VICTORIA

Auditor-General
of Victoria

Report of the
AUDITOR-GENERAL
on the
FINANCE STATEMENT
for the year ended
30 June 1994

MELBOURNE
L.V. NORTH, GOVERNMENT PRINTER
1994

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Section A

Review of the Finance Statement

Part 1

Executive Summary

Part 1.1

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 1994 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.

The major focus of the Government's current financial management strategy is to reduce the impact of debt charges on the budget. Workforce reductions and improved debt management are integral elements of this strategy.

In my Report on last year's *Finance Statement*, I referred to various measures adopted by the Government which, if sustained, would improve the State's financial position. For the year under review I can now report that the financial reform momentum has been maintained as indicated by the following not inconsiderable achievements:

- the consolidated liabilities of the State reduced by around $5.5 billion, which included a reduction in unfunded superannuation liabilities of around 20 per cent; and
- the overall outcome for the year after discounting the impact of various significant one-off transactions and the repayment of borrowings was a surplus of $798 million compared with a deficit of $1.1 billion in 1992-1993.

In this report I have again called for the introduction of whole of government reporting by the State which would not only enhance accountability over government operations but allow more informed debate on the financial position of the State. While comprehensive information is provided in the *Finance Statement* on the receipts and payments, and financial obligations of the State, limited information is provided on Victoria's publicly owned assets. In the absence of such information, it is not surprising that debate on Victoria's finances has tended in the past to concentrate on matters such as the liabilities of the State.

Part 1.2

Summary of major findings

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

ACCOUNTABILITY FRAMEWORK	Page 15

- The Finance Statement presents a summary of the cash transactions of the Public Account, together with certain supplementary information. Adequate accountability to the Parliament will not be achieved until information is presented on an accrual basis covering the whole of government.

Paras 2.1 to 2.7

- The reporting timeframe for the majority of public sector agencies will need to be brought forward in future years to enable the Government's Statement of Financial Operations to be tabled in the Parliament by the revised legislative deadline.

Paras 2.8 to 2.10

FINANCIAL RESULT	Page 21

- The Finance Statement discloses that the Consolidated Fund deficit for the year was $1.2 billion. However, after taking into account debt repaid and changes in cash and investment holdings, the financing transactions of the budget sector, that is, the overall deficit, was $572 million.

Paras 3.1 to 3.4

- An analysis of the year's result indicated that the overall outcome prior to transactions that were not of an on-going nature and the repayment of borrowings was a surplus of $798 million, compared with a deficit of $1.1 billion in 1992-93.

Paras 3.10 to 3.16

- The results for the year indicate that the Government's reforms are having a favourable financial impact and that the Government is well placed to produce positive financial results in the future.

Para. 3.12

CONSOLIDATED FUND RECEIPTS — Page 31

- The Consolidated Fund receipts for the year, excluding borrowings, were $1.8 billion higher than budget expectations and $2.9 billion greater than actually received in 1992-93.

  Paras 4.1 to 4.3

- The receipt of a special dividend of $1.2 billion from the Transport Accident Commission and an up-front licence fee of $200 million from the operator of the Crown Casino contributed significantly to the year's favourable outcome.

  Para. 4.2 and
  Paras 4.61 to 4.75

- During the year, 100 school property sites were sold, realising a total of $99 million.

  Paras 4.11 to 4.15

- In August 1994, the State received $609 million from the privatisation of the TAB and has incurred total costs associated with the float estimated at $19.5 million.

  Paras 4.30 to 4.45

CONSOLIDATED FUND PAYMENTS — Page 53

- The Consolidated Fund payments for the year were $1.2 billion below budget expectations

  Paras 5.1 to 5.3

- During 1993-94, the budget sector workforce was reduced by 14 300 employees through the implementation of the Government's employee departure programs, at a total cost of $732 million.

  Paras 5.7 to 5.22

BUDGET SECTOR ASSETS — Page 65

- Given the significant deficiencies in the recording and reporting of budget sector assets, it is vital that the positive momentum that currently exists to address the deficiencies in the area continues.

  Paras 6.1 to 6.9

- While the implementation of accrual reporting by departments will facilitate the introduction of whole of government reporting, there is a need for the Government to establish a firm timetable for its timely introduction.

  Paras 6.13 to 6.18

LIABILITIES AND COMMITMENTS — Page 73

- At 30 June 1994, the liabilities of the State totalled $66.9 billion, compared with $72.4 billion as at 30 June 1993.

  Paras 7.5 to 7.6

- The reduction of the State's liabilities of $5.5 billion during the year was due primarily to the lower level of employee liabilities including unfunded superannuation.

  Para. 7.7

- The Government has still not disclosed as a liability the Accelerated Infrastructure Program, valued at $205 million.

  Paras 7.24 to 7.29

- Taxpayers were required to finance the shortfall of $98.5 million of repayments to Victorian Equity Trust unit holders.

  Paras 7.30 to 7.34

- The State's exposure under the flexible electricity tariff arrangements is estimated by the Department of the Treasury to be around $1.6 billion as at 30 June 1994.

  Paras 7.66 to 7.70

- While some action was taken by the Department of the Treasury to address the deficiencies in the recording and monitoring of the State's contingent liabilities, I still cannot provide assurance to the Parliament as to the full extent of these liabilities.

  Paras 7.112 to 7.118

- Audit was advised that, at the date of preparation of this Report, franchise fees for the staging of the Grand Prix had not been paid by the Government or its associated companies.

  Paras 7.121 to 7.128

- The Department of the Treasury advised that a financial analysis was undertaken by the Department prior to the issue of indemnities to assess any consequent risks to the State relating to the staging of the Grand Prix. However, no evidence was made available to audit to support this statement.

  Paras 7.129 to 7.134

OTHER MATTERS — Page 117

- During 1993-94, parliamentary authority was provided for the validation of payments totalling $35 million made in 1989-90 without such sanction, and the repayment of Consolidated Fund advances from the Trust Fund of $22 million which had remained unfunded since 1970.

  Paras 8.2 and 8.9

Part 2

Accountability Framework

Part 2

Accountability Framework

KEY FINDINGS

- The Finance Statement presents a summary of the cash transactions of the Public Account, together with certain supplementary information. Adequate accountability to the Parliament will not be achieved until information is presented on an accrual basis covering the whole of government.

  Paras 2.1 to 2.7

- Legislative reforms will require greater accountability to the Parliament over government financial operations from 1994-95 onwards.

  Paras 2.8 to 2.9

- The reporting timeframe for the majority of public sector agencies will need to be brought forward in future years to enable the Government's Statement of Financial Operations to be tabled in the Parliament by the revised legislative deadline.

  Para 2.10

Financial accountability framework

2.1 The Finance Statement provides an annual summary of the transactions and balances of the Public Account, which comprises the Consolidated Fund and the Trust Fund, together with certain supplementary information relating to the State's financial assets, liabilities, commitments and contingent liabilities.

2.2 The annual presentation of the Finance Statement to the Parliament forms a key part of the State's accountability framework relating to the financial operations of government, as provided under the *Constitution Act* 1975, *Audit Act* 1958 and *Public Account Act* 1958.

2.3 The *Audit Act* 1958 requires 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, and for **the Auditor-General to then 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.** The inclusion within the Statement of supplementary information has evolved over many years, mainly in response to calls from this Office, the Parliament and the public for greater disclosure of the financial standing and obligations of the State.

2.4 Under the established legislative framework, the Consolidated Fund is used as the Government's main operating account and records the collection of all government revenues such as State taxes, Commonwealth grants and asset sale proceeds. Fundamental to the framework is the principle 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 the key means through which Parliamentary control is exercised over the public purse.

2.5 The Trust Fund comprises various specific purpose trust accounts, mainly relating to the on-passing of certain Commonwealth grants to specified recipients, the operation of departmental suspense and working accounts, and the receipt and payment of moneys of a trust nature.

2.6 In addition to the presentation of financial information in accordance with the established legislative accountability framework, in recent years the Government has presented within its various budget papers and monthly Niemeyer Statements financial information relating to the transactions of the budget sector in the *national accounting format*, which is based on a model developed by the Australian Bureau of Statistics. This information has been presented mainly due to the increasing demand for information which has a greater economic relevance in facilitating assessments of the impact of government financial operations on the economy, and for inter-governmental comparisons of financial performance.

2.7 **This Report is prepared in the context of the established accountability framework upon which the Finance Statement is presented.** However, the Report also outlines the key differences between the Consolidated Fund and national accounting format results for the year. However, as commented in my October 1993 Report, **adequate accountability to the Parliament over government financial operations will not be achieved until information is presented on an accrual basis, covering the whole of government.**

Changes to accountability framework

2.8 The implementation of the Government's financial management reform program, during 1993-94, included the repeal of the *Public Account Act* 1958 and the *Audit Act* 1958 and their replacement with the *Financial Management Act* 1994 and the *Audit Act* 1994. The *Financial Management Act* 1994, which is operative from 1 July 1994, will require the annual preparation by the Minister for Finance of a Statement of Financial Operations in future years. The Act provides that the Statement *present fairly the financial transactions of the Public Bank Account* and include, inter alia, *details of the liabilities (including contingent liabilities under guarantees and indemnities or in respect of superannuation payments and all other contingent liabilities) and prescribed assets of the State at the end of the financial year.* The Auditor-General will be required under that Act to audit the Statement of Financial Operations and to prepare a Report thereon for tabling before each house of the Parliament.

2.9 The impact of the new legislation, which is effective from the 1994-95 financial year, is that:

- information on liabilities, contingent liabilities and prescribed assets of the State will be **explicitly** required to be disclosed in the annual Statement of Financial Operations; and
- responsibility for explaining the Statement will no longer rest with the Auditor-General but with the Government. As a result, the Auditor-General's role in relation to that Statement will be consistent with general auditing practice, in that, it will focus on the expression of an audit opinion thereon and the presentation of a separate Report on the results of the audit.

2.10 **While these reforms will result in greater accountability to the Parliament, it will be important that a framework is developed to ensure that Statewide data is collated from the audited financial reports of all agencies and that inter-entity balances are eliminated. To enable the Statement of Financial Operations to be tabled in the Parliament by the future legislative deadline of 15 October, it will be necessary for the reporting timeframes for the majority of public sector agencies to be brought forward.**

Part 3

Financial Result

Part 3

Financial Result

KEY FINDINGS

- The Finance Statement discloses that the Consolidated Fund deficit for the year was $1.2 billion. However, after taking into account debt repaid and changes in cash and investment holdings, the financing transactions of the budget sector, that is, the overall deficit, was $572 million.

  Paras 3.1 to 3.4

- An analysis of the year's result indicated that the overall outcome prior to transactions that were not of an on-going nature and the repayment of borrowings was a surplus of $798 million, compared with a deficit of $1.1 billion in 1992-93.

  Paras 3.10 to 3.16

- The results for the year indicate that the Government's reforms are having a favourable financial impact and that the Government is well placed to produce positive financial results in the future.

  Para. 3.12

- During the year, the Government took action to unwind further expenditure deferral arrangements involving $364 million of Consolidated Fund expenditure.

  Paras 3.20 to 3.27

Financial result for the year

3.1 The *1993-94 Finance Statement* discloses a balanced position of the Consolidated Fund at 30 June 1994. However, this position was achieved after taking into account **borrowing proceeds of $1.2 billion (1992-93, $3.3 billion) paid into the Consolidated Fund in the year. These borrowings represent the Consolidated Fund deficit for the year** (described in Table A.2 on page xvi of the Finance Statement as the *amount required to be funded*). During 1993-94, $891 million (1992-93, $1.2 billion) was paid out of the Consolidated Fund to repay borrowings.

3.2 The balanced Consolidated Fund 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 insufficient receipts are available to meet total payments, the Government borrows to finance the shortfall and achieve a balanced financial outcome. In 1993-94, the recorded receipts of the Consolidated Fund of $17.6 billion (including borrowings) equalled the total payments of the Fund. However, as outlined later in this Report, the *Financial Management Act* 1994, which was enacted during the year, removed this requirement for the artificial balancing of the Consolidated Fund, with effect from the 1994-95 financial year.

3.3 Under the *national accounting format,* **the deficit for 1993-94**, as represented by the **budget sector financing transactions, totalled $572 million** (1992 - 93, $2.2 billion). This format takes into account the transactions of the Consolidated Fund, Trust Fund and those public bodies subject to substantial central budgetary control.

3.4 Table 3A presents the Consolidated Fund result for the year, together with the budget sector financing transactions calculated on the basis of the *national accounting format*.

TABLE 3A
FINANCIAL RESULT FOR THE YEAR
($million)

Item	*Actual (a) 1992-93*	***Actual 1993-94***	*Budget 1993-94*	***Variance from Budget***	*Variance from 1992-93 Actual*
Recurrent -					
Receipts excluding borrowings	12 487	**15 260**	13 777	**1 483**	2 773
Payments	13 664	*(b)***15 377**	16 426	**1 049**	(1 713)
Recurrent deficit for year	(1 177)	**(117)**	(2 649)	**2 532**	1 060
Works and services -					
Receipts excluding borrowings	1 007	**1 118**	818	**300**	111
Payments	3 159	**2 188**	2 331	**143**	971
Works and services deficit for year	(2 152)	**(1 070)**	(1 513)	**443**	1 082
Overall Consolidated Fund deficit for year (funded from borrowings)	(3 329)	**(1 187)**	(4 162)	**2 975**	2 142
Less - Reconciling items (refer to Table 3B of this Report)	1 156	**615**			
Financing transactions (national accounting format)	(2 173)	**(572)**			

(a) The 1992-93 comparatives have been adjusted to reflect the reclassification of certain items in 1993-94.

(b) Does not include a payment of $62 million relating to the refinancing of Cash Management Account borrowings, which is included as part of the overall Consolidated Fund deficit for the year.

Key factors impacting on result

3.5 **Overall, the year's outcome was substantially better than forecast, with the recurrent sector deficit $2.5 billion below budget and the total Consolidated Fund deficit $3 billion below expectations**. However, the following items which jointly contributed around $1.9 billion to the improved result, need to be taken into account when assessing the year's performance:

- a $1.2 billion special dividend received from the Transport Accident Commission, which was not provided in the 1993-94 budget;
- expenditure on employee departure programs was $568 million or 44 per cent below budget estimates, mainly due to the greater than expected utilisation of less costly departure packages; and
- a $200 million licence fee received from the operator of the Crown Casino in the year, which was not provided for in the budget estimates.

3.6 In addition to the impact of these items, the year's result was favourably impacted by the following:

- additional taxation revenues of $281 million, resulting mainly from improved economic activity in the State; and
- expenditure savings, achieved across many areas of departmental activity, of $624 million (excluding expenditure on employee departure programs). Of these savings, unspent recurrent and works and services appropriations of $190 million and $143 million, respectively, were carried forward to 1994-95.

3.7 The year's result was also impacted by a one-off payment of $1.4 billion from the Consolidated Fund to a number of public sector superannuation schemes, to eliminate the State's liability relating to deferred employer contributions to these schemes. This payment, which was provided for in the 1993-94 budget, needs to be taken into account when comparing the Consolidated Fund result achieved in 1993-94 with that achieved in previous years.

Difference between Consolidated Fund and national accounting format results

3.8 As previously highlighted, different results arise from the use of the Consolidated Fund and *national accounting* reporting formats due to divergence in coverage under the 2 formats. Table 3B presents a summary of the key differences arising between these results for the year.

TABLE 3B
RECONCILIATION OF 1993-94 CONSOLIDATED FUND DEFICIT WITH FINANCING TRANSACTIONS
($million)

Item			*Amount*
Consolidated Fund deficit (as per Table A.2 of the Finance Statement)			**1 187**
Less -			
Appropriations for repayment of borrowings -			
Treasury Corporation of Victoria	793		
Computer lease facility	13		
Public Transport Corporation leases	13		
Other	1	820	
Borrowing repayments outside the Consolidated Fund -			
Victorian Debt Retirement Fund	7		
Commonwealth Government	7	14	
Repayment of prior years' Trust Fund advances to the Consolidated Fund		22	
National Rail Corporation share purchase		2	
Net effect of other items (mainly changes in cash, investments and other items)		(243)	
Total reconciling items			**615**
Financing transactions (national accounting format)			**572**

3.9 The table indicates that the difference of $615 million between the Consolidated Fund and national accounting 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

3.10 My previous Reports to the Parliament have commented on the classification basis adopted for the Finance Statement, which segments all transactions between the recurrent and works and services sectors, consistent with parliamentary appropriations. Under this classification basis, the recurrent sector includes a number of capital items, such as borrowing repayments, and conversely the works and services sector includes certain operating costs. The absence of a clear dissection of operating and capital transactions precludes users of the Finance Statement from readily ascertaining and assessing the Consolidated Fund's operating result for the year. However, as stated in paragraph 3.18 of this Report, action is proceeding to provide a clearer differentiation between operating and capital items in the future.

3.11 Table 3C presents the Consolidated Fund result for the year, segmented according to operating and capital transactions. **The table highlights major transactions that are not of an on-going nature, which are known in accounting terms as abnormal items.**

TABLE 3C
AUDIT RE-STATEMENT OF
CONSOLIDATED FUND DEFICIT FOR YEAR *(a)*
($million)

Item	*1993-94*	*1992-93*
Operating transactions -		
Receipts	13 535	12 262
Payments	12 993	13 385
Operating surplus/(deficit) prior to abnormal items	**542**	**(1 123)**
Add/(Less) - Abnormal items *(b)*	106	(1 048)
Operating surplus/(deficit) for the year	**648**	**(2 171)**
Capital transactions (excluding borrowing transactions)		
Receipts	1 443	1 232
Payments	1 187	1 214
Capital surplus prior to abnormal items	**256**	**18**
Less - Abnormal items *(c)*	1 200	-
Capital surplus/(deficit) for year (excluding borrowing transactions)	**(944)**	**18**
Consolidated Fund deficit prior to borrowing repayments	**(296)**	**(2 153)**
Borrowing repayments	**(891)**	**(1 176)**
Overall Consolidated Fund deficit for year (funded from borrowings)	**(1 187)**	**(3 329)**
Less - Reconciling items (refer to Table 3B of this Report)	615	1 156
Financing transactions (national accounting format)	**(572)**	**(2 173)**

(a) Table 3D provides a summary of inappropriately classified receipts and payments, as identified by audit.

(b) Abnormal items include employee departure program payments of $732 million ($773 million, 1992,93), the reversal of prior year expenditure deferral arrangements of $362 million ($275 million, 1992-93) and the receipt of a $1.2 billion special dividend from the Transport Accident Commission (nil, 1992-93). It should be noted that the $1.2 billion special dividend is classified in the Finance Statement as a recurrent receipt.

(c) Abnormal items comprise the payment of deferred employer superannuation obligations of $1.4 billion (nil, 1992-93) and the receipt from Crown Casino of $200 million for the right (intangible asset) to operate the new casino (nil, 1992-93).

3.12 **An analysis of the restated result indicates that the overall outcome for the year prior to abnormal items and the repayment of borrowings was a surplus of $798 million, compared with a deficit of $1.1 billion in 1992-93. This result indicates that the Government's reforms are having a favourable financial impact and that the Government is well placed to produce positive financial results in the future.**

3.13 Table 3D, which is based on data extracted from the above table, shows the components contributing to this result.

TABLE 3D
CONSOLIDATED FUND DEFICIT PRIOR TO ABNORMAL ITEMS AND THE REPAYMENT OF BORROWINGS
($million)

Item	*1993-94*	*1992-93*
Operating surplus/(deficit) prior to abnormal items	542	(1 123)
Capital surplus prior to abnormal items and borrowing repayments	256	18
Surplus/(Deficit) prior to abnormal items and the repayment of borrowings	**798**	**(1 104)**

3.14 While the Finance Statement indicates that in 1993-94 borrowings of $117 million (1992-93, $1.2 billion) were used to finance Consolidated Fund expenditure incurred for recurrent purposes, audit analysis of the year's transactions (as presented in Table 3C) indicates that an operating surplus of $648 million was in fact achieved in 1993-94 (1992-93, $2.2 billion deficit).

3.15 **The operating surplus for the year prior to abnormal items was $542 million, compared with a deficit of $1.1 billion in 1992-93.** Contributing to the improved result for the year was the impact of the Government's revenue raising measures which were implemented in 1992-93, increased taxation receipts resulting from improved economic conditions in the State and expenditure restraint by departments. The year's operating result was also influenced by a number of *abnormal* items, including a special dividend of $1.2 billion received from the Transport Accident Commission, expenditure of $732 million on employee departure programs and payments of $362 million relating to the reversal of prior year expenditure deferral arrangements.

3.16 **The capital sector result prior to debt repayment transactions and abnormal items was a surplus of $256 million, compared with a surplus of $18 million in 1992-93.** The key reasons for the improved result for the year were the greater level of asset sales in the year and lower expenditure levels mainly due to slower than anticipated progress on capital projects. However, the overall capital result for the year was significantly affected by a payment of $1.4 billion to public sector superannuation schemes to eliminate the State's liability relating to deferred employer contributions that had accumulated over past years, and the receipt of a $200 million licence fee for the granting of the Crown Casino licence.

❑ ***RESPONSE*** *provided by the Secretary, Department of the Treasury*

The Department of Treasury does not agree with the reclassification of the receipt of $1.2 billion as a current receipt as in its opinion this does not recognise the substantive nature of the transaction, viz a reduction in the Government equity in TAC. The treatment of the transaction as a capital receipt is in accordance with the conventions of the national uniform budget presentation agreement as developed in conjunction with the ABS.

Re-classified transactions

3.17 In Table 3C, audit has presented a re-statement of the Consolidated Fund result, which differentiates between operating and capital transactions. Table 3E below details those transactions re-classified.

TABLE 3E
RE-CLASSIFIED CONSOLIDATED FUND TRANSACTIONS, 1993-94
($million)

Item	*Amount*
Receipts	
Capital receipts classified as recurrent -	
Repayment of Victorian Equity Trust (VET) equity	437
Repayment of advances (principal)	88
Re-classified receipts	**525**
Payments	
Operating payments classified as works and services -	
Employee departure programs	732
Repairs and maintenance	80
Planning and development programs	206
Finance charges	16
Other	2
	1 036
Less - Capital payments classified as recurrent:	
Deferred employer superannuation contributions	1 400
Repayment of borrowings (principal)	(a) 891
Other	35
	(2 326)
Re-classified payments (net)	**(1 290)**

(a) Includes $71 million paid to the Victorian Debt Retirement Fund in the year.

3.18 During 1992-93, the Government commenced a review of the classification of Public Account transactions as a first step towards the clearer differentiation between operating and capital items. In that year, the review focused on the reclassification of more readily identifiable items of an operating nature, in particular maintenance expenditure, which had previously been allocated to the works and services sector. The 1993-94 budget estimates appropriately classified these items to the recurrent sector. The review process was continued during 1993-94, with further minor reclassifications of items occurring in the 1994-95 budget estimates.

3.19 **The Department of the Treasury needs to consider the reclassification of the additional items identified in this Report, to more appropriately reflect the nature of the transactions and improve the transparency of the Finance Statement.**

Elimination of prior-year expenditure deferrals

3.20 My previous Report on the Finance Statement commented on the positive action commenced by the Government in 1992-93 to eliminate certain expenditure deferral arrangements established in prior years. These deferral arrangements resulted in the financing of substantial obligations being transferred to future periods. In 1992-93, expenditure deferrals totalling $296 million were reversed by the Government.

3.21 As part of a policy of ensuring that Consolidated fund cashflows reflect expenditure incurred during each financial period, the Government took action to unwind further expenditure deferral arrangements totalling $364 million in 1993-94. These arrangements related to debt payments to the Treasury Corporation of Victoria (TCV) and grants to non-government schools. **The impact of this action was to increase expenditure and accordingly the Consolidated Fund deficit by $364 million in the year. This positive action has also resulted in the more appropriate reporting of expenditure in the period to which it relates.**

3.22 Table 3F summarises the expenditure deferral arrangements that were unwound by the Government in 1993-94.

TABLE 3F
EXPENDITURE DEFERRALS DISCONTINUED IN 1993-94
($million)

Item		*Amount*
Operating transactions -		
TCV (interest)	333	
Grants to non-government schools	29	
		362
Capital transactions -		
TCV (principal)		2
Total deferrals eliminated in the year		**364**

Debt charges

3.23 The billing arrangements established in 1990-91 relating to the payment of debt charges on borrowings managed by the Treasury Corporation of Victoria (TCV) on behalf of the State required the TCV to assume responsibility for initially meeting these payments. The State, in turn, agreed to re-imburse the TCV in the month following payment. This arrangement enabled the deferral by the Consolidated Fund of these debt payments by up to one month.

3.24 In June 1994, payments totalling **$335 million** were made from the Consolidated Fund to the TCV to meet the debt charges incurred by the TCV during that month, which would have previously been paid at the commencement of the following financial year if the previous practice had continued.

Grants to non-government schools

3.25 Government financial assistance to non-government schools is provided in the form of annual grants. Prior to 1990-91, these grants were paid by instalments in February (25 per cent), July (50 per cent) and October (25 per cent), respectively.

3.26 My previous Reports on the Finance Statement commented on a 1990-91 Government decision to defer grant instalments from the Consolidated Fund, which would normally have been paid in February, until the following July. In order to facilitate this deferral, an arrangement was entered into with a private bank to advance funds to schools in February, up to the value of grants that would have previously been provided as at that date from the Consolidated Fund. The Government agreed to meet the associated finance charges of these bank advances.

3.27 In 1993-94, the Government commenced action to unwind this arrangement, with a Consolidated Fund payment of **$29 million** made in February 1994, representing a part reinstatement of the first instalment of grants to non-government schools for the 1994 calender year. The Government plans to fully unwind this deferral arrangement in the 1994-95 financial year.

Part 4

Consolidated Fund Receipts

Part 4

Consolidated Fund Receipts

KEY FINDINGS

- The Consolidated Fund receipts for the year, excluding borrowings, were $1.8 billion higher than budget expectations and $2.9 billion greater than actually received in 1992-93.
  Paras 4.1 to 4.3
- The receipt of a special dividend of $1.2 billion from the Transport Accident Commission and an up-front licence fee of $200 million from the operator of the Crown Casino contributed significantly to the year's favourable outcome.
  Para. 4.2 and
  Paras 4.61 to 4.75
- During the year, 100 school property sites were sold, realising a total of $99 million.
  Paras 4.11 to 4.15
- In August 1994, the State received $609 million from the privatisation of the TAB and has incurred costs associated with the float estimated at $19.5 million.
  Paras 4.30 to 4.45
- During 1993-94, the Gas and Fuel Corporation paid an increased dividend to the Consolidated Fund, which substantially reflected the proceeds of $129.5 million from the sale of its Heatane Division which had net assets of $51 million.
  Paras 4.46 to 4.51

Summary of Financial Transactions

4.1 The Consolidated Fund gross receipts for the year, excluding borrowings, totalled $16.4 billion, compared to budget expectations of $14.6 billion and actual receipts in 1992-93 of $13.5 billion.

