarantee to a value equal to the unpaid purchase price is lodged. Conditions are set within the agreements to establish the timing of the future lodgement of the guarantee.

2.29 My Report further highlighted that the developer had twice deferred the payment of the $1.1 million instalment due in July 1992. The developer has subsequently entered into a joint venture arrangement with a third party, forming a private company, to facilitate the development of the hospital site.

2.30 In addition to the company's involvement in the hospital site redevelopment, in December 1992, the company submitted a proposal to the Government for the redevelopment of the Regent Theatre in Melbourne, requiring Government and Melbourne City Council involvement and financial support. In January 1993, the Government provided an *in-principle* agreement to apply up to $12.5 million of the Queen Victoria Hospital sale proceeds towards the redevelopment, conditional upon:

- the company, as developer, securing sufficient funding for the Regent Theatre and associated City Square redevelopment by March 1993; and
- an accelerated settlement of the balance of the Queen Victoria Hospital sale price adjusted to reflect its present value, by December 1994.

2.31 While the company, in March 1993, paid an amount of $2.4 million to the Consolidated Fund, representing the July 1992 and December 1992 instalments under the sale arrangements, including interest to cover the delays in payments, at the date of preparation of this Report, the proposals relating to the Regent Theatre and City Square redevelopment had not been finalised.

Reduction in motor vehicle fleet

2.32 In my May 1993 *Report on Ministerial Portfolios*, I commented on the management of the Government motor vehicle fleet. In particular, the Report highlighted that a significant proportion of fleet vehicles were utilised less than the minimum level required under the Government's motor vehicle fleet management policy.

2.33 In March 1993, the Government determined it would reduce the budget sector vehicle fleet, excluding special purpose and police vehicles, by 850 vehicles or 15 per cent during 1992-93.

2.34 During 1992-93, around 750 vehicles were sold, with total proceeds of $8.2 million paid into the Consolidated Fund. Audit was advised by the Department of Finance that the targeted number of vehicle sales was not achieved due to a reluctance of certain departments to release vehicles for sale without receiving the commensurate financial benefit. At the date of preparation of this Report, negotiations were continuing with departments to facilitate a reduction in the number of vehicles during 1993-94.

Sale of State Insurance Office

2.35 In August 1992, a number of agreements were entered into to facilitate the sale of the major segments of the State Insurance Office (SIO), to GIO Australia Holdings Limited and its subsidiaries (GIO), effective from 31 July 1992. My October 1992 Report commented in detail on the sale arrangements, which provided for:

- the sale of specified SIO businesses and related net assets for a price anticipated by the SIO to be $214.4 million, with $167.3 million of the sale proceeds received in August 1992, and the balance to be received over a 5 year period in accordance with the terms and conditions specified in a licence agreement;
- the retention by the SIO of its business segment relating to employers' liability insurance written by SIO prior to the commencement of the former WorkCare Scheme, which will be administered on its behalf by GIO;
- the provision by the SIO of certain warranties and indemnities to GIO relating to specific elements of the businesses that were sold;
- an option for 800 permanent SIO staff who transferred to GIO at the date of sale to return to the Victorian Public Service, at their own initiative or at the request of GIO, at any time between 4 months and 2 years after the date of sale; and
- the retention by the SIO of certain assets, liabilities and contingent liabilities.

2.36 The following paragraphs outline key developments relating to the sale since my previous Report on the Finance Statement.

Financial result from sale

2.37 Under the sale arrangements, the final outcome of the sale was anticipated to be a loss, based on book values, of $2.9 million, with no return for accumulated goodwill. However, the result was dependent upon:

- determination of a final sale price, following the completion of an audit by a private accounting firm as at the date of sale; and
- the level of domestic and motor vehicle insurance business generated by GIO in Victoria, relating to the licence agreement, over the next 5 years.

2.38 Table 2F shows the outcome from the sale of SIO assets and liabilities, based on the final sale price, the value of net assets sold and the estimate of proceeds to be received under the licence agreement at the date of sale.

TABLE 2F
DETERMINATION OF LOSS ON SALE OF SIO BUSINESSES
($million)

Item			*Amount*
Net assets of SIO prior to special dividend and sale			301.8
Less - Net assets retained by SIO			2.2
			299.6
Amount receivable by State:			
Special dividend paid by SIO prior to sale to:			
Victorian Debt Retirement Authority	85.0		
Consolidated Fund	5.0	90.0	
Proceeds received at date of sale from GIO	163.4		
Amount anticipated to be received under a licence agreement over the next 5 years (in present value terms)	48.9	212.3	**302.3**
			2.7
Less- Costs of sale			(4.8)
Loss on sale of SIO businesses			**2.1**

2.39 The final outcome from the sale of SIO businesses is now expected to be a book loss of $2.1 million. However, the ultimate result will only be determined in the year 1997-98, when all licence fees are received.

How have the sale proceeds been applied?

2.40 As mentioned earlier, the cash proceeds received by SIO to date were $163.4 million. These proceeds have been applied as follows:

- $100 million paid directly to the Victorian Debt Retirement Fund for debt retirement purposes;
- $40 million paid to the Consolidated Fund and subsequently paid to the Victorian Debt Retirement Fund, also for debt retirement purposes; and
- the balance of $23.4 million retained by the SIO to cover obligations that have been retained.

2.41 The first instalment under the 5 year licence agreement is due in 1993-94. It is the intention of the Government that these fees will be either retained by the SIO to meet its obligations or paid to the Victorian Debt Retirement Fund.

Staff returned to SIO

2.42 At the date of sale, 800 permanent SIO employees transferred to GIO and a further 45 employees remained with SIO. Of the employees who remained, 40 were assessed as surplus to requirements.

2.43 As outlined in my October 1992 Report, the *State Insurance (Sale) Act* 1991 and the sale agreement prescribe that employees who were transferred to the GIO as part of the sale may, at their own initiative or at the request of GIO, return to the Victorian Public Service, at any time between 4 months and 2 years after the date of sale. Where employees return to the Public Service, SIO is responsible to meet the cost of employment, redeployment or termination.

2.44 During 1992-93, of the 800 employees that were transferred to GIO at the date of sale, 308 employees returned to the SIO. Of these, 236 returned at their own initiative, while a further 72 were not required by the GIO.

2.45 Of the employees that were retained by the SIO and those that returned from GIO, at 30 June 1993:

- 140 had been compulsorily terminated, with the SIO providing separation packages, while a further 3 resigned;
- 74 were on temporary training placements to other government agencies while seeking permanent positions in the public service, with SIO bearing the cost of employment;
- 49 had been permanently placed in the public service;
- 44 were placed on secondment with other government agencies for fixed periods of time, with employment costs paid by those agencies;
- 22 were engaged by the SIO on accounting and administrative tasks; and
- 21 were on various forms of leave of absence.

2.46 The aggregate net employment cost borne by the SIO during the 1992-93 financial year relating to surplus employees was $3.7 million. A further $5 million has been provided for redundancy payments to existing employees and additional staff expected to return to the SIO during 1993-94. These costs, in effect, will increase the loss incurred by the State from the sale of the SIO net assets as disclosed in Table 2F.

Current financial position

2.47 At 30 June 1993, the SIO had net assets of $74.7 million and a contingent liability relating to performance guarantees and bonds, with a maximum exposure of $220 million.

2.48 While at the date of preparation of this Report, no claims had been made by the GIO under the various indemnities and warranties provided by the SIO under the sale agreement, there is an ongoing exposure to such claims for a period of 5 years from the date of sale.

Public Authority Dividends

2.49 Dividends and statutory contributions are received annually by the Consolidated Fund from various public bodies under the *Public Authorities (Dividends) Act* 1983 and other specific legislation, and by virtue of the State's equity holdings in the Portland Smelter Unit Trust and the Victorian Equity Trust (VET). **During 1992-93, the Consolidated Fund received $905 million from this source, compared to $739 million in 1991-92, an increase of $166 million.** In addition to these amounts, $164 million was received by the Consolidated Fund from the VET relating to amounts paid by the Melbourne Water Corporation and the Gas and Fuel Corporation of Victoria to repurchase equity units.

2.50 The increased collections from dividends and statutory contributions in 1992-93 resulted from:

- the introduction of special dividends, payable by the State Electricity Commission of Victoria, the Gas and Fuel Corporation of Victoria and the Melbourne Water Corporation, from 1992-93. These dividends totalled $89 million and were financed from increased domestic gas and electricity charges and, in the case of the Melbourne Water Corporation, from a change in the timing of the issue of domestic consumption water bills and the implementation of a new tariff structure;
- the payment, for the first time, of a dividend by the Transport Accident Commission of $92 million in 1992-93;
- an additional dividend of $30 million from the VET, by virtue of the Treasurer's acquisition in 1991-92 and 1992-93 of all VET units; and
- the introduction of dividend payments in 1992-93 for certain non-metropolitan water authorities contributed $8 million.

2.51 These additional collections were offset by the reduction of other dividends from public bodies during the year.

2.52 My October 1992 Report commented on the significant increase in public authority contributions to the Consolidated Fund in recent years, and the adverse impact of such increases on the capacity of such entities to reduce their debt levels. **It is pleasing that the Government has announced the introduction, from 1 July 1993, of a tax equivalent system as a basis for determining future contribution levels for the State's major public bodies, together with dividends determined at commercial levels based on after-tax profits.**

PART 3

Consolidated Fund Payments

KEY FINDINGS

- Consolidated Fund payments for the year totalled $16.8 billion. Debt charges and Health and Community Services, Education and Transport related costs account for 70 per cent of these payments.

  Paras 3.1 to 3.5

- The major expenditure item is salaries and wages, which in 1992-93 accounted for around $6.4 billion or 38 per cent of total payments.

  Paras 3.6 to 3.7

- During 1992-93, employee departure programs financed around 20 000 departures from the budget sector workforce at a cost of $772 million.

  Paras 3.8 to 3.26

Summary of financial transactions

3.1 In the April 1993 *Budget Papers*, it was estimated that total Consolidated Fund payments in 1992-93 would be $16.6 billion, comprising $14.6 billion annual appropriations and $2 billion special appropriations. However, **actual payments for the year totalled $16.8 billion, some $160 million above budget expectations**. Table 3A provides a summary of the year's payments.

TABLE 3A
BUDGETED AND ACTUAL PAYMENTS
($million)

Item	*1991-92 Actual*	**1992-93 Actual**	*1992-93 (a)Budget*	**1992-93 Variance**
Recurrent -				
Annual appropriations *(b)*	10 967	**11 527**	12 015	**488**
Special appropriations	1 762	**2 034**	1 916	**(118)**
Total recurrent	12 729	**13 561**	13 931	**370**
Works and services -				
Annual appropriations	1 976	**2 549**	2 619	**70**
Special appropriations	203	**713**	113	**(600)**
Total works and services	2 179	**3 262**	2 732	**(530)**
Total payments	14 908	**16 823**	16 663	**(160)**

(a) Relates to the Government's April 1993 Budget.

(b) Does not include expenditure on finance charges of $362 million which was refinanced from borrowings undertaken by the Treasury Corporation of Victoria on behalf of the Consolidated Fund and netted-off outside the Fund.

3.2 To place the year's outcome in perspective, the following transactions need to be taken into account when assessing total payments for the year:

- debt retirement payments were $373 million below budget expectations, due to a commensurate shortfall in public authority receipts relating to the repurchase of Victorian Equity Trust (VET) units by public bodies. Given the off-setting reduction in receipts and payments, this variation did not have a significant overall impact on the year's result;
- the 1992-93 budget did not provide for 2 payments made during the year totalling $613 million, relating to the refinancing of a Consolidated Fund bridging finance facility ($48 million) and State Development Account borrowings including associated financing costs ($565 million), which did not impact on the overall level of budget sector debt;
- previous years' deferral arrangements relating to certain debt charges owing to the Commonwealth Government and flexible electricity tariff payments were discontinued, resulting in additional payments of $104 million in the year which were not provided for in the Budget; and

- an equity contribution to the Treasury Corporation of Victoria of $30 million was made, which was also not provided for in the Budget.

3.3 **After taking these factors into account, the payments for the year were $214 million below budget expectations**, rather than $160 million above budget as indicated in Table 3A of this Report. While savings were achieved in most areas of government activity, the major items contributing to this favourable result were:

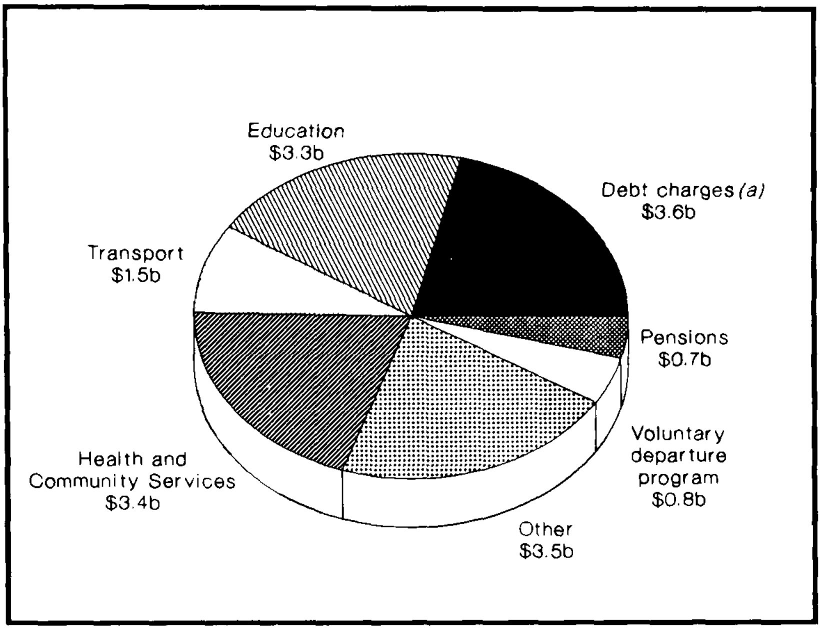
- expenditure under Voluntary Departure Program lower than anticipated by $27 million, due to certain employees accepting voluntary departure packages in 1992-93 but not terminating employment until 1993-94;
- employment program grants, subsidies and expenses reduced by $23 million;
- payments in respect of workers compensation, relating to periods prior to the introduction of WorkCare, lower than anticipated by $15 million;
- Commonwealth Better Cities Program expenditure by the Department of Planning and Development $10 million under budget, due to delays in the commencement of associated projects; and
- contributions to the State Superannuation Fund reduced by $8 million, due to lower than anticipated pension payments.

