V I C T O R I A

Auditor-General
of Victoria

Report of the AUDITOR-GENERAL

on the

STATEMENT OF FINANCIAL OPERATIONS 1994-95

VICTORIAN GOVERNMENT PRINTER
1995

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Executive Summary

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Overview

With the introduction of the Financial Management Act in 1994 I am now required to furnish an audit opinion on the Government's primary financial accountability document, the Statement of Financial Operations. It is pleasing to report that I have been able to provide a confirming opinion on the Statement for the year ended 30 June 1995.

My Report on the audit of the Statement of Financial Operations highlights the success to date of the Government's financial reform measures involving a combination of revenue enhancement and expenditure reduction. A major challenge now faced by the Government is to maintain this momentum while at the same time improving the State's competitiveness. In this context, the Government has, as one of its longer-term budget aims, recognised the need "to bring Victoria's overall tax effort into closer alignment with the average of the Australian States".

The Report also shows that the total liabilities of the State at 30 June 1995 stood at $67.6 billion which was a reduction of $400 million from the previous year. The level of the State's liabilities is expected to decline significantly in future financial periods due to the impact of the Government's privatisation program on debt levels.

Up to the date of preparation of this Report, significant asset sales have occurred or were in progress. Furthermore, a number of infrastructure arrangements involving private sector participation had been established or were in the process of finalisation. Parts 4 and 8 of this Report provide detailed comment on these sale and infrastructure arrangements.

A significant issue which I have had to address in reporting on these arrangements has been the inclusion in contracts of confidentiality clauses which have sought to restrict the parties to the contracts from publicly disclosing relevant details, except as required by law. While my officers have had full access to all documentation concerning the various arrangements, in deciding on matters to be included in my Report, it has been necessary to balance the State's legitimate commercial interests with the right of the Parliament and Victorian taxpayers to be informed of the adequacy of the returns and exposures associated with the various arrangements.

Finally, with the sale of significant business assets by the State, it is important that there be adequate accountability to the Parliament on the operation of these businesses up to the date of their sale. In this regard, the Government is proposing action to require the conduct of final audits by my Office, with accountability to the Parliament.

Summary of major findings

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

AUDIT OPINION ON STATEMENT Page 15

- The Statement of Financial Operations presents fairly the transactions of the Public Account and the liabilities and financial assets of the State.

  Para. 2.12

- 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.

  Paras 2.1 to 2.11

FINANCIAL RESULT Page 21

- An analysis of the Consolidated Fund outcome for the year indicated that the **operating** result prior to abnormal items was a surplus of $930 million, compared with $542 million in the previous financial year.

  Paras 3.9 to 3.15

- The achievement of the favourable outcomes in the past 2 years mainly reflects the positive impact of the Government financial reform program which was introduced in 1992-93, involving a combination of revenue raising and expenditure reduction measures.

  Para. 3.12

- The **overall** Consolidated Fund result for the year was a deficit of $911 million. However, after taking into account debt repaid and changes in cash and investment balances, the result determined on the national accounting format was a surplus of $215 million.

  Paras 3.1 to 3.3

ASSET SALES Page 31

- The **net** benefit to the State from the sale of United Energy is anticipated to be in the order of $621 million, subject to final contractual adjustments in respect to the value of net assets sold.

  Paras 4.4 to 4.13

- A significant portion of the capital proceeds of the United Energy sale of around $1.5 billion will be applied towards debt retirement.

  Paras 4.14 to 4.16

- The proceeds from the sale of the GEB were $74 million less than the net assets (excluding borrowings) of the business which had an estimated book value of $126 million.

  Paras 4.17 to 4.31

- While the proceeds from the GEB sale totalled $52.4 million, the State assumed and repaid GEB debt of $54.2 million and incurred selling costs of $1.1 million, giving an overall negative cashflow to the State of $2.9 million.

  Para. 4.31

- Financial statements for tabling in the Parliament were not prepared for the period up to the date of sale in respect to the operations of Energy Information Technology Company Pty Ltd and, accordingly, a final audit was not undertaken by my Office to ensure proper accountability.

  Para. 4.46

- While the State will generate a return from the proceeds of the sale of the VicRoads Plant Hire and Technical Services business, this benefit will be substantially off-set by additional hire costs incurred by VicRoads.

  Paras 4.69 to 4.79

- The sale price of $10 million for the State's interest in the land upon which the Southern Cross Hotel resides was considered to be reasonable by the Valuer-General.

  Paras 4.92 to 4.98

CONSOLIDATED FUND RECEIPTS Page 57

- The Consolidated Fund gross receipts for the year, excluding borrowings, were consistent with overall budget expectations.

  Paras 5.1 to 5.4

- The Government has established as one of its 4 longer-term budget aims to bring Victoria's overall tax effort into closer alignment with the average of the Australian States.

  Paras 5.5 to 5.8

CONSOLIDATED FUND PAYMENTS — Page 73

- Taxation rulings on certain prior year financing arrangements have increased the cost of those arrangements to the State by $158 million.

  Paras 6.13 to 6.20

- The realisation of budget sector savings from the employee separation program is ultimately dependent on the success of government strategies to maintain the reduced workforce levels and effective management of consultants and contractors.

  Paras 6.35 to 6.43

- During the year, the Commonwealth Bank of Australia became liable for an amount of $5.5 million under the conditions of the Victorian Investment Corporation Ltd (VIC) sale agreement and lodged an equivalent claim on the State, which was paid.

  Paras 6.51 to 6.53

ASSETS OF THE STATE — Page 91

- While the Statement of Financial Operations does not present the State's total asset holdings, it discloses that its financial assets at 30 June 1995 totalled $14.6 billion.

  Paras 7.1 to 7.3

- The focus on improved asset recording, reporting and management needs to be maintained to assist in the enhanced financial management of the State's resources.

  Paras 7.4 to 7.11

LIABILITIES AND COMMITMENTS — Page 99

- The total liabilities of the State at 30 June 1995 stood at $67.6 billion.

  Paras 8.1 to 8.6

- Under the arrangements established for the provision of the new emergency services call-taking and dispatch facilities, the provider of the facilities bears the financing risk as under certain specified circumstances the Government has a right to terminate the arrangements.

  Paras 8.32 to 8.43

- Given the critical nature of the services provided through the emergency services call-taking and dispatch facilities, the Government, if it terminated the arrangement with the private sector provider, would have to obtain immediate alternative service delivery to safeguard the health and security of the community.

  Para. 8.43

- Due to the future exposures to the State arising from the financing arrangements under the Accelerated Infrastructure Program, the Government commenced action to wind-up the Program through the purchase of bonds issued to finance the Program.

  Paras 8.69 to 8.77

LIABILITIES AND COMMITMENTS - *continued* Page 99

- Even though the Government during the year took specific action to reduce the liabilities of public sector superannuation funds by around $520 million, the State's unfunded superannuation liabilities nevertheless increased in the period by $454 million to total $15.1 billion at 30 June 1995.

  Paras 8.78 to 8.98

- After taking into account contributions paid to the Consolidated Fund, together with dividends paid to the SECV, the Victorian electricity industry paid net contributions of $319 million during the year, compared with $225 million in 1993-94.

  Paras 8.114 to 8.116

- During the year, the Government contributed around $21 million to meet operating and capital expenditure associated with the Formula One Grand Prix.

  Paras 8.139 to 8.149

- As part of the financial arrangements associated with the Australian Motorcycle Grand Prix, the Government has agreed to underwrite any annual deficits associated with the staging of this event.