4.2 The key factors contributing to this result, which was $1.8 billion higher than budget expectations and $2.9 billion greater than that actually achieved in 1992-93, were:

- the collection of a special dividend of $1.2 billion from the Transport Accident Commission and an up-front licence fee of $200 million from the operator of the Crown Casino;
- the full-year effect of various revenue raising initiatives introduced by the Government during the 1992-93 financial year to assist in the elimination of the current account deficit;
- higher contributions from public authorities in the form of dividends and proceeds relating to the wind-up of the Victorian Equity Trust (further comment on the Victorian Equity Trust is included in Part 7 of this Report); and
- increased taxation receipts, mainly in the areas of stamp duty and franchise fees, resulting from an improved level of economic activity within the State.

4.3 Table 4A provides a summary of the receipts (excluding borrowings) of the Consolidated Fund for the year.

TABLE 4A
BUDGETED AND ACTUAL CONSOLIDATED FUND RECEIPTS
($million)

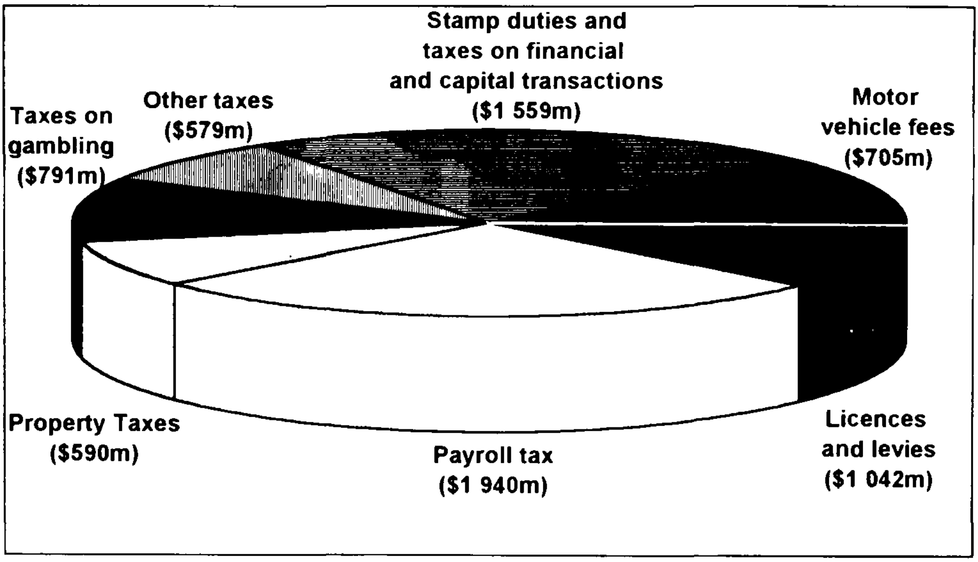
Item	*1992-93 (a) Actual*	***1993-94 Actual***	*1993-94 (b) Budget*	***Variance from Budget***	***Variance from 1992-93 Actual***
Recurrent -					
Taxation	6 357	**7 207**	6 926	**281**	**850**
Commonwealth	4 419	**4 627**	4 691	**(64)**	**208**
Other	1 711	**3 426**	2 160	**1 266**	**1 715**
Total recurrent	12 487	**15 260**	13 777	**1 483**	**2 773**
Works and services -					
Commonwealth	873	**671**	694	**(23)**	**(202)**
Sale of assets	119	*(c)***398**	112	**286**	**279**
Other	15	**49**	12	**37**	**34**
Total works and services	1 007	**1 118**	818	**300**	**111**
Total receipts (excluding borrowings)	13 494	**16 378**	14 595	**1 783**	**2 884**

(a) 1992-93 comparatives have been adjusted to reflect the reclassification of certain items in 1993-94.
(b) Budget Estimates 1993-94, Budget Paper No. 4.
(c) Includes $200 million licence fee received from the Crown Casino.

Taxation Revenue

4.4 Taxation receipts are the largest source of Government revenue and principally comprise payroll tax, various stamp duties and taxes on financial and capital transactions, taxes on land holdings and gambling activities, motor vehicle fees and other licences and levies. **In 1993-94, receipts from this source totalled some $7.2 billion (1992-93, $6.4 billion) and accounted for 44 per cent of total Consolidated Fund receipts (excluding borrowings)**. Chart 4B illustrates the key taxation categories in the year.

CHART 4B
KEY TAXATION CATEGORIES
($million)



Major variances

4.5 As indicated in Table 4A, **taxation receipts in 1993-94 were $281 million above the budget estimate** and $850 million higher than the previous year. Table 4C details the specific items contributing to this favourable outcome.

TABLE 4C
FAVOURABLE TAXATION VARIATIONS
($million)

Revenue sources	*1992-93 Actual*	***1993-94 Actual***	*1993-94 Budget*	***Variance from Budget***	***Variance from 1992-93 Actual***
Stamp duty on land transfers and marketable securities	660	**892**	694	**198**	**232**
Tobacco franchise fees	335	**424**	383	**41**	**89**
Electronic gaming machines	95	**259**	225	**34**	**164**
Motor vehicle taxes	594	**705**	681	**24**	**111**
Petroleum franchise fees	350	**470**	450	**20**	**120**
Debits tax	130	**244**	240	**4**	**114**

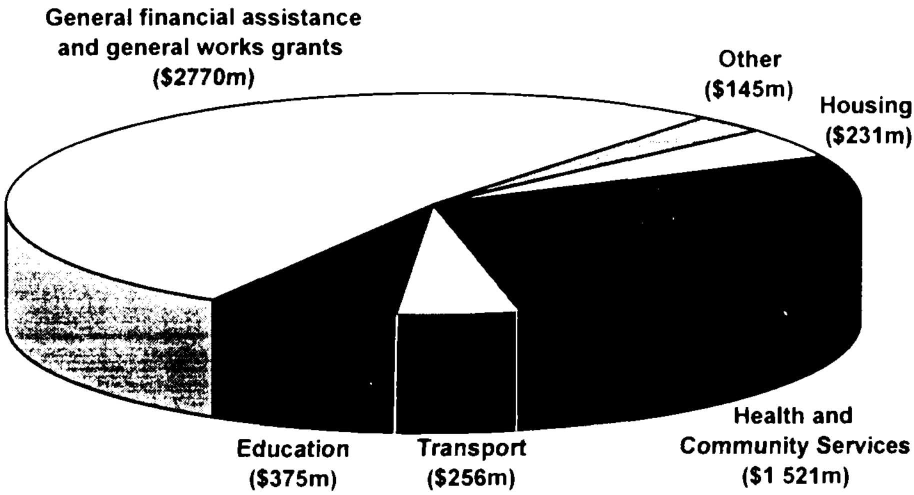
4.6 The key factors contributing to the major favourable taxation variations, as advised by the Department of the Treasury, were as follows:

- *Stamp duty on land transfers and marketable securities* - higher number of major commercial land transactions within the central business district and regional centres, and a stronger than anticipated recovery in the stock market;
- *Tobacco franchise fees* - a combination of factors, including unusually high levels of sales in 1993-94, reduced tax evasion resulting from the cessation of the tax differential between Victoria and Queensland, an increase in the tax rate from 50 per cent to 75 per cent in February 1993 and the positive tax differential with Western Australia, South Australia and Tasmania;
- *Electronic gaming machine revenues* - higher than budgeted average daily turnover of gaming machines and the continued opening of new gaming venues;
- *Motor vehicle taxes* - higher than anticipated prices for both new and used vehicles and the impact of various rate increases introduced by the Government in 1992-93;
- *Petroleum franchise fees* - consumption of fuel, particularly motor spirits, exceeding estimates and the introduction of the 3 cents per litre better roads fuel levy from August 1993; and
- *Debits tax* - full year effect of doubling the tax rate from 1 May 1993.

Commonwealth receipts

4.7 Commonwealth receipts mainly comprise annual grants relating to general financial assistance and specific funding relating to health and community services, education, transport and housing programs. These receipts represent the State's second largest source of revenue and **in 1993-94 were at the same level as the previous year and totalled $5.3 billion, accounting for approximately 33 per cent (39 per cent, 1992-93) of total Consolidated Fund revenues** not including borrowings. Chart 4D outlines the key components of Commonwealth receipts in the year.

CHART 4D
COMMONWEALTH RECEIPTS, 1993-94
($million)



4.8 The 1993-94 general financial assistance and works grants to the State accounted for 52 per cent of total Consolidated Fund receipts from the Commonwealth, with grants for funding of health and community services programs the next largest receipt, representing 29 per cent of revenue from Commonwealth sources.

Property asset sales

4.9 **In 1993-94, the Consolidated Fund received proceeds of $198 million from the sale of surplus or underutilised properties, which was $86 million above the budget expectation of $112 million.** Table 4E details the property asset sales achieved by each agency.

TABLE 4E
PROPERTY ASSET SALES BY AGENCY
($million)

Agency	*Actual 1992-93*	***Actual 1993-94***	*Budget 1993-94*	***Budget variance***
Department of Finance	70	**79**	46	**33**
Directorate of School Education	24	**99**	47	**52**
Transport Authorities	12	**11**	10	**1**
Office of Major Projects	9	**4**	5	**(1)**
Other	4	**5**	4	**1**
Total	**119**	**198**	**112**	**86**

4.10 The key factors contributing to increased asset sales in the year, as advised by the Department of Finance, were:

- receipts relating to the sale of the Queen Victoria and Prince Henry's hospital sites, which had not been included in budget estimates; and
- the sale of additional school property sites and higher than budgeted returns from properties identified for sale by the Directorate of School Education.

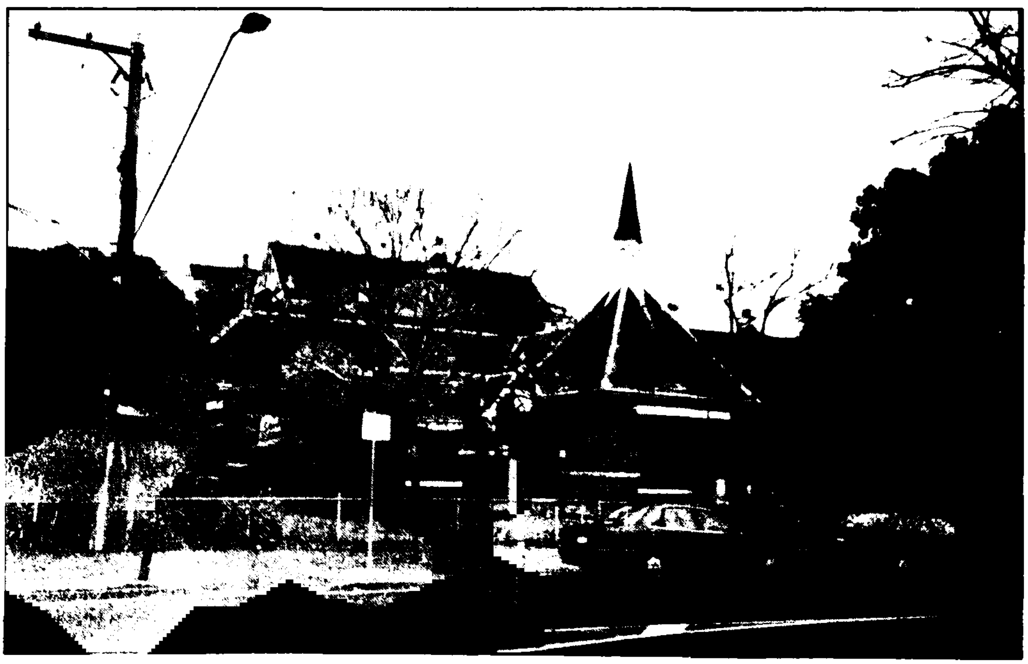
Sale of school sites

4.11 A major component of the Government's 1993-94 asset sales program was the sale of surplus school property sites by the Directorate of School Education. **During the year, around 100 sites were sold realising a total of $99 million for the Consolidated Fund, some $52 million above budget expectations.** The favourable result for the year was mainly due to the sale of 40 properties more than anticipated and the achievement of higher than expected prices from sales.

4.12 Prior to the sale of school properties, individual sites were reviewed by the Directorate to determine whether they were surplus to operational requirements. In this process, consideration was given to a number of factors, including the number of students enrolled at the school, the condition of the site and whether scope existed to rationalise the number of schools within the region. In completing these assessments, the Directorate also liaised closely with school councils.

4.13 In marketing and obtaining valuations of the surplus sites, the Directorate took into account the location and condition of the property and its potential for redevelopment. To maximise the returns to the State, the Directorate prepared redevelopment options which took into account such factors as costs relating to sub-division, demolition and site clean-up, and council planning considerations. Based upon this analysis, school sites were valued by the Valuer-General and an independent valuer. Reserve prices for the sites were based on these valuations.

4.14 **Audit examination of a number of property sales completed during the year revealed that, in the cases examined, the proceeds realised from the sales were consistent with the reserve prices assigned to individual properties.**



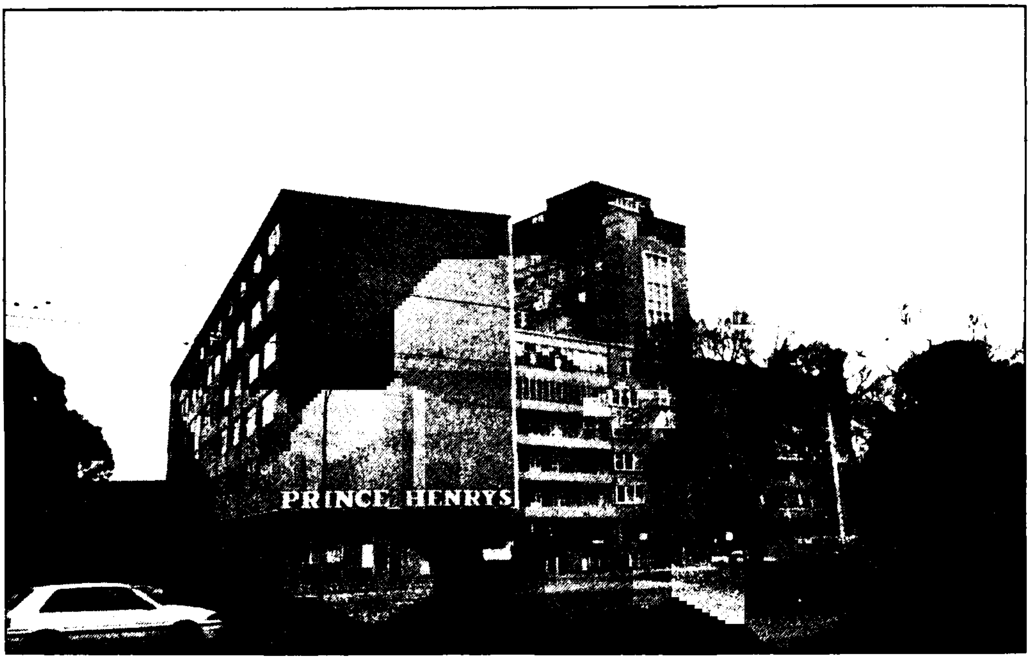
Eastern Road Primary School, sold in 1993-94.

4.15 At 30 June 1994, 230 school sites valued at $57.3 million were assessed as surplus to operational requirements and were awaiting sale.

Prince Henry's Hospital

4.16 Established in the 1880s, Prince Henry's Hospital provided health care services to the public up until its closure in 1991. The Hospital site, which spanned 3.5 hectares with frontages to St Kilda Road, Dodds, Wells, Miles and Grant Streets in South Melbourne, was declared surplus to requirements as part of the establishment of the Monash Medical Centre in 1987 and placed on the Government's asset sale program.

4.17 Action was not immediately commenced to facilitate the sale of the property due to planning concerns relating to the proposed Domain Tunnel development to link the Westgate and South Eastern freeways, the poor state of the property market and resolution of issues associated with re-zoning the site.



Prince Henry's Hospital, St Kilda Road

4.18 It was not until early 1994 that the site was sub-divided into 6 allotments, with 4 of these allotments offered for sale both locally and internationally by public tender. The remaining 2 sites were not originally offered for sale due to their limited use resulting from the planned Domain Tunnel development.

4.19 Tenders were subsequently received by the Government from 5 private developers. Following the evaluation of tenders, in May 1994 the Government entered into agreements for the sale of 5 sites, which included one site that was not originally offered for sale, at an agreed net price of approximately $25.5 million. The Valuer-General had assessed the value of these sites at $16.4 million.

4.20 Under the terms of the agreements, $13 million of the purchase price was paid to the Consolidated Fund in the 1993-94 financial year, with $9.1 million due and payable in 1994-95 and the balance of $3.4 million payable in 1995-96. However, the Government has agreed to incur up to $1 million on building demolition works at one of the sites. **In total, the net proceeds from the sale of the Prince Henry Hospital site will exceed the valuation provided by the Valuer-General by $8.1 million or 49 per cent.**

4.21 The purchasers have announced their intention to develop the hospital site as apartments, with construction expected to commence in 1994-95.

4.22 Since the closure of Prince Henry's Hospital in 1991, in excess of $400 000 has been spent by the Government on maintenance and security of the unoccupied site.

Queen Victoria Hospital

4.23 My previous 2 *Reports on the Finance Statement* have commented on the March 1992 sale to a private developer of the vacant Queen Victoria Hospital site, which covers an area of 1.9 hectares bordering Lonsdale, Swanston, Little Lonsdale and Russell Streets. The original sale arrangements involved 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 to be paid in June 1999.

4.24 Under the arrangements, the title of the property was not to transfer to the developer until the full price was paid or a guarantee to a value equal to the unpaid purchase price was lodged.

4.25 In 1992-93, the developer entered into a joint venture arrangement with a third party to facilitate the development of the hospital site. Subsequently, the developer submitted a proposal to the Government for the redevelopment of the Regent Theatre. This proposal involved the provision of financial support by the Government through the application of $12.5 million of the Queen Victoria site sale proceeds towards the redevelopment. In January 1993, an *in-principle* approval was given by the Government to this proposal, conditional upon, inter alia, the accelerated settlement of the balance of the Queen Victoria Hospital sale price, adjusted to reflect its present value.

4.26 **The sale of the Queen Victoria Hospital was finalised in April 1994, with the receipt by the Consolidated Fund of $12.5 million representing the present value of the outstanding principle of $21.8 million, originally due for payment in June 1999.**

4.27 The Government and the Melbourne City Council formally entered into arrangements with the developer in April 1994 under which the Government and the Council each acquired a 50 per cent ownership interest in the refurbished Regent Theatre by each contributing $12.5 million towards its redevelopment. Under the arrangements, the developer has entered into a 50 year commercial lease agreement with the Government and the Council to manage the Theatre. The term of the lease may be reduced to 10 years if a proposed hotel development on the Melbourne City Square site does not proceed within 4 years.

Government Employee Housing Authority

4.28 The Government Employee Housing Authority (GEHA) was established in 1981 to provide housing for government employees in areas where reasonable private housing was not available. However, with the trend of government services being centralised in provincial cities and larger country towns where there are generally well established private housing markets, in recent years the demand for houses owned by GEHA has reduced.

4.29 To effect the wind-down of GEHA operations, in 1993-94 a program was commenced under which its housing assets are to be progressively sold. **During the year, 830 properties were sold by GEHA, realising $43 million. These proceeds were applied toward the retirement of the Authority's outstanding borrowings of $20.5 million and the part repayment of equity to the Consolidated Fund of $22.5 million.**

Sale of business assets

Privatisation of TAB businesses

4.30 The Totalizator Agency Board of Victoria (TAB) was established in 1961 to conduct off-course wagering on thoroughbred, harness and greyhound racing. Subsequently, the TAB was authorised to conduct fixed odds betting on sporting and other events, and operate gaming machines and conduct keno games in licensed clubs and hotels. The TAB also operated on-course totalizators on thoroughbred, harness and greyhound racing as agent of racing clubs.

4.31 To enable the TAB to raise much needed capital to finance the growth in its business and to respond to the increasing competition in the gaming industry, in December 1993 the Government announced its intention to privatise the TAB. At the same time, the Government commenced negotiations with the racing industry to establish mutually acceptable arrangements whereby a new publicly-owned company would acquire and conduct its wagering and gaming activities. These negotiations were completed in March 1994 when the Government and racing industry entered into a memorandum of understanding which provided for:

- 100 per cent of the TAB's businesses to be floated on the Australian stock exchange;
- a new company, TABCORP Holdings Limited (TABCORP), and its subsidiaries to enter into a joint venture agreement with VicRacing Pty Ltd (VicRacing), a company established by the racing industry, under which it was to be entitled to a 25 per cent share in the income generated and expenditure incurred by TABCORP in the conduct of the gambling activities previously undertaken by the TAB; and
- a management committee, with equal representation from TABCORP and VicRacing, to oversee the conduct of TABCORP's activities previously undertaken by the TAB.

4.32 In April 1994, TABCORP was incorporated as a company and in June 1994 it was granted the sole licence permitting it to conduct:

- off-course wagering in Victoria, on throughbred, harness and greyhound racing in Australia and New Zealand, for the next 18 years;
- wagering and fixed odds betting on sporting events in Victoria; and
- on-course wagering in its own right on thoroughbred, harness and greyhound racing, rather than as the agent of the relevant racing club which was the case with the TAB.

4.33 In addition, TABCORP was granted one of two licences to conduct gaming in licenced clubs and hotels in Victoria under the *Gaming Machine Control Act* 1991 and conduct Keno games under the *Club Keno Act* 1993.

4.34 As part of the new arrangements, the State wagering tax rate was reduced to a single rate of 28.2 per cent of totalizator turnover less dividends paid, and 20 per cent of fixed odds betting revenue. Previously, the tax rate varied depending on the type of bet made and was based solely on turnover. The new tax rate is approximately equal to 4.5 per cent of turnover as opposed to the old tax regime which on average equated to 6.6 per cent. The State's share of gaming machine revenue remained unchanged at 33.3 per cent for licensed clubs and 41.7 per cent for hotel venues.

TABCORP Headquarters, Queens Road, Melbourne.

Key elements of the float

4.35 The prospectus for the float of TABCORP was lodged with the Australian Securities Commission on 1 July 1994, inviting applications from the public and institutional investors to subscribe to a total of 300 million shares, with certain restrictions specified for maximum permissible levels of share holdings.

4.36 The prospectus provided for an Employee Share Loan Plan whereby TABCORP was to finance employee share acquisitions through the provision of interest-free loans, up to a maximum of 3 per cent of its issued share capital. The managing director of TABCORP was also entitled to apply for 500 000 shares over the next 5 years on the same conditions as were to apply under the TABCORP Employee Share Loan Plan. The Department of the Treasury advised that, some 2030 employees were allotted 1.3 million shares, including 100 000 shares issued to the managing director, to a value of $3 million.

4.37 The managing director was further entitled to 3 million shares (one per cent of the float), with one cent per share to be funded by the managing director and the balance provided by TABCORP as an interest-free loan, with it retaining a security interest over the shares until the loan is repaid. The managing director subsequently took up this offer.

Proceeds from the float

4.38 Under the arrangements, 300 million shares were offered for subscription, at an application price of $2.70 per share in relation to the public offer, while Australian and international institutions, and members of the Australian Stock Exchange, were invited to submit bids in the range of $2.25 to $2.70 per share. On the basis of the maximum application price ($2.70 per share), the proceeds of the issue would have amounted to $810 million and were to be applied as follows:

- $77.9 million to pay the TAB for certain net operating assets transferred to TABCORP; and
- $732.1 million to the State in consideration for the granting of the wagering and gaming licences to TABCORP.

4.39 However, the actual amount to be paid to the State for the licences was dependent on the final price determined for the shares. In accordance with the terms of the prospectus, the final price of the share offer was to be set by TABCORP within the range of $2.25 and $2.70 per share, after evaluation of the public subscriptions and the institutional bids received. Any difference between the final price and the price paid by shareholders on application was to be refunded to the applicants. In these circumstances, the actual amount paid to the State for the licences was expected to range between the maximum of $732.1 million and a minimum of $597.1 million. The Government's April 1994 *Autumn Economic Statement* indicated that the Government expected to receive from the float estimated receipts of $600 million.

4.40 **The final price of $2.25 per share was announced by TABCORP on 15 August 1994. As a result, a total of $675 million was raised from the float, with approximately $78 million paid to the TAB and $597 million paid to the State.** This was $135 million less than the maximum amount that could have been received by the State when TABCORP was floated.

4.41 The amount of $78 million paid to the TAB from the proceeds of the share issue was actually applied as follows:

- $46 million to repay the borrowings of the TAB, plus accumulated interest;
- $20 million to VicRacing relating to certain statutory obligations; and
- $12 million to the State.

4.42 Accordingly, **in total the State received $609 million from the privatisation of the TAB businesses. At the date of preparation of this Report, an amount of $13 million had been paid by the State and the TAB in relation to the costs associated with the float, leaving a net benefit to the State from this transaction of around $596 million.** Table 4F outlines the costs paid associated with the privatisation of the TAB businesses.

TABLE 4F
COSTS ASSOCIATED WITH FLOAT
($million)

Item	*Amount*
Consultancies and brokerage fees	11
Printing	1
Other	1
Total	13

4.43 **At the date of preparation of this Report, further claims in relation to the float were still to be finalised. Therefore I am unable to provide to the Parliament the final net benefit to the State from this transaction.** The Department of Treasury estimates the final cost of the float to be $19.5 million representing 2.9 per cent of the float raisings.

Remaining obligations of the State

4.44 Under the *Gaming and Betting Act* 1994, provision is made for the Treasurer to make a direction in relation to property, rights and obligations to be retained by the TAB and not to be transferred to TABCORP. A direction was signed by the Treasurer on 12 August 1994, under which the TAB retained the following assets and obligations:

- cash and short-term investments;
- statutory obligations to the racing industry;
- borrowings owing to the Treasury Corporation of Victoria; and
- contingent liabilities.

4.45 As mentioned previously, part of the proceeds from the TABCORP share issue were applied by the TAB for the payment of outstanding statutory obligations to the racing industry and the repayment of borrowings. Accordingly, the remaining obligations of the TAB related to its contingent liabilities. At the date of preparation of this Report there were a number of outstanding commercial disputes involving the TAB. However, the potential financial impact of these actions could not be reliably determined.