3.4 The lower than anticipated payment levels in the year also reflect an intensified focus on the achievement of budgetary targets, through enhanced monitoring and the introduction of greater budgetary flexibility by the provision of global appropriations in the October 1992 Budget, and the introduction of a mechanism for departments to *carry forward unspent appropriations* to subsequent years.

Major expenditure categories

3.5 As illustrated in Chart 3B, the major categories of Consolidated Fund payments in the year were debt charges and Health and Community Services, Education and Transport portfolio related costs, which account for 70 per cent of total payments.

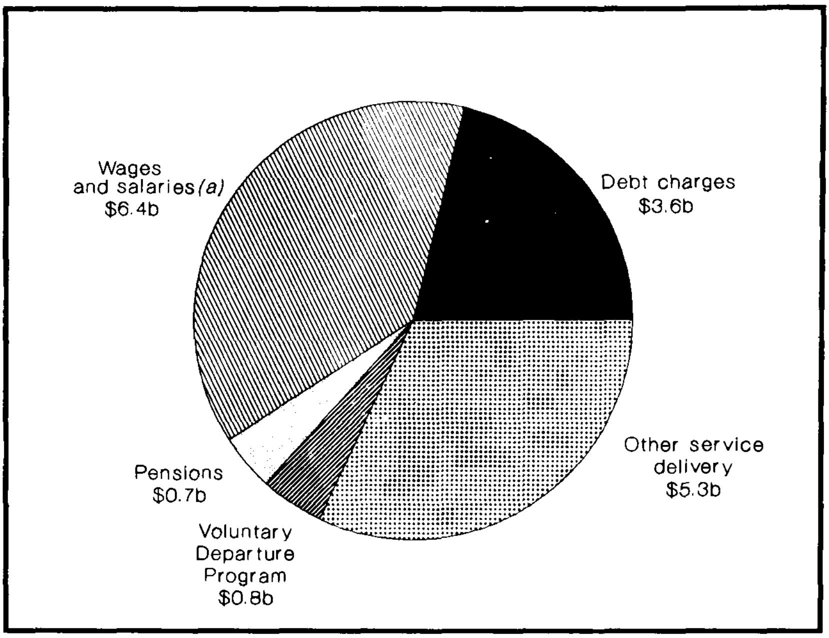
CHART 3B
MAJOR EXPENDITURE CATEGORIES, 1992-93
($billion)



(a) Debt charges include payments to the Flexible Management Unit Trust (FTMUT) and Tricontinental.

3.6 The major expenditure item is salaries and wages which, in 1992-93, accounted for around $6.4 billion or 38 per cent of payments, followed by debt charges which accounted for $3.6 billion or 21 per cent. Chart 3C shows the major payment categories on a functional basis for the year.

CHART 3C
MAJOR FUNCTIONAL EXPENDITURE CATEGORIES, 1992-93
($billion)



(a) Represents budget sector wages and salary costs as reported in 1993-94 Budget Paper No. 2.

3.7 As previously outlined in this Report, the key focus of the Government's financial management strategy, introduced in 1992-93, is to reduce the impact of debt charges on the budget, through implementation of various initiatives aimed at reducing the budget sector's reliance on borrowings to finance programs. Workforce reductions, through the provision of voluntary departure programs, and improved debt management arrangements are integral elements of this strategy.

Voluntary Departure Program

3.8 My October 1992 Report on the Finance Statement commented on the operation and outcomes of the Enhanced Resignation Program (ERP) which, during 1991-92, funded around 5 300 budget sector employee departures at a cost of $200 million. A similar initiative, namely, the Voluntary Departure Program (VDP), was introduced by the Government in 1992-93 to assist in the achievement of its medium-term budgetary objective of eliminating operating deficits by the year 1995-96. During the year, Special Loan Council allocations were provided to the State to enable borrowings to be raised to fund this Program.

3.9 The VDP involves the provision of separation packages to budget sector employees considered surplus to requirements, to enable the downsizing of the sector's workforce and, as a result, a reduction of associated employment costs. In 1992-93, a budgetary allocation of $800 million was provided for the VDP, to fund employee departures of around 16 500 equivalent full-time (EFT) positions. These departures, together with attrition and retirements, were anticipated to result in a total budget sector workforce reduction of 17 800 EFT.

3.10 During 1992-93, 3 separation packages were offered to budget sector employees under the program, namely:

- *Targeted Separation Packages (TSP)* - introduced in November 1992, for application to specific areas approved by the Minister for Finance, which mainly covered Education (school cleaning staff) and the Public Transport Corporation;
- *VDP Phase 1* - introduced in November 1992 and available to all budget sector agencies; and
- *VDP Phase 2* - introduced in March 1993, as an extension to the November 1992 program.

3.11 Program guidelines provided that separation packages were not to be offered to employees in receipt of WorkCare and WorkCover payments, or casual, temporary, contract or other limited tenure employees, for whom alternative means of compulsory separation already existed. Table 3D provides a summary of the key benefits available under each of the 3 separation packages offered during the year.

TABLE 3D
SEPARATION PACKAGE DETAILS, 1992-93

Item	*TSP*	*VDP Phase 1*	*VDP Phase 2*	
			Option 1	*Option 2*
Eligibility -				
Years of age	-	< 59	< 60	60 - 65
Package Details (a)(b) -				
- Weeks pay in lieu of notice	4	4	4	4
- Weeks pay per year of service	2, with a max. of 20	2, with a max. of 40	2, with a max. of 40	1, with a max.of 10
- Lump sum incentive	-	$5 000	$5 000	$2 500

(a) Total package payments were not to exceed the gross ordinary time pay entitlement, had the recipient continued employment to age 65 years.

(b) Accrued leave entitlements and superannuation resignation or retirement benefit payments were payable in addition to the package.

3.12 A key condition of VDP packages was that recipients could not seek re-employment and were not to be re-employed in any Victorian public sector agency for a period of 3 years from receipt of the package. However, Departmental Secretaries and Chief Executives of public sector agencies were given discretion to override this condition, in exceptional circumstances.

3.13 The VDP and TSP have been extended into 1993-94, with further budget sector workforce reductions of around 14 000 equivalent full time (EFT) staff planned for the year, at a cost of $1.3 billion.

3.14 The Workforce Management Unit (WMU) of the Department of the Treasury has overall responsibility for the management of VDP.

Departures funded by program

3.15 During 1992-93, the budget sector workforce was reduced by 26 416 persons, with 19 976 employee departures funded under the VDP and TSP at a cost of $772 million. The balance of departures resulted from natural attrition, including resignations and retirements, and reductions in casual employment. Table 3E shows the contribution of each separation package element to the achievement of the year's outcome.

TABLE 3E
VDP EMPLOYEE DEPARTURES AND COSTS, 1992-93 *(a)*

Element	*No. of departures (persons)*	*Cost ($million)*
Targeted Separation Packages	4 685	48.7
VDP Phase 1	8 766	264.5
VDP Phase 2	6 525	196.9
	19 976	510.1
Superannuation Costs		*(b)* 261.2
Other administrative costs		1.0
Total Program	**19 976**	*(c) (d)* **772.3**

(a) Based on data provided by the WMU.

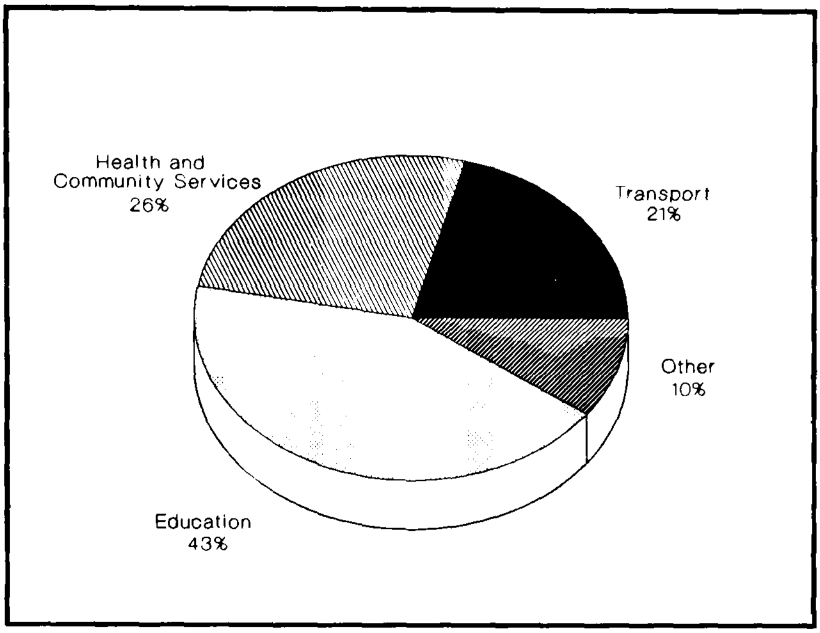
(b) Superannuation costs could not be allocated to individual program elements due to a lack of available information. The costs comprise contributions to the State Superannuation Fund of $207 million, Transport Superannuation Fund of $31 million and the State Employees Retirement Benefits Scheme (SERBS) of $23 million.

(c) The Finance Statement discloses total payments of $772.7 million for employee departure programs. The difference relates to payments made in the year for departures under the previous ERP program.

(d) Program costs did not include the cost of annual leave, except for departures from the Public Transport Corporation.

3.16 As illustrated in Chart 3F, departures financed by the VDP were mainly drawn from employees engaged within the Transport, Education and Health and Community Services portfolios.

CHART 3F
VDP DEPARTURES, BY MINISTERIAL PORTFOLIO
(per cent)



3.17 Audit analysis revealed that the average cost per separation package (not including accrued annual leave and superannuation entitlements) in 1992-93 was $25 600. However, wide variations existed in the average package cost between various employee age groups. Table 3G shows the average package cost per age group, for all exits other than those relating to the Targeted Separation Program (which was applied on a non-voluntary basis).

TABLE 3G
AVERAGE COST PER VDP DEPARTURE, OTHER THAN ACCRUED EMPLOYEE ENTITLEMENTS

Age group (years)	*(a)***Average Cost ($)**	*Departures (Number)*
< 30	**14 000**	1 820
30-35	**22 500**	2 147
36-40	**29 600**	2 088
41-45	**31 400**	1 861
46-50	**34 300**	1 728
51-55	**42 500**	2 842
> 55	**36 800**	2 805

(a) Costs other than those relating to accrued annual employee leave and superannuation entitlements. For departures from the Public Transport Corporation, the average cost includes all leave entitlements, which were funded under the program.

3.18 The table highlights that around 37 per cent of recipients were aged more than 50 years, with this category having the highest average package costs.

3.19 To provide greater incentive for younger employees to accept separation packages, the 1993-94 program provides a cash incentive of $10 000 to employees under 55 years of age, compared to an incentive of $5 000 offered to employees under phases 1 and 2 of the 1992-93 program.

Anticipated cost savings from program

3.20 While the immediate impact of the VDP has been to increase budget sector expenditure and borrowings by $772 million, the ultimate impact of the program needs to be assessed against the savings accruing from a reduced workforce, in terms of decreased employment costs.

3.21 The Department of the Treasury has estimated that budget sector workforce reductions achieved through the VDP have resulted in savings of around $146 million in 1992-93 and on-going annual savings of around $461 million. Based on these estimates, the Department has projected that phases 1 and 2 of the VDP will be cost-neutral in 1 to 1.5 years, and the targeted separation program will be cost-neutral within 3 years. After these periods, significant benefits in terms of reduced government outlays are anticipated to accrue to the budget sector.

Strategies to maintain savings

3.22 The achievement of the projected budget sector expenditure savings from VDP is ultimately dependent on the success of government strategies to maintain the reduced workforce levels achieved to date.

3.23 Strategies implemented by the Government to preserve the savings from the VDP include:

- a restriction against the re-employment of VDP recipients within a period of 3 years;
- the filling of staff vacancies, wherever possible, by the redeployment of surplus public service staff;
- a general moratorium on the external recruitment of staff, except for the filling of critical direct care positions within the Department of Health and Community Services, and the temporary replacement of essential teaching staff in the Department of Education; and
- reductions in departmental budgets equivalent to the salary and on-cost savings from VDP departures.

3.24 Significant indicators of the success of government strategies to preserve the benefits emanating from the VDP are the levels of budget sector employment and related costs, which are summarised in Table 3H.

TABLE 3H
BUDGET SECTOR EMPLOYMENT LEVELS AND COSTS, 1990-91 TO 1993-94

	Employment (a)		*Costs (b)*	
Year	*EFT*	**% variation**	*$million*	**% variation**
1990-91	201 337	n.a	6 373	n.a
1991-92	195 347	(3)	6 595	3
1992-93	173 048	(9)	6 420	(3)
1993-94	*(est.)* 159 000	(8)	*(est.)* 6 130	(5)

(a) Based on data provided by the Department of the Treasury.
(b) Represents budget sector wage and salary costs, as presented in 1993-94 Budget Paper No. 2.

3.25 The table indicates that the level of budget sector employment reduced by around 22 300 EFT during 1992-93, while operating salary and wages costs reduced by around $175 million during the same period. It is projected that, during 1993-94, budget sector employment levels will fall by a further 14 000 EFT, with associated aggregate employment costs reduced by $290 million.

3.26 Based on the above reductions, **audit concluded that the Government strategies to preserve the savings accruing from the VDP have generally been successful and, if maintained, will ensure the achievement of significant benefits to the State in terms of reduced budget sector expenditure.**

PART 4

Budget Sector Assets

KEY FINDINGS

- While the Government has presented detailed information on budget sector liabilities, there is still a need for more comprehensive reporting of asset holdings.