  Paras 8.150 to 8.154

- The consortium associated with the delivery of the automated ticketing system has lodged various notices of delay with possible cost implications for the State. However, the State has a right to receive compensation from the consortium for the late commissioning of the system.

  Paras 8.155 to 8.162

- A detailed audit assessment of the City Link arrangements, including an examination to determine the risks and financial exposures to the State resulting from the project, will not be undertaken until the arrangements are finalised.

  Paras 8.163 to 8.170

OTHER MATTERS Page 143

- While under the former *Public Account Act* 1958, the receipts of the Consolidated Fund (including borrowings) were required to equal the payments in any one year, under the *Financial Management Act* 1994 the Trust Fund balance can be applied towards financing Consolidated Fund deficits.

  Paras 9.1 to 9.2

PART 2

Audit Opinion on Statement

VICTORIAN
AUDITOR-
GENERAL'S
OFFICE

Auditing in the Public Interest

Part 2

Audit Opinion on Statement

KEY FINDINGS

- The Statement of Financial Operations presents fairly the transactions of the Public Account and the liabilities and financial assets of the State.

  Para. 2.12

- 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.

  Paras 2.1 to 2.11

Financial accountability framework

2.1 The accountability framework relating to the State's finances is set out in the *Constitution Act* 1975, *Financial Management Act* 1994 and *Audit Act* 1994.

2.2 While the *Constitution Act* 1975 creates the Consolidated Revenue and makes its appropriation the prerogative of the Parliament, the key element of the accountability framework is the requirement, under the *Financial Management Act* 1994, for the Government to annually present to the Parliament a Statement of Financial Operations. In broad terms, this Statement is required to provide a summary of the transactions and balances of the Public Account, comprising the Consolidated Fund and the Trust Fund, and the liabilities (including contingent liabilities) and prescribed assets of the State.

2.3 **In accordance with the *Financial Management Act* 1994, the Statement of Financial Operations must be audited by the Auditor-General and presented to the Parliament each year, together with a Report of the Auditor-General on that Statement. The *Audit Act* 1994 outlines the powers of the Auditor-General in conducting this and other audits in the public sector.**

2.4 In previous years, the Finance Statement (which has now been replaced by the Statement of Financial Operations) was prepared by the Government under the provisions of the former *Audit Act* 1958. Under those provisions, the Auditor-General was not required to audit that Statement but was required to explain the Statement in full in a Report to the Parliament.

2.5 **The 1994-95 financial year is the first accounting period for which an audit opinion has been provided to the Parliament on the Government's key financial accountability statement. This is a welcomed development, which aligns the accountability requirements relating to the Statement of Financial Operations with those relating to the financial statements of all public sector entities.**

2.6 As indicated previously, the Statement of Financial Operations, inter alia, is required to present a summary of Public Account transactions, including the transactions of the Consolidated Fund and Trust Fund. Under the current accountability framework, the Consolidated Fund is the Government's main operating account and records the collection of all departmental 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, Appropriation Acts, which provide the key means by which Parliamentary control is exercised over public finances, are prepared annually by the Government and sanctioned by the Parliament.

2.7 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.

2.8 Due to increasing demand, in recent years, for financial information of greater economic relevance which can be readily used for inter-governmental comparisons of financial performance, the Government has presented within various budget documents and Niemeyer Statements, information in the *national accounting* format. This information has been additional to that presented under the established accountability framework.

2.9 While in previous years the Finance Statement has included certain supplementary information relating to the liabilities and financial assets of the public sector, the relevant Act now specifically requires the Statement of Financial Operations to present a summary of the State's liabilities (including contingent liabilities) and prescribed assets.

2.10 **This Report presents detailed comment on the information contained in the Statement of Financial Operations to assist the Parliament in its analysis of the Statement. However, as commented in my previous Reports, 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.**

2.11 Based on the current timetable for the introduction of whole-of-government reporting, it is the Government's intention to consider publishing consolidated financial statements of the State for the 1995-96 financial year if the statements prepared comply with appropriate accounting standards.

Audit opinion on the Statement of Financial Operations

2.12 The Statement of Financial Operations for the year ended 30 June 1995 has been audited in accordance with the requirements of the *Financial Management Act* 1994. The audit has been undertaken in accordance with Australian Auditing Standards, using methodologies consistent with those applied by the accounting profession. My opinion on the Government's 1994-95 Statement of Financial Operations is as follows:

Audit Scope

The accompanying Statement of Financial Operations for the year ended 30 June 1995, comprising the financial statements and relevant notes contained in Parts A and B of the Statement, has been audited. The Secretary to the Department of Treasury and Finance is responsible for the preparation and presentation of the Statement and the information it contains. An independent audit of the Statement has been carried out in order to express an opinion on it as required by the *Financial Management Act* 1994.

The audit has been conducted in accordance with Australian Auditing Standards to provide reasonable assurance as to whether the financial statements are free of material misstatement. The audit procedures included an examination, on a test basis, of evidence supporting the amounts and other disclosures in the financial statements, and the evaluation of accounting policies and significant accounting estimates. These procedures have been undertaken to form an opinion as to whether, in all material respects, the financial statements are presented fairly in accordance with the *Financial Management Act* 1994 and comply with the requirements of that Act.

The audit opinion expressed on the Statement of Financial Operations has been formed on the above basis.

The explanatory notes provided on pages 10 to 28 and the supplementary material contained in Part C of the Statement are included for information purposes only and accordingly, an audit opinion is not expressed thereon.

Audit Opinion

In my opinion, the financial statements present fairly the financial transactions of the Public Account and the liabilities and financial assets of the State for the year ended 30 June 1995, in accordance with the *Financial Management Act* 1994.

Auditor-General's Report on the Statement of Financial Operations

2.13 As mentioned earlier, the Statement of Financial Operations broadly discloses the financial transactions of the Public Account and the liabilities and prescribed assets of the State.

2.14 To assist in the analysis and assessment of the Statement, the Auditor-General's Report on the Statement of Financial Operations is presented in a format consistent with that adopted for the Statement. The Report comments on:

- Financial result;
- Asset sales;
- Consolidated Fund receipts;
- Consolidated Fund payments;
- Assets of the State;
- Liabilities and commitments; and
- Other matters.

PART 3

Financial Result

VICTORIAN AUDITOR-GENERAL'S OFFICE

Auditing in the Public Interest

Part 3

Financial Result

KEY FINDINGS

- An analysis of the Consolidated Fund outcome for the year indicated that the operating result prior to abnormal items was a surplus of $930 million, compared with $542 million in the previous financial year.

  Paras 3.9 to 3.15

- The achievement of the favourable outcomes in the past 2 years mainly reflects the positive impact of the Government financial reform program which was introduced in 1992-93, involving a combination of revenue raising and expenditure reduction measures.

  Para. 3.12

- The overall Consolidated Fund result for the year was a deficit of $911 million. However, after taking into account debt repaid and changes in cash and investment balances, the result determined on the national accounting format was a surplus of $215 million.

  Paras 3.1 to 3.3

- There is a need to continue to review and improve transaction classifications within the Public Account to enhance the transparency of the Statement of Financial Operations and its usefulness to the Parliament and the public for informed assessments of financial outcomes.

  Paras 3.16 to 3.17

- Further action to eliminate arrangements established in prior years to defer certain expenditure was taken during the year.

  Paras 3.18 to 3.23

Financial result for the year

3.1 The Statement of Financial Operations discloses that **the overall Consolidated Fund result for the 1994-95 year (funded from borrowings) was a deficit of $911 million, which was $305 million less than budget expectations**.