Heatane sale

4.46 In the April 1993 *Statement on Victoria's Financial Management Strategy*, the Government foreshadowed major reforms to Victoria's energy industry, aimed at achieving greater efficiencies from the available State resources, increased consumer choice through the introduction of competitive market forces and lower State debt levels. Consistent with these objectives, the Heatane Division (Heatane) of the Gas and Fuel Corporation of Victoria (the Corporation) was identified as a non-core government business suitable for sale.

4.47 Heatane was the leading marketer of liquefied petroleum gas (LPG) supplying bulk gas to industrial and commercial consumers throughout Victoria and southern New South Wales, in addition to supplying domestic consumers with bottled gas through a network of dealers. It was also a major supplier of LPG to the automotive market.

4.48 In February 1993, the Government sought expressions of interest for the acquisition of Heatane from 7 companies involved in the gas industry, and in April 1993 received firm offers from 4 of these companies. Following the evaluation of the offers received, **Elgas Ltd, a company incorporated in New South Wales, was selected as the preferred bidder for the acquisition of Heatane, for an agreed purchase price of $129.5 million.**

4.49 In May 1993, Cabinet formally approved the sale of Heatane to Elgas Ltd and a contract of sale was executed. In accordance with the terms of the contract, on 30 June 1993 the proceeds from the sale of $129.5 million were paid to the Corporation.

4.50 During 1993-94, an aggregate dividend of $245 million was paid by the Corporation to the Consolidated Fund, which was $145 million higher than that paid in the previous year. The increased dividend during 1993-94 substantially reflected the on-passing of the Heatane net sale proceeds to the Consolidated Fund.

4.51 **The most recent financial statements of the Corporation prior to the sale, incorporated a carrying value of Heatane's net assets of $51 million, which compared favourably with the purchase price.**

VicComputing

4.52 VicComputing was a division of the Department of Finance, providing various computer bureau services to government agencies. Consistent with the Government's policy of out-sourcing non-core activities, in June 1994 the Department entered into arrangements to sell VicComputing to a private operator. The major determinants for this decision were its diminishing clientele and its cost of operations. The operating results of VicComputing for the previous 2 years were losses of $3.6 million in 1993-94 and $178 000 in 1992-93, with further losses projected for future years.

4.53 VicComputing was offered for sale by public tender in October 1993. The Department engaged consultants to assist in the evaluation of the tenders received, with the sale of VicComputing completed in June 1994. One of the key factors for the selection of the successful tenderer was its ability to provide flexible and higher quality services to government agencies.

4.54 The sale of VicComputing involved the following arrangements:

- sale of certain non-computing assets which were independently valued at $596 000, for a price of $135 000;
- the State remaining the lessee for the 3 major computer leases relating to equipment used for VicComputing operations, resulting in a net exposure to the Government of $2.1 million for these leases;
- the purchaser lodging a bank guarantee of $500 000 in favour of the Government in respect of outstanding lease commitments; and
- the payment of royalties to the State, estimated at $400 000 over a 3 year period.

4.55 Based on the above arrangements, it is anticipated that the sale of VicComputing will result in an estimated net cost to the State of around $2.2 million over the next 3 years. This compares to a cost projected by the Government of between $6.9 million to $9.1 million (in constant dollar terms) if VicComputing operations continued into the future.

Morwell Briquette and Power Station

4.56 The Morwell Briquette and Power Station complex (MBP) has operated since the 1950s as a division of the State Electricity Commission of Victoria (SECV), manufacturing brown coal briquettes for industrial, domestic and export markets, and generating electricity for local consumption. However, in recent years there has been a contraction in the domestic briquette market, resulting in MBP incurring substantial losses, with further losses projected into the future.

4.57 In view of the important role that the briquette industry plays in the economic future of the La Trobe Valley, and as part of the restructure of Victoria's electricity supply industry, the Government in October 1993 established arrangements to separate the MBP from the SECV and to merge its operations with the briquette marketing functions of the Coal Corporation of Victoria, to form a new State body, Energy Brix Australia (EBA). The key task to be tackled by the EBA is to turn the business from being a financial drain on the State to a profitable world class enterprise drawing export earnings and industry to Victoria.

4.58 Integral to the restructure was the provision of a financial support package by the SECV and the State, over a period of 3 years, which involved:

- Payment of $62 million compensation by the SECV to the Consolidated Fund, in respect of operating losses that the SECV would otherwise have incurred from the MBP's ongoing operations and costs anticipated to be incurred in respect of employee redundancy, site demolition and clean-up if the MBP site was closed. **In 1993-94, the Consolidated Fund received $34 million by way of compensation, with the balance of $28 million expected in 1994-95**;
- Financial assistance in respect of EBA's operating and capital expenditure, capped to $60.4 million over the 3 year period to 1995-96. This assistance was anticipated to be $53 million from the State, and $7.4 million from the SECV via electricity pricing arrangements. **In 1993-94, the Consolidated Fund provided $15.2 million to the EBA by way of financial assistance**; and
- Issue by the Treasurer of conditional indemnities to the SECV and EBA, for future clean-up and decommissioning costs. The indemnities provided were conditional upon receipt of independent confirmation by the State that an SECV assessment of environmental risks associated with the Morwell site provided an appropriate basis to accurately quantify future environmental liabilities. However, an independent assessment in January 1994 concluded that this was not the case. At the date of preparation of this Report, negotiations were continuing between the Government and the successor bodies of the SECV to determine the level of exposure under the indemnities.

4.59 The overall effect of the restructure has been that while the State is to receive compensation of $62 million, it is obligated to provide financial support to EBA, capped at $60.4 million over 3 years, to facilitate its conversion into a profit making organisation. The State has also conditionally indemnified the SECV and EBA against costs associated with the eventual clean-up and decontamination of the site, if a decision is taken in the future to close down the EBA's operations.

4.60 It is the Government's intention to review the financial standing of the EBA by mid-1995, to assist in determining its future.

Public Authority contributions

4.61 Dividends and statutory contributions are received annually by the Consolidated Fund from various public bodies under the *Public Authorities (Dividends) Act* 1983, the *State Owned Enterprises Act* 1992 and other specific legislation, and by virtue of the State's equity holdings in the Portland Smelter Unit Trust. **During 1993-94, the Consolidated Fund received $2 billion from this source (including a special dividend of $1.2 billion from the Transport Accident Commission). This represented an increase of $1.4 billion compared to the amount received in the previous year.**

4.62 Table 4G provides a summary of public authority dividends and statutory contributions received by the Consolidated Fund in the past 2 years.

TABLE 4G
PUBLIC AUTHORITY DIVIDENDS AND STATUTORY CONTRIBUTIONS, 1992-93 AND 1993-94
($million)

Business enterprises	*Actual 1992-93*	***Actual 1993-94***	*Budget 1993-94*	***Variance from previous year***
Transport Accident Commission	92	**1 274**	74	**1 182**
Gas and Fuel Corporation of Victoria	101	**245**	245	**144**
State Electricity Commission of Victoria	179	**225**	213	**46**
Melbourne Water Corporation	152	**205**	205	**53**
Other	97	**71**	72	**(26)**
Total *(a)(b)*	621	**2 020**	809	**1 399**

(a) Excludes payments relating to the wind-up of the Victorian Equity Trust, which are of a capital nature.
(b) Excludes statutory contributions relating to a share of natural gas revenues from the Gas and Fuel Corporation of Victoria, which are disclosed as taxation revenue in the Finance Statement.

4.63 The increased collections from dividends and statutory contributions in 1993-94 mainly resulted from:

- A Government decision to reduce the net assets of the Transport Accident Commission, through a payment of $1.2 billion to the Consolidated Fund during the year, with an additional payment of $300 million expected in 1994-95;
- The full year effect of special dividends introduced by the Government in 1992-93, payable by the State Electricity Commission of Victoria, the Gas and Fuel Corporation of Victoria, the Melbourne Water Corporation and various non-metropolitan water authorities. These dividends totalled $182 million in the year ($97 million, 1992-93) and were financed from increased public 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; and
- An additional dividend from the Gas and Fuel Corporation of Victoria mainly relating to the sale of its Heatane Division in 1993, which yielded a return of $129 million.

4.64 As referred to in my October 1993 *Report on the Finance Statement*, the Government introduced a tax equivalent system from 1 July 1993 to form the basis for determining future taxation contribution levels for the State's major public bodies. The tax equivalent system, which is based on the Commonwealth taxation regime, was introduced to bring Government Business Enterprises into line with the private sector and encourage a more commercial approach to their operations. At the date of preparation of this Report, the State Electricity Commission of Victoria, Melbourne Water Corporation, Gas and Fuel Corporation of Victoria, Transport Accident Commission, Urban Land Authority and the Rural Finance Corporation were subject to tax equivalent payments. Total payments to the Consolidated Fund under these arrangements are projected by the Department of the Treasury at $178 million during 1994-95.

4.65 In the 1994-95 Budget Papers, the Government announced its intention to broaden the tax equivalent base by extending the coverage of the tax framework to public bodies which are currently exempt, and to introduce a sales tax equivalent regime.

4.66 In addition to the broadened tax equivalent system, the Government has indicated that public bodies will be required to pay dividends determined on a more commercial basis, on after-tax profits, in future years.

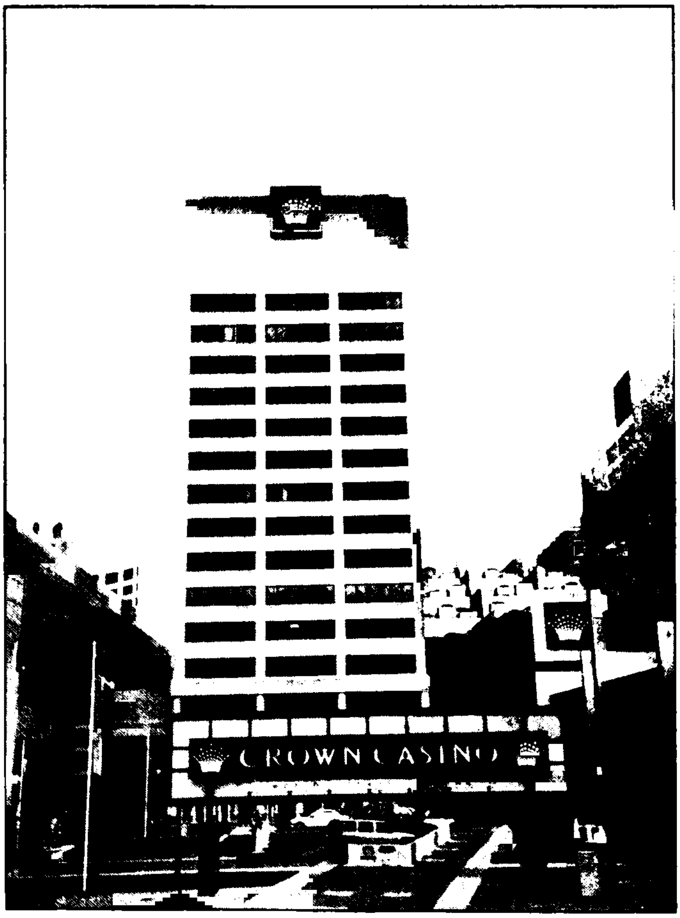
Major new revenue sources for 1993-94

Casino revenues

4.67 The establishment of a casino within Victoria commenced with the passing by the Parliament in October 1991 of the *Casino Control Act* 1991. Under the Act, the Victorian Casino Control Authority was established with the principal objective of administering and maintaining systems for the licensing, supervision and control of casinos in Victoria. The State's control over all gaming and betting was subsequently consolidated through the establishment of a new public authority, the Victorian Casino and Gaming Authority, under the *Gaming and Betting Act* 1994.

4.68 The most important and immediate task of the Casino Control Authority was overseeing the establishment of Victoria's first casino. Specialist staff and consultants were engaged to provide advice and services related to the selection of the most suitable applicant for a casino licence, covering such areas as financial and legal issues, probity investigations, and considerations relating to architectural, traffic, town planning, engineering and tourism matters.

4.69 Following a detailed selection process, in September 1993 the Minister for Gaming, on the recommendation of the Authority, awarded the casino operator's licence to Crown Casino Ltd. For the purpose of this Report, audit did not undertake an examination of the selection process.



Temporary Casino, World Trade Centre.

4.70 The terms and conditions for the operation of the casino, including details of taxes, fees and charges payable to the State by the operator, were embodied in the *Casino (Management Agreement) Act* 1993, which was passed by the Parliament in November 1993. The Act provided for the establishment of a temporary casino within the World Trade Centre while a permanent casino was constructed. The temporary casino opened to the public on 1 July 1994, with the permanent casino scheduled to open on 1 July 1996. Under the provisions of the Act, the casino operator will incur a penalty of $50 000 per day, payable to the State, for any unapproved delay in the commencement of operations of the permanent casino.

4.71 Table 4H summarises the fee structure imposed on the operator of the new casino, together with the revenues received by the Consolidated Fund in 1993-94 and those projected for 1994-95.

TABLE 4H
CONSOLIDATED FUND REVENUE FROM CASINO, 1993-94 AND 1994-95
($million)

Item	***1993-94 Actual***	*1994-95 Estimate*
Fixed payments	**200.0**	26.4
Taxation	-	57.1
Community benefits levy	-	2.9
Supervision levy	**5.0**	5.0
Employee levy	**0.4**	0.2
Total	**205.4**	**91.6**

4.72 The nature of each of the fees imposed on the casino operator, under the *Casino (Management Agreement) Act* 1993, are as follows:

- *Fixed payments* involve the payment of a premium of $200 million in 1993-94 on the granting of the casino licence and 24 fixed payments of $2.4 million per month, commencing in August 1994. The premium payment of $200 million was received by the Consolidated Fund in 1993-94, with $26.4 million in further fixed payments expected to be received in 1994-95;
- *Taxation* payments involve a 20 per cent tax imposed on the operator's gross gaming revenue. The tax rate rises to 21.25 per cent with effect from 1 July 1997. Total collections from this source are projected at $57.1 million in 1994-95;
- *Community Benefits Levy*, which is equivalent to one per cent of the operator's gross gaming revenue, is payable to the Consolidated Fund, for on-passing to the Hospitals and Charities Fund which is used to finance public health services. Revenues from this source are estimated at $2.9 million in 1994-95;
- *Supervisory Levy* of $5 million is payable annually to the Consolidated Fund for the first 4 years of the casino's operations to cover costs associated with the supervision of operations; and
- *Employee levy* is payable to the Consolidated Fund for the licensing of various casino employees, with estimated revenue from this source projected at $200 000 in 1994-95.

4.73 The Act also provides for the payment of an additional casino tax by the operator when gross gaming revenue exceeds a pre-determined base for each year of operation.

***4.74* As illustrated in the above table, total revenues paid into the Consolidated Fund from the operations of the Crown Casino in 1993-94 totalled $205.4 million, with a further $91.6 million expected for 1994-95.**

Application of casino generated revenues

4.75 The Government has previously announced that the net addition to budget revenues raised from taxes imposed on the new casino are to be dedicated to the funding of major civic projects of strategic significance under its *Agenda 21* program. Accordingly, infrastructure developments under this program are to be undertaken without the necessity of securing new borrowings, which impose additional financial obligations on the State's scarce resources. Projects to be funded from a combination of casino and gaming machine revenues include:

- construction of a new Museum of Victoria adjoining the Exhibition Buildings ($250 million);
- construction of the new Exhibition Centre at the Southbank precinct ($160 million); and
- development of the State Library ($39 million).

Better Roads Fuel levy

4.76 The Better Roads Fuel levy is equivalent to a 3 cents per litre tax on both motor spirit and diesel fuel which was introduced by the Government in August 1993, through the passing by the Parliament of the *Business Franchise (Petroleum Products) (Amendment) Act* 1993. The funds raised by the Consolidated Fund from the imposition of the levy are required to be transferred on a monthly basis to the *Better Roads Victoria Trust Account*, established within the Trust Fund, for application towards road construction and maintenance.

4.77 As detailed in the Government's 1993-94 Budget Papers, two-thirds of the levy is to be applied to metropolitan projects aimed at improving arterial roads and intersections, with the remaining funds to be employed in rural areas for key arterial road improvements, bridge upgradings and reconstruction activities, and works on local roads affected by State Government initiatives.

4.78 During 1993-94, $161 million was raised by the Consolidated Fund from the Better Roads Fuel Levy, of which $147.6 million was transferred to the Trust Fund in the year and the balance transferred in July 1994. At 30 June 1994, $106.8 million of the amount transferred to the Trust Fund in the year remained unspent, mainly due to the time lag between the approval of projects and the commencement of works.

Recall of VDF Capital

4.79 In the April 1993 Economic Statement, the Government announced its intention to wind-up the operations of the Victorian Development Fund (VDF), as part of its overall debt management strategy aimed at centralising all State borrowings to the Treasury Corporation of Victoria (TCV).

4.80 As part of the wind-up of the VDF, the Consolidated Fund received $45 million during 1993-94, representing the repayment of the majority of VDF retained earnings as at 30 June 1994. An amount of $3.6 million, representing the balance of VDF's retained earnings is to be paid to the Consolidated Fund in 1994-95. Further details on the cessation of the VDF's operations are contained in Part 7 of this Report.

Part 5

Consolidated Fund Payments

Part 5

Consolidated Fund Payments

KEY FINDINGS

- The Consolidated Fund payments for the year were $1.2 billion below budget expectations.
  Paras 5.1 to 5.3
- The major expenditure item is salaries and wages, which accounted for $5.5 billion or 31 percent of total payments (1992-93, 38 percent).
  Paras 5.4 to 5.6
- The major focus of the Government's current financial management strategy is to reduce the impact of debt charges on the budget. Workforce reductions and improved debt management are integral elements of the strategy.
  Para. 5.6
- During 1993-94, the budget sector workforce was reduced by 14 300 employees through the implementation of the Government's employee departure programs, at a total cost of $732 million.
  Paras 5.7 to 5.22

Summary of financial transactions

5.1 **The Consolidated Fund payments for the year totalled $17.6 billion, including $15.6 billion relating to annual appropriations and $2 billion relating to special appropriations. This result was $1.2 billion below the budget expectation of $18.8 billion.** Table 5A provides a summary of the year's gross payments.

TABLE 5A
1993-94 BUDGETED AND ACTUAL PAYMENTS
($million)

Item	*1992-93 (a)Actual*	***1993-94 Actual***	*1993-94 (b)Budget*	***Budget Variance***
Recurrent -				
Annual appropriations *(c)*	11 630	**13 438**	14 416	**978**
Special appropriations	2 034	**1 939**	2 010	**71**
Total recurrent	13 664	**15 377**	16 426	**1 049**
Works and services -				
Annual appropriations	2 445	**2 188**	2 331	**143**
Special appropriations	714	**-**	-	**-**
Total works and services	3 159	**2 188**	2 331	**143**
Total payments	16 823	**17 565**	18 757	**1 192**

(a) 1992-93 comparatives have been adjusted to reflect the reclassification of certain items in 1993-94.
(b) Budget Estimates 1993-94, Budget Paper No. 4.
(c) Does not include expenditure on finance charges of $426 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.

5.2 The exercise of expenditure restraint during the year contributed to the achievement by all departments of expenditure results below budget expectations. In particular, the following major factors contributed to the under-expenditure of $1.2 billion in the year:

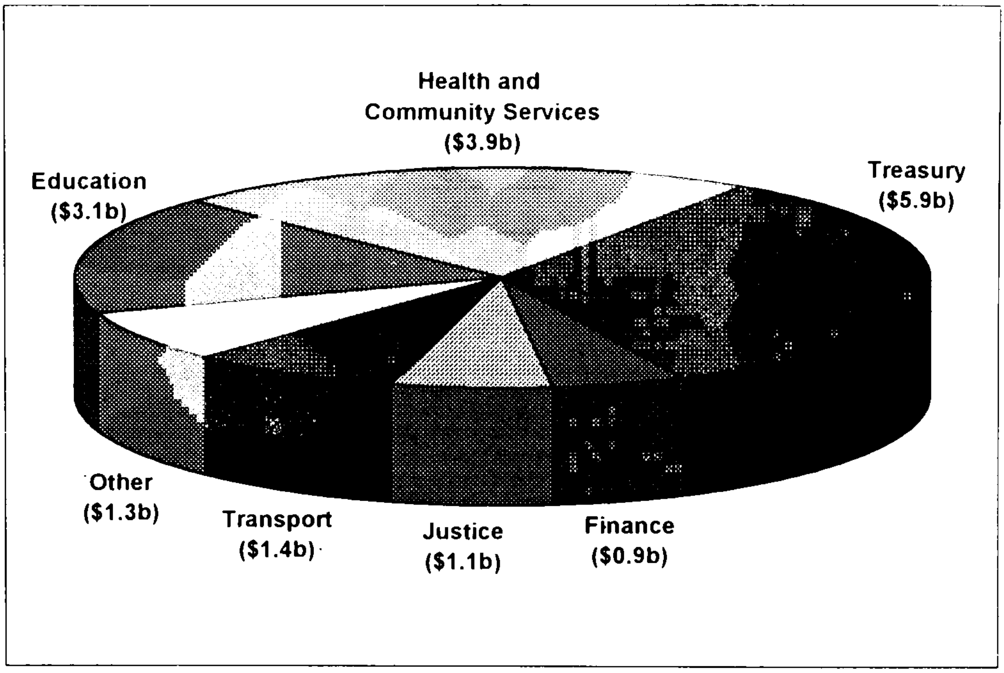
- spending on employee departure programs $568 million below budget, due to a greater than expected utilisation of less costly departure packages;
- postponement to 1994-95 of $143 million of capital works;
- contributions to the Hospitals and Charities Fund $105 million below expectations due to uncertainty over Commonwealth funding levels, resulting in slower than anticipated development and implementation of programs;
- carry-over of $190 million of unspent recurrent appropriations to the 1994-95 financial year;
- $84 million of the Treasurer's advance not required; and
- Government subsidy to Tricontinental lower than anticipated by $57 million due to reduced interest rates and lower borrowing levels.

5.3 These expenditure reductions were to an extent off-set by non-budgeted payments in the year, including the repayment of $22 million of outstanding advances from the Trust Fund to finance Consolidated Fund deficits incurred prior to 1970, and the elimination of prior year expenditure deferral arrangements of $364 million relating to debt payments to the Treasury Corporation of Victoria and grants to non-government schools (referred to in Part 3 of this Report).

Major expenditure categories

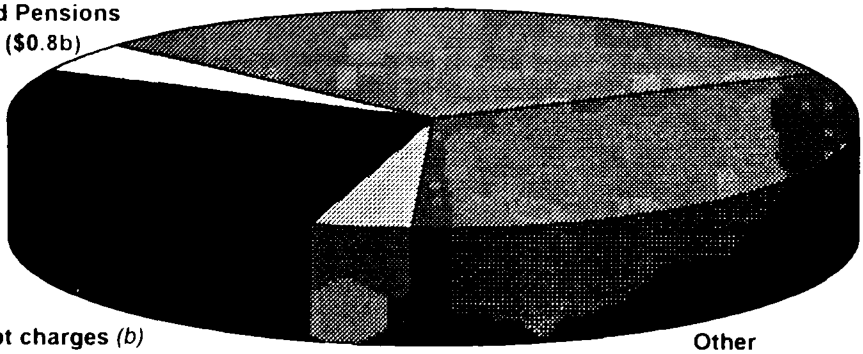
5.4 The portfolios accounting for the major levels of expenditure in the year were Treasury, Health and Community Services, Education, Transport and Justice. These portfolios jointly accounted for 87 per cent of total Consolidated Fund payments during 1993-94. Chart 5B below illustrates this position.

CHART 5B
DEPARTMENTAL EXPENDITURE LEVELS, 1993-94
($billion)



5.5 The major Consolidated Fund expenditure item is salaries and wages, which accounted for around $5.5 billion or 31 per cent of payments in 1993-94 (38 percent, 1992-93). Debt charges, which amounted to $4.8 billion, accounted for 27 per cent of total payments and included a $1.4 billion one-off payment of deferred employer superannuation contributions. Chart 5C shows the major payment categories on a functional basis for the year.

CHART 5C
MAJOR FUNCTIONAL EXPENDITURE CATEGORIES, 1993-94
($billion)



(a) Represents budget sector wages and salary costs as reported in 1994-95 Budget Paper No 2

(b) Debt charges include payments to the Flexible Management Unit Trust and Tricontinental and deferred employer superannuation contributions

5.6 As outlined throughout this Report and in my previous Reports to the Parliament, **the major focus of the Government's current financial management strategy is to reduce the impact of debt charges on the budget through implementation of various initiatives aimed at reducing the level of budget sector liabilities and the sector's reliance on borrowings to finance programs. Workforce reductions, through the provision of employee departure programs, and improved debt management are integral elements of this strategy.**

Voluntary Departure Program

5.7 My October 1992 and October 1993 *Reports on the Finance Statement* commented on the operation of various employee separation programs which operated in 1991-92 and 1992-93 and funded in excess of 25 000 departures from the budget sector, at a cost to the Consolidated Fund of around $970 million. The separation programs involved the provision of redundancy packages to budget sector employees considered surplus to requirements, to enable the downsizing of the sector's workforce and, as a result, a reduction in associated employment costs. The 1993-94 Budget provided an additional $1.3 billion to fund some 14 000 equivalent full-time (EFT) employee departures in the year.

5.8 Two redundancy packages were offered during 1993-94 under the program, namely the Voluntary Departure Package (VDP) and the Targeted Separation Package (TSP). The VDP provided different benefits for employees less than 55 years of age than for employees exceeding this age group. Table 5D provides a summary of the key benefits available under the separation packages offered during the year.

TABLE 5D
SEPARATION PACKAGE DETAILS, 1993-94

Item	*TSP*	*VDP Option 1*	*VDP Option 2*
Age eligibility	n.a	Under 55	Over 55
Package Details *(a) (b)* -			
Weeks pay in lieu of notice	4	4	4
Weeks pay per year of service	2 with max. of 10	2 with max. of 15	1 with max. of 10
Lump sum incentive	-	$10 000	$5 000

(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.

5.9 Although the direct benefits payable to TSP recipients under the separation package were less than those payable to employees accepting the VDP, recipients of the TSP were entitled to superannuation payments at a higher level. However, TSPs were only allowed to be applied to specific areas approved by the Minister for Finance, generally where facilities were to be closed or substantially restructured, functions discontinued or where specific groups of surplus staff had been identified. During the 1993-94 financial year, the vast majority of TSPs were applied to the Transport portfolio, which is undergoing substantial restructure.