  Paras 4.1 to 4.5

- A 3 year program has been introduced, requiring all departments to produce accrual accounting financial statements by 1995-96.

  Para. 4.6

- The implementation of accrual accounting by departments will lead to significant improvements in budget sector financial accountability and performance monitoring. To accelerate the realisation of the benefits arising from such an initiative, consideration should be given to advancing the implementation timetable.

  Paras 4.7 to 4.8

- According to Department of Finance records, properties with an estimated value of $400 million had been identified as surplus to government needs and were awaiting sale.

  Paras 4.9 to 4.12

Lack of comprehensive asset information

4.1 Meaningful assessments of the budget sector's financial position and performance can only be undertaken if comprehensive financial statements are prepared for the sector, which encompass a balance sheet, operating statement and statement of cash flows. In the past, while governments have presented detailed information on budget sector liabilities, there has been an absence of comprehensive information on asset holdings.

4.2 My previous Reports on the Finance Statement have commented on deficiencies in budget sector asset records and significant delays in the valuation of non-current asset holdings. In addition, these Reports have commented on the need for asset information to be segmented between income producing and community assets, to enable meaningful assessments to be made of the extent to which the State's asset base will in future contribute towards the financing of debt repayments.

4.3 While in 1987 the previous Government commenced an asset recording and reporting program, its August 1991 Accounting Policy Statement No. 4 (APS 4), *Recording and Reporting of Non-Current Physical Assets*, as revised, did not require departments to complete the identification and valuation of land and buildings until June 1996. In addition, the valuation of heritage asset holdings was deferred pending development of an appropriate valuation basis.

4.4 In June 1993, the Department of Finance requested all departments to defer the implementation of APS4:

- *until a number of issues have been resolved, primarily in relation to the potential need for amendments to APS 4 following the subsequent release* by the Australian Accounting Research Foundation *of Exposure Draft ED 55 "Reporting by Government Departments"; and*
- *due to the development and implementation of accrual financial reporting by departments.*

4.5 While it is recognised that the development of a financial reporting framework for government departments has not yet been finalised by the accounting profession, audit is of the view that this should not inhibit the timely development of comprehensive information on budget sector assets.

Introduction of accrual accounting by departments

4.6 In October 1991, the Government introduced a pilot program for the implementation of accrual accounting for 6 departments, which required the preparation of balance sheets as at 30 June 1993. In April 1993, the Department of Finance revised the accrual accounting implementation program. The revised program involves a 3 year staged approach which culminates in all departments being in a position to produce accrual accounting financial statements which are suitable for audit by 1995-96.

4.7 Accrual accounting, once fully implemented, will without doubt lead to significant improvements in budget sector financial accountability and performance monitoring. However, **to enable the more rapid realisation of these benefits, consideration should be given to advancing the implementation timetable**, while accepting that the valuation of certain assets may need to be progressively undertaken.

4.8 The Victorian Commission of Audit, in its May 1993 Report, which included a comprehensive financial report on the whole of government, also recommended that the Government build on the advances made by the Commission in public sector reporting in Victoria and prepare consolidated financial statements for the whole of government and for individual departments for the financial year ended 30 June 1993. The Commission considered that such statements should include a balance sheet, operating statement and cash-flow statement, based on Australian Accounting Standards and Statements of Accounting Concepts.

Identification of surplus assets

4.9 My previous Reports on the Finance Statement have commented on the Government asset sale program, which has operated since 1986-87 and has raised around $1 billion to 30 June 1993.

4.10 To assist in the improvement of asset management within the budget sector, in March 1993, the Department of Finance established an Asset Audit Unit. A short term objective of the Unit is to review the property registers of all budget sector agencies and identify surplus assets for immediate sale. This initiative represents a positive step towards enhanced budget sector financial management.

4.11 According to Department of Finance records, at 30 June 1993, around 2 700 properties with an aggregate estimated value of $401 million ($444 million 1991-92) had been identified as surplus to government needs and were awaiting sale. Table 4A provides a summary of these assets.

TABLE 4A
ASSETS AWAITING SALE, AT 30 JUNE 1993
($million)

Year approved for sale	*Estimated value*
1986-87	36.2
1987-88	16.1
1988-89	9.3
1989-90	8.4
1990-91	75.7
1991-92	*(a)* 164.6
1992-93	90.8
Total	**401.1**

(a) 877 properties, including 9 properties with a total estimated value of $91 million.

4.12 The Department of Finance advised that the key reasons for delays in the sale of these properties were the on-going depressed state of the commercial property market, low market demand for development properties, and the poor quality of assets within the portfolio.

PART 5

Budget Sector Liabilities and Commitments

KEY FINDINGS

- The Government has recognised as liabilities for the first time various financial arrangements upon which I have commented in previous Reports. However, the Government has still not disclosed as a liability the Accelerated Infrastructure Program valued at $205 million.
  Paras 5.1 to 5.10

- At 30 June 1993, the liabilities of the State were approximately $72 billion (unaudited), of which budget sector liabilities accounted for $42.9 billion.
  Paras 5.6 to 5.7

- It is currently estimated that the Victorian taxpayers will meet $98 million of the total debt of $712 million assumed by the State in 1991-92 for financing the payments to Victorian Equity Trust unit holders.
  Paras 5.36 to 5.40

- Net obligations to be met by the Transport Accident Commission (TAC) in relation to the Farrow Group arrangements were estimated at $561 million at June 1993, which was $249 million more than when the debt was transferred in January 1993.
  Paras 5.41 to 5.50

- In addition to the net obligations to be met by TAC relating to the Farrow Group, $244 million has been met by Victorian taxpayers mainly from the special petrol levy.
  Paras 5.44 and 5.51

- The present value of the State's current exposure under the flexible electricity tariff arrangements associated with the Portland and Point Henry aluminium smelters is estimated to be around $1.7 billion. This is in addition to $563 million already paid under the arrangements.
  Paras 5.68 to 5.75

- The aggregate cost to Victorian taxpayers of Tricontinental as at 30 June 1993 was $2.4 billion, of which $1.5 billion is yet to be funded.
  Paras 5.76 to 5.81

- The Government has announced major reforms to Superannuation Funds principally operated for budget sector employees, aimed at reducing associated costs and the level of unfunded liabilities which currently stands at $18 billion.

  Paras 5.87 to 5.95

- Interest incurred on budget sector borrowings in 1992-93 was $2.2 billion.

  Paras 5.96 to 5.100

- Interest paid in the year represented 21 per cent of total Consolidated Fund revenues available for general application.

  Paras 5.101 to 5.102

- A major objective of the Government is to restore the State's former AAA credit rating through a budgetary strategy aimed at arresting the growth in debt, with a target to eliminate current account deficits by 1995-96. The Government has implemented various expenditure reduction and revenue raising measures aimed at achieving this target.

  Paras 5.103 to 5.111

- Assurances again cannot be given to the Parliament as to the full extent of the State's contingent liabilities. However, action has commenced to review the processes and records presently utilised to identify, monitor and report on these exposures.

  Paras 5.132 to 5.137

AGGREGATE LIABILITIES

5.1 A key focus of my previous Reports on the Finance Statement has been the presentation and analysis of the aggregate budget sector liabilities (indebtedness) and other financial commitments, in order to facilitate informed assessments of the sector's financial position and the impact of borrowing costs on State finances. Indeed, over the past 4 years, the pivotal issue confronting the Government has been the increasing impact of budget sector liabilities on the State's financial operations and the strategic management of such liabilities.

5.2 The magnitude of current levels of debt and the need to reduce the rate of growth due to on-going deficits, and associated financing costs, was recently articulated in the Government's October 1992 and April 1993 *Statements on Victoria's Financial Management Strategy*, which, inter alia, stated that:

> *"The first and most urgent task facing the Government is to tackle Victoria's burgeoning deficit in order to arrest the growth in budget sector debt."*
>
> *"Once* [the current account deficit is eliminated], *the objective is to eliminate the overall Budget deficit and to generate a surplus so that debt can progressively be retired, debt servicing costs reduced and the burden on State taxes and charges alleviated."*
>
> *"Interest paid is the largest single functional outlay of the budget. Interest costs have risen sharply in recent years... Increases in Victoria's budget sector debt giving rise to this have occurred mainly through accumulated Budget deficits...The Government is committed to restoring Victoria's former AAA credit rating through a budget strategy which will arrest this growth in debt....Arresting the growth in the level of unfunded public sector superannuation liabilities is also a key priority of the government.*

5.3 The Victorian Commission of Audit, in its May 1993 Report on State finances, also concluded that:

> *"If the Government is to achieve its stated objective of restoring Victoria's AAA credit rating within 10 years, it must, at the very least, restore the State's current balance to surplus as soon as possible; begin financing at least part of the State's capital expenditure from sources other than borrowings; and reduce the State's debt burden ...The measures announced in the Treasurer's April 1993 mini-Budget appear to fulfill these objectives."*

5.4 In recognition of the ongoing Parliamentary and public focus on the critical issue of budget sector liabilities, as a positive step, the Government has incorporated more comprehensive information in the 1992-93 Finance Statement on these financial obligations. In addition, **it is pleasing to report that the Government has recognised as liabilities, for the first time, various financial arrangements upon which I have commented in previous Reports to the Parliament. These liabilities relate to transport sale and lease-back transactions, deferred expenditure arrangements, Portland Smelter Unit Trust delayed compensation payments and the financing arrangements associated with the World Congress Centre.**

5.5 To assist in the assessment of the budget sector's total financial obligations, a detailed analysis of the key components of budget sector liabilities, together with information on the sector's contingent liabilities and other financial commitments is presented in this Part of the Report.

Budget sector liabilities and commitments

5.6 **At 30 June 1993, the liabilities of the State were around $72 billion (unaudited), of which total budget sector liabilities accounted for $42.9 billion** (30 June 1992, $41.8 billion). Table 5A provides a summary of budget sector liabilities, and total financial commitments (relating to operating leases and contracted capital works) and contingent liabilities.

TABLE 5A
BUDGET SECTOR LIABILITIES AND COMMITMENTS
($billion)

Item	**1992-93**	1991-92
Liabilities		
Borrowings and associated accrued interest *(a)*	**20.8**	19.7
Unfunded superannuation liabilities *(b)*	**15.5**	15.2
Flexible electricity tariff payments to Portland and Point Henry aluminium smelters	**1.7**	1.7
Tricontinental Group deficiency	**1.5**	1.7
Infrastructure projects (World Congress Centre and St. Vincents Hospital)	**0.2**	0.1
Accelerated Infrastructure Program *(c)*	**0.2**	0.1
Other liabilities *(d)*	**3.0**	3.3
Total budget sector liabilities	**42.9**	**41.8**
Financial commitments *(e)*	**1.8**	**2.1**
Contingent liabilities	**20.6**	**22.5**

(a) Borrowings are disclosed at their face value.

(b) Based on latest actuarial estimates of unfunded superannuation liabilities. Unfunded liabilities of Superannuation Funds operated principally for budget sector employees totalled $18 billion ($17.7 billion, 30 June 1992). However, this amount included $2.5 billion relating to employees engaged within the non-budget sector. For the purposes of identification of budget sector liabilities, the amount of $2.5 billion has been excluded from the figures in the above table.

(c) Financial obligations arising from this program are regarded by audit as liabilities, while the Finance Statement discloses these obligations as operating leases.

(d) Mainly includes creditors and accrued employee leave entitlements of departments, in-substance borrowings of the Emergency Services Superannuation Scheme ($176 million), Portland Smelter Unit Trust delayed compensation payments ($144 million) and other liabilities of budget sector public bodies.

(e) Comprise operating leases and works not carried out under existing contracts.

5.7 Liabilities presented in the above table do not include liabilities relating to entities forming part of the non-budget sector and public financial institutions.

Understatement of budget sector liabilities

5.8 The major differences between the value of budget sector liabilities as determined by audit and that presented in the Finance Statement relate to the treatment of financial obligations arising from the Accelerated Infrastructure Program, and the non-inclusion of departmental employee accrued leave entitlements and liabilities of certain budget sector bodies such as public hospitals and Colleges of TAFE. **The Department of the Treasury has advised audit that the departmental employee accrued leave entitlements and liabilities of the above budget sector bodies will be included in future Finance Statements.**

5.9 The financial obligations arising from the Accelerated Infrastructure Program have been presented by the Department of the Treasury within Table B.9 of the Finance Statement as operating lease commitments. However, as commented in my previous Reports to the Parliament, I regard the financial obligations under this Program as budget sector liabilities. This view was more recently espoused by the Victorian Commission of Audit in its May 1993 Report, which was supported by advice received from the 2 major Australian accounting bodies.

5.10 The financial arrangements under the Accelerated Infrastructure Program, in substance, do not transfer the principal risks and benefits incidental to ownership of the leased assets to an external party, but commit the State to future financial obligations. A key element of the arrangements is an indemnity provided by the Government to parties financing the Program, which effectively places the majority of risks with the Government. Accordingly, I have included an amount of $205 million representing the finance raised under this Program in my calculation of budget sector liabilities as presented in Table 5A of this Report. Further comment on the Accelerated Infrastructure Program is provided in paragraphs 5.28 to 5.35 of this Report.

Analysis of liabilities and commitments

5.11 A more detailed analysis of the key components of budget sector liabilities and financial commitments, at 30 June 1993, is included in the following sections:

- Budget sector borrowings *(paras 5.12 to 5.54)*;
- Other liabilities *(paras 5.55 to 5.86)*;
- Unfunded superannuation liabilities *(paras 5.87 to 5.95)*;
- Finance charges *(paras 5.96 to 5.116)*;
- Financial commitments *(paras 5.117 to 5.131)*;
- Contingent liabilities *(paras 5.132 to 5.151)*.

BUDGET SECTOR BORROWINGS

Level of budget sector borrowings

5.12 **The budget sector's accumulated borrowings excluding accrued interest, as determined by audit, at 30 June 1993, amounted to $20 billion, a net increase of $1.1 billion since the previous year.** Table 5B provides a summary of the major movements in the level of budget sector borrowings during the year.