3.2 However, the result when calculated under the *national accounting format* was a **surplus of $215 million, as represented by the budget sector financing transactions** (1993-94, $572 million deficit). While the Statement of Financial Operations discloses the overall Consolidated Fund result, the *national accounting format* takes into account not only the transactions of the Consolidated Fund, but also the transactions relating to the Trust Fund and those public bodies subject to substantial central budgetary control.

3.3 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 1993-94*	***Actual 1994-95***	*Budget 1994-95*	***Variance from Budget***	*Variance from 1993-94 Actual*
Recurrent -					
Receipts excluding borrowings	15 260	**14 713**	14 803	**(90)**	(547)
Payments	15 377	**14 788**	15 149	**361**	589
Recurrent deficit for year	(117)	**(75)**	(346)	**271**	42
Works and services -					
Receipts excluding borrowings	1 118	**1 444**	1 323	**121**	326
Payments	2 188	**2 280**	2 193	**(87)**	(92)
Works and services deficit for year	(1 070)	**(836)**	(870)	**34**	234
Overall Consolidated Fund deficit for year (funded from borrowings)	(1 187)	*(a)***(911)**	(1 216)	**305**	276
Less - Reconciling items (refer to Table 3C of this Report)	615	**1 126**			
Financing transactions surplus / (deficit) (national accounting format)	(572)	**215**			

(a) Includes a $78 million balance of the former Works and Services Account transferred to the Consolidated Fund during the year.

Key factors impacting on result

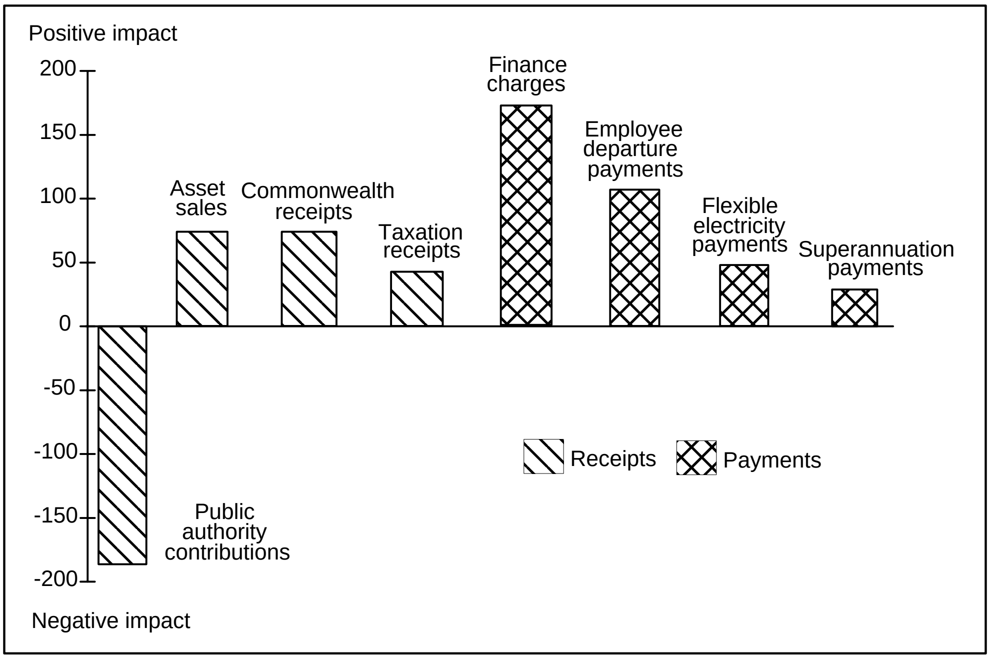
3.4 The favourable Consolidated Fund result for the year as compared with budget was achieved mainly due to:

- receipts from taxation sources, the Commonwealth Government and asset sales being higher than expected; and
- payments relating to financing charges, employee departure programs, flexible electricity tariff arrangements and superannuation contributions being lower than anticipated.

3.5 However, the positive impact of the above items was to an extent offset by lower than expected contributions from public authorities.

3.6 Chart 3B shows the contribution of the above items to the year's result.

CHART 3B
MAJOR BUDGET VARIANCES, 1994-95
($million)



Difference between Consolidated Fund and national accounting format results

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

TABLE 3C
RECONCILIATION OF 1994-95 CONSOLIDATED FUND DEFICIT WITH THE REPORTED RESULT UNDER THE NATIONAL ACCOUNTING FORMAT
($million)

Item			*Amount*
Financing transactions - surplus (national accounting format)			**215**
Less -			
Appropriations for repayment of borrowings -			
Treasury Corporation of Victoria managed debt	1 110		
Public Transport Corporation leases	15		
Computer lease facility	6	*(a)*1 131	
Borrowing repayments outside the Consolidated Fund by -			
Victorian Debt Retirement Fund	92		
Commonwealth Government	7	99	
National Rail Corporation share purchase		12	
Net effect of other items (mainly changes in cash, investments and other items)		(116)	
Total reconciling items			**1 126**
Consolidated Fund deficit			**(911)**

(a) Does not include a $200 million payment to repurchase bonds previously issued to finance projects undertaken under the Accelerated Infrastructure Program (refer to Part 8 of this Report for further comment on this matter).

3.8 Table 3C indicates that the difference of $1.1 billion between the Consolidated Fund and *national accounting* reporting format results largely relates to borrowing repayments, which have been partly off-set by a reduction in cash and investment holdings.

Re-statement of Consolidated Fund result by audit

3.9 The Statement of Financial Operations classifies Consolidated Fund transactions between the recurrent and works and services sectors, consistent with parliamentary appropriations. However, as commented in my previous Reports on the Finance Statement, 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 items inhibits the ability of users of the Statement of Financial Operations to ascertain and assess the Consolidated Fund's operating result for the year.

3.10 A review was commenced in 1992-93 by the Department of Treasury and Finance to enhance the classification of Public Account transactions, resulting in the re-classification of significant items since that time, mainly relating to repairs and maintenance costs. However, as indicated in Table 3E, there is a need for continuing action by the Department to satisfactorily address this matter.

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

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

Item	***1994-95***	*1993-94*
Operating transactions -		
Receipts	**14 471**	13 535
Payments	**13 541**	12 993
Operating surplus prior to abnormal items	**930**	542
Add/(Less) - Abnormal items *(b)*	**(421)**	106
Operating surplus for the year	**509**	648
Capital transactions (excluding borrowing transactions)		
Receipts	**1 004**	1 443
Payments	**1 543**	1 187
Capital surplus/(deficit) prior to abnormal items	**(539)**	256
Add/(Less) - Abnormal items *(c)*	**450**	(1 200)
Capital deficit for year (excluding borrowing transactions)	**(89)**	(944)
Consolidated Fund surplus/ (deficit) prior to borrowing repayments	**420**	(296)
Borrowing repayments	**(1 331)**	(891)
Overall Consolidated Fund deficit for year (funded from borrowings)	**(911)**	(1 187)
Less - Reconciling items (refer to Table 3C of this Report)	**1 126**	615
Financing transactions (national accounting format)	**215**	(572)

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

(b) Abnormal items of an operating nature include employee departure program payments of $293 million ($732 million, 1993-94), the reversal of prior year expenditure deferral arrangements of $40 million ($362 million, 1993-94) and a payment of $88 million to the State Superannuation Fund under revised funding arrangements. The 1993-94 abnormal items included a receipt of a $1.2 billion special dividend from the Transport Accident Commission.

(c) Abnormal items of a capital nature comprise the receipt of $656 million from the sale of the Totalizator Agency Board of Victoria and Grain Elevators Board businesses, the receipt from Crown Casino of $26 million for the right (intangible asset) to operate the new casino ($200 million, 1993-94) and payment of deferred employer superannuation contributions of $232 million ($1.4 billion, 1993-94).