5.10 As with previous separation packages, the 1993-94 program guidelines provided that packages were not to be offered to employees in receipt of WorkCare and WorkCover weekly payments, or casual, temporary, contract or other limited tenure employees, for whom alternative means of compulsory separation already existed.

5.11 Also consistent with previous years' programs was the key requirement that recipients of the packages 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. Audit was advised by the Department of the Treasury that this discretion was only used in a small number of instances. However, the re-employment restriction does not prevent package recipients from being engaged as consultants or contractors within the Victorian public sector.

5.12 The 1994-95 Budget indicates that the VDP and TSP will continue to apply to selected departments, with further budget sector workforce reductions of around 5 000 equivalent full-time positions planned for the year, at a cost of $400 million.

5.13 The Workforce Management Unit (WMU) of the Department of the Treasury has continued to have overall responsibility for the management of the employee separation programs.

Departures funded by program in 1993-94

5.14 **During 1993-94, the budget sector workforce was reduced by some 15 300 persons, with 14 302 employee departures funded under the VDP and TSP at a cost of $731.7 million, which was some $568.3 million below the budget estimate.** The balance of departures resulted from natural attrition, including resignations and retirements.

5.15 The key reason for the achievement of the substantial budget saving on the program, as advised by the Department of the Treasury, was the higher than expected utilisation of the less costly departure packages. Table 5E shows the number of departures and the costs associated with each separation package.

TABLE 5E
DEPARTURE PACKAGES AND COSTS, 1993-94 *(a)*

Element	*No. of departures (persons)*	*Cost ($million)*
Voluntary Departure Packages	11 807	382.8
Targeted Separation Packages	2 495	69.4
	14 302	452.2
Superannuation costs		*(b)* 278.8
Administrative costs		0.7
Total program	**14 302**	*(c)* **731.7**

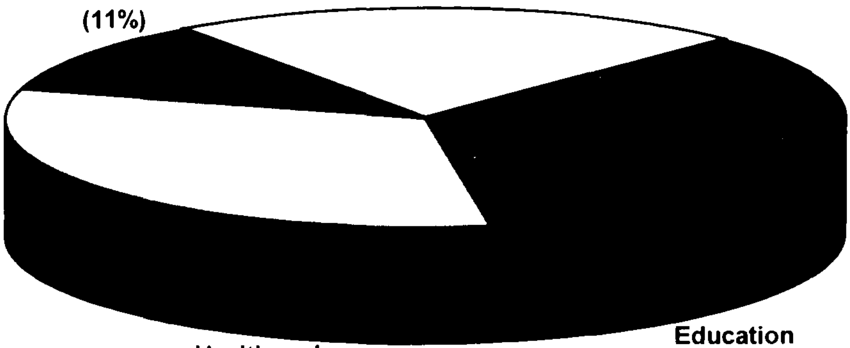
(a) Based on data provided by the WMU.

(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 $230.9 million, Transport Superannuation Fund of $46.8 million and the State Employees Retirement Benefits Scheme (SERBS) of $1.1 million.

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

5.16 Departures financed by the program in 1993-94 were mainly related to employees in the Transport, Education and Health and Community Services portfolios, as illustrated in Chart 5F.

CHART 5F
DEPARTURE PACKAGES, BY MINISTERIAL PORTFOLIO
(per cent)



5.17 The average cost per separation package (not including accrued annual leave and superannuation entitlements) in 1993-94 was $31 600, compared to $25 600 in the previous year. The Department of the Treasury advised that the increase in the average cost was mainly due to the use of TSPs for full time employees in the Transport portfolio in the year, whereas such payments in the previous year were made mainly to part-time school cleaners.

Anticipated cost savings from program

5.18 The ultimate impact of the program, which resulted in increased Consolidated Fund expenditure and borrowings of $732 million in the year, needs to be assessed against the savings accruing from a reduced workforce, in terms of decreased employment costs. In this regard, the Department of the Treasury has estimated that budget sector workforce reductions achieved through the program which was implemented in the year have resulted in savings of around $187 million in 1993-94 and on-going annual savings of around $429 million. Based on these estimates, the Department has projected that the voluntary departure program will be cost-neutral by the end of the 1994-95 financial year and the targeted separation program will be cost neutral in 3 to 3.5 years. After this period, significant benefits in terms of reduced government outlays are anticipated to accrue to the budget sector.

5.19 **However, achievement of the projected budget sector expenditure savings from the program is ultimately dependent on the success of government strategies to maintain the reduced workforce levels achieved to date and effectively manage the use of consultants and contractors.**

5.20 Strategies implemented by the Government to preserve the savings from the program include:

- reductions in departmental budgets equivalent to the ongoing salary and on-cost of employees who accepted the package;
- a restriction against the re-employment of package recipients within a period of 3 years; and
- the filling of staff vacancies, wherever possible, by the redeployment of surplus public service staff and the overall monitoring of all employment vacancies by the Department of the Treasury's Workforce Management Unit.

5.21 The success of these strategies can be assessed with reference to the movements in the levels of budget sector employment and related costs, which are summarised in Table 5G.

TABLE 5G
BUDGET SECTOR EMPLOYMENT LEVELS AND COSTS, 1991-92 to 1994-95

	Employment (a)		*Costs (b)*	
Year	*EFT*	*% variation*	*$million*	*% variation*
1991-92	195 347	-	5 988	-
1992-93	173 092	(11)	5 872	(2)
1993-94	159 044	(8)	5 527	(6)
1994-95	(est.)154 000	(3)	*(c)* 5 525	-

(a) Based on data provided by the Department of the Treasury.

(b) Represents budget sector current outlays on wages and salaries, as presented in 1994-95 Budget Paper No. 2. These figures do not include employment costs of the Public Transport Corporation which, from 1993-94 was classified as a non-budget sector body.

(c) Includes the effect of a projected 3 per cent increase in wages and salaries in the year.

5.22 The table indicates that the level of budget sector employees reduced by around 14 000 EFT during 1993-94, while operating salary and wages costs reduced by around $345 million during the same period. It is projected that, during 1994-95, budget sector employment levels will fall by a further 5 000 EFT. **The Government strategies have resulted in a significant reduction in employment numbers and associated costs, and employee related liabilities.**

Part 6

Budget Sector Assets

Part 6

Budget Sector Assets

KEY FINDINGS

- Given the significant deficiencies in the recording and reporting of budget sector assets, it is vital that the positive momentum that currently exists to address the deficiencies in the area continues.

  Paras 6.1 to 6.9

- Accrual accounting once fully implemented by departments will lead to significant improvements in budget sector accountability and performance monitoring.

  Paras 6.10 to 6.12

- While the implementation of accrual reporting by departments will facilitate the introduction of whole of government reporting, there is a need for the Government to establish a firm timetable for its timely introduction.

  Paras 6.13 to 6.18

Progress towards establishment of comprehensive asset information

6.1 My previous Reports to the Parliament have highlighted that 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 include a balance sheet, an operating statement and a statement of cash flows prepared in accordance with Australian Accounting Standards. However, the absence of comprehensive information on departmental asset holdings and extensive delays in the recording and valuation of non-current physical assets have hampered the preparation of comprehensive financial statements.

6.2 In late 1992-93, the Department of Finance commenced action to establish a comprehensive central register of physical assets controlled by budget sector bodies, with the objective of recording the full details of all asset holdings, including information on asset locations and values, by June 1996. This information is planned to be used for insurance purposes, the preparation of departmental accrual based financial statements and to facilitate the creation of a statewide digital map of total State land holdings to assist in the effective management of these assets.

6.3 The process established to achieve the above objective involves 4 stages, the first 2 of which were completed at 30 June 1994 and involved the collation and recording of information relating to individual assets which had an estimated value in excess of $250 000. The Department of Finance has now moved to stage 3 of its plan, which involves the collation and recording of further information in relation to the above assets which includes their condition and utilisation.

6.4 Stage 4 of the project which is due to be completed by June 1996, to coincide with the full implementation of accrual accounting by all government departments, involves the validation of information recorded on the asset register, particularly asset valuations. A Draft Technical Information Paper entitled *Valuation Methodologies for Non-Current Physical Assets* which was issued in May 1994 is currently being finalised by the Department, which will outline the principles that are to be applied for the valuation of assets such as land, buildings, infrastructure, plant and equipment, heritage assets, natural resources and roads. The Department envisages that this paper will be issued in October 1994.

6.5 In addition to the positive work being undertaken by the Department of Finance to ensure the establishment of a comprehensive record of departmental asset holdings, the Department of the Treasury, through its co-ordination of the expenditure and asset management project of the Government's Management Improvement Initiative (MII), is also carrying out extensive work in the area of asset management. A key goal of the project is to promote the optimal holdings and use of public assets and, in particular to:

- develop standards and where necessary procedures for departments to undertake and be accountable for effective asset planning, management and performance; and
- implement an improved planning, evaluation and budgeting process for capital expenditure proposals.

6.6 The strategy adopted by the MII project team for the achievement of this goal involves the development of:

- principles for the management of assets, for adoption across the public sector; and
- policies and practices relating to the management of all classes of assets, and specific classes of assets.

6.7 A draft paper entitled *Asset Management Principles: Guide for Agencies* has been developed by the MII project team which addresses a wide range of asset accountability and management issues. The Department envisages that the paper will be released to Government agencies by October 1994.

6.8 The Department of the Treasury has also proposed that, from 1994-95, a capital charge will be introduced to encourage departments to optimise the utilisation of assets and to dispose of assets that do not effectively contribute to service delivery. In the 1994-95 Budget Papers, the Government has indicated, for the current year and 1995-96, that this charge will be based on the level of State-funded capital outlays of each department. It is anticipated that, from 1996-97 when asset registers are finalised and accrual reporting is implemented by all departments, the capital charge will be based on the total value of assets.

6.9 **Given the importance of maintaining accurate asset information for effective management and financial reporting purposes, it is vital that the positive momentum that currently exists to address the significant deficiencies in this area continues.**

Status of accrual accounting by departments

6.10 My previous Reports on the Finance Statement and my May 1994 Report on Ministerial Portfolios, commented on the introduction of accrual accounting for government departments. The current 3 year staged program, established by the Government in April 1993, provides for all departments to be in a position to prepare accrual financial statements, in a form suitable for audit, for the 1995-96 financial year. The Department of Finance has progressively issued various *Accrual Guidance Releases* and in June 1994 issued an *Accrual Accounting Manual* to assist departments with the implementation of accrual accounting.

6.11 Under the current implementation program, accrual based financial statements, for the 1993-94 financial year, of 3 administrative units will be subject to audit, with a further 9 administrative units producing unaudited financial statements, which will be subject to audit in the subsequent year. The balance of administrative units will not be required to produce financial statements suitable for audit until the 1995-96 financial year.

6.12 **Accrual accounting, once fully implemented will lead to significant improvements in budget sector financial accountability and performance monitoring. As previously recommended in my Reports to the Parliament, 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.**

Need for Whole of Government Reporting

6.13 For many years my Reports to the Parliament have advocated the adoption of consolidated whole of government financial reports to enhance the level of accountability over government operations. In its May 1993 Report, the Victorian Commission of Audit also recommended the adoption of whole of government financial reporting, in accordance with Australian Accounting Standards, to improve the State's financial management and accountability framework. This recommendation, together with other key recommendations of the Commission relating to the State's budget and financial management framework, was further supported by the Parliament's Public Accounts and Estimates Committee, which, in its May 1994 report, recommended that:

> *"the Government make a commitment to the introduction of whole of government reporting at the earliest possible practical opportunity which should be no later than 1995-96. A detailed timetable should be drawn up to include all implementation issues which need to be worked through, including a 'pilot' whole of government financial statement by 1994-95 ...".*

6.14 **While the implementation of accrual reporting by departments will facilitate the introduction of whole of government reporting, a timetable is yet to be established by the Government for the implementation of this consolidated form of reporting.**

6.15 Consolidated information presented by the Government in relation to the financial operations and affairs of the State is applied by users, which include the Parliament, Loan Council, taxpayers, financial analysts and the media, for various purposes including assessments of:

- operating performance of the State, including whether sufficient revenues are raised to finance recurrent operations;
- financial position of the State, including the level of resources and obligations;
- government resource allocation decisions, including priorities for the funding of programs; and
- extent of government borrowing and investing activities.

6.16 While the financial reports of individual public sector agencies assist users in assessing the financial standing of such agencies, they do not provide a clear and concise picture of the overall financial position and operating result of the State. **In the absence of comprehensive consolidated information on the total revenues and expenses of government operations, and the assets and financial obligations of the State, the Government and the Parliament are making decisions relating to the State's current and future financing activities and strategies, and on resource application and allocation issues, without access to complete information.**

6.17 Whole of government financial reports are currently prepared by a number of other jurisdictions, including New South Wales and New Zealand. The significant benefits which accrued to these jurisdictions from the presentation of this information included:

- provision of transparent reporting, enabling taxpayers to determine how their taxes were spent and what their future obligations were likely to be, including the financial implications and long-term sustainability of Government policies;
- presentation of a more accurate picture of the financial result of government activities through the elimination of inter-entity transactions;

- presentation of a single set of concise and meaningful financial statements, which allowed assessments to be made on the government stewardship of public resources and therefore enhanced accountability to the Parliament and taxpayers; and
- more responsible decision making and improved financial management, including the imposition of a stronger discipline on public sector managers to more effectively manage public assets as inefficiencies were more readily identifiable.

6.18 **Given the significant benefits available from the introduction of whole of government reporting for the State, the least of which is enhanced accountability over government operations, there is a need for the Government to establish a firm timetable for its timely introduction.**

Identification of surplus assets

6.19 My previous Reports on the Finance Statement have commented on the management of the Government's asset sales program, which has operated since 1986-87 and has raised in excess of $1 billion to 30 June 1994.

6.20 According to Department of Finance records, at 30 June 1994, approximately 3 350 properties with an aggregate estimated value of $230 million ($401 million, 1992-93) had been identified as surplus to government requirements and were awaiting sale. Table 6A shows the periods that these assets were identified as surplus to requirements and approved for sale.

TABLE 6A
ASSETS AWAITING SALE,
AT 30 JUNE 1994
($million)

Year approved for sale	*Estimated value*
Prior to 1990-91	24.6
1990-91	44.9
1991-92	51.7
1992-93	34.5
1993-94	74.1
Total	**229.8**

6.21 The key reasons, as advised by the Department of Finance, for deferring the sale of surplus assets, were:

- the on-going depressed state of the commercial property market;
- low demand for development properties; and
- poor quality of assets within the portfolio.

6.22 The Government estimates that the disposal of surplus assets in 1994-95 will generate revenue of $142 million.

Part 7

Liabilities and Commitments

Part 7

Liabilities and Commitments

KEY FINDINGS

- At 30 June 1994, the liabilities of the State totalled $66.9 billion, compared with $72.4 billion as at 30 June 1993.

  Paras 7.5 to 7.6
- The reduction of the State's liabilities of $5.5 billion during the year was due primarily to the lower level of employee liabilities including unfunded superannuation.

  Para. 7.7
- The Finance Statement discloses details of the liabilities of the budget sector, non-budget sector and public financial enterprises. It will not be until consolidated information on both the State's total assets and liabilities is presented that meaningful analyses can be undertaken of the State's financial standing.

  Paras 7.1 to 7.4
- The Government has still not disclosed as a liability the Accelerated Infrastructure Program, valued at $205 million.

  Paras 7.24 to 7.29
- Taxpayers were required to finance the shortfall of $98.5 million of repayments to Victorian Equity Trust unit holders.

  Paras 7.30 to 7.34
- The Government restructure of the Portland Smelter Unit Trust resulted in the State assuming responsibility for $274 million of its debt and the extinguishment of the State's obligations to the Trust of $144 million.

  Paras 7.58 to 7.65
- The State's exposure under the flexible electricity tariff arrangements is estimated by the Department of the Treasury to be around $1.6 billion as at 30 June 1994.

  Paras 7.66 to 7.70
- The unfunded liabilities of Superannuation Funds principally operated for budget sector employees reduced by around 20 per cent during the year, from $18.2 billion at 30 June 1994 to $14.6 billion at 30 June 1993.

  Paras 7.77 to 7.87
- To provide the Parliament with comprehensive information regarding total budget sector financial obligations, information on capital commitments should be disclosed within the Finance Statement.

  Paras 7.110 to 7.111

KEY FINDINGS - continued

- While some action was taken by the Department of the Treasury to address the deficiencies in the recording and monitoring of the State's contingent liabilities, I still cannot provide assurance to the Parliament as to the full extent of these liabilities.

  Paras 7.112 to 7.118

- Audit was advised that, at the date of preparation of this Report, franchise fees for the staging of the Grand Prix had not been paid by the Government or its associated companies.

  Paras 7.121 to 7.128

- The Department of the Treasury advised that a financial analysis was undertaken by the Department prior to the issue of indemnities to assess any consequent risks to the State relating to the staging of the Grand Prix. However, no evidence was made available to audit to support this statement.

  Paras 7.129 to 7.134

- The State contributed $55.8 million to the National Tennis Centre Trust as part of the restructuring of the Trust's financing arrangements.

  Paras 7.141 to 7.149

AGGREGATE LIABILITIES OF THE STATE

7.1 The critical issue confronting the Government in recent years has been the increasing impact of budget sector liabilities on the State's financial operations and the strategic management of such liabilities. The Government has responded to this issue by introducing various measures aimed at raising revenue and curtailing expenditure, reducing the growth in unfunded superannuation liabilities and improving debt management, together with a reform program involving the restructuring and privatisation of public business enterprises.

7.2 Given the strategic importance of the effective management of budget sector liabilities to government operations, a key focus of my previous Reports on the Finance Statement has been the presentation and analysis of the aggregate liabilities and other financial commitments of the budget sector.

7.3 While in previous years the Finance Statement has provided information on the liabilities and other financial commitments of the budget sector, **a positive initiative is the disclosure in the 1993-94 Finance Statement of financial information in relation to the non-budget sector and public financial enterprises. This additional information is aimed at enhancing the disclosure of the total liabilities and other commitments of the State and is a step towards whole of government reporting.**

7.4 **However, it will not be until consolidated information on both the State's total assets and liabilities is presented in the Finance Statement that meaningful analyses can be undertaken of the State's financial standing.**

7.5 **The consolidated liabilities of the State at 30 June 1994, which include the liabilities of the budget sector, the non-budget sector and public financial enterprises, net of inter-entity balances, stood at around $66.9 billion (30 June 1993, $72.4 billion).** These figures have been generally derived from information included in the Finance Statement, which does not include the liabilities of Universities, and public sector entities with liabilities of less than $5 million.

7.6 Table 7A illustrates the composition of the State's liabilities at 30 June 1994.

TABLE 7A
COMPOSITION OF STATE LIABILITIES
AS AT 30 JUNE 1994
($billion)

Item	***1994***	*1993*
Budget Sector	**39.3**	*42.9*
Non-Budget Sector	**20.9**	*20.8*
Financial Institutions	**41.8**	*36.0*
Inter-sector balances	**(35.1)**	*(27.3)*
Total liabilities of the State	**66.9**	***72.4***

7.7 **The reduction of $5.5 billion during the year in the liabilities of the State was due primarily to the lower level of employee liabilities, comprising unfunded superannuation and other accrued leave entitlements.** This reduction mainly reflects the impact of a smaller workforce brought about by the implementation of the Government's employment departure programs and the impact of the Government's superannuation reforms introduced in 1993-94.

BUDGET SECTOR LIABILITIES AND COMMITMENTS

7.8 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 section of the Report.

7.9 Part B of **the Finance Statement discloses that, at 30 June 1994, the liabilities of the budget sector stood at around $42 billion (30 June 1993, $45.2 billion).**

7.10 **However, in my opinion, these liabilities have been overstated by $2.7 billion (30 June 1993, $2.3 billion) as they include unfunded superannuation liabilities of $2.9 billion (30 June 1993, $2.5 billion) relating to employees engaged outside the budget sector, but do not include the financial obligations relating to the Accelerated Infrastructure Program, amounting to $205 million** (for further comment on this matter refer to paragraphs 7.12 to 7.14).

7.11 At **30 June 1994, budget sector liabilities as determined by audit totalled $39.3 billion (30 June 1993, $42.9 billion).** Table 7B provides a summary of budget sector liabilities, and the sector's total financial commitments (relating to operating leases and contracted capital works) and contingent liabilities.

TABLE 7B
BUDGET SECTOR LIABILITIES AND COMMITMENTS
($billion)

Item	***1994***	*1993*
Liabilities		
Borrowings *(a)*	**22.1**	*20.5*
Accrued interest on borrowings	**0.6**	*0.6*
	22.7	*21.1*
Unfunded superannuation liabilities *(b)*	**11.7**	*15.7*
Flexible electricity tariff obligations to Portland and Point Henry aluminium smelters	**1.6**	*1.7*
Employee related entitlements	**1.2**	*1.3*
Tricontinental Group deficiency	**0.9**	*1.5*
Infrastructure projects (World Congress Centre and St. Vincent's Hospital)	**0.2**	*0.2*
Accelerated Infrastructure Program *(c)*	**0.2**	*0.2*
Creditors and other liabilities *(d)*	**0.8**	*1.2*
Total budget sector liabilities	**39.3**	***42.9***
Financial commitments *(e)*	**1.2**	***1.3***
Contingent liabilities	**19.9**	***21.4***

(a) Borrowings are disclosed at their historical capital value (capital proceeds plus amortised discount/premium).

(b) Based on latest actuarial estimates of unfunded superannuation liabilities. Unfunded liabilities of Superannuation Funds operated principally for budget sector employees totalled $14.6 billion (30 June 1993 $18.2 billion). However, this amount included $2.9 billion (30 June 1993, $2.5 billion) relating to employees engaged within the non-budget sector. For the purpose of identification of budget sector liabilities, these amounts have been excluded from the figures in the 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 of departments and other liabilities of budget sector public bodies.

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

Overstatement of budget sector liabilities

7.12 The major differences between the value of budget sector liabilities as determined by audit and that presented in the Finance Statement relate to the apportionment of unfunded employee superannuation liabilities between the budget and non-budget sectors and the treatment of financial obligations arising from the Accelerated Infrastructure Program.

7.13 As explained in the Finance Statement, the unfunded liabilities of Superannuation Funds operated principally for budget sector employees, include obligations of $2.9 billion relating to employees not engaged within the sector, such as those engaged in Colleges and Universities. While these obligations have been included as part of budget sector liabilities in the Finance Statement, in my opinion, they are more appropriately attributed to the non-budget sector where the costs have been incurred.

7.14 The financial obligations arising from the Accelerated Infrastructure Program have been presented by the Department of the Treasury within Table B.17 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, on the basis that the financial arrangements under the 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. This view was also 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. Further comment on the Accelerated Infrastructure Program is provided in paragraphs 7.24 to 7.29 of this Report.

Analysis of budget sector liabilities and commitments

7.15 A more detailed analysis of the key components of budget sector liabilities and financial commitments, at 30 June 1994, is included in the following sections:

- Budget sector borrowings *(paras 7.16 to 7.46)*;
- Other liabilities *(paras 7.47 to 7.76)*;
- Unfunded superannuation liabilities *(paras 7.77 to 7.87)*;
- Finance charges *(paras 7.88 to 7.106)*;
- Financial commitments *(paras 7.107 to 7.111)*;
- Contingent liabilities *(paras 7.112 to 7.173).*

BUDGET SECTOR BORROWINGS

Level of budget sector borrowings

7.16 **The accumulated borrowings of the budget sector, as determined by audit, at 30 June 1994 amounted to $22.1 billion, a net increase of $1.6 billion since the previous year.** Table 7C provides a summary of the major movements in the level of budget sector borrowings during the year.

TABLE 7C
MOVEMENTS IN BUDGET SECTOR BORROWINGS
($million)

Item			*Amount*
Public Account -			
Borrowings at 1 July 1993 *(a)*			20 159
Add -			
New borrowings paid to Public Account	**1 289**		
Borrowings raised and held by TCV on behalf of the State for future application	**559**		
Assumption of borrowings during 1993-94 *(b)*	**777**		
Indexation, (premium) and discount	**(24)**		
Book losses on borrowings refinanced during the year *(c)*	**246**		
Borrowings arising from interest swap transactions	**16**	2 863	
Less -			
Debt redemptions by Consolidated Fund *(d)*	**1 145**		
Debt redemptions outside Consolidated Fund	**40**	1 185	1 678
Total Public Account borrowings at 30 June 1994			21 837
Budget sector statutory authorities *(a)*-			
Borrowings at 1 July 1993		312	
Net borrowings in 1993-94		(27)	
Total budget sector statutory authority borrowings at 30 June 1994			285
Total budget sector borrowings at 30 June 1994 *(e)*			**22 122**

(a) Represents the historical capital value of borrowings (capital proceeds plus amortised discount/premium). In previous years, borrowings were disclosed in the Finance Statement at their face value.

(b) Includes borrowings assumed from Tricontinental ($500 million), Aluminium Smelters of Victoria ($274 million) and Geelong Regional Commission ($2.8 million).

(c) Represents the difference between the historical capital value of borrowings refinanced during the year and the capital value of the new borrowings.

(d) Includes an amount of $263 million representing capitalised accrued interest on zero coupon borrowings repaid in the year.

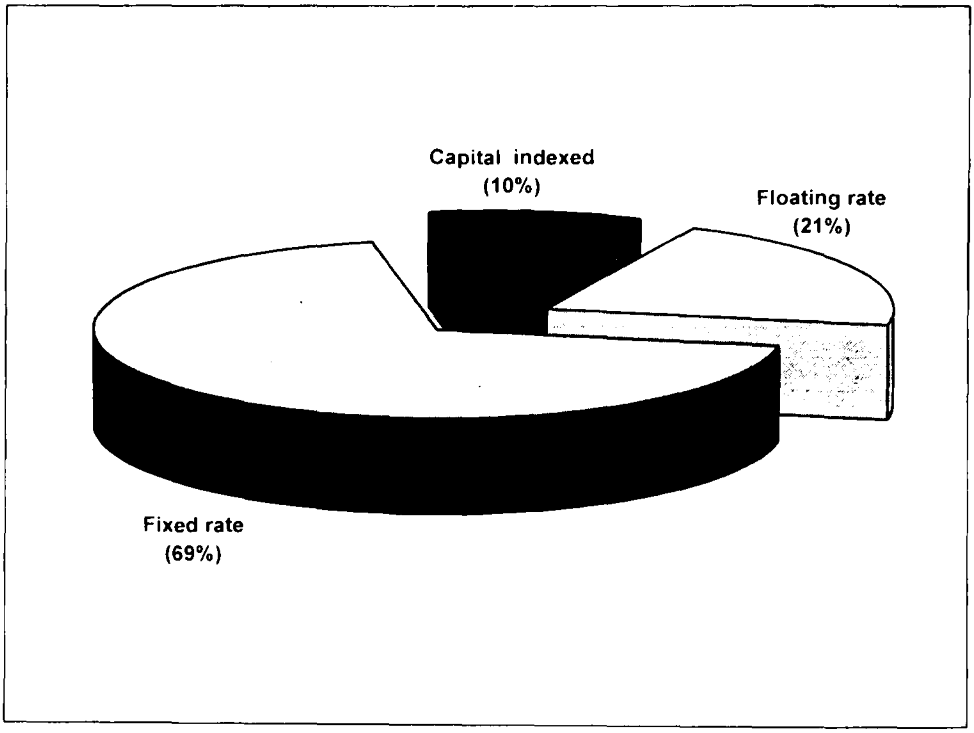
(e) The difference of $16 million between this balance and that presented in Table B.5 of the Finance Statement relates to in-substance borrowings arising from an interest swap transaction entered into in 1989-90 involving up-front receipts. This amount has been included by the Department of the Treasury within Table B.10 of the Finance Statement as part of accrued interest.