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

Item			*Amount*
Public Account -			
Borrowings at 1 July 1992- per Finance Statement			18 108
Add -			
Prior year borrowings brought to account in the year			
Transport leases	422		
Office of Major Projects borrowings	35		457
			18 565
Add -			
New borrowings	3 355		
Assumption of borrowings of the former Rural Water Commission	100		
Indexation, (premium) and discount	(146)		
Mobile Radio Network lease	15		
Borrowings arising from interest swap transactions	37	3 361	
Less -			
Debt redemptions by Consolidated Fund	*(a)*1 159		
Debt redemptions outside Consolidated Fund	175		
Transfer of debt to TAC	*(b)* 785		
		2 119	1 242
Total Public Account borrowings at 30 June 1993			19 807
Budget sector statutory authorities -			
Borrowings at 1 July 1992			350
Net borrowings in 1992-93			(139)
Total budget sector statutory authority borrowings at 30 June 1993			211
Total budget sector borrowings at 30 June 1993			*(c) (d)* **20 018**

(a) Includes the payment of capital indexation of $29 million, relating to State Development Account borrowings.

(b) Represents the transfer of outstanding Farrow Group related financial obligations to the Transport Accident Commission. Refer to paragraphs 5.41 to 5.51 of this Report for further details.

(c) The difference of $37 million between this balance and that presented in Table B.1 of the Finance Statement relates to in-substance borrowings arising from interest swap transactions entered into in 1989-90 involving up-front receipts. This amount has been included by the Department of the Treasury within Table B.4 of the Finance Statement as part of accrued interest.

(d) The difference between financing transactions as disclosed in part 1 of this Report ($2.2 billion) and the movement in borrowings in the year ($1.1 billion) is mainly related to a transfer of debt to the TAC ($785 million), changes in cash and investment balances ($163 million) and discount and indexation costs ($146 million).

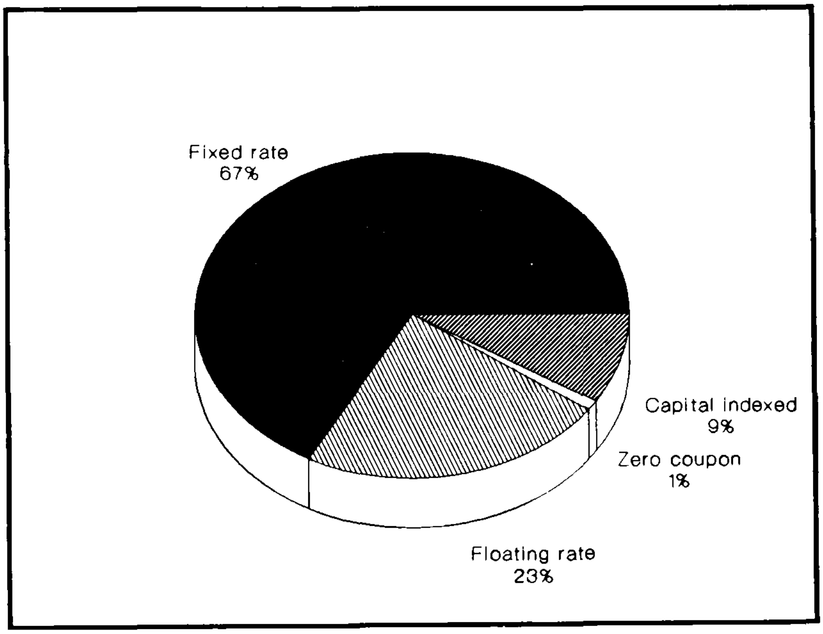
Borrowing composition and maturity profile

5.13 The borrowing mix and maturity structure are significant determinants of the State's financing requirements in any one year, the level of financing costs incurred by the State, and the State's exposure to adverse movements in interest rates.

5.14 To minimise interest costs, the State undertakes borrowings in various forms, commonly referred to as fixed rate, floating rate, capital indexed and zero coupon. These borrowings are complemented, as deemed appropriate, by the use of various debt management instruments, aimed at minimising interest costs. Debt maturities are spread over future years to minimise the State's exposure to adverse interest rates that may prevail in any particular year in which debt is due for refinancing.

5.15 Chart 5C shows the composition of budget sector borrowings at 30 June 1993.

CHART 5C
COMPOSITION OF BUDGET SECTOR BORROWINGS, AT 30 JUNE 1993
(per cent)



5.16 The chart illustrates that, **at 30 June 1993, fixed rate instruments account for around 67 per cent of total budget sector borrowings**. The prevalence of these instruments within the debt portfolio reflects the need for the State to minimise its exposure to interest rate volatility, the ready availability of such instruments in capital markets and the predictability of associated future outflows.

5.17 As explained in my October 1992 Report, to achieve the optimum level of financing costs, the former Government in 1991-92 introduced a 3 year strategic plan setting out various goals and targets in relation to Public Account debt currently managed by the Treasury Corporation of Victoria (TCV). The plan includes targets for the progressive diversification of the debt portfolio. Table 5D shows the targeted mix of borrowings to be raised on behalf of the Public Account over the years 1991 to 1994, and the mix of borrowings actually raised during 1992-93.

TABLE 5D
TARGETED MIX OF BORROWINGS FOR 1991 TO 1994 AND ACTUAL MIX OF BORROWINGS RAISED IN 1992-93
(per cent)

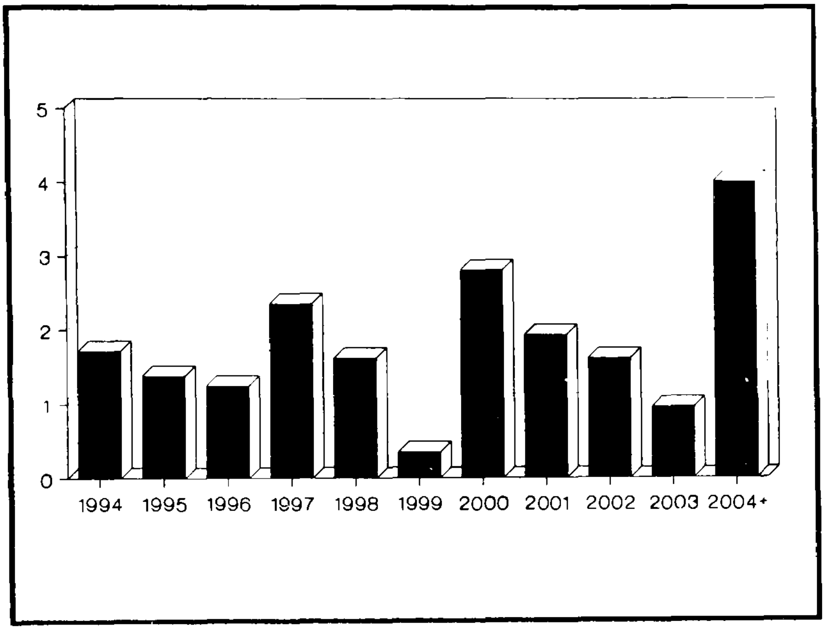
Type of borrowing	*Targeted*	*Actual 1992-93*
Fixed rate	60	53
Capital indexed	15	11
Zero coupon	15	-
Floating rate	10	36

5.18 As illustrated in the above table, the mix of borrowings actually raised during 1992-93 was not consistent with established targets. The Department of the Treasury advised that the variation occurred mainly due to a decision to cease the utilisation of zero coupon borrowings and the limited market opportunities available during the year to raise fixed borrowing instruments.

Maturity profile

5.19 An analysis of the budget sector borrowings portfolio at 30 June 1993 indicates that **around 80 per cent or $16 billion of the portfolio will mature and require repayment or refinancing in the next 10 years. During 1993-94, $1.7 billion will require repayment or refinancing**. Chart 5E illustrates the maturity profile.

CHART 5E
MATURITY PROFILE OF BUDGET SECTOR BORROWINGS, AT 30 JUNE 1993
($billion)



5.20 The extent to which debt is repaid rather than refinanced upon maturity, in future years, will be largely determined by the success of current and future government debt reduction strategies.

Retrospective Loan Council allocation

5.21 My Reports on the Finance Statement over the past 3 years have drawn attention to the substantial utilisation of short-term borrowings for the financing of Consolidated Fund operations, and the increasing costs of such borrowings. In particular, my October 1992 Report commented on the conversion by the former Government, in May 1992, of short-term borrowings to the value of $1.3 billion to medium-term borrowings. That Report also highlighted that my Office had been denied access to Loan Council documentation in relation to the conversion of this debt and other financial transactions, and commented as follows:

> *"I was not in a position to verify whether the State had borrowed in excess of its Loan Council allocation. The ramifications of any excess borrowing could be far reaching, particularly in terms of National economic objectives."*

5.22 **Subsequent to that Report, it was confirmed that these borrowings were in fact in excess of the State's loan allocation and the Government made application to the Loan Council for a retrospective loan allocation to the State to cover the conversion of the $1.3 million borrowings. In December 1992, the Loan Council approved an additional allocation to the State to cover this conversion.**

Assumption of Rural Water Commission financial obligations

5.23 In my 1992 and 1993 *Reports on Ministerial Portfolios* I referred to a review, known as *the McDonald Review*, into the future management of the Rural Water Commission of Victoria. The review culminated in the abolition of the Commission and the establishment of the Rural Water Corporation as its successor, effective from 1 July 1992.

5.24 To ensure the future commercial viability of the newly established Corporation and to eliminate the need for future government support of its operations, the Government during 1992-93 provided a financial assistance package to the Corporation which included:

- the assumption by Government of borrowings of the former Commission, valued at $99.8 million, together with associated finance charges of $8.3 million;
- the transfer to the Government of responsibility for meeting the accrued superannuation liabilities of the Corporation as at 1 July 1992 totalling $296 million; and
- the provision of $1.4 million to the Corporation in June 1993, to finance payments in lieu of long service leave to employees who ceased employment with the Corporation since 1 July 1992.

5.25 The borrowings and unfunded superannuation liabilities transferred to the Government are included in the respective tables in the Finance Statement. The assumption of these liabilities is in addition to the waiving of the repayment of loans and advances totalling $346 million, provided by the State to the former Commission, on the establishment of the Commission on 1 July 1984.

Extinguishment of State Development Account borrowings

5.26 An important element of the Government's debt management strategy, introduced in 1992-93, is the progressive centralisation of the management of all State borrowings to the Treasury Corporation of Victoria (TCV). Consistent with this strategy, during the year, all Public Account borrowings from the State Development Account (SDA) of the Victorian Development Fund (VDF) were repaid during the year. The total SDA borrowings of $724.8 million were extinguished as follows:

- $585.1 million repaid, together with finance charges of $50.4 million, from Special Appropriations of the Consolidated Fund. This amount was financed from Public Account borrowings raised via the TCV; and
- $139.7 million repaid by the Victorian Debt Retirement Fund, from proceeds of $140 million provided to the Fund from the sale of State Insurance Office businesses.

5.27 Furthermore, in the April 1993 Budget Papers, the Government announced its intention to wind-up the VDF, by eliminating the utilisation of the Fund for the financing of short-term budget shortfalls and transferring its cash management function to the TCV.

Accelerated Infrastructure Program

5.28 In previous years, I have commented on the financial obligations of the budget sector arising from the Accelerated Infrastructure Program, which was established by the Government in conjunction with a major private bank in 1990-91. The program was aimed at providing accommodation for government agencies, principally for utilisation as police stations and law courts. The arrangement was intended to cover around 30 projects across Victoria at a cost of approximately $300 million over a 3 to 5 year period.

5.29 Under the arrangement, a special purpose public company was established by a subsidiary of the bank with the sole purpose to finance and commission the construction of buildings for lease by the Government. As reported in previous years, the specific financing arrangements involved:

- the company borrowing funds, through the issue of capital indexed bonds which will mature over a period of 20 years, to finance the construction costs;
- the Government entering into non-cancellable lease agreements for terms of 20 years with the company, with a 5 year renewal option, and rental payments by the Government set at a level that covers interest and certain principal payments and other costs of the company;
- the provision by the Treasurer of an indemnity to bond holders, under which the Government is required to meet any shortfall in the payment by the company of interest and principal relating to the bonds raised by the company, **effectively negating the company's financing risk**; and
- the company providing the Government a first right to purchase the buildings on expiration of the initial lease period.

5.30 **At the 30 June 1993, the company had raised $205 million from the issue of bonds and completed construction of 3 projects, for which property leases have been formalised.** The projects were:

- Frankston police and courts complex, completed in June 1993 at a cost of $24.1 million;
- Wangaratta police station, completed in June 1993 at a cost of $10.9 million; and
- Narre Warren police station, completed in October 1992 at a cost of $6.3 million.

5.31 A further 2 projects were completed in July 1993 (South Morang and Keilor Downs police stations) at an aggregate cost of $10.1 million. In addition, construction is proceeding on a further 7 buildings, which include 5 police stations, a health clinic and a hospital. The construction of these buildings, estimated to cost $70.1 million, is due to be completed by August 1994.

5.32 Subsequent to the October 1992 State election, the Government introduced a policy to provide local police facilities, as against the previous policy for the provision of larger consolidated facilities. Consequently, the Minister for Police and Emergency Services initiated a review of the future operation of the Program, which is expected to be completed by December 1993.

5.33 At the date of preparation of this Report, 3 other projects previously approved had been cancelled and an additional 15 projects which were in the planning phase, with an estimated value of $126 million, had been suspended. **The financing company under the Program was paid $2.6 million compensation for costs incurred on the 3 cancelled projects**. The cancellation of these projects has also resulted in the company holding some $83 million in uncommitted funds previously raised through the issue of capital indexed bonds. These funds are currently invested by the company, pending direction from the Government as to their future application. **Any shortfall between investment earnings and financing costs payable to bond holders relating to the uncommitted funds will ultimately be met by Victorian taxpayers.**

5.34 As commented earlier in this Report, **it is my view that the financing arrangements under the Accelerated Infrastructure Program are, in substance, finance leases.** The major considerations in support of this view include:

- the lease agreements are non-cancellable from the Government's perspective over the initial 20 year lease term;
- the Government has provided an indemnity to bond holders which effectively negates the company's financing risk (the principal risk) as it guarantees the repayment of all coupon interest obligations and commits the Government to meeting any shortfall that may occur between the amount needed to redeem the bonds on maturity and the proceeds obtained from the eventual disposal of the properties at the expiration of the lease term;
- the Government has a right of first refusal, to enable it to purchase the properties at the expiration of the initial lease period;
- rentals are set at a level which will cover interest and other outgoings of the company, therefore off-setting the company's exposure to increasing interest rates; and
- the initial lease terms of 20 years, together with the additional optional term of 5 years, account for a substantial portion of the economic lives of the buildings (i.e. 25 out of 30 years). This indicates a significant degree of permanency in relation to the intentions of the lessee to occupy and use the buildings for the purposes for which they are constructed.