3.12 **An analysis of the restated result indicates that the operating surplus for the year prior to abnormal items was $930 million, compared with $542 million in 1993-94. The achievement of these favourable outcomes in the past 2 years mainly reflects the positive impact of the Government financial reform program which was introduced in 1992-93, involving a combination of revenue raising and expenditure reduction measures.**

3.13 Specifically, the improved operating result in the year was due to increased taxation receipts due to improved economic conditions, higher collections from electronic gaming machines due to their progressive installation and increased turnover, increased recurrent grants from the Commonwealth Government and expenditure restraint by departments. However, the year's overall operating result was influenced by a number of abnormal items, including expenditure of $293 million on employee departure programs, superannuation payments of $88 million under revised funding arrangements and payments of $40 million relating to the reversal of prior year deferral arrangements.

3.14 **The capital sector result prior to debt repayment transactions and abnormal items was a deficit of $539 million, compared with a surplus of $256 million in 1993-94**. The significant shift between years was due to a reduced level of capital grants from the Commonwealth Government and increased capital works expenditure by departments, consistent with the Government's objective of improving the quality of the State's infrastructure. In addition, the 1993-94 result was significantly influenced by receipts in that year from public bodies in relation to the wind-up of the Victorian Equity Trust

3.15 However, the overall result for the capital sector in 1994-95 was also significantly influenced by a number of abnormal transactions, including receipts of $656 million from the sale of the Totalizator Agency Board of Victoria and Grain Elevators Board businesses and payments of $232 million on account of deferred employer superannuation contributions.

Re-classified transactions

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

TABLE 3E
RE-CLASSIFIED CONSOLIDATED FUND TRANSACTIONS, 1994-95
($million)

Item	*Amount*
Receipts	
Capital receipts classified as recurrent -	
Repayment of advances (principal)	242
Re-classified receipts	**242**
Payments	
Operating payments classified as works and services -	
Employee departure programs	293
Repairs and maintenance	44
Planning and development programs	150
Finance charges	6
	493
Less - Capital payments classified as recurrent -	
Deferred employer superannuation contributions	232
Repayment of borrowings (principal)	1 084
Other	3
	1 319
Re-classified payments (net)	**(826)**

3.17 I re-iterate the comments made earlier in this Report that **the Department of Treasury and Finance should continue to review and improve transaction classifications within the Public Account to enhance the transparency of the Statement of Financial Operations and its usefulness to the Parliament and the public for informed assessments of the year's financial outcomes.**

Elimination of prior-year expenditure deferrals

3.18 In 1992-93, the Government commenced action to eliminate certain expenditure deferral arrangements established in prior years, which transferred to future periods the financing of significant obligations. As commented in my previous Reports on the Finance Statement, expenditure deferrals totalling $660 million were reversed by the Government in the period July 1992 to June 1994.

3.19 In 1994-95, action was taken to reverse further expenditure deferrals totalling $40 million. These arrangements are discussed below.

Municipal rate concessions

3.20 Prior to 1990-91, grants to municipalities for the funding of pensioner rate concessions were paid in December and August of each calendar year. Thereafter, it was decided that payments would be made in July only, effectively deferring the December payments by 7 months.

3.21 In 1994-95, the Government re-established the previous payment timetable to municipalities, resulting in an additional payment of $24 million during the year in relation to the pensioner rate concessions scheme.

Grants to non-government schools

3.22 Financial assistance is provided to non-government schools in the form of annual grants. As mentioned in my previous Report on the Finance Statement, prior to 1990-91, these grants were paid in instalments in February (25 per cent), July (50 per cent) and October (25 per cent). However, in 1990-91, the Government entered into an arrangement whereby a private bank would provide advances to schools commensurate to the level of grant funding normally received in February and the Government agreed to meet finance charges associated with these bank advances.

3.23 The Government commenced action to reverse this arrangement in the 1993-94 financial year and, in 1994-95, fully re-instated the previous timetable with an additional payment of $16 million during the year.

PART 4

Asset Sales

VICTORIAN
AUDITOR-
GENERAL'S
OFFICE

Auditing in the Public Interest

Part 4

Asset Sales

KEY FINDINGS

- During the 1993-94 financial year and up to the date of preparation of this Report, there have been a number of major business and property sales undertaken by the Government.
Paras 4.1 to 4.3
- The net benefit to the State from the sale of United Energy is anticipated to be in the order of $621 million, subject to final contractual adjustments in respect to the value of net assets sold.
Paras 4.4 to 4.13
- A significant portion of the capital proceeds of the United Energy sale of around $1.5 billion will be applied towards debt retirement.
Paras 4.14 to 4.16
- The proceeds from the sale of the GEB were $74 million less than the net assets (excluding borrowings) of the business which had an estimated book value of $126 million.
Paras 4.17 to 4.31
- While the proceeds from the GEB sale totalled $52.4 million, the State assumed and repaid GEB debt of $54.2 million and incurred selling costs of $1.1 million, giving an overall negative cashflow to the State of $2.9 million.
Para. 4.31
- The result achieved by the State from the sale of Energy Information Technology Company Pty Ltd was significantly above an independent valuation of the business.
Paras 4.38 to 4.45

KEY FINDINGS - *continued*

- Financial statements for tabling in the Parliament were not prepared for the period 1 July 1994 to the date of sale of 28 February 1995 in respect to the operations of Energy Information Technology Company Pty Ltd and, accordingly, a final audit was not undertaken by my Office to ensure proper accountability.
  Para. 4.46
- GFE Resources Pty Ltd was sold for $15.9 million greater than the book value of its net assets, which excluded debt previously assumed by the State.
  Paras 4.54 to 4.61
- While the State will generate a return from the proceeds of the sale of the VicRoads Plant Hire and Technical Services business, this benefit will be substantially off-set by additional hire costs incurred by VicRoads.
  Paras 4.69 to 4.79
- The Government has entered into an arrangement for the sale and development of Cathedral Place. The development, which is estimated to cost $100 million, will comprise a hotel complex, an underground car parking facility and the construction of a palliative care facility for the Peter MacCallum Institute.
  Paras 4.80 to 4.91
- The sale price of $10 million for the State's interest in the land upon which the Southern Cross Hotel resides was considered to be reasonable by the Valuer-General.
  Paras 4.92 to 4.98
- Proceeds from the sale of properties within the education portfolio totalled $52.5 million in the year.
  Paras 4.99 to 4.102
- At 30 June 1995, approximately 2 750 properties with an aggregate value of $205 million had been identified as surplus to Government requirements and were awaiting sale.
  Paras 4.107 to 4.110
- A formal response to the State's submission for tax compensation on account of the privatisation of GBEs was yet to be received from the Commonwealth Government.
  Paras 4.111 to 4.116

GOVERNMENT ASSET SALES PROGRAM

4.1 A major component of the Government's public sector reform program has been the privatisation of government business enterprises with a key stated objective of improving the efficiency of the key service industries in order to reduce business costs and enhance the productivity of the Victorian economy. In addition, to enhance the operational efficiency and effectiveness of the budget sector, since 1987-88, the Government has operated an asset sales program involving the disposal of surplus and under-utilised properties.

4.2 This part of the Report outlines the major business and property sales undertaken by the Government during the 1994-95 financial year and up to the date of preparation of this Report. The sales covered in the Report include:

- United Energy Limited;
- Grain Elevators Board;
- Totalizator Agency Board of Victoria (TAB);
- Energy Information Technology Company Pty Ltd;
- BASS joint venture;
- GFE Resources Ltd;
- State Supply Service;
- VicRoads Plant Hire and Technical Services business;
- Cathedral Place property;
- Southern Cross Hotel site;
- Educational properties; and
- Employee Housing.