Borrowing composition and maturity profile

7.17 As explained in previous Reports on the Finance Statement, the borrowing portfolio mix and maturity structure are significant determinants of the State's financing requirements in any one year, the level of financing costs and the State's exposure to adverse movements in interest rates. To minimise interest costs, the State undertakes borrowings in various forms, commonly referred to as fixed rate, floating rate and capital indexed borrowings, with these complemented, as deemed appropriate, by the use of various debt management instruments. 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.

7.18 Chart 7D shows the composition of budget sector borrowings at 30 June 1994.

CHART 7D
COMPOSITION OF BUDGET SECTOR
BORROWINGS, AT 30 JUNE 1994
(per cent)



7.19 The high percentage of fixed rate instruments within the budget sector's borrowings portfolio, as illustrated in the above chart, 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 impacting on the budget. **At 30 June 1994, fixed rate instruments accounted for around 69 per cent of total budget sector borrowings.**

7.20 Consistent with a Government decision to discontinue the use of zero coupon borrowings, in June 1994 such borrowings with a value of $241 million were refinanced, resulting in the reduction in the level of outstanding borrowings in zero coupon bonds at 30 June 1994 to only $7.4 million.

7.21 Under current administrative arrangements, the Treasury Corporation of Victoria (TCV) is responsible for the management of the budget sector debt portfolio, within specific parameters outlined in a 3 year portfolio management plan approved by the Treasurer. This plan sets out the objectives and constraints that are to apply to the management of the portfolio, including targets for its progressive diversification over the 3 year period to 30 June 1996. Table 7E shows the targeted mix of borrowings to be raised on behalf of the budget sector during 1993-94, and the mix of borrowings actually raised during the year.

TABLE 7E
TARGETED AND ACTUAL MIX OF BORROWINGS RAISED IN 1993-94
(per cent)

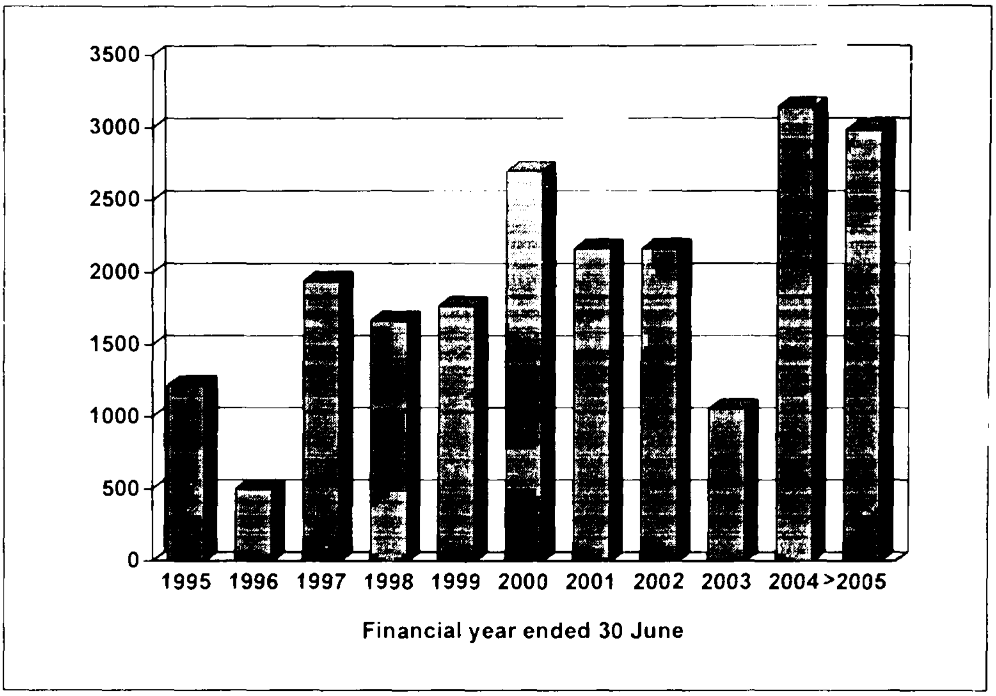
Type of borrowing	*Targeted*	*Actual 1993-94*
Fixed rate	70	75
Capital indexed	15	13
Floating rate	15	12

7.22 The Department of the Treasury advised that the variation between the established targets and actual borrowings raised in the year occurred mainly due to the favourable opportunities available during the year to raise fixed borrowing instruments and to refinance its zero coupon borrowings.

Maturity profile

7.23 An analysis of the budget sector borrowings portfolio at 30 June 1994 indicates that around 86 per cent or $18.4 billion of the portfolio will mature and require repayment or refinancing in the next 10 years. **During 1994-95, $1.2 billion will require repayment or refinancing.** Chart 7F illustrates the maturity profile.

CHART 7F
MATURITY PROFILE OF BUDGET SECTOR
BORROWINGS AT 30 JUNE 1994 *(a)*
($million)



(a) Borrowings are shown in the Chart at their face value.

Accelerated Infrastructure Program

7.24 My previous Reports on the Finance Statement have commented on the Accelerated Infrastructure Program, and in particular the financial obligations of the budget sector arising from the arrangements established under the program.

7.25 The Accelerated Infrastructure Program was established in 1990-91 by the State in conjunction with a major private bank to provide accommodation to government agencies, principally for police stations and law courts. It was intended to cover around 30 projects across Victoria at a cost of approximately $300 million over a 3 to 5 year period. The arrangements under the program involve the lease by the Government of buildings constructed by a special purpose public company established by a subsidiary of the bank. In particular, the program involves:

- 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 arrangements for terms of around 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 bonds raised by the company, **effectively negating the company's financing risk**; and
- the company providing the Government with a first right to purchase the buildings on expiration of the initial lease period.

7.26 **At 30 June 1994, the total amount raised by the company from the issue of bonds was $205 million,** with no new raisings and no further projects commenced during the 1993-94 financial year. However, the company completed construction of 9 buildings upon which construction commenced in previous years, bringing to 12 the total number of buildings completed and leased under the program to 30 June 1994. The projects completed in the year were:

- Police and court complexes at Dandenong, Craigieburn, Moorabbin, Williamstown, Melton, South Morang and Keilor Downs at an aggregate cost of $55.5 million;
- Werribee Hospital, at a cost of $17 million; and
- Dandenong health centre, at a cost of $2.8 million.

7.27 As mentioned in my October 1993 Report, the Minister for Police and Emergency Services in 1992-93 initiated a review of the future operation of this program. At the date of this Report, a decision had not been made by the Government as to the future of the program. Consequently, the financing company continues to hold some $85 million in uncommitted funds previously raised through the issue of capital indexed bonds. The company has invested these funds and is awaiting Government direction as to their future application. As stated in my previous Report, **any shortfall between investment earnings and financing costs payable to bond holders relating to the uncommitted funds will ultimately be met by Victorian taxpayers.**

7.28 The Government has disclosed its obligations under this program as operating lease commitments. However, **it is my view that the financing arrangements constitute, in substance, finance leases**. This view is based on the following key considerations:

- the lease arrangements are non-cancellable over the initial lease term of around 20 years;
- an indemnity has been provided by the Government 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;
- 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 covers interest and other outgoings of the company, in effect, off-setting the company's exposure to any increases in interest rates; and
- the initial lease terms of around 20 years together with the additional optional terms of 5 years account for a substantial portion of the economic lives of the buildings.

7.29 Based on this assessment, an amount equal to the $205 million raised from the issue of bonds at 30 June 1994 has been included in my calculation of budget sector liabilities, in Table 7B of this Report.

Victorian Equity Trust

7.30 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, the Gas and Fuel Corporation of Victoria and the Melbourne Water Corporation. Table 7G outlines the VET equity investments with each of the publicly owned entities, at the time of its establishment:

TABLE 7G
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**

7.31 My previous reports referred to arrangements established by the Government in June and July 1993 to repay individuals who invested in the VET, principally from borrowings totalling $712 million. It was the Government's intention to wind-up the Trust by redeeming its investment in the abovementioned entities and to apply the funds raised from these redemptions towards the part repayment of these borrowings.

7.32 In the 1992-93 financial year, the Gas and Fuel Corporation of Victoria and the Melbourne Water Corporation made a $164.3 million contribution to the Consolidated Fund for the redemption of all VET units held in these entities. **During 1993-94, the Consolidated Fund received a further $449.2 million relating to the redemption of VET Units**, comprising:

- $120 million from the Portland Smelter Unit Trust; and
- $329.2 million from the State Electricity Commission of Victoria.

7.33 The funds received by the Consolidated Fund over the past 2 financial years were applied toward the part retirement of the borrowings raised by the Government to repurchase the VET units from the public. Table 7H highlights the contribution required by taxpayers to enable the full repayment of the borrowings raised.

TABLE 7H
ULTIMATE FINANCING OF REPAYMENTS TO VET UNIT HOLDERS
($million)

Items		*Amount*
Amount paid by the Government to individuals investing in the VET		712.0
Less - Contributions from publicly-owned entities -		
equivalent to initial VET investment	*(a)* 490.0	
additional to initial VET investment	*(a)* 123.5	613.5
Contribution by taxpayers		**98.5**

(a) Disclosed in the Finance Statement as "Current Account Financing - Payment on Wind-Up of the Victorian Equity Trust".

7.34 **As the contributions from the publicly-owned entities did not equate to the amount paid to VET unit holders, Victorian taxpayers have been required to finance the shortfall of $98.5 million.**

Wind-up of the Victorian Development Fund

7.35 As part of an overall debt management strategy to progressively centralise all State borrowings to the Treasury Corporation of Victoria (TCV), in April 1993 the Government announced its intention to wind-up the operations of the Victorian Development Fund (VDF). The process to wind-up its operations commenced in the 1992-93 financial year with the extinguishment of all Public Account long-term borrowings with the VDF.

7.36 During the 1993-94 financial year, the assets and liabilities of the VDF were progressively scaled down through the non-acceptance of deposits from public authorities, and the repayment of maturing investments and borrowings.

7.37 In June 1994, the remaining investments and financial obligations of the VDF were assigned to the TCV under contractual agreements between the TCV and the Treasurer. The TCV has now assumed responsibility for managing the cash requirements of the budget sector which was previously undertaken by the VDF.

New Loan Council arrangements

7.38 The Loan Council, which comprises ministerial representatives from the Commonwealth, States and Territories, is responsible for co-ordinating public sector financing to ensure that the overall level of public sector borrowings is consistent with the economic objectives of the Commonwealth Government.

7.39 In 1993-94, the *Financial Agreement Act* 1994 was passed by the Victorian Parliament which authorised a new financial agreement between the Victorian Government, the Commonwealth, other States and Territories, covering inter alia, the role, powers and operation of the Loan Council. The agreement provides for the abolition of the restriction on States to borrow in their own right and the removal of the Commonwealth's explicit power to borrow on behalf of the States. The agreement also formalises the role and operations of the Loan Council, which were previously undertaken on a voluntary basis.

7.40 Under the new arrangements, the Loan Council is responsible for approving annual Loan Council Allocations (LCA) and monitoring the level of financing activity of each jurisdiction against these allocations throughout the year. The LCA covers the net call of each jurisdiction on financial markets, including the financing of public sector deficits or surpluses plus other financing activities. Under the current operating arrangements, LCAs are established after taking into account the sustainability of each jurisdiction's budget and financial strategies and the overall impact of these strategies on financial markets.

7.41 In March 1994, the Loan Council approved new guidelines for the accountability to Loan Council of infrastructure project financing involving the private sector, which require the use of a *risk weighting approach* to determine the impact of such projects on the reported level of financing activity. Implementation of these guidelines in 1994-95 is intended to facilitate improved accountability of each jurisdiction's liabilities in relation to infrastructure projects.

f Capital Works Authority

The Capital Works Authority (CWA) was established in 1985 by an order of the ernor in Council, in response to Loan Council requirements at that time which prevented jurisdictions from borrowing directly in their own names. The principal function of the CWA was to act as agent of the Treasurer for all financial arrangements negotiated, entered into and executed on behalf of the State relating to borrowings.

7.43 Following changes to Loan Council arrangements in 1993-94 which enable jurisdictions to directly raise borrowings, the CWA ceased operations on 31 January 1994 by an order of the Governor in Council. As from February 1994, the Treasurer has borrowed directly from the Treasury Corporation of Victoria in the name of the Treasurer and on behalf of the State of Victoria.

Prudential Supervision of financial institutions

7.44 As a key part of the Government's debt management strategy, the Treasury Corporation of Victoria (TCV) was established in January 1993 as the State's central borrowing authority, to consolidate the State's debt portfolio and provide centralised debt management and other treasury services to the public sector. In March 1993, the Department of the Treasury commissioned a private accounting firm to provide advice on the establishment of a prudential supervision framework over the operations of TCV, to ensure that the Corporation's operations and risks were properly managed and that the Treasurer was in a position to exercise sufficient oversight to ensure the Corporation was operating in a sound and prudential manner.

7.45 In its June 1993 report, the private accounting firm confirmed the proposed implementation of a prudential supervision approach for TCV which was based on that established by the Reserve Bank of Australia in relation to the banking sector. In February 1994, the Treasurer appointed a partner of a major accounting firm to perform the role of prudential supervisor of TCV and to provide regular reports on the financial operations, policies, procedures and prudential standards of the Corporation.

7.46 At the date of preparation of this Report, the Department of the Treasury was in the process of introducing similar prudential supervision arrangements for the financing and investing activities of the Rural Finance Corporation of Victoria, public sector superannuation funds and other public financial institutions.

OTHER LIABILITIES

St. Vincent's Hospital Redevelopment

7.47 In August 1991, the Government entered into a series of complex financial arrangements to fund the redevelopment of part of the St. Vincent's Hospital, which is owned by the Sisters of Charity religious order. A detailed analysis of these arrangements was contained in my October 1992 Report to the Parliament.

7.48 The construction associated with the redevelopment commenced in January 1993 and is expected to be completed by February 1996 at an estimated cost of $146 million. The associated financing arrangements provided for the redevelopment to be initially funded from a combination of borrowings raised by the Hospital ($80 million) and equity finance provided by banks. The servicing of the financial obligations were then to 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 of the Hospital, provided that health services continue to be provided to the public over this period. Ownership of the redevelopment is to be with the banks for the first 15 years of the arrangement and, following a settlement payment will pass to the Sisters of Charity.

7.49 **At 30 June 1994, the Hospital had raised $83.9 million to finance the redevelopment**, comprising $80 million raised through the issue of bonds in 1992-93, and an additional $3.9 million in equity financing provided by the banks during 1993-94. The amount of outstanding financing as at 30 June 1994 has been included as part of budget sector liabilities.

Financial obligations relating to Tricontinental

7.50 As outlined in my previous Reports on the Finance Statement, the State acquired Tricontinental Corporation Limited and became obligated to meet its net deficiency under the arrangements established subsequent to the sale of the State Bank of Victoria in December 1990. As at that date, Tricontinental had a net deficiency of $1.7 billion.

7.51 In 1991-92, the State commenced the provision of an operating subsidy to Tricontinental, principally to finance the shortfall arising between income earned on its loan portfolio and amounts payable on its borrowings. The aim of the subsidy was to assist in the orderly realisation of the loan portfolio. **The total subsidy paid by the Consolidated Fund to Tricontinental to 30 June 1994 totalled $326 million, including an amount of $53 million which was paid during the 1993-94 financial year.**

7.52 The level of the subsidy significantly reduced during 1993-94 compared to that paid in previous years ($150 million in 1991-92 and $123 million in 1992-93), principally due to the lower interest costs incurred as a result of falling interest rates and the reduced level of borrowings as a result of:

- better than anticipated loan recoveries including penalty interest which totalled $292 million in the year, of which $26 million related to loans previously assessed as bad; and
- receipt of a $136 million out-of-court settlement from the previous auditors of Tricontinental in relation to a legal action previously commenced.

7.53 In June 1994, the State assumed $500 million of Tricontinental's borrowings. It is proposed by the Government that the balance of Tricontinental's debt of around $940 million, comprising short term loans and medium term notes, will be assumed by the State prior to the end of 1994.

7.54 As mentioned in my October 1993 Report, litigation was initiated by the State against the former auditors of Tricontinental, seeking $1.1 billion in losses and damages. **In January 1994, an out-of-court settlement of $136 million was reached with the auditors.** The settlement recognised that a commercial resolution of the claim was preferable to engaging in protracted and expensive litigation extending for some years into the future. The payment which was made to Tricontinental in April 1994 was applied towards the reduction of its liabilities.

7.55 **At 30 June 1994, Tricontinental's net deficiency, which is yet to be funded by the State, stood at $856 million (30 June 1993, $1.5 billion).** Table 7I provides details **of the aggregate cost to Victorian taxpayers of Tricontinental's financial demise, which as at 30 June 1994 totalled $2.3 billion.**

TABLE 7I
AGGREGATE COST TO VICTORIAN TAXPAYERS OF TRICONTINENTAL, AT 30 JUNE 1994
($million)

Items		*Amount*
Debt assumed by the State (a)	1065	
Cost of servicing debt assumed	49	
Operating subsidy provided by the Consolidated Fund	326	1 440
Net Deficiency at 30 June 1994 (b)		856
Total cost to Victorian taxpayers		**2 296**

(a) Debt assumed by the State of $1.1 billion comprises $576 million assumed prior to the sale of the State Bank less $11 million subsequently recovered on this portfolio, and $500 million debt assumed during 1993-94.

(b) Disclosed in unaudited management accounts of Tricontinental at 30 June 1994 at $818 million, but adjusted by $38 million to take account of operating subsidy owed by the State.

7.56 Under the Government's financial support package, the State may become responsible for additional obligations arising from Tricontinental's contingent liabilities. Based on information provided by Tricontinental, these contingent liabilities at 30 June 1994 comprised:

- guarantees and letters of credit of $7 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.

7.57 At the date of preparation of this Report, the Government had initiated negotiations with the Rural Finance Corporation to assume responsibility for, and develop a satisfactory agreement with Tricontinental for the future management of its loan portfolio.

Portland Smelter Unit Trust

7.58 The Portland Smelter Unit Trust (PSUT) was established by the Government in 1984 to acquire an interest in a joint venture with Alcoa and other parties relating to the construction and operation of the Portland Aluminium Smelter. As at 30 June 1994, the PSUT held a 25 percent interest in the Portland Aluminium Smelter operation.

7.59 As commented in my previous Report on the Finance Statement, the Government's April 1993 *Statement on Victoria's Financial Management Strategy* outlined a program for the reform of public businesses, including the privatisation of the PSUT. Consistent with this program, a restructure package was approved by the Government in 1993-94 to address the high debt levels of the PSUT and to place the Trust on a more commercial footing.

7.60 The restructure package, which was implemented during the year, involved:

- acquisition of PSUT by Aluminium Smelters of Victoria Pty Ltd (Aluvic), a company wholly-owned by the State, for a part consideration of 307 million $1 ordinary Aluvic shares, held in the name of State Trustees Limited on behalf of the State;
- assumption by the State of $404 million of PSUT debt;
- Aluvic borrowing $130 million without a government guarantee and paying the proceeds to TCV to partly reduce the debt assumed. This payment represented the monetary consideration by Aluvic for the purchase of PSUT;
- PSUT payment of $120 million to the Victorian Equity Trust (VET) for the re-purchase of equity units held by the Trust in PSUT;
- release of the Government from its delayed cost compensation payment obligation to PSUT of $144 million. This obligation resulted from a 1991-92 Government agreement to provide grants to PSUT over a 26 year period, to compensate it for a $180 million payment to the SECV in 1984, on account of lost revenue associated with delays in commissioning the Portland Aluminium Smelter; and
- agreement by Aluvic that no further Government financial support will be required.

7.61 **The effect of the restructure is that the State assumed responsibility for $274 million of PSUT debt and extinguished its obligations to PSUT of $144 million.** In addition, the State received $120 million for the repurchase of VET equity units.

7.62 During the year, Aluvic paid a dividend of $7.2 million to the Consolidated Fund and in the 1994-95 financial year the Government expects to receive a dividend of $23.6 million. The finance costs associated with the debt assumption are to be financed from these dividends.

7.63 Table 7J outlines the financial position and performance of the PSUT for the 3 year period to 30 June 1994.

TABLE 7J
FINANCIAL POSITION AND PERFORMANCE OF THE PORTLAND SMELTER UNIT TRUST
($million)

Item	*1991-92*	*1992-93*	*1993-94*
Assets	800	805	450
Liabilities -			
Borrowings	(406)	(396)	(79)
Other	(97)	(68)	(70)
Net assets	297	341	301
Less deferred cost compensation supported by government	(152)	(144)	-
Net assets, excluding government support	**145**	**197**	**301**
Operating profit	**4**	**26**	**81**

7.64 The above table discloses that PSUT's net asset position improved significantly in 1993-94, which was mainly achieved as a result of the restructure. The PSUT also achieved an operating profit of $81 million during the year ($26 million, 1992-93). The key factors for this improved result, as advised by the Department of the Treasury, were the reduced costs resulting from the restructure, improved aluminium prices and profits arising from foreign exchange dealings.

7.65 In the 1994-95 Budget Papers, the Government has re-affirmed its intention to privatise Aluvic in 1995.

Flexible Tariff Management Unit Trust

7.66 My previous Reports have commented on the flexible electricity tariff arrangements established by the Government in 1984, in relation to the Portland and Point Henry aluminium smelters, and the associated financial obligations and exposures of the State. Under the arrangements, which extend to the year 2017, the Flexible Tariff Unit Trust (FTMUT) has been responsible for meeting the Government's obligation to make payments to the SECV when aluminium prices fall below a stipulated level, or to receive payments from Alcoa and Portland Smelter Services Pty Ltd when prices rise above that level.

7.67 The 1993-94 Budget provided for payments of $229.4 million to be made from the Consolidated Fund to FTMUT to meet the flexible tariff payments to the SECV, together with the financing and administrative costs of the Trust. **Payments actually made by the Consolidated Fund in 1993-94 totalled $211 million (1992-93, $236 million), comprising $198 million of flexible tariff payments to the SECV and $13 million of FTMUT financing and administrative costs.** The $25 million reduction in payments made in the year was principally due to the lower finance charges due to the assumption by the State during the year of FTMUT borrowings of $285 million. Following this assumption, FTMUT was wound-up, with the obligations and exposures relating to the flexible electricity tariff arrangements resting directly with the Consolidated Fund.

7.68 As mentioned in my previous Reports to the Parliament, the State's maximum exposure under the flexible electricity tariff arrangements at 30 June 1992 was estimated to be $2.4 billion. However, this exposure was significantly dependent on the level of future aluminium prices.

7.69 **Based on current expectations of future aluminium prices, the present value of the State's exposure under the arrangements is estimated by the Department of the Treasury to be around $1.6 billion at 30 June 1994.** This amount has been included in Table 7B of the Finance Statement as a part of budget sector liabilities.

7.70 The Government is currently examining various options aimed at reducing both the State's liability under the flexible electricity tariff arrangements and the on-going exposure to changes in aluminium prices.

New Infrastructure Investment Policy

7.71 In recent years there has been an increased involvement of the private sector in the provision of public infrastructure, mainly due to the increased demand for new and upgraded facilities and services, the scarcity of public sector resources and the need to ensure the procurement of such facilities and services in the most cost effective manner. Examples of private sector involvement in the provision of public facilities have been the provision of accommodation facilities under the Accelerated Infrastructure Program and the St Vincent's Hospital Redevelopment.

7.72 In May 1991, the former Government published the *Infrastructure Investment Guidelines* to provide the basis for private sector participation in public infrastructure projects. These guidelines outlined the Government decision making processes and established standards for the preparation and evaluation of bids from the private sector.

7.73 In August 1994, the Government released its *Infrastructure Investment Policy for Victoria*, which outlines the framework to be followed for future infrastructure projects involving private sector participation. The stated objectives of the policy, which is to apply to all projects with a value exceeding $10 million, are to:

- procure assets, and goods and services in the most efficient, cost effective and timely manner;
- take advantage of new technologies and innovations, private sector management skills and a wide range of financing techniques;
- promote the growth of new and existing Victorian businesses and employment; and
- strengthen the State's economy, producing sustainable social, cultural or other quality of life benefits.

7.74 The policy provides that these objectives are to be achieved through the application of a number of principles, which include:

- allocation of risk to those parties which the Government considers are best positioned to assess and manage the risk;
- encouragement of forms of private sector involvement which result in lower costs to Government, taking into account the risks transferred from the Government and the benefits and costs associated with the private sector participation; and
- maintenance of the ability to respond to changing circumstances by avoiding long term inflexible arrangements.

7.75 The policy further provides that the Government will consider mechanisms for sharing and minimising risks. However, risks associated with the design, construction, financing and operation of an infrastructure investment will generally be borne by the private sector.