5.35 **Based on the audit assessment of these arrangements, an amount equal the value of the proceeds from the issue of bonds at 30 June 1993 has been included in my calculation of budget sector liabilities, in Table 5A of this Report.**

Victorian Equity Trust

5.36 The Victorian Equity Trust (VET) was a publicly listed trust, established in 1988 to raise equity funding for the Portland Smelter Unit Trust and the State's 3 major public bodies, namely the State Electricity Commission of Victoria (SECV), the Gas and Fuel Corporation of Victoria and the Melbourne Water Corporation. On establishment, the VET raised $504 million from the public, of which $490 million was invested in equity units in the abovementioned entities and $14 million was retained to meet establishment costs and working capital requirements. Table 5F outlines the VET equity investments with each entity.

TABLE 5F
VET EQUITY INVESTMENTS
($million)

Publicly-owned entities	*Amount*
State Electricity Commission of Victoria	240
Melbourne Water Corporation	100
Portland Smelter Unit Trust	100
Gas and Fuel Corporation of Victoria	50
Total	**490**

5.37 My October 1992 Report commented on the arrangements established by the Government to repay, in June and July 1993, individuals who invested in the VET, principally from borrowings totalling $712 million. This amount exceeded the $504 million initially raised due to the capital growth in the value of the VET units.

5.38 It was the Government's intention to wind-up the VET, in 1992-93, by redeeming the Trust investment in the abovementioned entities. To this effect, the *1992-93 Budget* provided for the receipt by the Consolidated Fund of contributions amounting to $537 million, and for the application of this amount towards the partial retirement of the $712 million borrowings raised to repay individuals who invested in the VET.

5.39 **During 1992-93, contributions totalling $164.3 million were received by the Consolidated Fund, relating to the redemption of VET equity units** from the Melbourne Water Corporation and the Gas and Fuel Corporation of Victoria, for $107.1 million and $57.2 million respectively. These proceeds were applied towards the retirement of an equivalent amount of debt. The anticipated redemption of the investment in the SECV and Portland Smelter Unit Trust was not completed prior to 30 June 1993 due to delays in the finalisation of negotiations between the respective parties. However, the 1993-94 Budget Papers provide for the receipt by the Consolidated Fund of $449.3 million in the year in respect of these redemptions. At the date of preparation of this Report, negotiations with the respective parties as to the amount payable had not been concluded.

5.40 **If the amount provided in the 1993-94 Budget Papers is received by the Consolidated Fund, the net effect of the above transactions will be that the Government has borrowed $712 million to repay VET investors and will only receive $613.6 million from participating authorities. Accordingly Victorian taxpayers will be required to meet the shortfall totalling $98.4 million.**

Farrow Group of Building Societies

5.41 My Reports on the Finance Statement in recent years have provided detailed comment on the financial obligations and associated costs to the State arising from the June 1990 closure of the Farrow Group of Building Societies (consisting of the Pyramid, Geelong and Country Wide Building Societies).

5.42 In summary, the State's financial obligations arose from a Government commitment, following the forced closure of the Group, that depositors would receive, over time, the principal component of their deposits held at 24 June 1990. This commitment was subsequently met through:

- an initial payout of $362 million to depositors by the former State Bank of Victoria. In return for this payout, depositors assigned their rights to the former State Bank of Victoria (now the Commonwealth Bank of Australia) in respect of equivalent distributions from the liquidator. The Government in turn agreed to meet all financing and administrative costs associated with this arrangement, and to indemnify the bank against any shortfall between the payout and distributions subsequently received from the liquidator;
- special emergency payments of $6 million to depositors suffering extreme hardship as a result of not having immediate access to their funds; and
- an offer to provide depositors with Victorian Government Security Bonds, to a value equal to the balance of deposits, excluding interest credited after 30 June 1989. Bonds with an aggregate value of $875 million were subsequently issued and entitled depositors to amounts equal to the face value of the bonds, over a period of 5 years ending August 1995. In return for the bonds, depositors were required to assign to the State all their rights to future liquidator distributions.

5.43 The former Government, in December 1990, introduced a special petrol levy to finance the shortfall that would arise between the cost of the above financial support arrangements and proceeds to be received from the liquidator of the Farrow Group. However, in the Government's October 1992 *Statement on Victoria's Financial Management Strategy*, it announced a decision to abolish the special petrol levy as from 1 January 1993, and to transfer all State liabilities associated with the Farrow Group arrangements, including associated rights to liquidator distributions, to the Transport Accident Commission (TAC). Legislation was subsequently passed by the Parliament to formalise this decision, which set the transfer date at 15 January 1993.

5.44 The aggregate cost of the State's commitment to Farrow Group depositors to 15 January 1993 totalled $473 million. Of this amount, $244 million had been funded by Victorian taxpayers through the special petrol levy and Consolidated Fund Appropriations, and $32 million by way of liquidator distributions. Table 5G provides a summary of the key cost components and funding sources used to meet these costs.

TABLE 5G
AGGREGATE COSTS AND FUNDING SOURCES TO MEET FARROW GROUP OBLIGATIONS, TO 15 JANUARY 1993, PRIOR TO THE TRANSFER TO TAC
($million)

Item			*Amount*
Aggregate costs			
Finance and administrative costs associated with the initial payout to depositors by State Bank*(a)*		87	
Special emergency payments		6	
Payments to holders of Victorian Government Security Bonds*(b)*		353	
Financing and other costs associated with Security Bonds*(c)*		27	
Total cost			**473**
Funding sources			
State borrowings		270	
Met by Victorian taxpayers -			
Petrol levy	202		
Government revenues	42	244	
Liquidator distributions		32	**546**
Petrol levy not applied at 15 January 1993			**73**

(a) Include costs of $41 million in 1990-91, $36 million in 1991-92 and $10 million in 1992-93.
(b) Include payments to bondholders of $195 million in August 1991 and $158 in August 1992, leaving $522 million yet to be paid.
(c) Comprise payments of $1 million in 1990-91, $12 million in 1991-92 and $14 million in 1992-93.

5.45 The Government transferred to the TAC net financial obligations, related to the Farrow Group arrangements, of $312 million. These obligations included all borrowings previously raised in relation to Farrow Group arrangements and the remaining commitments associated with Victorian Government Security Bonds, partly offset by the assignment to the TAC of the unused proceeds from the special petrol levy and future distributions from the liquidator.

5.46 In addition to the above financial obligations, the State's exposure under the indemnity, provided by the Government to the Commonwealth Bank of Australia to facilitate the initial payout to depositors, was also transferred to the TAC. Under this arrangement, the TAC will be required to meet any future shortfall arising between the initial payout to depositors by the bank and liquidator distributions received by the bank. The TAC's contingent liability in relation to this indemnity at 30 June 1993 was $141 million. However, it is anticipated that future distributions from the liquidator will cover this amount.

5.47 Table 5H provides a summary of the position at the date of transfer, 15 January 1993, and at 30 June 1993, relating to the assets and liabilities assumed by the TAC from the State, incorporating estimates of liquidator distributions and financing and administrative costs.

TABLE 5H
FARROW GROUP RELATED FINANCIAL OBLIGATIONS
AS AT 15 JANUARY 1993 AND 30 JUNE 1993
($million)

Item	*15 January 1993*	*30 June 1993*
Victorian Government Security Bonds		
- Payments due August 1993, 1994, 1995	522	522
Borrowings transferred from the Consolidated Fund *(a)*	263	263
Estimated future financing and administrative costs	51	120
	836	905
Less		
Petrol levy proceeds made available to the TAC	73	73
Projected liquidator distribution	451	371
TAC provision for possible reduction in future liquidator distribution	-	(100)
	524	344
Net financial obligations to be met by the TAC	**312**	**561**

(a) While $270 million was received by the State from these borrowings, $7 million of this amount related to premium associated with the debt raising.

5.48 As indicated in the above table, the **net obligations to be met by the TAC in relation to the Farrow Group arrangements at 30 June 1993 were estimated at $561 million, which was $249 million greater than that estimated when the debt was transferred in January 1993.** The main reasons for the increased exposure were downward revisions to projected liquidator distributions and an upwards revision in the projected financing costs.

5.49 A legal action, which is currently in progress, may impact on the final distribution by the liquidator. This action was initiated by the holders of non-withdrawable shares in Pyramid to ascertain their eligibility to participate in distributions from the liquidator. The High Court of Australia is yet to decide on an appeal against a previous Supreme Court ruling that these shareholders are not entitled to rank equally with depositors in the liquidation.

5.50 In a further action, borrowers of funds from Farrow claimed that their loans were invalid and thus not repayable. A Federal Court appeal found that these loans were valid and therefore repayable by the borrowers. The borrowers sought leave to appeal to the High Court of Australia, however, this application was not granted.

5.51 **Based on the current estimates of future distributions and financing costs, the aggregate cost of the Government commitment to Farrow Group depositors will be around $805 million. Of this amount, $244 million has been met by Victorian taxpayers, with the balance of $561 million to be met by the TAC.**

Financing of Mobile Radio Network infrastructure

5.52 Mobile radio communications are important for the effective delivery of services by a number of public sector bodies, particularly those providing emergency services, such as the Department of Police and Emergency Services, the Department of Conservation and Environment, and the SECV. These bodies, in past years, have operated separate communications networks. However, changes to Commonwealth telecommunication regulations, to be progressively phased-in until 1998, will result in the alteration of frequencies available for use and the number of frequencies allocated, necessitating the review of existing public sector arrangements.

5.53 To ensure the efficient and effective provision of State-wide mobile radio communications, in July 1992, the Government approved the establishment of a single Mobile Radio Network, to be utilised by relevant major public sector agencies. To implement this decision, in August 1992, the Treasurer entered into a contract with the Australian and Overseas Telecommunication Corporation Limited (AOTC) for the design, supply and installation of the Network equipment by the end of the 1993 calender year, at a cost of $30 million. Under the arrangements, AOTC will also provide on-going maintenance services for the Network, over a 10 year period, at an estimated additional cost of around $47 million in present value terms. The Department of Finance has overall management responsibility, with a number of agencies committed to utilisation of the Network over a 6-7 year period, in return for making contributions to its capital and operating costs in the form of user charges.

5.54 Under the arrangements, the Government will fund the acquisition of the Network via the Computer Lease Facility, through finance lease payments over an initial period of 6-7 years. At the end of the initial lease term, the Department of Finance has an option to extend the lease by a similar period. **At 30 June 1993, Network equipment acquired through the computer lease facility totalled $15 million. This amount has been included in the Finance Statement as part of budget sector debt.**

OTHER LIABILITIES

5.55 The Finance Statement outlines a number of liabilities with an aggregate value of $3.8 billion, which are disclosed separately to budget sector borrowings. Specific comment on certain of these liabilities is provided in this section of my Report.

Portland Smelter Unit Trust

5.56 My October 1992 Report commented on the progressive deterioration in the Portland Smelter Unit Trust's (PSUT) financial position and operating result.

5.57 The PSUT was established by the Government in 1984 as the vehicle to acquire an equity interest in a joint venture with Alcoa and other parties relating to the construction and operation of the Portland Aluminium Smelter. In September 1992, a 10 per cent interest in the Portland Aluminium Smelter was sold by PSUT for a gross price of $180 million.

5.58 At 30 June 1993, following the sale, the PSUT held a 25 per cent interest in the smelter. All PSUT's equity is held by the State, through a direct contribution of $20 million, and by virtue of a $100 million VET investment in the PSUT.

5.59 **The most recently available financial information regarding PSUT operations, relating to the 1992-93 year, indicated an improved operating result and financial position, compared to the previous 3 years.** Table 5I outlines key financial statistics relating to the financial position and performance of the PSUT for a 3 year period to 1992-93.

TABLE 5I
KEY FINANCIAL DATA RELATING TO PORTLAND SMELTER UNIT TRUST
($ million)

Item	*1990-91*	*1991-92*	*(a)* **1992-93**
Assets	835	800	**827**
Liabilities -			
Borrowings	(426)	(406)	**(396)**
Other	(116)	(97)	**(90)**
Net assets	293	297	**341**
Less deferred cost compensation payments supported by government	(158)	(152)	**(146)**
Net assets, excluding government support	**135**	**145**	**195**
Operating profit/(loss)	**(2)**	**4**	**26**

(a) The 1992-93 data has been drawn from the latest available financial statements, which had not been subject to audit.

5.60 As indicated in the above table, the PSUT achieved an unaudited operating profit of $26 million in 1992-93, compared to $4 million in 1991-92. The key factors contributing to this favourable result, as advised by the Department of the Treasury, were reduced interest costs from the increased utilisation of floating rate borrowings, a profit of $15 million arising from the sale by PSUT of a 10 per cent interest in the Portland Aluminium Smelter, and additional interest earnings from the associated sale proceeds.

Deferred Cost Compensation Payments to Trust

5.61 My previous Reports on the Finance Statement have commented on an arrangement established by the Government to secure the construction and commissioning of the Portland Aluminium Smelter, which involved PSUT, in 1984, making a $180 million payment to the SECV, at the direction of the Treasurer, as compensation for lost revenue from delays in commissioning the smelter.

5.62 In 1991-92, the Treasurer agreed to provide annual grants to PSUT of $6 million over 26 years, to compensate the Trust for the payment to the SECV. Additional grants of $8 million were to be made in 1991-92 and 1992-93.