4.3 The proceeds paid into the Consolidated Fund during the 1994-95 financial year from both business and property assets are shown in Part 5 of this Report.

United Energy Limited

4.4 My previous *Reports on Ministerial Portfolios* have provided detailed comment on the Government's substantial reform program relating to the Victorian electricity supply industry. An initial stage of this program involved the disaggregation of the former State Electricity Commission of Victoria and the establishment, in October 1994, of 5 independent electricity distribution businesses, namely, CitiPower, Solaris, United Energy, Powercor and Eastern Energy. These businesses assumed responsibility for the distribution operations of the former State Electricity Commission of Victoria and the 11 Municipal Electricity Undertakings (MEUs) that were previously managed by Melbourne metropolitan municipal councils.

4.5 In December 1994, the Government agreed in principle to the privatisation of all 5 of the distribution businesses and one electricity generation company, commencing in 1995. It was subsequently announced that United Energy Limited would be the first distribution business to be privatised.

4.6 The strategy that was to be adopted for the privatisation of the distribution businesses was to involve either trade sales or floats, or a combination of both. The Government took the view that having first established a competitive industry model (including legislatively provided maximum uniform tariffs) which was geared towards delivering long-term economic reform, and having also established the Office of the Regulator-General some considerable time prior to the sale of the first distribution business, the sale process itself was to be directed at optimising the sale proceeds to facilitate maximum public sector debt reduction.

4.7 In the case of the United Energy sale, the Government decided to proceed with a trade sale based on advice received from its appointed financial advisors. Key considerations underlying this decision included:

- a trade sale was considered most likely to achieve the highest return to the State;
- market conditions at the time were not considered conducive to the maximisation of returns from a float;
- strong interest was received from potential trade buyers, therefore ensuring a strong competitive sale environment;
- the likely higher sale price achieved under the trade sale option would facilitate the establishment of a higher valuation benchmark for future distribution business sales, and lead to more informed judgements of respective values;
- the float process was considered to be more vulnerable to political influences; and
- a trade sale offered the opportunity to bring in expertise and international knowledge and methods to the Victorian electricity industry, to enhance the efficiency of service provision.

Sale process

4.8 In March 1995, an Information Memorandum was issued in relation to the proposed sale to a number of potential bidders who had previously lodged an expression of interest in the acquisition of electricity businesses. Based on the information included in the Information Memorandum, indicative bids were received from potential purchasers in May 1995. The assessment of these bids resulted in the short-listing of 4 bidders who were then required to submit firm offers. The assessment of the initial bids was based on the price offered, together with consideration of:

- the bidding parties' financial standing;
- the relevant skills and experience of the bidding parties; and
- the extent of Australian equity participation, or the commitment to obtain significant Australian equity participation.

4.9 Once selected, the short-listed bidders conducted due diligence inquiries to establish the financial standing of United Energy. The due diligence process included access to data covering various operating, legal and financial information, and access to key management personnel of United Energy.

4.10 The final bids were lodged in early August 1995 and, shortly thereafter, the Government announced the sale of United Energy to a consortium, Power Partnership, comprising the AMP Society, the New South Wales State Authorities Superannuation Board and the United States-based company, Utilicorp. The sale price was well above the book value of the net assets of United Energy.

4.11 The Government announced that the total value to be received by Victorian taxpayers from the sale of United Energy was $1.8 billion. This amount included the value to be received by the State for the business, together with a responsibility for the purchaser to pay an outstanding loan of United Energy to the Treasury Corporation of Victoria which at the date of sale totalled $471 million, dividends payable by United Energy to SECV as at 30 June 1995 of $11 million and stamp duty on the sale transaction payable to the State of $8 million. In addition, the amount included the sum required to be paid by the company to the State for franchise fees over the next 5 years, based on forecast profits, which had an estimated present value of $275 million. However, the State may be required to make a payment to the purchaser in the event that an unfavourable ruling received from the Australian Taxation Office, in relation to the deductability of these fees for taxation purposes, is not overturned within 3 years.

4.12 Table 4A outlines the key components of the proceeds receivable by the State under the sale arrangements.

TABLE 4A
COMPOSITION OF UNITED ENERGY PROCEEDS
($million)

Details	*Amount*
Proceeds in excess of book value of business	724
Proceeds for SECV interest in the net assets of the business	339
	1 063
Repayment by purchaser of outstanding debt of the business	471
Dividend to the State	11
Stamp duty on transaction	8
Franchise fees (net present value)	275
Total proceeds	**1 828**

4.13 Under the arrangements, the State received $1 063 million for the sale of the net assets of United Energy, excluding the SECV's interest in the business, which at 30 June 1995 had an estimated (unaudited) value of $339 million. In effect, this resulted in the State obtaining $724 million more than the book value of the business assets. Of this amount, $95 million will be payable to municipal councils in relation to electricity undertakings' net assets previously transferred to United Energy. In addition, the Department of Treasury and Finance estimates that costs directly incurred by the State in relation to this sale were in the order of $8 million. **Accordingly, the net benefit to the State from the sale of the assets of United Energy is anticipated to be in the order of $621 million, subject to final contractual adjustments in respect to the value of the net assets sold.**

4.14 In September 1995, the sale was completed and the settlement proceeds were paid as follows:

- repayment of United Energy borrowings of $471 million owed to the Treasury Corporation of Victoria; and
- the balance of $1 074 million paid to the SECV to retire debt and for working capital purposes.

4.15 The SECV Administrator is required to pay $95 million to municipal councils as consideration for the net assets previously transferred from municipal electricity undertakings (MEUs) to United Energy prior to the sale. This payment is to be made in October 1995.

4.16 The costs of $8 million directly associated with the sale will be initially met from the Consolidated Fund by the Department of Treasury and Finance and recouped from the SECV. These costs do not cover expenditure incurred by the Electricity Supply Industry Reform Unit of the Department which was not solely related to the sale.

Grain Elevators Board

4.17 The Grain Elevators Board (GEB) was established in 1935 to provide storage, handling and distribution services for bulk agricultural commodities within Victoria and southern New South Wales. Its operations were principally conducted through a network of 250 country grain receival facilities, including port terminals at Geelong and Portland, and a metropolitan terminal at Sunshine. The grain storage capacity of the GEB totalled approximately 5 million tonnes.

4.18 Despite the volatility of the grain handling market, which is exposed to substantial financial losses during prolonged periods of drought, the GEB has been able to successfully generate substantial accumulated funds, which have been totally financed from operating surpluses. At 30 September 1994, the total accumulated funds of the GEB amounted to $84 million.

4.19 In April 1994, the Government announced its intention to privatise the businesses of the GEB, with the aim of:

- enhancing the long-term efficiency and competitiveness of grain storage, handling and transport services to the Victorian industry;
- providing for future growth of the grain storage business; and
- obtaining a reasonable financial return to the Government.

Former GEB bulk product export terminal facility at Portland.

Sale process

4.20 In June 1994, the Government commenced negotiations with the Victorian Farmers Federation for the sale of the GEB's business. At that time, an independent valuation placed the value of this business at $89 million on the assumption that the Government would accept responsibility for the repayment of all outstanding loans, which at that time totalled $53.9 million.

4.21 Detailed negotiations between the 2 parties resulted in a purchase offer from the Victorian Farmers Federation of $51.9 million. However, given that the offer was substantially below the above valuation of the business, it was rejected by the Government.