7.76 The implementation of this policy should provide a sound basis for the development of future partnerships between the Government and the private sector for the provision of public infrastructure. It is further pleasing that the policy addresses the issue of confidentiality agreements entered into by the Government in relation to arrangements established with the private sector, by specifically stating that:

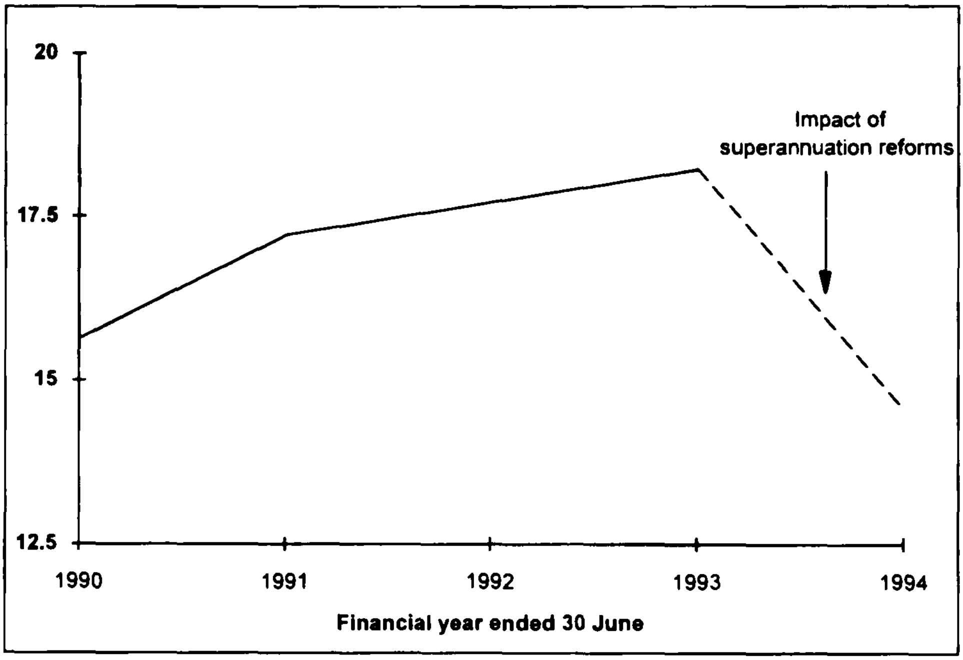
> *"Formal confidentiality agreements relating to commercially sensitive information will be considered when requested by a private sector proponent, but any agreements will have regard to the responsibilities of the Auditor-General, the Freedom of Information Act and Parliament's right to be informed of financial commitments entered into by the Government".*

UNFUNDED SUPERANNUATION LIABILITIES

7.77 Unfunded superannuation 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. These financial obligations represent the second largest component of budget sector liabilities and 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.

7.78 As disclosed in Table B.9 of the Finance Statement, **the unfunded liabilities of Superannuation Funds principally operated for budget sector employees reduced by around 20 per cent during the year, from $18.2 billion at 30 June 1993 to $14.6 billion at 30 June 1994.** Chart 7K shows the movement in the level of these superannuation liabilities over the past 5 years.

CHART 7K
MOVEMENT IN UNFUNDED LIABILITIES OF SUPERANNUATION FUNDS MAINLY OPERATED FOR BUDGET SECTOR EMPLOYEES, 1988-89 TO 1993-94
($billion)



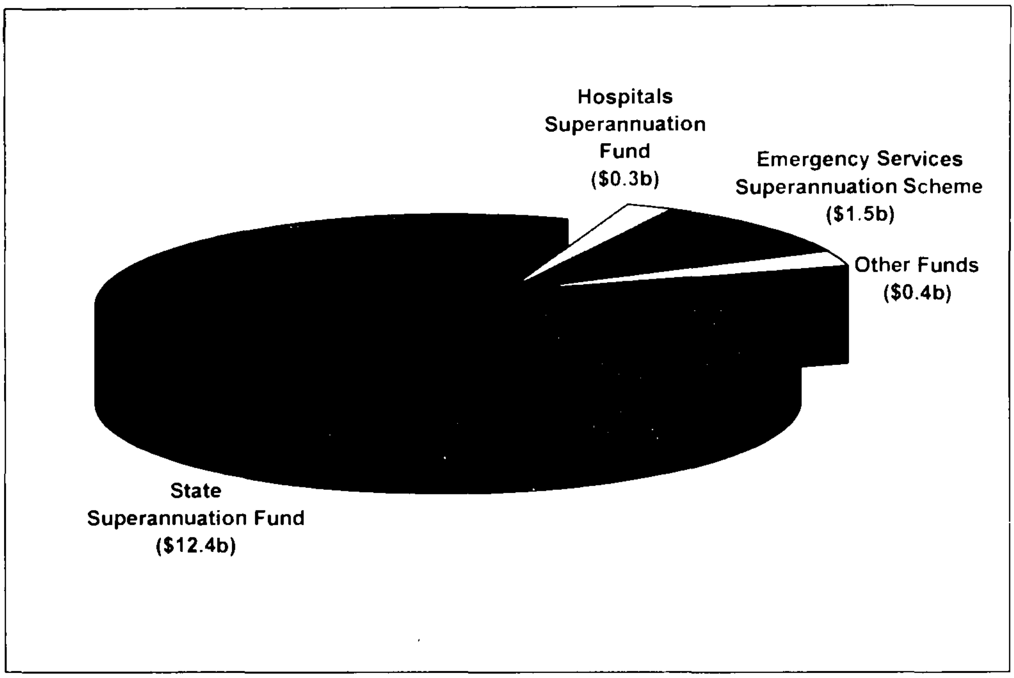
7.79 The substantial reduction in the level of unfunded liabilities of budget sector Superannuation Funds in the year was principally due to:

- a reduction in the budget sector workforce of around 19 per cent since 30 June 1992, resulting from the operation of the Government's employee departure programs;
- the low rate of growth in wages and salaries;

- the effect of the various superannuation reforms introduced by the Government in 1993-94; and
- a one-off contribution of $1.4 billion from the Consolidated Fund to various superannuation schemes in the year to meet the Government's liability for deferred employer contributions.

7.80 Chart 7L illustrates the Superannuation Funds principally responsible for managing the unfunded liabilities in respect of budget sector employees at 30 June 1994.

CHART 7L
UNFUNDED LIABILITIES OF SUPERANNUATION FUNDS MAINLY OPERATED FOR BUDGET SECTOR EMPLOYEES, 30 JUNE 1994
($billion)



7.81 While the unfunded liabilities of Superannuation Funds principally operated for budget sector employees totalled $14.6 billion at 30 June 1994, these unfunded liabilities included $2.9 billion relating to employees not engaged within the budget sector. Therefore, **in my opinion, budget sector liabilities relating to unfunded superannuation at 30 June 1994 totalled $11.7 billion.**

7.82 As stated previously, an important factor contributing to the decline in the budget sector unfunded superannuation liabilities during the year was a one-off payment of $1.4 billion by the Consolidated Fund to meet the Government's liability to various superannuation schemes for deferred employer contributions. This payment extinguished the liability that had arisen from a 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 past 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.

7.83 In the 1993-94 Budget Papers, the Government announced that in future it would meet the employer obligations to the Superannuation Schemes as they emerge.

7.84 As commented in my previous Report on the Finance Statement, the Minister for Finance in April 1993 drew to the Parliament's attention the significant and escalating level of unfunded superannuation liabilities, and the associated adverse impact that these liabilities have on budget sector finances. In the May 1993 *Statement on Victoria's Financial Management Strategy* and the 1993-94 Budget Papers, the Government re-affirmed that the reduction of both public sector superannuation costs and unfunded liabilities was a high priority. The Government also foreshadowed the presentation in the Parliament of legislation during 1993-94 which encompassed various reforms to public sector superannuation schemes, with the key objectives of:

- *containing future budget sector superannuation outlays to a sustainable and affordable level;* and
- *management of the unfunded liabilities in a way which does not increase the burden to future generations.*

7.85 In October 1993, an agreement was entered into between the Government and the Victorian union movement to reform arrangements relating to budget sector superannuation schemes. The reforms outlined in the agreement, which were subsequently embodied in legislation, included:

- 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 entitlements were based;
- future member benefits to be adjusted so that the taxation costs were borne from members' funds and not by the Government;
- pension payments and deferred benefits to be indexed annually, instead of at six-monthly intervals;
- member contributions to the State Superannuation Revised Scheme to be increased;
- future benefits to Members of the Parliament to be reduced by 25 per cent; and
- a number of small budget sector superannuation schemes to be amalgamated.

7.86 Subsequent to the introduction of the reforms, the Insurance and Superannuation Commissioner (ISC) was requested by the Victorian union movement to ratify the validity of the change of semi-annual indexation to annual indexation of pensions. In May 1994, the Commissioner did not approve of this change, thereby reducing the impact of the reforms. The Department of Finance has estimated that the cost to the State of the ISC ruling will be in the order of $135 million over 20 years. As outlined in the 1994-95 Budget Papers, alternative benefit changes are currently being examined by the Government to compensate for these increased costs.

7.87 The immediate impact of the reforms has been to reduce the average superannuation costs to the Government. Table 7M outlines the average employer superannuation costs as a percentage of salaries, prior to and following the implementation of the reforms, for the major superannuation funds.

TABLE 7M
SUPERANNUATION COSTS AS A PERCENTAGE OF SALARY *(a)*

	Member contribution rate - % salary	*Average cost as % of salary*		
		Pre-reform	*Post-reform*	***Reduction***
State Superannuation Fund -				
Revised Scheme	Various	20.5	13.2	**7.3**
New Scheme	0	7.8	7.6	**0.2**
" "	3	9.9	9.1	**0.8**
" "	5	11.3	10.1	**1.2**
Emergency Services Superannuation Scheme	Various	22.0	18.0	**4.0**
Hospital Superannuation Fund	3	10.2	9.4	**0.8**
	6	13.9	12.1	**1.8**

(a) Source: Department of Finance.

FINANCE CHARGES

7.88 Budget sector liabilities, as outlined in Table 7B of this Report, include borrowings and associated accrued interest costs of $22.7 billion. The liability for accrued interest has reduced by $35 million since 30 June 1993 to $565 million at 30 June 1994. This reduction has resulted mainly from the elimination of a previously established arrangement involving the deferral of debt payments to the Treasury Corporation of Victoria (which was referred to in Part 3 of this Report), the restructuring of the budget sector debt profile and lower interest rates in the year.

7.89 Table 7N 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 7N
INTEREST CHARGES ON PUBLIC ACCOUNT BORROWINGS
(EXCLUDES STATUTORY AUTHORITY INTEREST PAYMENTS) *(a)*
($million)

Item	*Interest incurred but not paid at 1 July 1993*	*add 1993-94 interest incurred*	*less 1993-94 interest paid (a)*	*Interest incurred but not paid at 30 June 1994*
Long and medium-term borrowings-				
Treasury Corporation of Victoria (TCV)	824	1 923	2 157	590
Short-term borrowings -				
TCV	-	6	6	-
Other financing *(b)*	14	39	44	9
	838	1 968	2 207	599
Finance charges off-set against borrowings outside the Consolidated Fund by TCV	-	426	426	-
Total interest charges	838	**2 394**	**2 633**	599
Less portion relating to growth of debt (included in borrowings)	238			34
Accrued interest at 30 June	**600**			**565**

(a) The State also made contributions, which included interest charges, to the South Eastern Medical Centre ($21.6 million).

(b) Mainly comprises financing associated with the computer lease facility and World Congress Centre.

Impact of borrowings on the Consolidated Fund

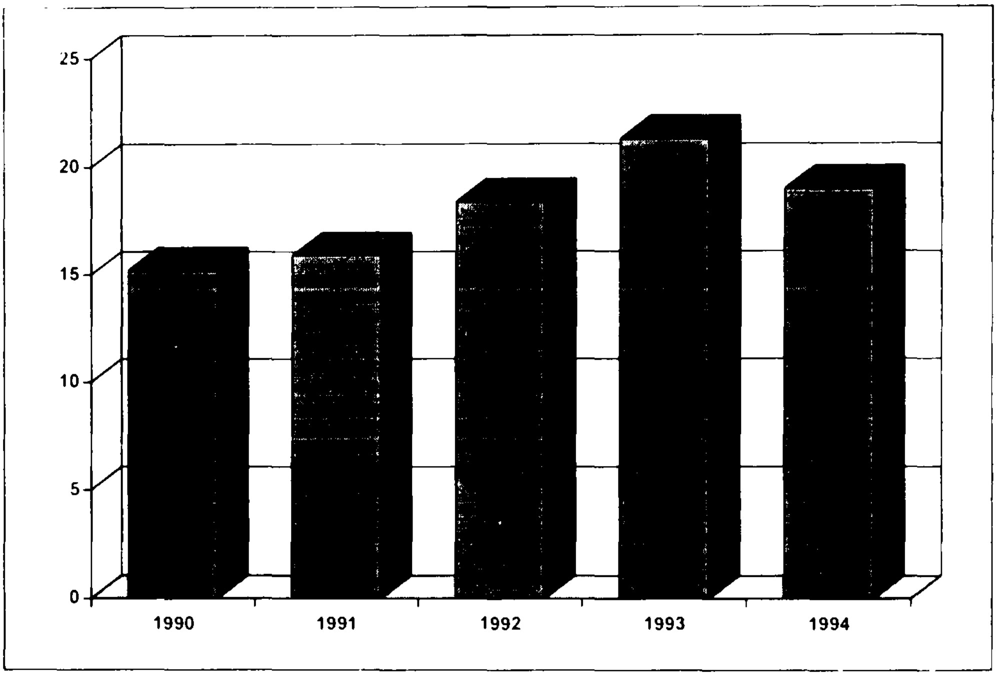
7.90 Finance charges reflect the present burden on taxpayers created by borrowings undertaken by Governments to acquire assets and partly fund government programs. As shown in the above table, the Finance Statement discloses that **finance charges paid in 1993-94 amounted to $2.2 billion (1992-93, $2 billion).** However, as the Statement is prepared on a cash basis of accounting, this figure does not reflect interest incurred but not paid in the period.

7.91 An analysis by audit revealed that **interest incurred in 1993-94 (calculated on an accrual basis) was $2.4 billion (1992-93, $2.2 billion).** The difference of $187 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 ($426 million); and
- the decrease in the year of interest incurred but not paid ($239 million).

7.92 **In 1993-94, finance charges paid represented an annual cost to the community of $589 per capita (1992-93, $523).** Chart 7O highlights the impact of finance costs on the budget, over the past 5 years.

CHART 7O
FINANCE CHARGES PAID 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. Revenue for 1994 included one-off receipts of $1.4 billion.

7.93 My previous Reports have commented on the need for the Finance Statement (or equivalent accountability documents) to 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. **While certain information on finance charges has been included in Budget Papers, the Department of the Treasury has not taken any action to improve disclosure in the Finance Statement.**

State's credit rating

7.94 The State's credit rating, which is generally assessed annually by rating agencies, is a significant determinant of the cost of its borrowings.

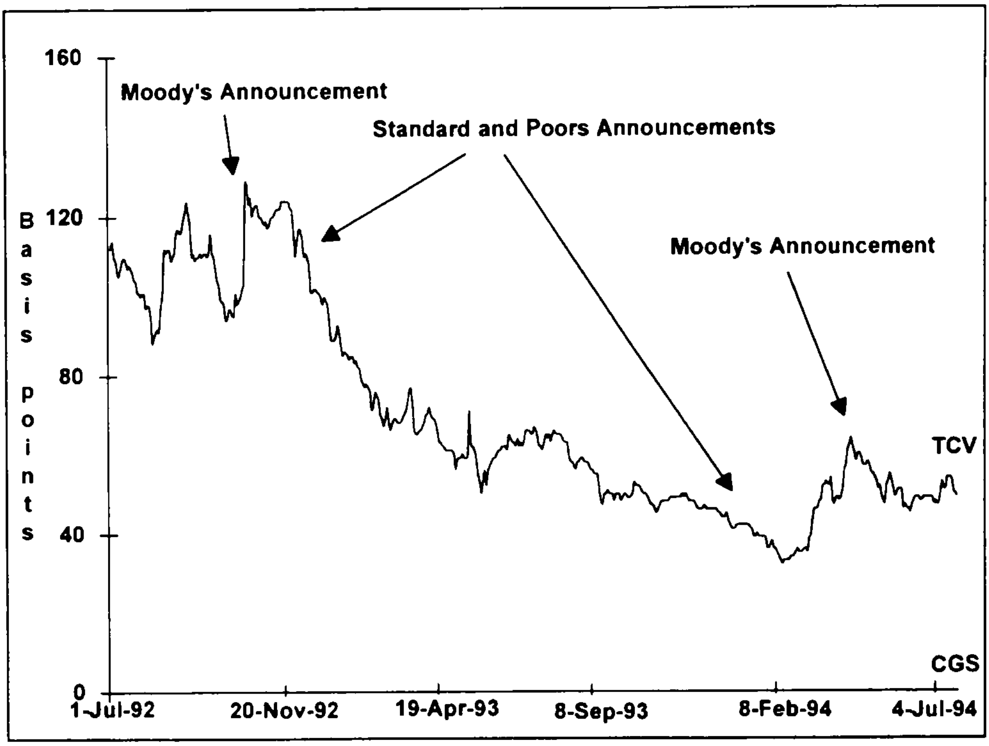
7.95 My October 1991 and 1993 Reports commented on the impact on the State's borrowing costs of the downgradings of the State's long-term debt credit rating by 2 rating agencies. Specifically, the State's rating was downgraded 4 levels by Moody's Investor Services, from Aaa in June 1990 to A1 in October 1992, 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*".

7.96 In its 1992-93 budget, the Government established as one of its key goals the restoration of 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. To enable achievement of this goal, the Government in 1992-93 implemented various expenditure reduction and revenue raising measures. In December 1992, subsequent to the Government's 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*".

7.97 Following the implementation of a number of reforms by the Government, in March 1994, Moody's Investor Services upgraded the long term Victorian debt credit rating from A1 to Aa3, an increase of 1 level, on the basis that "*..policies adopted by the present government since its election in October 1993 have had a surprisingly swift impact. The government put its policies in place early on, and these have resulted in deeper and more radical correction of the State's budget profile than anticipated.*"

7.98 Chart 7P illustrates the impact of the credit rating reviews over the past two years on the State's borrowing costs by highlighting the interest rate differential between the long term borrowings of the Treasury Corporation of Victoria (TCV) and the Commonwealth Government (CGS). Specifically, the chart shows that Victoria is paying higher interest costs compared with the Commonwealth Government.

CHART 7P
HIGHER INTEREST RATES PAYABLE BY VICTORIA ON LONG TERM BORROWINGS AS COMPARED WITH THE COMMONWEALTH GOVERNMENT, 1 JULY 1992 TO 30 JUNE 1994
(basis points)



7.99 The Chart shows that the State's cost differential of raising and refinancing borrowings, compared to the Commonwealth Government, has reduced since 1992 as a result of Victoria's credit rating upgrades and the increased confidence by financial markets in the State's improved financial and economic position. However, a 20 basis point deterioration occurred in the borrowing margin between February 1994 and April 1994. In its *Autumn Economic Statement 1994*, the Government attributed this movement to *the ending of the long bull run in world bond markets...This movement eclipsed the impact of the March 1994 Moody's Investor Services' upgrade, which had been anticipated by financial markets for many months and was reflected in TCV margins prior to the Moody's announcement.*

7.100 To achieve a AAA credit rating within the next 10 years, the Victorian Commission of Audit in its May 1993 Report considered that the minimum performance requirements for the State were to:

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

7.101 As commented earlier, **the Government's budgetary strategies have already impacted favourably on the State's credit rating. A sustained focus on deficit and debt reduction will improve the State's financial position and should assist in the achievement of further improvement in its credit rating.**

Additional financing costs resulting from taxation ruling

7.102 My October 1993 Report commented on a financial arrangement entered into in 1986 by the former Victorian Public Authorities Finance Agency (VicFin) 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. The arrangement was structured 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. In addition, the arrangement included a provision to the investor, by VicFin and ultimately the State, of a guaranteed after-tax rate of return from the annuity.

7.103 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. Under the terms of the financing arrangement, the Consolidated Fund paid $25.5 million to the TCV (the successor to VicFin) to cover the additional costs incurred as a result of the investor's taxation assessment.

7.104 Subsequently, a tax assessment was issued in relation to the 1986-87 year, requiring the payment of additional taxes and penalties totalling $44.9 million. Of this amount, $29.4 million was paid from the Consolidated Fund in 1993-94, with the balance of $15.5 million held in abeyance, without penalty, pending the outcome of an appeal lodged by the investor.

7.105 In December 1993, the Department of the Treasury engaged a consultant to review this financial arrangement and report on the costs and benefits of retaining this borrowing arrangement. In January 1994, the consultant recommended that, based on all taxation scenarios, considerable savings were to be gained by TCV refinancing the annuities. At the date of preparation of this Report, no decision had been made on this matter.

7.106 Taxation assessments, in relation to this arrangement, for years subsequent to 1986-87, are yet to be issued by the Commissioner of Taxation and may result in additional financial obligations on the Consolidated Fund. The outcome of the investor's appeal against the taxation assessments will assist in the clarification of this position.

FINANCIAL COMMITMENTS

7.107 In addition to the financial obligations commented upon earlier in this Part of the Report, the budget sector has entered into a number of arrangements which will impact on the sector's future financial operations. At 30 June 1994, the budget sector had financial commitments relating to operating leases and works not carried out under existing contracts, valued at $1.2 billion (1992-93, $1.3 billion).

Operating lease commitments

7.108 The budget sector's financial commitments include future obligations under operating lease arrangements. Audit examination revealed that such commitments, at 30 June 1994, amounted to $606 million ($751 million, 30 June 1993). Table 7Q details the timing and extent of these commitments.

TABLE 7Q
OPERATING LEASE COMMITMENTS
($million)

Year	*Amount*
1994-95	105
1995-96	88
1996-97	171
1997 onwards	242
Total commitments *(a)*	**606**

(a) The Finance Statement discloses total commitments, excluding those relating to the Accelerated Infrastructure Program which audit regard as liabilities, of $558 million. The $48 million difference between this figure and that disclosed by the Department of the Treasury is mainly due to the Finance Statement not including commitments of certain budget sector bodies, such as hospitals.

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

Capital commitments

7.110 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 1994, amounted to $586 million (30 June 1993, $587 million). Table 7R details the amount and likely timing of these commitments.

TABLE 7R
CAPITAL COMMITMENTS
($million)

Year	*Amount*
1994-95	547
1995-96	16
1996 onwards	23
Total	**586**

7.111 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.**

CONTINGENT LIABILITIES

7.112 Contingent liabilities of the State can be described as potential commitments, the occurrence of which is dependent upon future events or outcomes. Such commitments arise from the provision of guarantees, indemnities, sureties, letters of comfort and other forms of financial support. These 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.

7.113 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. While the above instruments place no immediate demand on the public purse, they are significant as the Government may be required to honour its undertakings many years after such undertakings are given.

7.114 In previous years, I have been unable to provide assurances to the Parliament as to the full extent of the State's contingent obligations, due to deficiencies in the Department of Treasury's processes for recording and monitoring contingent liabilities. As commented in my October 1993 Report, the Department commissioned an accounting firm to review its policies and action plans in August 1993, with the aim of assisting in establishing a sound basis for the accurate reporting of contingent obligations in future years.

7.115 The accounting firm's report on the results of that review in October 1993 confirmed my previous assessments of the position and found that the major deficiency in the Department's processes was that existing processes placed heavy reliance on a survey of inner and outer budget sector agencies, which did not capture all contingent liabilities and tended to focus mainly on debt guarantees and other debt related contingent liabilities. In effect, the survey was used by the department as a data capture process rather than a means of verification of existing information. The review also found that there was a lack of awareness within agencies as to their exposures relating to contingent liabilities.

7.116 A subsequent in-house review by the Department of its contingent liability recording and monitoring processes identified the following additional deficiencies:

- a lack of a comprehensive central recording system;
- comprehensive information of guarantees executed in years prior to 1988-89 not available;
- insufficient information held on securities underlying specific guarantees, and inadequate monitoring of the net asset positions of guaranteed entities; and
- a lack of segregation of duties between officers responsible for the review of applications and the execution of instruments creating contingent liabilities, and the recording, reporting and monitoring of such contingencies.

7.117 Following the finalisation of the above reviews, the Department commenced the following actions during the year to address the major identified deficiencies:

- all Departmental Secretaries were requested, as part of the annual survey process, to advise of all contingent liabilities incurred by their relevant Ministers or on behalf of their departments, and to establish registers of departmental contingent liabilities, placing the onus for the maintenance of comprehensive and accurate information on individual departments. However, audit examination revealed that the majority of departments had not established registers of contingent liabilities during 1993-94;

- development of a policy and procedures manual for the control and monitoring of guarantees and other contingent liabilities. The manual is expected to be submitted for Treasurer's approval in October 1994, prior to release to all departments;
- upgrade the Department of the Treasury of its database during 1994-95, to improve the recording and monitoring of State contingent liabilities.

7.118 While the positive action taken by the Department will assist in the establishment of an accurate record of State contingent liabilities for future periods, **in relation to the position at 30 June 1994, I am again unable to provide assurance to the Parliament as to the full extent of the State's contingent liabilities.**

Government guarantees and indemnities

7.119 **The Finance Statement discloses that the estimated contingent liabilities arising from Government guarantees and indemnities at 30 June 1994 were around $20.2 billion.**

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

Formula One Grand Prix

7.121 In 1991, the Government established Melbourne Major Events Company Limited (MMEC), a company limited by guarantee, to assist the State in identifying and attracting major sporting and cultural events, exhibitions, displays or any other major events which have the capacity to benefit the State. The operations of MMEC have been funded from Government grants, which in 1993-94 totalled $320 000.

7.122 The company's memorandum of association restricts its financial activities in a number of key areas by providing that, without the prior written approval of the Treasurer, it shall not borrow or lend funds, acquire or lease property (except that required for day to day operations), invest funds, provide guarantees or indemnities or distribute any of the property of the company to its members. In addition:

- the Premier is entitled to appoint and remove the Directors;
- the members' liability is limited to $50; and
- in the event that the company is wound up, any surplus of assets over liabilities shall be distributed as determined by the Governor in Council.

7.123 The company has managed to attract several sporting and other events for Melbourne since its establishment, including the 1992 World Cricket Cup final and the 1992 Australian International Airshow and Aerospace Expo. However, securing the Formula One Grand Prix race, the world's premier racing event, for Melbourne has been its most significant achievement to date.

7.124 As part of staging the Grand Prix race, the Government has committed funds to the general improvement of sporting facilities in the Albert Park area, including the following projects:

- construction of the Grand Prix track and ovals within the Albert Park region, at an estimated cost of $43 million ($21 million in 1994-95 and $22 million in 1995-96); and
- construction of a new sports complex and associated swimming centre in Albert Park, at an estimated cost of $30 million and $22 million respectively.

7.125 These projects are to be mainly funded from revenues received by the State from the casino and other gambling activities.

7.126 Subsequent to securing the Grand Prix event for Melbourne, both MMEC and the Department of the Treasury considered that an alternative company structure was required to ensure the availability of adequate expertise to facilitate the staging of the event. Accordingly, in April 1994, MMEC established a wholly owned subsidiary company, Melbourne Grand Prix Promotions Pty Ltd (MGPP) which was to be solely responsible for the promotion and staging of the Grand Prix in Melbourne. The memorandum of association of this company contains similar restrictions on its activities as those of MMEC.