5.63 Consistent with the above agreement, **total payments of $28 million were made by the Consolidated Fund to the PSUT in 1991-92 and 1992-93, leaving an amount yet to be funded at 30 June 1993 of $144 million**.

5.64 In the April 1993 *Statement on Victoria's Financial Management Strategy*, the Government announced a program for the reform of public businesses. This program includes the privatisation of the PSUT, following a restructure to address its high debt levels and to put the Trust on a more commercial footing. Consistent with the Government's plans to privatise the PSUT, the 1993-94 Budget Papers foreshadowed a restructure package involving:

- the transfer of PSUT borrowings to the State; and
- the transfer of PSUT ownership from the Government to Aluminium Smelters of Victoria Pty Ltd (Aluvic), a company also wholly-owned by the State.

5.65 The restructure package is premised on:

- PSUT agreeing to pay $120 million to the Victorian Equity Trust to re-purchase the equity units held by the Trust in PSUT;
- the Government being released from its obligations detailed above relating to the delayed cost compensation payment arrangements;
- an agreement with Aluvic to ensure Budget neutrality of the debt assumption for the next 2 years, or until Aluvic is privatised, through receipt of sufficient dividends by the State from Aluvic to cover associated interest costs; and
- satisfactory completion of all related legal documentation.

5.66 The effect of the proposed PSUT restructure will be that **the State will assume responsibility of PSUT debt, extinguish its obligations relating to the delayed cost compensation payment arrangements, and receive $120 million in relation to PSUT's repurchase of VET equity units.**

5.67 At the date of preparation of this Report, the proposed restructure was under consideration by Aluvic.

Flexible Tariff Management Unit Trust

5.68 A key component of the Government's involvement in the aluminium industry in Victoria has been the provision of a flexible electricity tariff to the Portland and Point Henry aluminium smelters. This arrangement, which extends to the year 2017, was established in 1984 to ensure that electricity tariffs for these smelters fluctuate in line with aluminium prices.

5.69 My previous Reports have commented on the role of the Flexible Tariff Unit Trust (FTMUT), which is responsible for meeting the Government's obligations under the above arrangement, and its impact on the Consolidated Fund and budget sector liabilities. In simple terms, FTMUT is required to make payments to the SECV when aluminium prices fall below a stipulated level and, conversely, Alcoa and Portland Smelter Services Pty Ltd are required to pay certain amounts to FTMUT when prices rise above that level.

5.70 On establishment of the flexible tariff arrangement, the Government did not anticipate that it would result in a long-term subsidy to the aluminium industry. However, **because of depressed world aluminium prices, it has been necessary for FTMUT in the 3 years to 1991-92 to make payments totalling around $350 million to the SECV.** These payments were financed by FTMUT through a $30 million equity contribution from the State-owned PSUT, $280 million of borrowings by FTMUT from the VDF and a $40 million contribution to FTMUT from the Consolidated Fund. In addition, the Consolidated Fund contributed a further $25.2 million to meet associated financing and administrative costs.

5.71 Given the continuing depressed aluminium prices, the 1992-93 Budget provided for further payments of $233.4 million to be made from the Consolidated Fund to FTMUT to meet the flexible tariff payments to the SECV and financing and administrative costs. **Payments actually made by the Consolidated Fund in 1992-93 totalled $236 million, comprising $208 million to meet SECV tariff payments and $28 million to meet FTMUT financing and administrative costs.** Further tariff payments of $5 million were funded by FTMUT early in the 1992-93 year, which were financed from borrowings.

5.72 The funding by the Consolidated Fund in 1992-93 of flexible tariff obligations as they were incurred, represented a change from the previous practice of principally funding these payments "off-budget", through FTMUT raising funds to meet these payments from borrowings. In line with this new funding arrangement, the Government announced in the recent Budget Papers an intention to assume and repay the outstanding FTMUT borrowings of $285 million in the 1993-94 year.

5.73 A consultant's assessment of the State's future financial exposure under the flexible tariff arrangements at 30 June 1992 concluded that the prospects of FTMUT earning positive cash flows were remote. Furthermore, the consultant estimated that the present value of the State's maximum liability under this arrangement, which extends to the year 2017, in relation to the Portland Aluminium Smelter, was $1.7 billion. This, together with a further estimated exposure of $700 million, determined by the Department of the Treasury, in relation to the Point Henry Aluminium Smelter, brought the State's maximum exposure from these arrangements to $2.4 billion. However, this exposure was significantly dependent on the level of future aluminium prices.

5.74 **Based on current expectations of future aluminium prices, the present value of the State's exposure under the flexible tariff arrangements is estimated by the Department of the Treasury to be around $1.7 billion.** This amount has been included in Table B.2 of the Finance Statement as a part of budget sector liabilities.

5.75 **Given the magnitude of the State's exposure under the flexible tariff arrangements, and that it was not originally the Government's intention to provide a long-term subsidy to the aluminium smelters, the Government, in 1992-93, wrote to all participants seeking a review and adjustment of the arrangements. At the date of preparation of this Report, such a review had not commenced.**

Financial obligations relating to Tricontinental

5.76 Under the arrangements established subsequent to the December 1990 sale of the State Bank of Victoria, the State acquired Tricontinental Corporation Limited and became obligated to meet its net deficiency. At 30 June 1992, the deficiency was around $1.7 billion.

5.77 Commencing in 1991-92, the State provided an operating subsidy to Tricontinental, principally to finance the shortfall arising between income earned on its loan portfolio and amounts payable on its borrowings, to assist in the orderly realisation of the loan portfolio. The subsidy amounted to $150 million in that year.

5.78 **In 1992-93, a further subsidy of $122.9 million was provided from the Consolidated Fund to meet the Tricontinental operating shortfall.** The reduced subsidy, compared to that paid in the previous year, was principally due to the lower interest costs incurred as a result of the decline in interest rates and reduced borrowing levels. The reduction in borrowings was achieved from better than anticipated loan recoveries. **During 1992-93, loan recoveries totalled $403 million, with $143 million relating to loans, the recovery of which was previously assessed as bad or doubtful.**

5.79 **At 30 June 1993, Tricontinental's net deficiency, which is yet to be funded by the State, stood at $1.5 billion ($1.7 billion, 30 June 1992). The aggregate cost to Victorian taxpayers of Tricontinental's financial demise, at that date, was $2.4 billion.** Table 5J provides relevant details.

TABLE 5J
AGGREGATE COST TO VICTORIAN TAXPAYERS OF TRICONTINENTAL, AT 30 JUNE 1993
($million)

Items		*Amount*
Net Deficiency at 30 June 1993*(a)*		1 538
Add -		
Debt assumed by the State, net of subsequent recoveries*(b)*	571	
Cost of servicing debt assumed - 1990-91*(c)*	48	
Operating subsidy provided by the Consolidated Fund - 1991-92 and 1992-93	273	892
Total cost to Victorian taxpayers		**2 430**

(a) Disclosed in unaudited management accounts of Tricontinental at 30 June 1993 at $1.492 billion, but adjusted by $46 million to take account of operating subsidy owed by the State.

(b) Debt assumed by the State prior to the sale of the State Bank.

(c) No additional cost in 1991-92 and 1992-93 as debt was repaid in 1990-91.

5.80 Under the established support arrangements, the State may become responsible for additional obligations arising from Tricontinental contingent liabilities. Based on information provided by Tricontinental, these contingent liabilities at 30 June 1993 comprised:

- guarantees and letters of credit of $46 million issued by Tricontinental in respect of moneys borrowed by other entities; and
- outstanding litigation cases against Tricontinental, the impact of which cannot be quantified.

5.81 The State's financial position in relation to the Tricontinental deficiency may be improved if certain litigation initiated by the Government is successful. The most significant of the litigation actions involves a claim against the former auditors of Tricontinental, K.P.M.G. Peat Marwick, seeking losses and damages of not less than $1.1 billion. At the date of preparation of this Report, court action was pending.

St Vincent's Hospital Redevelopment

5.82 My October 1992 Report on the Finance Statement contained a detailed analysis of the complex financial arrangements entered into by the Government, in August 1991, to finance the redevelopment of part of the St. Vincent's Hospital, which is owned by the Sisters of Charity religious order and is one of the State's major hospitals.

5.83 **The redevelopment is expected to be completed by February 1996 at a total estimated cost of $146 million.** The project will principally comprise the construction of a 13 level building which will accommodate 400 in-patient beds, a 16 bed intensive care unit, 10 operating theatres and an emergency facility. The redevelopment will also include a 260 space underground carpark, estimated to cost $5 million, which will be financed by the Hospital without any Government support.

5.84 The arrangements provide for the redevelopment to be initially financed from a combination of borrowings raised by the Hospital ($80 million), and equity finance provided by banks. The servicing of the financial obligations will then be met by the Hospital from funds provided by the State over a 25 year period, in accordance with a Health Services Agreement entered into between the Hospital and the Department of Health and Community Services. Under the arrangements, the State, in substance, will fund the redevelopment to the extent that the Hospital provides health services to the public over this period. Ownership of the redevelopment is with the banks for the first 15 years of the arrangement and, following a settlement payment, will pass to the Sisters of Charity.

5.85 These financial arrangements were ratified by the current Government in November 1992 and construction of the facilities commenced in January 1993. **At 30 June 1993, the Hospital had raised borrowings of $80 million under the financial arrangements.** The provision of bank finance to complete the project will not be required until around August 1994.

5.86 **An amount equal to the borrowings raised by the Hospital, which will be ultimately funded by Government, has been included in Table B.2 of the Finance Statement as a part of budget sector liabilities.**

UNFUNDED SUPERANNUATION LIABILITIES

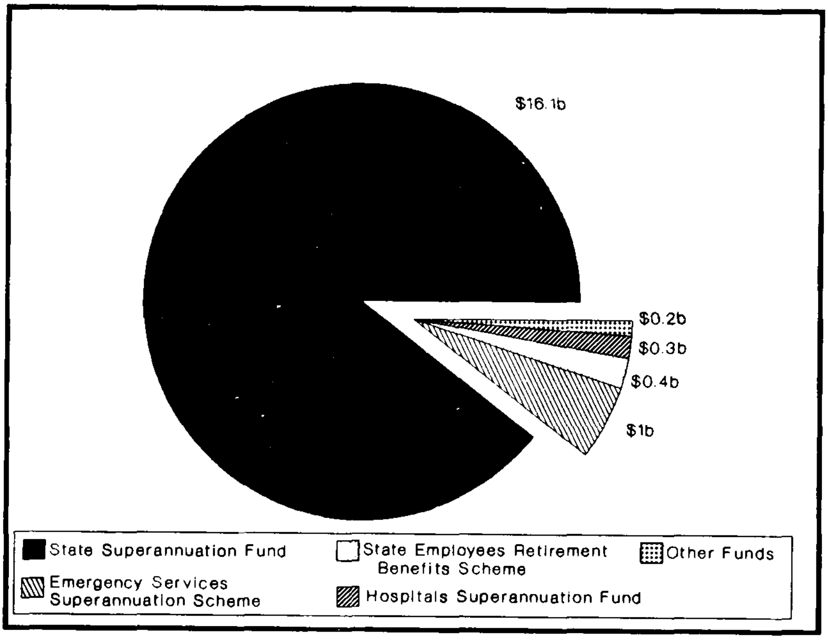
5.87 Unfunded superannuation liabilities represent the second largest component of budget sector liabilities. These liabilities comprise employer superannuation contributions yet to be paid by the Government to budget sector superannuation schemes, in respect of services previously provided by employees. The liabilities have arisen as a result of decisions of previous governments to progressively meet the employer share of superannuation benefits after employees retire, rather than as benefits accrue over the working lives of employees.

5.88 Table B.3 of the Finance Statement details the unfunded liabilities of Superannuation Funds principally operated for budget sector employees which, at 30 June 1993, totalled $18.2 billion ($17.9 billion, 1991-92). However, this amount included borrowings of the Emergency Services Superannuation Scheme of $169 million.

5.89 As explained in the Finance Statement, the low rate of growth in these liabilities in the year was principally due to a reduction in the budget sector workforce brought about by the VDP Program, and the low rate of growth in wages and salaries.

5.90 Chart 5K illustrates the Superannuation Funds responsible for managing these unfunded liabilities at 30 June 1993.

CHART 5K
UNFUNDED LIABILITIES OF SUPERANNUATION FUNDS MAINLY OPERATED FOR BUDGET SECTOR EMPLOYEES, 30 JUNE 1993
($billion)



5.91 The unfunded liabilities of the above Superannuation Funds included $2.5 billion relating to employees engaged within the non-budget sector. Therefore, budget sector liabilities relating to unfunded superannuation totalled $15.5 billion at 30 June 1993.

5.92 In April 1993, the Minister for Finance drew to Parliament's attention the significant and escalating level of unfunded superannuation liabilities and the associated adverse impact on budget sector finances. In that statement, the Government outlined several options under consideration to reduce the level of unfunded liabilities. In its May 1993 *Statement on Victoria's Financial Management Strategy* and the 1993-94 Budget Papers, the Government re-affirmed that the reduction of public sector superannuation costs and the high level of unfunded liabilities were a high priority.