4.22 In November 1994, public advertisements were widely placed in the print media, inviting interested bidders to submit expressions of interest for the acquisition of the GEB's assets and undertakings. The Department of Treasury and Finance also appointed consultants to act as advisers to the Government on the sale process and an accounting firm to review the tender process and ensure that all tenderers were accorded fair treatment and evaluated fairly against established selection criteria.

4.23 An **informal** independent valuation of the GEB's assets and business in early 1995 placed the value of the GEB (not including outstanding borrowings) at between $50 million to $60 million, which was $30 million to $40 million below the June 1994 valuation of the business. However, part of this difference was attributable to the adverse impact of drought conditions on the operating results of the business for the 1994-95 financial year.

4.24 In May 1995, following a detailed evaluation of the 2 tenders received, the Government announced the sale of the GEB business to a consortium headed by the Victorian Farmers Federation. A *Sale of Business and Shares Agreement* was signed by the respective parties which outlined the terms of sale and was ratified in June 1995 by the Parliament through the enactment of the *Grain Handling and Storage Act* 1995.

Key terms of sale

4.25 The *Sale of Business and Shares Agreement* provides for the acquisition by the consortium on 30 June 1995 of all GEB assets and liabilities, except for the outstanding loan liabilities. The estimated book value of the net assets to be acquired by the purchasers at 30 June 1995 was $126 million.

4.26 Under the sale agreement, the State was entitled to receive total estimated proceeds of $52.4 million, as follows:

- $46.6 million at 30 June 1995, subject to final adjustments for variations in the value of assets and liabilities sold; and
- $5.8 million receivable over the next 3 years, $5 million of which is receivable only if the purchaser obtains a favourable tax ruling in relation to fixed asset depreciation deductions, and the remaining $800 000 subject to the receipt from marketers of amounts in respect of grain received but not distributed by the GEB at the time of sale.

4.27 Consistent with the terms of the sale agreement, at 30 June 1995, the State received the $46.6 million sale proceeds from the consortium and assumed the GEB's loan liabilities which had a net market value of $54.2 million. The sale proceeds, together with an additional Government appropriation of $7.6 million, were applied to the retirement of the loan liabilities of the GEB.

Costs of sale

4.28 The estimated costs incurred by the State in relation to the sale to 30 June 1995 were $900 000, mainly relating to the engagement of financial advisors by the Government to provide assistance in the sale process. In addition, the Department of Treasury and Finance estimates that a further $200 000 will be required during 1995-96 to wind-down the activities of the GEB "shell".

Assessment of sale result

4.29 **Immediate benefits derived by the State from the sale of the GEB business include a reduction of public sector debt and the elimination of an exposure to the highly volatile grain handling industry, particularly in periods of prolonged drought. This exposure had been accentuated in recent times with the GEB facing increasing competition from on-farm and privately operated storage facilities under the deregulated domestic wheat market.**

4.30 The financial advisors to the Government on this sale considered that, while no direct public company comparisons could be made in assessing the sale result for the State, on the basis of a "price to earnings multiples" analysis, the final sale price was fair and equitable.

4.31 **An analysis of the sale result, from the State's perspective, indicated that:**

- **while the estimated sale price of $52.4 million was consistent with an informal independent valuation of the business obtained in early 1995, it was $37 million less than an independent valuation conducted on behalf of the Government in 1994;**
- **the sale proceeds were $74 million less than the GEB's net assets (excluding borrowings) which had an estimated book value of $126 million; and**
- **while the estimated proceeds to be received by the State from the sale total $52.4 million, the State has assumed and repaid outstanding loans from the GEB totalling $54.2 million and has incurred costs associated with the sale of $1.1 million, giving an overall negative cashflow of $2.9 million.**

TAB businesses

4.32 My October 1994 Report on the Finance Statement commented on the arrangements established by the Government to privatise the Totalizator Agency Board of Victoria (TAB) businesses and the financial result for the State from this privatisation.

4.33 Specifically, the Report noted that to enable the TAB to raise necessary capital to finance the growth in its business and to respond to the increasing competition in the gaming industry, the Government in March 1994 moved to establish arrangements with the racing industry under which a new publicly-owned company (TABCORP) would acquire and conduct wagering and gaming activities of the TAB.

4.34 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. 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 result was $135 million less than the maximum amount that could have been received by the State when TABCORP was floated. Of the $78 million paid to the TAB from the proceeds of the share issue, $12 million was subsequently returned to the State.

4.35 **In total, the State received $609 million during 1994-95 from the privatisation of the TAB businesses. However, after taking into account costs of $19 million incurred by the State and the TAB in relation to the float, the net proceeds to the State from this transaction was $590 million.**

4.36 In accordance with the provisions of the *Gaming and Betting Act* 1994, the TAB was dissolved in June 1995 and all its remaining assets and liabilities, including contingent liabilities, were transferred to the State. At that date, the remaining asset of the TAB was an amount of cash of $6.5 million.

4.37 **A number of commercial disputes were settled by the TAB prior to 30 June 1995 at a cost of $17 million. One dispute remained outstanding and involved a claim relating to an unexecuted agreement for the purchase by the TAB of software and gaming machines.** At the date of preparation of this Report, legal proceedings were still in progress in relation to this matter.

Energy Information Technology Company Pty Ltd

4.38 In September 1993, upon the disaggregation of the former State Electricity Commission of Victoria (SECV), the Energy Information Technology Company Pty Ltd (EITc) was established as a wholly-owned subsidiary of the former National Electricity. The company comprised the data processing and information technology divisions of the former SECV and was established as the principal supplier of information technology services to the Victorian electricity supply industry.

4.39 In June 1994, control of EITc was transferred to the SECV Administrator with a charter of providing continuing information technology support to the Victorian electricity industry during the transitional phase of the Government's reform program and beyond. At that time, the company had successfully negotiated letters of understanding for the provision of services to all existing customers up to the year 1997, which is the anticipated time of completion of the Government's electricity industry reform program. After this period, electricity companies will be able to competitively select their information technology service providers.

4.40 Faced with a decision concerning the operations of the company beyond the transitional phase of the Government's reform program, in July 1994 the Board of EITc appointed an external valuer to provide an assessment of 3 options, namely, liquidation, controlled wind-down and privatisation. The external valuation report provided to the Board at that time assessed the value of these options at $9.6 million, $18 million and $29 million, respectively.

4.41 Following consideration of the valuation report, in October 1994 the EITc Board resolved to privatise the company. The privatisation strategy, which was ratified by the SECV Administrator, was considered the most appropriate in meeting the Government's objectives of maximising the price of EITc, supporting the company's ongoing business viability and continued service capacity to the Victorian electricity industry, and the preservation of employment for workers in the company.

4.42 In November 1994, an information memorandum was issued to perspective purchasers, seeking the submission of formal offers by December 1994. At that time, the net assets of the company were valued at around $4.5 million.

4.43 At the conclusion of the bidding process, 2 offers were received. The successful offer for the purchase of the company was for a net price $37.5 million. However, the final price was dependent upon resolution of a number of issues relating to taxation and employee superannuation matters.

4.44 The sale was completed in February 1995, with the SECV Administrator receiving net proceeds of $37.5 million from the sale, which were applied towards the retirement of SECV debt. In May 1995, the outstanding tax issues were resolved, resulting in additional sale proceeds of $4.1 million to the SECV Administrator, which were also applied towards debt retirement. The resolution of the outstanding employee superannuation issues is expected by the SECV Administrator to result in additional sale proceeds of $500 000.