7.127 During 1993-94, Government funding of $599 000 was provided to MGPP. A further $900 000 was provided by the Government in the period July 1994 to September 1994.

7.128 As I am not the auditor of the MGPP and MMEC companies, I have not been privy to the contractual arrangements entered into by the companies in relation to the staging of the Grand Prix event and the payment of associated franchise fees to the race controlling bodies and promoters. **However, according to advice received from the auditors of MGPP, K.P.M.G. Peat Marwick, and the Department of the Treasury, as at the date of preparation of this Report, franchise fees for the staging of the event have not been paid by either MMEC, MGPP or the Government.**

7.129 In June 1994, the Treasurer provided an indemnity to MGPP against any liability arising from or relating to the carrying out of any activities associated with its objects as set out in the Memorandum of Association, together with further indemnities to its Directors against liability, except where caused by acts which are inconsistent with the company's business plan approved by the Treasurer, wilful neglect or lack of good faith.

7.130 **Audit was advised by the Department of the Treasury that an analysis was undertaken by the Department, of preliminary financial projections associated with the race prepared by the company, prior to the issue of the indemnities to assess any consequent risks to the State. However, no evidence was made available to audit to support this statement.**

7.131 **The State's commitments and exposures under the financial arrangements for the staging of the Melbourne Grand Prix in Melbourne, include:**

- **the funding of any liabilities or losses incurred by MGPP, which cannot be funded from its own revenues and other resources; and**
- **the funding of MGPP operations on a month to month basis, with final financing arrangements to be established once the company's business plan is approved by the Treasurer.**

7.132 However, significant benefits are anticipated to flow to the State from the staging of this event, including international exposure of the City as a world sporting capital and tourism destination.

7.133 The Government has presented in the current session of the Parliament a Bill to establish a public authority to be known as the *Australian Grand Prix Corporation*, to assume responsibility for the staging of the annual Grand Prix event. The Bill, inter alia, empowers the Corporation, with the approval of the Minister, to acquire or assume the assets and liabilities of the MGPP.

7.134 At the date of preparation of this Report, the company's business plan referred to in the Government's indemnities, had been submitted by the company and was awaiting formal approval by the Treasurer.

Bayside development project

7.135 My previous Reports to the Parliament have commented in detail on the Government's involvement in and financial obligations relating to the Bayside development in Port Melbourne. As highlighted in these Reports, government agency costs relating to this development exceeded $70 million prior to the project being deferred, pending finalisation of legal action.

7.136 The legal action involved a writ lodged by the developer in May 1992 against the State and the Urban Land Authority (ULA), claiming $8.5 million in costs and other unspecified damages, which was subsequently revised upwards to $9.1 million. 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, which was subsequently revised to $13.2 million.

7.137 **In April 1994, a settlement was reached between the parties, whereby the Government paid a sum of $8 million** to the developer in damages, being full and final settlement in relation to the Bayside development project.

Current development of the site

7.138 Following the calling of expressions of interest in December 1992 for the development of the 30 hectare Bayside site by the Office of Major Projects (OMP), and a subsequent detailed evaluation of offers received, in August 1994 a Heads of Agreement was entered into with a private developer.

7.139 The Heads of Agreement addresses 2 major components of the development, namely, a residential development which will encompass the staged construction of at least 850 dwellings, roads and associated community facilities, and a waterfront development comprising commercial and retail buildings, aimed at establishing an attractive and viable waterfront precinct.

7.140 At the date of preparation of this Report, negotiations were nearing completion for the finalisation of a Deed of Agreement for the development of the site.

National Tennis Centre Trust debt restructure

7.141 The Flinders Park National Tennis Centre was constructed in the late 1980's primarily to ensure that Melbourne retained the Australian Tennis Open, which is one of only 4 grand slam tennis events in the world and generates significant economic activity for the City in January of each year. In addition, the Centre provides Melbourne with a world class indoor entertainment venue capable of hosting a variety of performances throughout the year.

7.142 My May 1992 *Report on Ministerial Portfolios* and April 1993 Special Report No. 20 *National Tennis Centre Trust,* commented on the substantial debt obligations of the Trust and its mounting operating deficits resulting from the financial arrangements put in place by the Government in 1988 to finance the Centre's construction. The financial arrangements between the Trust and the former State Bank of Victoria (now the Commonwealth Bank of Australia) involved financing of $110 million under a 9 year funding arrangement and the likely payment of a deferred amount of $104.5 million in 1997. Additional amounts also became payable during the term of the arrangement in the event that market interest rates exceeded 14 per cent.

7.143 To assist in financing the substantial obligations of the Trust, in August 1991 the Government announced a long-term financial support package to be provided to the Trust, involving annual grants of $12 million from the Consolidated Fund over a period of 12 years. **Payments made by the Consolidated Fund under this package to 30 June 1994 totalled $29 million**.

7.144 To enable a reduction in the future financing charges so that the Trust would be in a position to manage its own operations without future financial assistance from the State, in November 1993, the Treasurer approved a restructure of the financing arrangements. In December 1993, an agreement was reached between the Trust and the Commonwealth Bank of Australia to terminate the existing arrangements. To facilitate this agreement, the outstanding obligations of the Trust to the Commonwealth Bank of Australia of $120.6 million were financed as follows:

- $74.6 million by the Trust, financed from a $55 million government guaranteed loan from the Treasury Corporation of Victoria, the off-setting of a $1.6 million payment due from the Commonwealth Bank under the financing arrangements, and $18 million from internal funds; and
- $46 million from the Consolidated Fund, provided as an interest free loan to the Trust.

7.145 In addition, in May 1994, a further sum of $9.8 million was paid by the Consolidated Fund to the Commonwealth Bank on account of the Trust, for the early termination of the Trust's financing arrangements, bringing **the total State contribution to the National Tennis Centre Trust on account of the financing restructure to $55.8 million.**

7.146 The financing arrangements entered into in 1988 with the former State Bank of Victoria involved the provision by the Treasurer of certain warranties to the Bank as to the taxation assumptions underlying the arrangements. When the State Bank of Victoria was acquired by the Commonwealth Bank in 1990, a ruling was sought by the Commonwealth Bank from the Australian Taxation Office on the taxation status of the Trust's financing arrangements. A final ruling is yet to be made by the Australian Taxation Office on these arrangements.

Future development of the Centre

7.147 In January 1994, the Government announced a further development of the National Tennis Centre, at an estimated cost of $16 million over 2 years. This development involves the provision to the Trust, at no cost, of approximately half of a 8.5 hectare site, currently utilised by the Public Transport Corporation as part of the Jolimont rail yards, for the development of:

- a 500 space car park;
- 10 Rebound Ace tennis courts;
- 1 clay court;
- a 1 500 capacity function centre; and
- associated access roadways and a garden square.

7.148 The project is to be funded by the Trust from government guaranteed borrowings from the Treasury Corporation of Victoria and is to be completed prior to the commencement of the 1996 Ford Australian Open. Works are to commence on the project following the relocation, by the Office of Major Projects (OMP), of a workshop building located in the rail yards at a total estimated cost of $7 million which is to be met by the Government.

7.149 At the date of preparation of this Report, the Treasurer had provided in principal approval to this development, with final approval expected in late October 1994.

Loy Yang B Power Station

7.150 My May 1994 *Report on Ministerial Portfolios* commented on the December 1992 sale by the State Electricity Commission of Victoria (SECV) of a 51 per cent share in its Loy Yang B power station to a private operator. The transaction represented the largest privatisation undertaken by a government in Australia and involved complex and extensive financial and legal arrangements. Under the arrangements, the SECV's remaining 49 per cent share in Loy Yang B was purchased by a wholly owned subsidiary company, Loy Yang B Power Station Pty Ltd (LYBCO), with the purchase funded by way of a loan from the SECV.

7.151 **The Treasurer has entered into a State Support Agreement, under which the State undertakes to ensure the performance of obligations required to be fulfilled by the SECV under certain project contracts with the private operator and LYBCO.**

7.152 This obligation of the State is disclosed by way of a note to Table B.15 of the Finance Statement on contingent liabilities.

Automated ticketing system

7.153 As part of the Government's public transport reform program, aimed at enhancing the financial viability and efficiency of public transport services, in early 1993 the Public Transport Corporation (PTC) commenced action to facilitate the automation of functions associated with the sale and collection of fares on all forms of public transport.

7.154 In March 1993, the PTC invited public tenders for the provision and management of an automated fare collection system. In September 1993, following a detailed tender evaluation process, a consortium comprising 3 private companies was selected to provide the new ticketing system to the PTC.

7.155 In May 1994, the PTC entered into a 10 year service agreement with the consortium for the supply, installation, testing, commissioning, maintenance and management of the automated fare collection system, for **an estimated nominal cost in the order of $300 million.** The new system will involve the installation of automated ticketing dispensers and validation machines on all trains, trams, buses and stations, within the next 2 years. In addition, the PTC plans to create a network of retail agents and ticket vending machines across the metropolitan area in order to make the system more accessible to the community. The new system will use magnetic credit card sized tickets which can be validated on each form of public transport. Approximately 300 new customer service officer positions are also anticipated to be established in order to administer the new system and to ensure that the commuters fully understand the system.

7.156 Under the service agreement between the PTC and the consortium, ownership of the equipment will rest with the consortium and the PTC is not at any point in time obligated to purchase the equipment. In addition, the company will be fully responsible for the maintenance of the equipment and the collection of revenues on behalf of the PTC. Payments under the agreement are not to commence until the consortium can demonstrate to their bankers and the PTC it has successfully installed and commissioned the equipment. The agreement also makes provision for the PTC to reduce payments if the company does not comply with its service obligations.

7.157 **The Treasurer has provided a guarantee in relation to this agreement, which obliges the State to honour PTC's financial obligations if it defaults on the payments for services provided.** An amount *in the order of* $300 million has been disclosed in the Finance Statement by way of a note to table B.15 on contingent liabilities.

Co-operative Housing Societies

7.158 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 deposits for the acquisition of properties.

7.159 During 1993-94, the Government issued guarantees and indemnities in favour of various lending institutions and Co-operative Housing Societies, with an aggregate value of $45.3 million. **As disclosed in the Finance Statement, the Government's total contingent liability in relation to this form of assistance amounted to $414 million at 30 June 1994.**

Home Opportunity Loan Scheme

7.160 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 and provides housing finance to low and middle income earners who normally would not have the opportunity to borrow from traditional finance sources.

7.161 The financial assistance provided by HOLS is mainly financed from 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, with the indemnity supported by first mortgages over the properties subject to housing finance.

7.162 During 1993-94, Victorian housing bonds with an aggregate value of $10.2 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 1994 amounted to $905 million.**

Totalizator Agency Board

7.163 In June 1993, the Treasurer issued a guarantee in favour of the Treasury Corporation of Victoria for the Totalizator Agency Board (TAB) to borrow $45 million to meet its 1993-94 cash flow requirements, with the borrowings to be repayable during the year.

7.164 During 1993-94, the TAB revised its gaming machine strategy, necessitating the scrapping of 3,300 existing Tabaret machines and the acquisition of an equivalent additional number of NSW style machines at a cost of $30 million. This action resulted in a cashflow shortage in the year and required the $45 million borrowings which were due for repayment in February 1994, to be maintained for a further 6 months. In March 1994, the Treasurer issued a guarantee to cover these new borrowings on the understanding that they would be repaid in 1994-95.

7.165 These borrowings were repaid in the 1994-95 financial year from the proceeds of the privatisation of the TAB businesses.

State Insurance Office

7.166 Since 1987, the State Insurance Office (SIO) and a number of private insurers have engaged in litigation against the former Accident Compensation Commission and its successor body, the Victorian WorkCover Authority (WorkCover), in relation to claims against its Supplementation Funds.

7.167 These Supplementation Funds were established in 1975 and 1979 following Government decisions to increase the entitlements to injured workers by indexing weekly compensation payments. As the majority of insurers had not factored the increased payments to injured workers into the premiums charged to employers, a levy was placed on the industry and the proceeds paid into the Supplementation Funds. Once insurers had paid the increased benefits, they were entitled to claim against the Supplementation Funds. However, in 1987, the former Accident Compensation Commission refused to make payments to insurers claiming against the Supplementation Funds until the principles governing the claims were determined by the courts.

7.168 In 1991, the insurers received a favourable Supreme Court judgement against the former Accident Compensation Commission in relation to this matter. However, following an appeal against the decision by the successor body, WorkCover, the High Court handed down a decision in favour of WorkCover in June 1994.

7.169 **Negotiations are currently proceeding between WorkCover and SIO in relation to payments, if any, that may have been incorrectly made to SIO from the Supplementation Funds, during the period 1975 to 1987.**

Impact of High Court decision on SIO and the State

7.170 Prior to the High Court decision, the SIO had included an asset in its balance sheet at a value of $24 million, for compensation expected to be received from the Supplementation Funds. However, given the court decision, the recovery of this amount is considered doubtful and a subsequent write down in the asset is required.

7.171 In addition, as approximately two thirds of the SIO's employer liability policies are 'pay as you go' policies with the public sector, any claims in relation to these policies by WorkCover as a result of the High Court decision will be required to be met by individual agencies and, in respect to the budget sector, the Consolidated Fund.

7.172 In June 1994, the Department of Finance entered into an *in principle* agreement with the SIO to buy-out the Government's employer liability under the budget sector "pay as you go" policies, based upon a mutually agreeable actuarial valuation of the liability. As part of the agreement, an initial sum of $23 million was paid to the SIO by the department, which is repayable (together with interest) in the event that final agreement cannot be reached between the parties on the final buy-out sum. At the date of preparation of this Report, the actuarial assessment of the Government's liability had not been finalised and the final buy-out amount had not been determined.

7.173 The impact of the High Court decision on the State and associated public sector entities was not determined at the time of preparation of this Report. The Department of the Treasury has not quantified this contingent liability in table B.15 of the Finance Statement. However, the Department has indicated that there are various claims pending resolution which may result in future payments.

Part 8

Other Matters

Part 8

Other matters

KEY FINDINGS

- During 1993-94, parliamentary authority was provided for the validation of payments totalling $35 million made in 1989-90 without such sanction, and the repayment of Consolidated Fund advances from the Trust Fund of $22 million which had remained unfunded since 1970.

Paras 8.2 and 8.9

Treasurer's Acquittance

8.1 Section 34 of the *Audit Act* 1958 requires the Auditor-General to acquit the Minister for Finance for the amount of public monies 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*". **All Public Account moneys that were expended in 1993-94 were acquitted to the Minister for Finance except for the value of advances totalling $9.4 million held by departments at 30 June 1994.**

8.2 My previous 4 Reports on the Finance Statement have referred to an amount of $35 million, representing interest charges that were paid from the Consolidated Fund in 1989-90 without parliamentary authority. The *Financial Management Act* 1994, which was enacted in the year, addressed this matter by providing the necessary authority for the incurrence of the expenditure. Accordingly, the outstanding amount of $35 million was acquitted to the Minister for Finance.

Trust Fund

8.3 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 and local government bodies;
- 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.

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

8.5 Details of new accounts opened within the Trust Fund in 1993-94 and their specified purposes are set out in Table 8A.

TABLE 8A
NEW TRUST ACCOUNTS

Account or Fund	*Purpose for which established*
Better Roads Victoria Trust Account	To receive Special Appropriations funded from motor spirit fees collected under the *Business Franchise (Petroleum Products) (Amendment) Act* 1993, and to make payments for the construction and maintenance of roads.
Commonwealth National Landcare Program - Healthy Rivers and Catchment Program Trust Account	To record the receipt and disbursement of contributions from the Commonwealth Government and participating State bodies for projects undertaken by the Department of Conservation and Natural Resources under the National Landcare Program.
Fringe Benefits Tax Trust Account	To record the receipt of fringe benefits tax deducted from executive salaries and the disbursement of these funds to the Australian Taxation Office.
Melbourne Sports Centre Development Account	To record the receipt of funds, including amounts provided by the Community Support Fund, and interest thereon, and the disbursement of the available funds towards the development of the Melbourne Sports Centre.
Performance Incentive Payments Scheme Trust Account	To record funds set aside by departments, including interest thereon, for the subsequent payment of annual performance bonuses to executive officers under the terms of their employment contracts.
RACV Support Program Trust Account	To administer funds donated by the RACV to finance activities undertaken by the Victorian State Emergency Services.
Small Business and Farming - Flood Relief Fund 1993 Trust Account	To administer private sector donations received for the provision of assistance to small businesses and farmers, relating to losses and damage suffered as a result of floods in Northern and North-Eastern Victoria.

8.6 The Unclaimed Moneys Fund was abolished during the year, with all moneys standing to the credit of this account transferred to the Consolidated Fund in accordance with amendments to the *Unclaimed Moneys Act* 1962. All unclaimed moneys are now paid into the Consolidated Fund and any subsequent claims are recouped from that Fund.

Balances of Public Account

8.7 The transactions recorded in the Public Account for the past 2 years and the investment of the resultant balances are summarised in Table 8B.

TABLE 8B
RECEIPTS AND PAYMENTS OF THE PUBLIC ACCOUNT
(\$million)

Item	*1993-94*	*1992-93*
Balance 1 July	404	469
Receipts -		
Consolidated Fund	17 628	16 917
Trust Fund -		
Works and Services Account	1 100	2 249
Specific accounts	50 483	64 389
	69 615	84 024
Payments -		
Consolidated Fund	17 628	16 917
Trust Fund -		
Works and Services Account	1 070	2 265
Specific accounts	50 333	64 438
	69 031	83 620
Balance 30 June	**584**	404
Represented by the following investments -		
Trust Fund -		
Cash at bank	7	14
Fixed deposit accounts	494	8
Stocks and securities	74	2
Investment with the Victorian Development Fund	-	344
Advances -		
Consolidated Fund	-	22
Departments and other purposes	9	14
Trust Fund	584	404
Consolidated Fund	nil	nil
Total investments at 30 June	**584**	404

8.8 **The net effect of the year's transactions was an increase of \$180 million in the total balances of the Public Account, brought about by an equivalent increase in the balance of the Trust Fund.**

8.9 My previous Report on the Finance Statement referred to Consolidated Fund advances of \$22 million which remained unfunded at 30 June 1993, relating to Consolidated Fund deficits to 30 June 1970 financed by way of advances from moneys standing to the credit of the Trust Fund. **During 1993-94, these advances were repaid by the Consolidated Fund from a Special Appropriation provided under the authority of the *Financial Management Act* 1994.**

Transfer of Appropriations

8.10 The *Audit Act* 1958 requires 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.

8.11 Consistent with the 1992-93 financial year, no transfers under the *Audit Act* 1958 were necessary during 1993-94 as the *Appropriation (1993-94, No. 1) Act* 1993 and *Appropriation (Parliament 1993-94, No. 1) Act* 1993 provided specific authority to the Treasurer and Ministers authorised by the Treasurer, to transfer appropriations within and across programs (commonly known as section 9 Appropriation transfers). All such transfers are detailed in Appendix 2 to the Finance Statement.

Section B

Matters of Special Interest

Information Systems Development in the Public Sector

Information Systems Development in the Public Sector

KEY FINDINGS

- Poor quality management practices identified by audit on the PARMS project reinforce the findings of other audit reviews of information systems projects on the need for Government to address the adequacy of systems development within the public sector.

  (para. 1.1 to 1.6)

- Certain key information was not included in ministerial submissions prepared by VicRoads relating to the project.

  (paras 1.43, 1.60 and 1.76)

- Payments totalling $687 300 were made by VicRoads to a project management consultant without ministerial approval.

  (para. 1.59)

- Weaknesses in the administration of contracts by VicRoads enabled substantial work on PARMS to be undertaken by external parties, involving payments by VicRoads in excess of $688 800, without the protection of formal contracts.

  (paras 1.59 to 1.77)

- Significant delays and the non-achievement of anticipated benefits have resulted from major deficiencies in the strategic management and control of the PARMS project at VicRoads.

  (paras 1.81 to 1.85)

1.1 Over recent years, the public sector has invested significant resources on information systems (IS), including hardware, software and human resources. As most public sector bodies are now totally reliant on IS to support their daily operations, it is important that those resources are managed efficiently and effectively.

1.2 For several years, my Reports to the Parliament have commented upon various major deficiencies in the development and implementation of IS within the public sector. It is of concern to me that, despite the audit references, little action has occurred in rectifying the problems highlighted in my Reports, as evidenced by the recurring nature of these deficiencies in subsequent audit reviews. Examples of recurring issues are outlined below.

1.3 In my 30 June *1990 Report on the Treasurer's Statement,* I commented on the development of the computer-aided dispatch and management information system (CADAMS) at the Metropolitan Ambulance Service, I found that:

- completion of the CADAMS project was more than 2 years behind schedule;
- benefits from the system's implementation were not achieved within the forecast time frame;
- ministerial approval was not obtained; and
- poor contract administration prevailed.

1.4 In my May 1993 Report on Information Technology in the public sector, I commented on the development by the central government agencies of an integrated personnel/payroll system (Perspay) for use within the budget sector. I identified a number of significant factors which contributed to the failure of the system, including:

- indecisiveness and lack of direction by executive management in monitoring and controlling the project;
- lack of accountability for the development and implementation of the project;
- the failure to enter into a formal contract until 6 years after the supplier commenced development of the system;
- the ineffective implementation of a sound system development lifecycle methodology (SDLC) to facilitate the efficient and effective development of the proposed system within a specific time frame; and
- deficiencies in the skills of staff involved in the project.

1.6 In the earlier reports I recommended a number of general principles of systems development which were consistent with standards of best practice and suitable for use as benchmarks to guide management practices and to measure performance in this area.

1.5 As part of my continuing coverage of Information Systems I have addressed the development of a key management information system, known as the Project and Resource Management System (PARMS), at VicRoads. The findings contained in this Report, particularly in relation to poor project management, lack of financial controls and failure to provide accountability, reinforces the need for the Government to decisively address the adequacy of systems development within the public sector.

1.7 Based on the results of my audit reviews, there are several factors which can be regarded as critical to effective management of IS development projects, namely:

- establishment of a policy framework for the overall direction and central monitoring of major system projects;
- development of policies to identify the management responsibilities, accountability framework and monitoring requirements associated with the creation of information systems;
- utilisation of well-structured and proven management and control procedures in conjunction with sound SDLC methodologies where applicable when acquiring, developing or maintaining information systems within the public sector;
- contractual protection and ministerial approval; and
- post-implementation reviews to ascertain if the projected benefits of new information systems have been realised and to develop solutions that address any inadequacies.

1.8 It is the responsibility of an organisation's management to establish and implement an appropriate internal control framework, a reliable SDLC methodology and sound review and monitoring procedures. Failure to implement these practices can result in a huge investment of resources in systems which do not meet business, management and user needs. In such circumstances, the systems are often not subsequently utilised and the benefits justifying their development not realised.

1.9 It is emphasised that the above fundamental characteristics of sound project management apply equally to systems that are operated internally and those that are contracted-out. In this regard, outsourcing should not be seen as a panacea to project development problems as it is essential that organisations retain responsibility, accountability, ownership and control over the development, implementation, maintenance and operation of IS.

1.10 Several major IS projects are currently under development within public sector agencies and an amount of $48.8 million has been allocated in the Government's 1994-95 budget for expenditure on IS development. It is my view that all government organisations contemplating IS development have an obligation to adhere to standards and procedures which ensure that systems are developed, implemented, maintained and utilised in the most economic, efficient and effective manner with due regard to the substantial public resources involved.

BACKGROUND TO PARMS PROJECTS

1.11 In 1989, the Road Traffic Authority (RTA) and the Road Construction Authority (RCA) merged as part of a government restructure designed to minimise costs and to gain the highest level of efficient road services for Victorians. The merger, which formed the Roads Corporation (trading as VicRoads), was put in place from 1 July 1989 as part of an overall rationalisation of transport services.

1.12 With the merger of the RCA and RTA, a need was identified by the Chief Executive Officer of VicRoads for a single system to manage all day-to-day activities of the new entity. Justification for the need included the rationalisation of a number of ageing systems and the establishment of an integrated Statewide network. In particular, VicRoads was of the opinion that various problems with the existing information systems necessitated specific attention, including the requirement to re-input information, management reporting was often late and inaccurate, decentralised operations could not be properly managed, resources were wasted in maintaining multiple systems and network failures were excessive.

1.13 As part of the merger process, executive management of VicRoads determined that a major project was required to consolidate the computing environments of the 2 former bodies where over 50 existing systems had operated. The complexity of this project, which was accorded the name PARMS, was increased by the different cultural environments in existence within the 2 merging organisations: one operating on a centralised approach and the other in a decentralised environment.

1.14 During 1989, VicRoads entered into negotiations to develop and implement PARMS as a single system with integrated modules replacing all ex-RCA and ex-RTA financial, administration, construction management, maintenance management and service systems.

1.15 The following benefits were expected to be derived from the implementation and use of PARMS:

- the availability of timely and accurate management information for key decision-making;
- elimination of manual data collection and duplicated input of system data; and
- more efficient and effective administrative practices.

1.16 In July 1990, following public tenders, VicRoads assigned the appointed tenderer the task of developing PARMS. Although over subsequent months, the appointed tenderer completed specifications for the system, uncertainty existed between the parties as to the range of required deliverables under the tender. This uncertainty was exacerbated by the overall complexity of the project. As a consequence, there was a reluctance by the tenderer to sign a contract. By February 1991, the tenderer and VicRoads could not reach agreement on the contractual arrangements and the tenderer withdrew from the project.

1.17 In December 1991, following a re-tendering process, a prime contractor was appointed to develop PARMS at a cost of $13.9 million. Due to non-recording by VicRoads of complete budget information, the total estimated and actual costs of the project cannot be clearly identified by VicRoaas and audit. While initial deadlines for the first 3 key modules of PARMS (payroll, finance and human resources) were targeted for completion during November 1992, contractual extensions of the deadlines up to December 1993 were subsequently necessary. The 3 modules finally became operational in February 1994, 15 months after the initial target date. At the time of preparation of this report, the remaining 2 modules had been completed and were substantially operational.

1.18 Audit carried out a review to evaluate the extent to which economy, efficiency and effectiveness were achieved in the acquisition, modification and implementation of PARMS.

OVERALL CONCLUSION

1.19 During 1989 VicRoads identified the need to develop a comprehensive project and resource management information system. In an attempt to meet the need VicRoads commenced negotiations in late 1989 to develop and implement PARMS as a single integrated information system.