5.93 In the Budget Papers, **the Government foreshadowed the presentation of legislation in the Spring session of the Parliament which will encompass various reforms to public sector superannuation schemes**, with the objectives of:

- *containing future budget sector superannuation outlays to a sustainable and affordable level*;
- *management of the unfunded liabilities in a way which does not increase the burden to future generations; and*
- *ensuring that appropriate transitional arrangements are in place to cater responsibly for the State's employees.*

5.94 In addition, **the Government provided a specific budgetary allocation of $1.4 billion in the 1993-94 year to meet its liability for deferred employer contributions to the State Superannuation Fund and the Emergency Services Superannuation Scheme.** This liability has arisen from the practice adopted by previous Governments of requiring the Superannuation Schemes to initially meet the employer share of lump sum payments to retiring employees, with progressive re-imbursement provided from the Consolidated Fund to the Schemes as if these benefits were being paid in the form of pensions. In effect, this practice resulted in the deferral to future years of Consolidated Fund financial obligations in respect of the employer's share of benefit payments made by the superannuation schemes. **In the 1993-94 Budget Papers, the Government also announced a decision to meet its obligations to the Superannuation Schemes in future years as they emerge.**

5.95 Subsequent to the tabling of the 1993-94 Budget Papers, an agreement was entered into between the Government and the Victorian union movement in October 1993, outlining various reforms to budget sector superannuation arrangements. The reforms, which are to be embodied in legislation, include:

- defined benefit entitlements to be based on the employee average salary over the last 2 years of service, instead of the final salary on which current entitlements are based;
- future member benefits to be adjusted so that the taxation costs are borne from members' funds and not by the Government;
- pension payments and deferred benefits to be indexed annually, instead of at six-monthly intervals;
- increased member contributions to the State Superannuation Revised Scheme;
- future benefits to Members of the Parliament to be reduced by 25 per cent, which includes taxation costs which are to be borne from members' funds; and
- a number of small budget sector superannuation schemes to be amalgamated.

FINANCE CHARGES

5.96 Budget sector liabilities, as outlined in Table 5A of this Report, include borrowings and associated accrued interest costs of $20.8 billion, with accrued interest accounting for $729 million. The liability for accrued interest has reduced by $31 million since 30 June 1992. This reduction has been achieved through the restructuring of the budget sector debt profile and the partial elimination of previously established arrangements involving the deferral of Consolidated Fund payments relating to financing costs.

5.97 Table 5L provides details of interest paid and incurred in the period, together with interest accrued at year-end. The table also highlights the reduction in accrued interest in the year.

TABLE 5L
INTEREST CHARGES ON PUBLIC ACCOUNT BORROWINGS
(Excludes statutory authority interest payments) *(a)*
($million)

Item	*Interest incurred but not paid at 1 July 1992*	+	*1992-93* Interest incurred	-	*1992-93* Interest paid(a)	=	*Interest incurred but not paid at 30 June 1993*
Long and medium-term borrowings -							
Treasury Corporation of Victoria (TCV)	869		1 702		1 749		822
Victorian Development Fund *(b)*	51		71		122		-
Short-term borrowings -							
State Development Fund	2		14		16		-
TCV	-		6		6		-
Other financing (c)	19		71		75		15
	941		1 864		1 968		837
Finance charges off-set against borrowings outside the Consolidated Fund by TCV	-		362		362		-
Total interest charges	941		**2 226**		**2 330**		837
Less portion relating to capital growth of debt (included in borrowings)	181						108
Accrued interest at 30 June	**760**						**729**

(a) The State also made contributions, which included interest charges, to the Commonwealth Bank of Australia relating to the initial payout to Farrow Group depositors ($10 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) Mainly comprises financing associated with the computer lease facility, FTMUT, transport leases and World Congress Centre.

Impact of borrowings on the Consolidated Fund

5.98 Finance charges reflect the present burden on taxpayers created by borrowings undertaken by Governments to acquire assets and partly fund government programs. The Finance Statement discloses that **finance charges paid in 1992-93 amounted to $2 billion (1991-92, $1.8 billion).** However, as highlighted in my previous Reports, the Finance Statement is prepared on a cash basis of accounting, therefore this figure does not reflect interest incurred but not paid in the period.

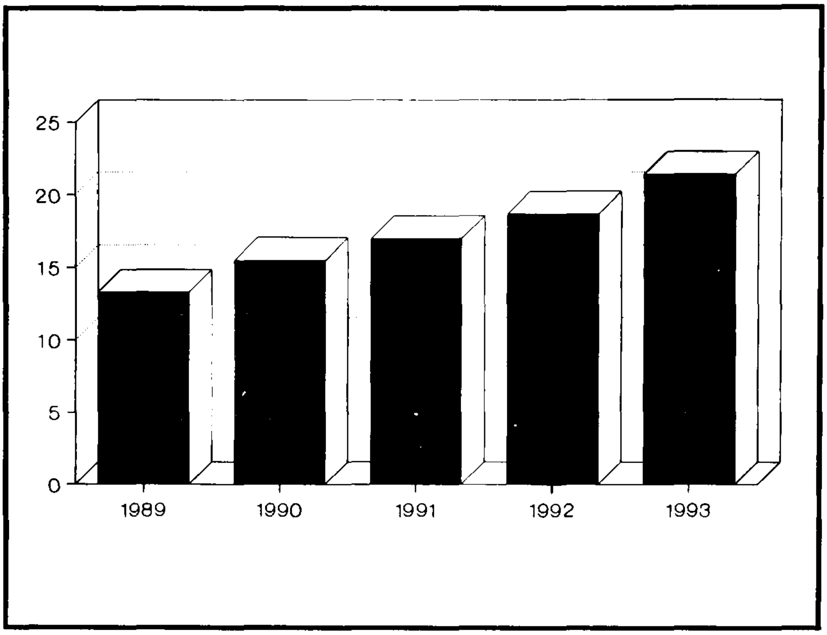
5.99 Analysis by audit revealed that **interest incurred in 1992-93 (calculated on an accrual basis) was $2.2 billion.** The difference of $258 million between interest paid (as disclosed in the Finance Statement) and interest incurred was due to:

- the non-recording within the Consolidated Fund of finance charges offset outside the Fund against borrowings raised by the TCV on the Government's behalf ($362 million); and
- the decrease in the year of interest accrued but not paid ($104 million).

5.100 I re-iterate my recommendation of previous years that **future Finance Statements (or equivalent accountability documents) should disclose consolidated information on finance charges incurred in the year and those paid, to enable informed debate on the impact of these costs on the State's financial operations.**

5.101 My previous Reports have commented on the significant increase in the level of finance charges in recent years, and the consequent adverse effect on State finances. Chart 5M highlights the impact of finance costs on the budget, in the past 5 years.

CHART 5M
FINANCE CHARGES AS A PROPORTION OF TOTAL CONSOLIDATED FUND REVENUE available for general application (a)
(per cent)



(a) Revenue available for general application excludes specific purpose Commonwealth grants and proceeds from borrowings.

5.102 In 1992-93, finance charges paid represented 21 per cent of total Consolidated Fund revenues available for general application (19 per cent, 1991-92) or an annual cost to the community of $523 per capita ($433, 1991-92).

State's credit rating

5.103 A significant determinant of the cost of borrowings is the State's credit rating which is normally assessed annually by rating agencies.

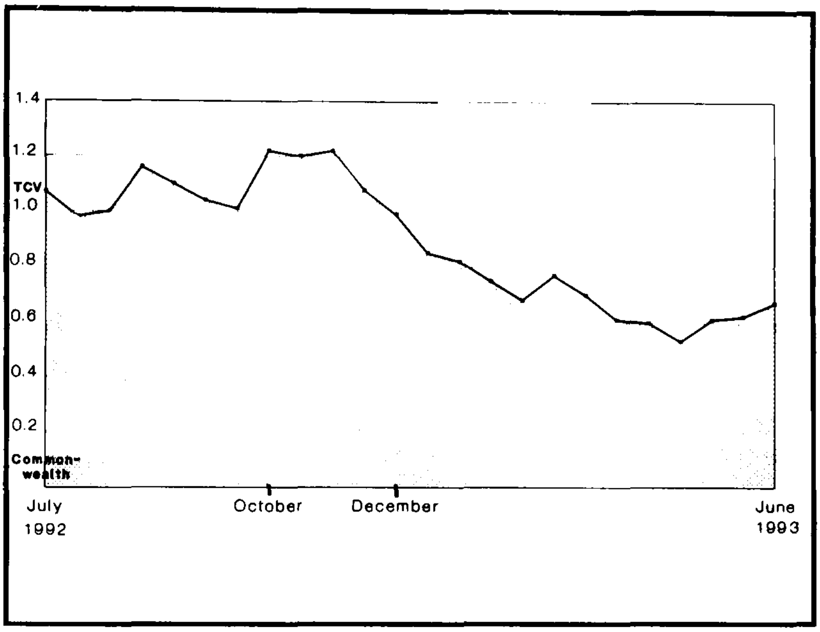
5.104 My October 1991 Report on the Finance Statement commented on the June 1990 and May 1991 downgradings of the State's long-term debt credit rating by 2 rating agencies (from AAA to AA and AA2 respectively). The rationale for these downgradings was related to the State's relatively high levels of public sector debt and debt charges as a percentage of revenue, the rapid deterioration of the State's finances and the poor performance of State-owned enterprises.

5.105 In October 1992, prior to the release of the Government's interim Budget, Moody's Investor Services further downgraded the State's credit rating by 2 levels (from AA2 to A1), principally due to *" the severe structural difficulties facing Victoria's budgetary position. These include recent projected sizeable budget deficits and Victoria's rapidly rising debt burden".*

5.106 However, in December 1992, following the October 1992 Budget, another rating agency, S&P Australian Ratings, affirmed the State's long-term debt rating (AA), mainly due to *"the new government's commitment to reversing the deteriorating trend in the State's finances".*

5.107 Chart 5N illustrates the impact of the October 1992 and December 1992 reviews of the State's credit ratings on the State's borrowing costs by highlighting the interest rate differential between TCV and Commonwealth Government long-term borrowings.

CHART 5N
INTEREST RATE DIFFERENTIAL BETWEEN TCV AND COMMONWEALTH GOVERNMENT LONG TERM BORROWINGS, 1992-93
(basis points)



5.108 While the State's cost of raising or refinancing borrowings, compared with the Commonwealth Government, increased immediately following the October 1992 rating downgrade, the cost differential has progressively reduced during the year and, at 30 June 1993, was lower than that prevailing prior to the downgrade.

5.109 A major objective of Government is to restore the State's former AAA credit rating through a budgetary strategy aimed at arresting the growth in debt, with a target to eliminate current account deficits by 1995-96. In 1992-93, the Government implemented various expenditure reduction and revenue raising measures aimed at achieving this target.

5.110 In the Victorian Commission of Audit's May 1993 Report, the Commission considered that the minimum performance requirements for the State to achieve a AAA credit rating within the next 10 years were:

- *to restore the State's operating balance to surplus as soon as possible;*
- *to begin financing at least part of the State's capital expenditure commitments from sources other than borrowings;*
- *to reduce the State's debt-servicing ratio to around current NSW levels; and*
- *to reduce the State's indebtedness (as indicated by the ratio of public sector net debt to gross state product) to around current NSW levels.*

5.111 In my opinion, if the revenue raising and expenditure reduction measures announced in the Government's October 1992 and April 1993 Budgets are sustained, the Current Account deficits will be eliminated and the State's financial position will be enhanced, which could impact favourably on the State's credit rating.

Additional financing costs resulting from taxation ruling

5.112 Interest paid by the Consolidated Fund in the year included an amount of $25.5 million, relating to additional financing costs emanating from an unfavourable taxation ruling on a financial arrangement used to raise borrowings for on-lending to the State transport authorities.

5.113 In 1986, the former VicFin entered into an arrangement for the issue of a 12 year fixed rate annuity to a major Australian insurance company (the investor), to raise $92.3 million for public transport purposes.

5.114 The annuity arrangement was structured in a form intended to raise funds at a cost below the prevailing market rates, while enabling the investor to receive a required rate of return through the realisation of tax benefits. An important element of the arrangement was the provision to the investor, by VicFin and ultimately the State, of a guaranteed after-tax rate of return from the annuity.

5.115 In May 1993, following a Federal Court ruling on the taxation treatment of certain financing arrangements, the Commissioner of Taxation issued amended taxation assessments to the investor, for taxation and penalties payable in relation to the annuity, for the 1985-86 year.

5.116 Under the terms of the financing arrangement, the Consolidated Fund in June 1993 paid an amount of $25.5 million to the TCV (the successor of VicFin) to cover the additional costs incurred as a result of the investor's taxation assessment. However, the amount paid by the TCV to the investor will be repaid in the event that the taxation assessment is reduced in future. Taxation assessments for years subsequent to 1985-86 are yet to be issued by the Commissioner of Taxation and may result in additional financial obligations on the Consolidated Fund.

FINANCIAL COMMITMENTS

5.117 In addition to the financial obligations commented upon earlier in this Part of the Report, the State has entered into a number of arrangements which will impact on the budget sector's future operations. At 30 June 1993, the budget sector had financial commitments relating to operating leases and works not carried out under existing contracts, valued at $1.8 billion.

Operating lease commitments

5.118 The budget sector's financial commitments include future obligations under operating lease arrangements. Audit examination revealed that such commitments, at 30 June 1993, amounted to $751 million ($775 million, 30 June 1992). Table 5O details the timing and extent of these commitments.

TABLE 50
OPERATING LEASE COMMITMENTS
($million)

Year	*Amount*
1993-94	124
1994-95	105
1995-96	81
1996 onwards	441
Total commitments *(a)*	**751**

(a) The Finance Statement discloses total commitments, excluding those relating to the Accelerated Infrastructure Program which audit regard as liabilities, of $670 million. The $81 million difference between this figure and that disclosed by audit is mainly due to the Finance Statement not including commitments of certain budget sector bodies, such as hospitals and Colleges of TAFE.

5.119 Obligations relating to the provision of office accommodation form the major portion of the operating lease commitments.

Capital commitments

5.120 The Finance Statement does not disclose budget sector capital commitments. Such commitments, in respect of works not yet carried out under existing contracts at 30 June 1993, amounted to $1 billion (30 June 1992, $1.3 billion). Table 5P details the amount and likely timing of these commitments.

TABLE 5P
CAPITAL COMMITMENTS
($million)

Year	*Amount*
1993-94	712
1994-95	134
1995-96	112
1996 onwards	57
Total commitments	**1 015**

5.121 I re-iterate the recommendation of my previous Reports that, **to provide the Parliament with comprehensive information regarding total budget sector financial obligations, information on capital commitments should be disclosed within the Finance Statement.**

Melbourne Magistrates Court Complex

5.122 In my October 1992 Report, I outlined details of the arrangements entered into by Government in August 1992 for the construction and subsequent lease of a new Melbourne Magistrates Court complex.