4.45 In summary, the sale of EITc represents a good result for the State, in that **the total proceeds from the sale at the time of preparation of this Report were $41.6 million, which was $12.6 million above the independent valuation of the business and significantly above the estimated book value of its net assets.**

4.46 **A significant issue that has arisen following the sale of this publicly-owned company relates to the need for final audits to be conducted on such companies up to the date of sale, to ensure proper accountability to the Parliament and Victorian taxpayers over the operations of the companies for the period they were under public control. In the case of EITc, financial statements were not prepared for the period 1 July 1994 to the date of sale of 28 February 1995 and a final audit was not undertaken by this Office.** However, the Government is proposing action to require the conduct of final audits by my Office with accountability to the Parliament on future sales.

BASS joint venture

4.47 BASS Victoria was established in 1978 as a division of the Victorian Arts Centre Trust to provide ticketing services to entertainment venues throughout Victoria. In recent years, the Australian entertainment industry has experienced considerable growth, which has led to pressure from promoters and the general public for changes to the ticketing industry, including the need for:

- ticketing providers with access to national and international markets;
- technological advancements to improve service delivery; and
- increased competition in Australia.

4.48 In 1993, the Government moved to meet these challenges by seeking private sector participation in BASS. The objectives of the privatisation of BASS were to:

- meet the changing needs of customers;
- provide managerial expertise for the expansion of BASS;
- retain a successful ticketing activity in Victoria on a competitive basis; and
- provide a stream of income to the Victorian Arts Centre Trust other than through government outlays.

4.49 The sale of BASS was complicated by pre-existing contractual arrangements with Ticketmaster Corporation, a leading ticket provider in the United States of America and the manufacturer of the software used by BASS under licence for its operations. The assignment by the Victorian Arts Centre Trust of the rights held by BASS may not have been approved by Ticketmaster if BASS was sold to a competitor of the firm. Accordingly, it was not possible to offer BASS for sale by tender as the potential termination of the software licences would have put into question the future operations of the business. Therefore, it was decided to approach Ticketmaster for the possible purchase of BASS. Audit was however advised that prior to deciding to pursue negotiations with Ticketmaster, the Department of Treasury and Finance had considered various other options to ensure that the best result was achieved for the State.

4.50 In July 1993, based on the maintainable earnings of the business, BASS was independently valued at between $5.1 million and $6.1 million. This valuation was confirmed by the valuer as current in 1995. At 30 June 1995, the net assets of BASS totalled approximately $1.2 million.

4.51 Following extensive negotiations, **in April 1995, the Victorian Arts Centre Trust, through the establishment of a joint venture arrangement with Ticketmaster Corporation, agreed to sell 50 per cent of BASS to Ticketmaster for an estimated amount of $4 million**. The key terms of sale include:

- Deposit of $100 000 payable in May 1995, with the balance of the purchase price payable at completion date, which is anticipated to be in October 1995. However, the completion of the sale will depend on the successful finalisation of ticketing arrangements with certain venues;
- The joint venture to be managed by Ticketmaster, with management fees payable for the provision of this service;
- Joint venture profits to be allocated and future capital requirements to be provided on a 50:50 basis; and
- In the event that one party wishes to divest its interest, the other party has first option to purchase the share at an independently assessed fair value.

4.52 In May 1995, the deposit of $100 000 was paid to a solicitor's trust account, with the full sale price payable to the Consolidated Fund in 1995-96.

4.53 Based on the independent valuation of the business, the BASS sale arrangements represent a good result for the State.

GFE Resources Ltd

4.54 GFE Resources Ltd was established in 1978 as a subsidiary of the Gas and Fuel Corporation of Victoria to assist in the stimulation of gas exploration activity in the State, to enhance the Corporation's knowledge of the Victorian gas industry and the available gas reserves, and to develop profitable oil and gas production. Its objectives were later extended to include involvement in areas outside Victoria.

Drilling rig used by GFE and BP Australia in the offshore Otway Basin.

4.55 In March 1994, the Government announced its intention to publicly float 27 per cent of its interest in the company to raise approximately $15 million. Further, as part of the proposed float, GFE was to issue additional shares to raise $20 million which it would retain to finance its exploration program. Under the terms of the float, GFE was valued at $55 million. However, in April 1994 the proposed float was abandoned due to adverse market conditions.

4.56 Following the introduction by the Government of its gas industry reform program, and the subsequent disaggregation of the Gas and Fuel Corporation of Victoria in December 1994, the ownership of all GFE shares was transferred from the Corporation to the State pending the sale of the company.

4.57 To enhance the saleability of the company, in January 1995, independent consultants recommended that the company be privatised unencumbered by any significant debts to the State. Accordingly, in May 1995, the Treasurer instructed the Directors of the company to swap an outstanding loan due to the State of $49.9 million to equity, through the issue of shares with an equivalent aggregate value in the name of State Trustees Ltd to be held on behalf of the State. **While this debt for equity swap had no effect on the Government's interest in the company, the arrangement substantially benefited the company's balance sheet by improving the company's financial position from an estimated net liabilities position of $9.6 million to a net assets position of $40.3 million as at 30 June 1995.**

4.58 In May 1995, the Government issued an Information Memorandum to those Australian and foreign petroleum companies which had previously expressed an interest in the full acquisition of the State's interest in the company. Three formal tenders were received in August 1995 and evaluated against a range of selection criteria, including the tendered price and the tenderer's commitment to the development of a competitive gas supply market in Victoria. Based on the results of the evaluation, in August 1995, the Government announced the successful purchaser of GFE, a Sydney-based oil and gas company.

4.59 The sale agreement provided for the transfer of all GFE shares to the purchaser for a price of $56.2 million to be paid to the Consolidated Fund in September 1995. Under the agreement, the purchase price was conditional on a Government undertaking not to request or accept from the company any dividend payments, or distribution of shares, from the date of the Agreement to the sale completion date.

4.60 **The sale price of $56.2 million for GFE compared favourably with the value of net assets disposed, which was estimated at $40.3 million, and the value of the business under the abandoned float of $55 million. However, the sale result was $1.8 million lower than the bottom range of a February 1995 independent valuation of the business, which estimated the value of GFE in the range of $58 million to $65 million.**

4.61 **Analysis of the sale result from the State's perspective indicated that:**

- **the sale proceeds were $15.9 million greater than GFE's net assets (which excludes debt assumed by the State); and**
- **given the Government's intention to repay debt with an equivalent value to that assumed of $49.9 million, and after taking account of the costs associated with the abandoned float and the sale (as advised to audit) of around $2.6 million, the net cashflow to the State will be $3.7 million.**

State Supply Service

4.62 The State Supply Service was a unit of the former Department of Finance established in 1988 to centrally purchase and distribute products, including office equipment and stationery, to government-funded agencies. The unit was self-funding and operated on a commercial basis.

4.63 To enhance the operating efficiency of the Service, in April 1992, the Government engaged On-line Distribution Services (Online), a division of Mayne Nickless, to provide sales order processing, warehousing, replenishment purchasing and distribution services, on behalf of the Service over a 5 year period. In return for these services, Online received fees based on the net sales achieved in each financial year.

4.64 Consistent with the Government's policy of outsourcing non-core activities, in April 1994, the Department advised Online that it proposed to privatise the State Supply Service and offered the company a first right of refusal for the acquisition of the business.

4.65 In June 1994, Mayne Nickless agreed to acquire the stock and goodwill of the business. Under the sale agreement, the purchaser acquired the inventories of the Service for a price of $4.3 million, which was equivalent to the book value of the inventories and this amount was paid into the Public Account in August 1994. In addition, the purchaser is to make payments to the State on account of goodwill, over a 3 year period. These payments are based on sale revenues achieved over the same period and are capped at a total of $500 000. In August 1995, the Public Account received $300 000, representing the first instalment of goodwill payments.