OVERALL CONCLUSION - continued

1.20 There was a delay of some 16 months between the established time frame for implementing PARMS of November 1992 and the practical completion date for the key modules of February 1994. In audit opinion, the major problems in implementing PARMS included:

- failure to prepare a comprehensive organisation IS strategy prior to the commencement of the project;
- indecisiveness and lack of direction by executive management, via the Corporate Information Management Committee (CIMC) and the PARMS steering committee, in monitoring and controlling the project in the initial stages; and
- the failure of VicRoads management to provide full and proper justification for the project.

1.21 In addition, mainly as a direct result of the major problems identified above, various shortcomings in the acquisition, modification and implementation of PARMS also arose. These included the failure to:

- provide adequate and complete information to the Minister prior to ministerial approval to proceed being granted;
- obtain ministerial approval for expenditure being incurred in every instance where required by legislation;
- maintain adequate organisational control over project management;
- expedite contractual negotiations between the initial successful tenderer and VicRoads' executive management;
- enter into binding contractual arrangements prior to the commencement of all work; and
- record, maintain and monitor financial information.

1.22 The inability of VicRoads management to successfully develop and implement PARMS within agreed time frames, in audit opinion, has affected the attainment of tangible and intangible benefits of $5.85 million and $9.23 million, respectively. VicRoads contends that the loss of the envisaged benefits has been partly offset by various other benefits which have been achieved that were not envisaged at the commencement of PARMS. While at this early stage of the PARMS life cycle these benefits cannot be measured, the conduct of a post-implementation review, during 1995, will provide evidence of the nature and magnitude of the benefits realised and forgone from the implementation of PARMS.

1.23 The difficulties encountered and the subsequent delays illustrate the importance of sound project management skills and practices, establishing an effective accountability framework, the need for firm contractual arrangements and the requirement for senior management to actively participate in the development of major IS.

1.24 The majority of the problems experienced with PARMS were encountered in the initial 12 to 18 months of the project. Subsequently, VicRoads has made every reasonable attempt, in the succeeding 3 years, to ensure that the PARMS project has been delivered as close to the revised completion dates as practicably possible.

WEAKNESSES IN INFORMATION SYSTEMS STRATEGIC PLANNING

1.25 With information technology now an intrinsic part of business systems and processes, an IS strategic plan has become a vital element of effective corporate planning. The principal purpose of an IS plan is to articulate how information systems will support overall business needs and those factors identified as critical to the successful achievement of corporate goals.

1.26 In June 1989, in preparation for the merger between the RCA and the RTA, representatives from both organisations developed 2 strategic documents aimed at providing a common direction between the 2 different information technology (IT) environments. The documents, according to advice provided to audit by VicRoads management, were not intended to constitute a strategic plan. They included some details of the IS environment, a number of user requirements and an incomplete IS plan. However, the strategic documents did not address:

- the mission statement of the merged bodies;
- strategic directions for the organisation;
- funding constraints faced by the new body;
- the existing political environment;
- relevant economic factors likely to impact on the organisation's future direction; and
- key implementation issues concerning the proposed IS environment, including critical dates for principal tasks and a framework for systematic monitoring of progress under PARMS.

1.27 While the decision to initiate PARMS was included in the Corporate Plan of VicRoads, the failure to develop a well structured IS strategic plan became a significant factor which adversely affected the quality of initial project management with PARMS. The restricted scope and effectiveness of the strategic documents as a critical management control instrument meant that project decisions and actions were not directly linked to, or monitored against, the organisation's strategic directions under its Corporate Plan. In these circumstances, VicRoads could not be certain decisions regarding capital and operational expenditure for PARMS were consistent with its overall business priorities. The specific ramifications of this situation on the PARMS project was that VicRoads was unable to establish compatibility of hardware, software and network requirements with strategic directions prior to the calling for tenders. This situation was the major reason for the resultant uncertainty between VicRoads and the initial tenderer on the range of deliverables required under the PARMS tender and which subsequently led to protracted negotiations between the parties and subsequent withdrawal by the tenderer from the project.

1.28 There is little doubt, in audit's view, that the above shortcomings in the strategic planning framework of VicRoads adversely impacted on the quality of the initial management of the PARMS project. **Many of the problems which subsequently emerged, including inadequate monitoring of the project manager's activities, non-realisation of envisaged benefits, and significant cost and time overruns, could have been avoided if the strategic control mechanisms established for the project had been soundly based.**

1.29 VicRoads subsequently acted to strengthen the organisation's strategic planning process for IS during formulation of its June 1993 strategic plan. This plan specifically addressed:

- the Corporate Plan;
- needs of VicRoads;
- critical success factors;
- IS targets; and
- key implementation factors.

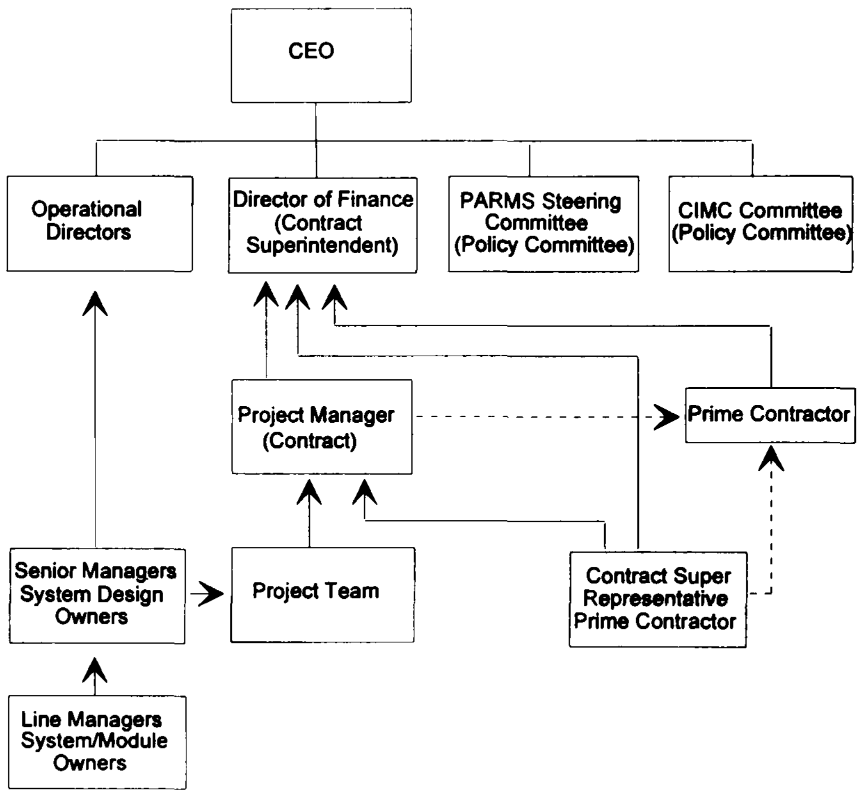
1.30 In addition, audit was advised that specific focus has been directed to the importance of sound strategic controls over IS by the Government's current outsourcing proposals for IS within VicRoads.

SHORTCOMINGS IN STEERING COMMITTEE FRAMEWORK

1.31 An important task in planning, managing and controlling IS projects is the establishment of roles, responsibilities, lines of delegation and accountability of senior management, user departments and other relevant parties. A key element in this process involves the setting of steering committees and provision for effective overview and control by executive management.

1.32 Chart 1A outlines the PARMS management organisation structure and the interrelationships between the key management groups.

CHART 1A
PARMS MANAGEMENT STRUCTURE



IS steering committee

1.33 In May 1990, some 11 months after the merger and 8 months after the commencement of the PARMS project, VicRoads established a Corporate Information Management Committee (CIMC) to perform the function of an IS steering committee for all VicRoads information systems. The tasks assigned to CIMC included:

- approval of the development and implementation strategies and programs for significant projects; and
- monitoring progress with projects and progressively reporting results to a corporate management group established within VicRoads.

1.34 Although CIMC's work program incorporated the PARMS project, an examination by audit of minutes could find no evidence of involvement by CIMC in co-ordinating the introduction of PARMS, monitoring the progress of the project's implementation and reporting of results for further organisational scrutiny.

1.35 Audit considers that CIMC's late establishment in relation to the commencement of PARMS, and its lack of involvement in the strategic co-ordination and control of the project, reduced VicRoads' capacity to ensure that:

- the implementation of PARMS was aligned with corporate goals;
- proposed information systems were capable of achieving targeted benefits and enhancing the effectiveness of VicRoads operations; and
- the benefits and disadvantages of outsourcing PARMS compared with the adopted strategy of maintaining these services internally, and the subsequent impact on information systems, were properly evaluated.

1.36 **It is vital that an IS steering committee be established prior to the commencement of significant IS projects and be actively involved in the scrutiny of progress throughout the various phases of each project.**

PARMS steering committee

1.37 In September 1989, prior to the establishment of the CIMC, VicRoads formed the PARMS steering committee to manage the development and implementation of PARMS. While the PARMS steering committee met on a monthly basis and its members included key personnel involved with the project, the documented minutes of the committee's deliberations did not indicate that a close reporting relationship had been established with the CIMC on specific tasks and milestones, or agreement had been reached with that committee to control PARMS development from an organisational perspective. Review of the PARMS steering committee's minutes also highlighted the limited involvement of the then Chief Executive Officer (CEO) in the planning, monitoring and control of this project. **This failure to provide executive support and leadership contributed to the initial problems encountered with the project and ultimately the inability to achieve the projected benefits due to the ensuing extended delays.**

1.38 Consequently, VicRoads could not be certain that decisions regarding PARMS were complementary to the organisation's entire IS requirements, including the adequacy of consideration as to whether all existing systems needed to be replaced and whether the project's deliverables were capable of achievement within the desired time frame. In addition, although there was common membership of personnel on the 2 steering committees, the relationship and communications between the 2 committees on key decisions regarding PARMS were assumed to be soundly based and occurring without any substantiation by senior management.

1.39 **The weaknesses in the steering committee framework established by VicRoads for PARMS, as identified in the above paragraphs, illustrate the importance of strong strategic direction and control to ensure effective project management. Failure of an organisation to properly control and manage major projects can seriously jeopardise successful project implementation and result in significant wastage of financial and human resources.**

INADEQUATE FEASIBILITY STUDY FOR PARMS

1.40 When assessing the underlying justification for a potential project or system, there are some fundamental actions which need to be taken by any organisation in order to have assurance that its final decision to proceed or not to proceed with a proposal is soundly based. These actions include:

- clear identification of need;
- evaluation of alternative options, including the feasibility of development of new systems or modification of existing systems; and
- completion of cost-benefit analyses to support the recommended course of action.

1.41 Although VicRoads had determined that existing systems within the 2 former bodies were aged and in need of replacement, many of the key applications incorporated in PARMS had been either implemented or upgraded at considerable cost in the 18 months prior to the merger. It was therefore of concern to audit that evidence could not be provided to show that the deliberative process leading up to ministerial approval for the PARMS project had taken into account all alternative solutions, including the potential for minor modification to existing systems.

1.42 VicRoads performed a number of benefit analyses which identified likely tangible and intangible benefits from PARMS totalling $43 million and which were included in an October 1991 ministerial briefing paper. An analysis of the projected cost of PARMS to achieve these benefits was not undertaken as VicRoads could not identify all costs likely to be incurred on PARMS.

1.43 A direct consequence of this situation was that a submission from the Chief Executive Officer to the Minister in November 1991 for approval and signature by the Minister of a contract with the selected prime contractor, and thus proceed with the PARMS project, did not include a full cost-benefit analysis. The absence of complete cost information on PARMS meant that an inflated "net benefit" scenario was incorporated in the recommendation for ministerial approval. Based on the recommendation included in the submission and assuming completeness of cost estimates, the Minister proceeded to approve the contract. Had the submission included a full cost-benefit analysis, a different decision on PARMS may well have been given by the Minister.

1.44 **For all major project proposals, VicRoads should ensure that complete and accurate feasibility studies are performed in order that initial decisions on projects are soundly based.**

ENGAGEMENT OF PROJECT MANAGER

1.45 At the inception of the project, the PARMS steering committee had the responsibility of identifying the skills required for the effective management of PARMS' and for evaluating whether the level of internal expertise was sufficient to meet those requirements.

1.46 In July 1990, some 10 months after the inception of the project, VicRoads considered there was a shortage within the organisation of staff with sufficient experience and skills in the fields of project management, knowledge of construction industry standards and procedures, contract management, software applications, hardware performance and system design, which were considered to be vital for the PARMS project. VicRoads duly proceeded to appoint a project management consultant to assume overall responsibility for the management of the project.

1.47 The audit review identified several shortcomings in the manner in which VicRoads supervised and monitored the involvement of the project manager. These shortcomings are outlined in the following paragraphs.

Selection process

1.48 Audit is of the opinion that the assessment by VicRoads of internal project management skills should have occurred at the inception of the project in September 1989, rather than 10 months later in July 1990. Such action would have averted some of the problems experienced within the initial planning phase of the project and reduced the delays subsequently encountered.

1.49 In addition, documentary evidence was not available at VicRoads to substantiate the shortage of necessary expertise for PARMS within the organisation and thus, to fully justify the appointment of the project manager. Also, ministerial approval for the appointment, which was required under VicRoads' *Delegation of Authority* manual, was not sought.

1.50 In audit opinion, the procedures followed by VicRoads for the appointment of the project manager raise doubts as to whether VicRoads was in a position to determine the best available external expertise to perform the project management tasks.

1.51 The contract with the project manager was subsequently suspended in March 1991 due to a breakdown in negotiations between VicRoads and the appointed tenderer. When seeking to appoint a new project manager subsequent to the suspension, VicRoads proceeded to follow the same approval process. This submission was rejected by the Minister who demanded a proper analysis and selection process be undertaken. A detailed review of 5 consulting firms, including an examination of proposals, resumes and formal interviews, was undertaken and the details were incorporated into a ministerial brief dated 19 December 1991. After an 8 month analysis and review period, the original consultant was re-appointed as project manager in August 1992.

1.52 **All long-term external consultancy engagements which have a significant impact on the success of a project should be subject to formal selection and approval processes, with the evaluation of skill requirements occurring immediately upon approval of the project.**

Management control over the project manager's activity

1.53 VicRoads had no formal monitoring and control procedures in place over the performance of the external project management consultant from his appointment in July 1990 to the signing of a contract in August 1992. In addition, although the 1992 contract incorporated procedures for management within VicRoads to monitor and control the performance of the project manager, these procedures were not put into place.

1.54 The failure of VicRoads to effectively monitor the project manager's performance restricted its ability to assess the quality of the management services provided to it and to determine whether it was receiving value-for-money from such services.

1.55 It became evident to audit, from a review of the minutes of the PARMS steering committee and discussions with representatives of a number of the organisations which submitted tenders for the prime contract, that the project manager, rather than VicRoads management, assumed the key strategic decision-making role and strongly influenced the direction of the project.

1.56 When external consultants are engaged for major IS projects, it is important that suitable performance benchmarks are established and that executive management regularly overview the performance of consultants against such benchmarks. Further, the strategic direction of projects should always remain the primary responsibility of executive management.

1.57 *It should be emphasised at this point that the scope of this audit review focused solely on the way VicRoads managed the project and did not include an evaluation of the selected project manager's competency or diligence in performing his contracted duties nor should any of the points raised in this Report reflect the proficiency with which these duties were carried out.*

Contractual arrangements and ministerial approvals

1.58 Initial contractual arrangements between VicRoads and the project manager related to the acquisition, enhancement and implementation of PARMS software and were entered into in July 1990. The arrangements involved 2 stages with an aggregate contract sum of $394 300. A further contract for a sum of $320 000 was entered into with the project manager in August 1992.

1.59 Over the period to May 1994, VicRoads made payments to the project manager totalling $1 039 300. **It was quite disturbing to find that, of this amount, payments of $687 300 were made by VicRoads without ministerial approval and payments of $464 700 were made either in advance of or outside contractual arrangements with the project manager.**

1.60 During a breakdown in negotiations between VicRoads and the initially appointed tenderer for PARMS, which occurred in early 1991, the contractual arrangements with the project manager were suspended. Notwithstanding this suspension, the project manager continued to provide services to VicRoads and over a 17 month period received monthly payment of $19 000, that is, a total of $323 000. These payments to the project manager, which formed part of the above amounts identified by audit as without ministerial approval and the protection of a contract, had been endorsed by the then Director of Finance of VicRoads. Furthermore, when a second contract for a sum of $320 000 was entered into with the project manager in August 1992, following the lifting of the suspension period, the documentation submitted to the Minister for approval of the contract did not include details of the earlier unauthorised payment.

1.61 **For the protection of scarce government resources and the establishment of an appropriate accountability framework, there is a need to ensure that all necessary ministerial approvals are obtained and that enforceable written contracts are entered into prior to the commencement of all IS works and services. Contracts should clearly outline the terms and conditions of the agreement including deliverables, time frames, responsibilities, payment arrangements and special legal protection issues.**

CONTRACTUAL ADMINISTRATION, NEGOTIATION AND PLANNING

1.62 The function of a contract in the engagement of professional services is to formalise the terms and conditions under which services are to be provided. The details of work to be carried out must be specific enough so that a comprehensive contract can be developed regarding the work assignments, responsibilities, delivery of products and billing and payment arrangements. The contract should also itemise special terms and conditions that protect the assets of the organisation.

1.63 The following paragraphs outline a series of problems which arose as a consequence of VicRoads allowing various tasks to be performed by, initially, the appointed tenderer and prime contractor on the acquisition and enhancement of PARMS without the protection of a properly signed contract.

Original successful tenderer

1.64 In July 1990, following a public tendering process, VicRoads appointed a tenderer to undertake the major developmental tasks associated with PARMS.

1.65 During 1990 there were doubts as to the system requirements and deliverables expected from the successful tenderer. In an attempt to address these doubts, the tenderer was awarded a separate contract (Contract No. 1692) in July 1990 to develop the system requirement specifications at a cost of $244 000.

1.66 After completion of the system requirement specifications VicRoads, in conjunction with the tenderer, continued with the next stage of acquisition and enhancement, designing the detailed software. The tenderer, without signing a contract, was paid $224 100 for involvement in this process.

1.67 In early 1991, as a result of the time that had elapsed and the modifications to system requirements, the tenderer was asked by VicRoads to re-confirm its bid for ministerial approval. In February 1991, based on legal advice, the tenderer withdrew its original offer and resubmitted an offer with an increased cost component.

1.68 The revised tender was rejected by VicRoads principally due to the unacceptable price and the tenderer's reluctance to accept all the performance guarantee clauses. In addition, VicRoads considered that other interested parties should be allowed the opportunity to re-tender, based on the amended system requirements, thereby eliminating any criticism of VicRoads circumventing the open tendering process.

1.69 Aggregate outlays at the time of the tenderer's withdrawal amounted to $950 400. Details of payments to the tenderer are outlined in Table 1B.

TABLE 1B
COSTS DURING CONTRACT NEGOTIATION
($)

Details	*Amount*
Project management consultant payments	282 300
VICROADS salary costs (approx.)	200 000
Payments to successful tenderer -	
System requirement specification (Contract No. 1692)	244 000
Detailed software design	224 100
Total costs	**950 400**

1.70 Based on discussions with the consultant, **audit estimates that of the $950 400 expended up to February 1991 benefits could not be attributed to approximately $450 000 of costs incurred**. Audit considers that if a binding contract for the entire project had been in place between the tenderer and VicRoads from the time of the initial decision in May 1990, or subsequently after the completion of the system requirement specification contract, this period of wasted time and resources could have been avoided.

Prime contractor

1.71 During the period between the withdrawal of the tenderer in February 1991 and the appointment of the prime contractor in December 1991, VicRoads was actively involved in the preparation of new tender specifications and documentation and the subsequent tender evaluation processes. Audit is of the view that this tender specification and documentation process should have occurred in early 1990 prior to the engagement of the original tenderer.

1.72 In addition, audit considered that the 11 months taken by VicRoads to develop the above documentation was an excessive period, given that many of the processes involved had already been undertaken and should not have required duplication at additional expense and effort. The protracted exercise undertaken also reflected on the lack of management and steering committee direction, in conjunction with poor planning. The impact of the 11 month delay resulted in an escalation in the total costs of the project and was a significant contributing factor to the overall delay in implementing the system.

1.73 When the prime contractor was awarded the PARMS contract in December 1991, the contractor offered VicRoads 2 payment options, namely:

- a lump sum payment; or
- a licensing fee arrangement.

1.74 The cash flow for the licence fee was to be $13.9 million in years 2 to 5, versus the lump sum costs of $9.3 million in years 1 and 2. The net present value of the licence fee compared with the lump sum was $9.9 million and $8.7 million, respectively.

1.75 VicRoads selected the licensing arrangement on the basis that it did not have the funds to pay the lump sum payment. In addition, during discussions with senior management, audit was advised that VicRoads had no borrowing powers and could not access a capital allocation of funds.

1.76 Despite the above restrictions there was no comprehensive evaluation of each funding option and as a consequence the information provided to the Minister in late 1991 in a ministerial briefing paper was incomplete. Accordingly, there is no assurance that the leasing option was the most cost-effective scenario. Notwithstanding the fact that VicRoads did not have borrowing powers, it was appropriate that both funding options should have been brought to the attention of the Minister for his consideration prior to approving the financing arrangements.

1.77 **For all future projects, financing arrangements should be fully evaluated, with all costs and benefits properly defined, thereby ensuring that the Minister and executive management within VicRoads have adequate information on which to base their selection of the best alternative.**

COST BUDGET MONITORING

1.78 A fundamental prerequisite when dealing with a project of the magnitude of PARMS is the effective management, systematic recording and reporting of information. It is important that procedures are in place for the preparation of a sound budget, with progressive expenditure monitored on an ongoing basis by management in order to ensure that the total costs of projects do not exceed approved budgets, after taking into account any critical changes required during the course of a project. Any such changes requiring amendment to budgets should be approved by management prior to the additional work being undertaken, or the next stage being proceeded with.

1.79 In addition to VicRoads' failure to critically evaluate the performance of the consultant, the review found that it did not establish an effective cost budget monitoring system. Specifically, VicRoads did not identify all projected costs in order to establish the total budget against which expenditure could be monitored. Further, an overall budget for the development and implementation of PARMS was not established during the justification process. An adequate management information system to allow the proper recording of total costs incurred was also not maintained.

1.80 Consequently, ongoing management information on total costs incurred for the acquisition and modification of PARMS was not maintained to provide some form of financial control and performance measurement. The failure to maintain and monitor overall costs prevented VicRoads from performing valuable comparisons of actual amounts expended with budgeted costs, which precluded executive management from systematically monitoring the financial status of the project and incorporating the results into decision-making processes.

FAILURE TO MEET TIME CONSTRAINTS

1.81 To ensure potential benefits outlined as part of the justification for any long-term project are realised, it is important that the completion time frames are achieved. As a result of the lack of a comprehensive IS strategy, indecisiveness and inadequate direction by executive management and the failure to provide full and proper justification for the project, VicRoads did not meet the time deadlines set down in the contractual agreement. Consequently, a number of opportunities anticipated from the system were lost in the form of benefits forgone. Table 1C provides an outline of the implementation timetable of the 5 modules of PARMS, and highlights the delays encountered in the implementation.

TABLE 1C
TIMETABLE FOR PARMS IMPLEMENTATION

Module	*Targeted completion dates as per October 1991 submission to the Minister*	*Current status*
Part A: Payroll - all sites	April 1992	Completed ~ 2 June 1993
Part B: Human resources all sites	August 1992	Completed ~ 16 Feb. 1994
Part C: Finance all sites	Nov. 1992	Completed ~ 16 Feb. 1994
Part D: Task management all sites	March 1993	Substantially completed ~ May 1994
Part E: DB2 version of payroll	Not included	Completed June 1994

1.82 The failure to produce PARMS within the established time frame of November 1992 has meant that the anticipated benefits from the system, included in the October 1991 ministerial submission, may not have materialised. The submission to the Minister stated that:

> *"Tangible benefits of the project total more than $27 million over the next six years, with a net present value of $8.7 million. If intangible benefits are included, the return increases to over $43 million in the same period with a present value of $21 million."*

1.83 Audit noted that specific tangible benefits were principally based on anticipated staff reductions and intangible benefits included improvements in controls through centralisation, contract administration, maintenance management, access and management reporting.

1.84 **Based on the projected benefits available of $27 million over 6 years and the delays of 16 months to complete the 3 key modules, audit has calculated that tangible and intangible benefits of $5.85 million and $9.23 million, respectively, were forgone.**

1.85 Although various other benefits that were not envisaged at the commencement of PARMS have in VicRoads' opinion been achieved, there is no evidence to support the assertions. The conduct of a post-implementation review, to commence prior to 1 January 1995, will provide evidence of the nature and magnitude of the benefits realised and forgone from PARMS.

FUTURE DIRECTIONS FOR VICROADS' INFORMATION SYSTEM PROJECTS

1.86 VicRoads has become increasingly aware of the need to improve its efficiency by streamlining certain operations and providing an improved level of service to the community. VicRoads, in line with government road policy "Roads to Recovery", is concentrating on core activities and contracting or divesting to the private sector all feasible activities. VicRoads is currently market testing the IT services to establish whether it would be cost-effective to outsource this function to the private sector. Outsourcing involves the contracting-out of a particular function or operation where a significant contribution is expected from external parties and sometimes involves the transfer of property.

1.87 In August 1992, the then Government agreed to call for tenders to establish a new computer data centre for transport information technology. The centre would amalgamate the computer systems of both the Public Transport Corporation and VicRoads. In May 1993, a chartered accounting firm was appointed to give an independent evaluation on the expressions of interests received. The outcome of the evaluation process was the short-listing of a number of organisations to be considered for the outsourcing contract. In August 1993, the Government announced that the successful tenderer will establish the IS centre in the country city of Ballarat. The short-listed companies were invited to submit tenders based on locating operations in Ballarat. In November 1993, responsibility for establishment and implementation of these combined computer services was transferred from the Ministers of Transport and Roads and Ports to the Minister of Finance.

1.88 In late August this year, a consortium led by the prime contractor and another high profile organisation was chosen by the Government as the preferred tenderer in a $150 million deal to build the computer centre in Ballarat. The 5 year contract between the Government and the consortium covers VicRoads and the Public Transport Corporation's communications and information systems. In particular the outsourcing will encompass:

- computer processing;
- network support;
- application maintenance; and
- end user servicing.

1.89 Discussions with VicRoads management revealed that the impact of incorporating PARMS in the information systems to be outsourced is currently under evaluation.

❑ ***RESPONSE** provided by Department of Transport*

The Department is concerned about a number of the issues raised by the Auditor-General. Arthur Andersen Internal Auditors to the Roads Corporation have been engaged to examine the findings and to report to the Department on any action which needs to be taken.

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