5.123 In summary, the arrangements involved a private sector developer constructing the complex at a cost of $39 million, supported by a Treasurer's indemnity and a long term government lease. The fit-out costs of the complex were estimated at $16 million and were to be funded directly by the Government, with the project expected to be completed in August 1994. The overall effect of these arrangements was that, while the Government would not at any time become owner of the complex, it would have financed 90 per cent of the development costs over a period of 20 years, but only utilised the complex for around 67 per cent of its estimated useful life.

5.124 Following a review of the financing arrangement by the Government, which revealed that the arrangement was approximately 26 per cent more expensive than if it was government funded, the Treasurer, in April 1993, entered into revised agreements with the developer. The revised agreements involved:

- construction of the complex on land purchased by the developer from the Government for $4.1 million, which is consistent with the original arrangement;
- **the Government purchasing the complex upon practical completion estimated to be in May 1995, for $38.9 million;**

- the Government financing the fit-out, which is now estimated to cost $14.7 million; and
- key risks such as construction, insurance, practical completion and cost over-runs being borne by the developer.

5.125 The revised arrangements have substantially improved the cost effectiveness of this development to the State.

Southbank Museum Redevelopment

5.126 Due to significant inadequacies in the existing facilities which housed the Museum, in June 1991, the former Government approved the development of a new Museum at a site located within Melbourne's Southbank precinct. The project was estimated to cost $184 million and involved the construction of a new facility to house a Museum, exhibition facilities, a planetarium, a research centre, public lecture theatres and a laboratory. It was envisaged the project would be financed by a combination of public and private sector funding.

5.127 In order to prepare the site for development, some $15 million was spent on site amalgamation, which involved the purchase of certain property leases and the construction of roads. The design development work for the facility commenced in 1989 and was completed in June 1992, at a further cost of $13 million. In February 1992, a contract to undertake certain building construction was let. As at 30 June 1993, a total of $8 million had been expended on the building's construction.

5.128 The former Government in August 1992 entered into a contract to acquire an adjacent property known as "the Tea House", to be utilised by the Museum for administrative purposes, at a price of $4.2 million payable in January 1994. The former Government also purchased specialist equipment for a theatre for $1.4 million, which was to be delivered on the completion of the facility.

5.129 As at 30 June 1993, around $37 million had been expended on this project , with a further $6 million committed for the acquisition of the Tea House and the completion of works in progress on the Museum site.

5.130 In May 1993, the Government released its *Agenda 21* Program, which outlined a number of major capital projects to be completed by 1 January 2001. The Program now provides for the Government to build the Museum at the Exhibition Buildings site in Carlton and convert the current construction at Southbank to a new exhibition centre.

5.131 Audit was advised that the works undertaken to date on the Southbank site will be substantially utilised in the construction of the new exhibition centre. The Government has announced that all Agenda 21 projects will be funded mainly from profits generated from future casino operations.

CONTINGENT LIABILITIES

5.132 Contingent liabilities of the Government arise from the issue of guarantees, indemnities, sureties, letters of comfort and other forms of financial support. Such instruments are issued for various purposes, but generally to provide assistance to entities in raising funds by reducing the level of risk to private sector institutions. While these instruments create potential commitments on the State, any liabilities arising are dependent upon future events or outcomes.

5.133 Guarantees obligate the State to meet commitments to a third party in the event that the organisations in receipt of the guarantees are unable to meet their commitments in the first instance. Indemnities, on the other hand, generally impose a primary obligation on the Government to protect entities in receipt of the indemnities against certain financial losses.

5.134 Unlike loans or other forms of debt, the above instruments place no immediate demand on the public purse but, nevertheless, are significant as the Government may be required to honour its undertakings under these instruments many years after such undertakings are given.

5.135 My previous Reports on the Finance Statement have commented on deficiencies in the Department of the Treasury's processes for recording and managing the State's contingent liabilities. Due to these deficiencies, I have been unable in the past to provide the Parliament with an unqualified assurance as to the full extent of the State's contingent obligations.

5.136 During 1992-93, inadequate action had been taken to improve the completeness of the Department's records. Accordingly, **I am again unable to provide assurances to the Parliament as to the full extent of the State's contingent liabilities at 30 June 1993**.

5.137 However, **as a positive step towards overcoming this unsatisfactory situation, the Department in August 1993 engaged a private accounting firm to review the processes and records presently utilised to identify, monitor and report on the State's contingent liabilities**. The objective of the review was to assist in the formulation of appropriate policies and action plans to ensure the effective management and reporting of these obligations in the future. At the date of preparation of this Report, the review had not been finalised.

Government guarantees and indemnities

5.138 The Finance Statement discloses that the estimated contingent liabilities arising from Government guarantees and indemnities at 30 June 1993 was around $21 billion.

5.139 Comments follow on the major guarantees and indemnities issued during the year.

Co-operative Housing Societies

5.140 Under the *Co-operative Housing Societies Act* 1958, the Treasurer may guarantee borrowings raised by Co-operative Housing Societies to provide loans to members and may indemnify Societies against certain losses arising on account of defaulting loan recipients. Society members receiving loan assistance, generally, would not be eligible for conventional forms of home finance from banks and other financial institutions because of their inability to accumulate sufficient funds as a deposit for the acquisition of property.

5.141 During 1992-93, the Government issued guarantees and indemnities in favour of various lending institutions and Co-operative Housing Societies, with an aggregate value of $87 million. **As disclosed in the Finance Statement, the Government's total contingent liability in relation to this form of assistance amounted to $502 million at 30 June 1993.**

Home Opportunity Loan Scheme

5.142 My previous Reports to the Parliament have outlined the financial operations of the Home Opportunity Loans Scheme (HOLS) which is administered by a company known as Home Opportunity Loans Limited. The Scheme provides housing finance to low and middle income earners who normally would not have the opportunity to borrow from traditional finance sources.

5.143 The financial assistance provided by HOLS is principally financed frcm funds raised by Victorian Housing Bonds Limited, through the issue of Victorian housing bonds. All funds raised by this company are subject to a Government indemnity under the *Housing Act* 1983. This indemnity is supported by first mortgages over the properties subject to housing finance.

5.144 During 1992-93, Victorian housing bonds with an aggregate value of $79.3 million were issued to finance loans provided by HOLS. **As disclosed in the Finance Statement, the Government's total contingent liability in relation to Victorian housing bonds raised as at 30 June 1993 amounted to $917 million.**

Totalizator Agency Board

5.145 In 1991-92, a Treasurer's approval was given for the Totalizator Agency Board (TAB) to temporarily borrow $90 million during 1992-93 for the acquisition of gaming machines. This approval was given on the basis that these borrowings would be repaid by the TAB by 30 June 1993 so that they would not impact on the State's global borrowing limits.

5.146 These borrowings were repaid by the TAB during the year. However, in June 1993, the Treasurer issued a guarantee in favour of the Treasury Corporation of Victoria for the TAB to borrow a further $45 million to meet its 1993-94 cash flow requirements.

Bayside development project

5.147 My previous Reports to the Parliament, including Special Report No. 18 - *Bayside Development*, have provided detailed comment on the Government's involvement in, and financial obligations relating to, the Bayside development in Port Melbourne. As outlined in these Reports, government agency costs relating to this development exceeded $70 million prior to the project being deferred, pending finalisation of legal action.

Status of legal action

5.148 In May 1992, the developer lodged a writ against the State and the Urban Land Authority (ULA), claiming $8.5 million in costs and other unspecified damages. In July 1992, the Government issued a counter claim against the developer for $14 million, for project costs paid to the developer and associated interest costs.

5.149 In July 1993, the claim lodged by the developer was revised to $9.1 million and the counter claim lodged by the Government revised to $13.2 million.

5.150 **At the date of preparation of this Report, the 2 legal actions were still pending.** As at 30 June 1993, the State had incurred over $1 million in legal fees relating to this litigation.

Future development of the site

5.151 In December 1992, the Office of Major Projects sought tenders for the sale and development of part of the Bayside site, and sought expressions of interest for the sale and development of the entire site. In July 1993, final tenders were called from all interested parties in relation to the entire Bayside site. At the date of preparation of this Report the successful tenderer had not been selected.

PART 6

Other Matters

KEY FINDING

OTHER MATTERS

- Payments totalling $35 million, made in 1989-90 without parliamentary authority, remain unacquitted. However, the Treasurer has advised that it is the Government's intention to validate this expenditure in 1993-94 through the introduction of enabling legislation.

Para. 6.3

Treasurer's Acquittance

6.1 Section 34 of the *Audit Act* 1958 requires the Auditor-General to acquit the Minister for Finance for the amount of public moneys spent which has been ascertained to have been duly and properly expended. This legislative provision requires that the acquitted expenditure exclude those amounts which are *"... the subject of query or observation or of show cause action or of disallowance or discharge"*.

6.2 **All Public Account moneys that were expended in 1992-93 were acquitted to the Minister for Finance except for the value of advances totalling $13.8 million held by departments at 30 June 1993.**

6.3 My Report on the Finance Statement, 1991-92, referred to an amount of $35 million, representing interest charges that were paid from the Consolidated Fund in 1989-90 without parliamentary authority. At the date of preparation of this Report, these payments remained unacquitted. However, **the Treasurer has advised that it is the Government's intention to validate this expenditure in 1993-94 through the introduction of enabling legislation.**

Trust Fund

6.4 The *Public Account Act* 1958 allows the Minister for Finance to establish trust accounts, within the Trust Fund, and to define the purposes for which they are to be used. 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 which records borrowings received from the Treasury Corporation of Victoria and their payment into the Consolidated Fund;
- the Victorian Development Fund, encompassing the Cash Management Account and the State Development Account;
- several Commonwealth and joint Commonwealth/State accounts used for on-passing specific Commonwealth grants to educational institutions, housing and transport authorities;
- specific State trust accounts established by legislation for specific purposes, such as the Hospitals and Charities Fund; and
- accounts established to manage bequests, scholarships etc.

6.5 A summary of the transactions and balances of the various trust accounts comprising the Trust Fund are provided in the Finance Statement.

6.6 Details of new accounts opened within the Trust Fund in 1992-93 and their specified purposes are set out in Table 6A.

TABLE 6A
NEW TRUST ACCOUNTS

Account or Fund	*Purpose for which established*
Cash Suspense Account - Premier and Cabinet	To facilitate the drawing by the department of its own cheques and the progressive drawdown of funds from the Public Account to meet the cash requirements relating to such payments.
Crime Prevention and Victims Aid Fund	To record the receipt of Appropriations and specified funds from confiscated assets, and the disbursement of these funds for the provision of information, support and assistance to victims of crime.
NIFS Trust Account	To record the receipt and disbursement of funds from the Commonwealth and participating States for projects undertaken by the National Institute of Forensic Science.
NPEAB Trust Account	To record the receipt and disbursement of funds from the Commonwealth and participating States for the operations of the National Police Ethnic Advisory Bureau.
Pro-active Fisheries Research and Development Fund	To record the receipt and disbursement of funds from the Commonwealth for fisheries research and development activities.
Resource Recovery Fund	To record the receipt of landfill levies by the Environment Protection Authority and the disbursement of these funds to municipal councils, the Recycling and Resource Recovery Council, Waste Management Council and Regional Waste Management Groups.
Revenue Suspense Account - Department of the Treasury	To initially record the receipt of revenue collections by the Department and the disbursement of these collections to the Consolidated Fund.
Working Account - Mobile Radio Network	To record the receipt of Appropriations equivalent to the revenues raised by this Unit and paid into the Consolidated Fund, and the disbursement of these funds to meet operating costs.

6.7 The following accounts were closed during 1992-93:

- Historical and Community Projects Trust Account;
- Land Protection Working Account;
- Motor Accidents and Insurance Premiums Suspense Account;
- National Parks Working Account; and
- Nurseries Working Account.

Balances of the Public Account

6.8 The transactions recorded in the Public Account for the past 2 years and the investment of the resulting balances are summarised in Table 6B.

TABLE 6B
RECEIPTS AND PAYMENTS OF THE PUBLIC ACCOUNT
($million)

Item	*1992-93*	*1991-92*
Balance 1 July	469	401
Receipts -		
Consolidated Fund	16 917	15 389
Trust Fund -		
Works and Services Account	2 249	1 240
Specific accounts	64 389	78 098
	84 024	95 128
Payments -		
Consolidated Fund	16 917	15 389
Trust Fund -		
Works and Services Account	2 265	1 189
Specific accounts	64 438	78 081
	83 620	94 659
Balance 30 June	**404**	469
Represented by the following investments -		
Trust Fund -		
Cash at bank	14	42
Fixed deposit accounts	8	9
Stocks and securities	2	3
Investment with the Victorian Development Fund	344	383
Advances -		
Consolidated Fund	22	22
Departments and other purposes	14	10
Trust Fund	404	469
Consolidated Fund	nil	nil
Total investments at 30 June	**404**	469

6.9 The net effect of the year's transactions was a decrease of $65 million in the total balances of the Public Account, brought about by an equivalent decrease in the balance of the Trust Fund.

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6.10 Consolidated Fund advances of $22 million included in the above table relate to the balance of Consolidated Fund deficits to 30 June 1970 financed by way of advances from moneys standing to the credit of the Trust Fund. At 30 June 1993, these advances remained unfunded. The Consolidated Fund net deficits were incurred prior to amendments to the Public Account Act in 1970 which now preclude the Fund from going into deficit. **The Treasurer has advised that it is the Government's intention to introduce enabling legislation in 1993-94 to authorise the funding of these outstanding advances.**

Transfer of Appropriations

6.11 The *Audit Act* 1958 provides that I summarise in my Report approvals given under the Act 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.

6.12 During the 1992-93 financial year, no transfers under Section 25 of the *Audit Act* 1958 were necessary as the *Appropriation (1992-93) Act* 1993 and *Appropriation (Parliament 1992-93) Act* 1993 provided specific authority to the Treasurer, and Ministers authorised by the Treasurer, to transfer appropriations within and across programs (known as section 8 Appropriation transfers). All such transfers are detailed in Appendix 2 to the Finance Statement.

Finance Statement 1992-93

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