4.66 The agreement entitles the State to conduct independent audits to validate the amounts payable to it by the purchaser over the next 3 years. In addition, if the purchaser fails to make these payments to the State or does not maintain a customer base in accordance with the agreement, the State is entitled to receive immediate payment of the maximum outstanding amount relating to goodwill.

4.67 The return on goodwill achieved from the sale of the State Supply Service, which has an estimated net present value of $384 000, compares favourably with a valuation of $299 000 provided by the Valuer-General in July 1994. While the gross goodwill value estimated by the Valuer-General exceeded the above amount, the return to the State was reduced on account of anticipated costs that would have been incurred by the Government to terminate its contractual arrangements with Online.

4.68 As part of the wind-up of the State Supply Service, the Department during 1994-95 contributed a further $1.7 million to the Consolidated Fund from the realisation of residual debtors and certain fixed assets, and the discharge of the Service's creditors.

VicRoads Plant Hire and Technical Services business

4.69 Over the past 80 years, the Roads Corporation of Victoria has maintained a Plant Hire and Technical Services Group which provided plant and vehicle hire services to the Corporation in connection with its road maintenance and construction activities. The Group, whose central operations were situated at Glen Waverley in Melbourne, employed approximately 210 staff and operated a hire business with an annual turnover of around $30 million, using plant and vehicle assets valued at around $43 million as at 30 June 1994.

4.70 In recent years, the Corporation's policy has been to outsource non-core services, provided that these services could be supplied on a more economical basis or at a higher quality for the same cost. In March 1993, the Corporation initiated an internal review to consider its options for the possible outsourcing of the plant and vehicle hire services. As part of the initial stages of this review, which included an external evaluation of the business on a going concern basis and the possible sale of its assets, the Corporation decided to test the market by calling for expressions of interest from the private sector for the potential sale of the business. Consequently, in August 1993, registrations of interest were sought from interested parties, which resulted in the receipt of 10 responses.

4.71 In October 1993, following consideration of these responses, 3 of the interested parties were short-listed as potential purchasers. At this time, the Corporation engaged a private sector accounting firm to provide a valuation of the business in order to establish a benchmark value against which tenders could be assessed. In April 1994, the firm valued the business at $42 million, reflecting the net present value of its estimated future cash flows. Consequently, the Corporation adopted this valuation as the minimum consideration that would be required for a sale of the business to proceed.

4.72 Prior to the valuation of the business, in March 1994, the Corporation sought public tenders for the sale of the business and the hire-back of certain equipment, including from those parties previously short-listed. Following a detailed evaluation of the tenders received against established selection criteria, including tender price, hire rates and the number of employees to be taken over by the purchaser, it was established that it was more economical to outsource this activity rather than to retain the service as an internal function of the Corporation. Consequently, in November 1994, the Corporation entered into an agreement with a private sector consortium, Australian Highway Plant Services, for the sale of the business.

Sale arrangements

4.73 The arrangements between the Corporation and the consortium provided for the sale of specified plant and vehicles, which had an estimated value of $39 million, for a cash consideration of $42 million. In return, the Corporation undertook to hire back certain items in line with its operating requirements over the next 5 years. In addition, under the arrangements, the purchaser engaged 121 Corporation staff previously employed by the Plant Hire and Technical Services Group and assumed their accumulated annual leave and long service leave entitlements, which were estimated at $2 million as at November 1994.

4.74 Prior to the sale, the Corporation satisfied the majority of its plant requirements from the Plant Hire and Technical Services Group, with the remaining requirements met under private sector hire arrangements. The sale agreement provides for the hire-back of certain specified equipment and a limited number of motor vehicles over a 5 year period, for an annual fee of $13.5 million (net present value of $50 million over the 5 year period). Through this sale and hire-back arrangement, the Corporation proposes to hire-back a substantially reduced level of its original fleet. The sale agreement provides for the progressive reduction of plant hirings from the consortium over the 5 year period.

Sale result

4.75 Audit conducted a review of the benchmark valuation performed by the private accounting firm on behalf of the Corporation to determine whether the benchmark provided a reasonable valuation of the business as a going concern and whether other realisation options, such as the direct sale of the assets themselves, had been considered in order to maximise the return to the State. The review included an examination of the model developed by the advisors to determine the appropriate value of the business, including the underlying data and assumptions used in the model. Based on the results of the audit review, it was concluded that other realisation options were considered and the valuation of the business, using a net present value of future cash flows methodology, was soundly based.

4.76 However, as the benchmark valuation of the business was based on estimates of its cashflows over the next 5 years, the decision to sell the business at the benchmark price was not purely based on financial considerations, given that the sale arrangements were not significantly advantageous as compared with operating the plant hire as an internal function of the Corporation. The sale decision placed emphasis on the transfer of the commercial risks associated with the plant and vehicles away from the Government and provided an opportunity to downsize the public sector workforce by some 170 staff, of which 120 transferred to the consortium.

4.77 The final sale price of $42 million achieved by the Corporation was equivalent to the April 1994 benchmark valuation of the business determined by the advisors. However, subsequent to the valuation of the net assets to be acquired by the purchaser, there was a reduction of around $8.5 million in the net assets of the business without an equivalent reduction in price. **In effect, the Corporation achieved a sale price which was $8.5 million higher than the valuation of the business.**

4.78 **Of the $42 million sale proceeds received by the Corporation, $37 million was paid to the Consolidated Fund during the year, with the balance retained by the Corporation to finance its operations, including costs related to this sale which were in the order of $2.1 million.**

4.79 **While the State will generate a return from the proceeds paid into the Consolidated Fund, this benefit will be substantially off-set by additional costs incurred by the Corporation over and above previous inhouse chargeout rates, associated with the hire of an equivalent quantum of equipment, plant and motor vehicles over the 5 year period of the contract.**

Sale and development of Cathedral Place

4.80 In 1970, the Government acquired a property known as Cathedral Place, located at 33 to 63 Cathedral Place and 68 to 102 St Andrews Place, East Melbourne, from the Catholic Archdiocese of Melbourne. The property, which covers a combined area of approximately 8 100 square metres, was subject to a covenant restricting the height of any future development on part of the site. Despite its prime location, for many years the property was under-utilised in that it was mainly used as a car park.

4.81 In January 1992, the Government approved the sale of the property. However, on the day of its auction, solicitors acting on behalf of a private developer successfully negotiated with the Government the postponement of the auction, due to the potentially adverse impact of the proposed development on adjoining properties. As a consequence, the Government decided not to sell the property but reserved a substantial part of the site (approximately 6 000 square meters) for the development of accommodation facilities for the Peter MacCallum Cancer Institute.

4.82 In the later part of 1992, the Peter MacCallum Institute sought expressions of interest for the development of the site which had been set aside for its use. However, to optimise the potential of the whole Cathedral Place property, in late 1993, the Government decided to remove the reservation previously placed on the site and to transfer the property to the Urban Land Authority to facilitate its development, in consultation with the Peter MacCallum Institute and the Catholic Archdiocese of Melbourne.

4.83 In December 1994, the site was expanded with the acquisition by the Government of a property located at 14 to 20 Parliament Place, for $2.2 million. **The State had previously owned and disposed of this property in April 1992 for $1.6 million, which was $600 000 lower than the price paid for its acquisition.**

Tender process

4.84 Expressions of interest were invited in December 1994 by the Urban Land Authority for the development of the Cathedral Place property, to achieve the following objectives:

- produce an appropriate development of high quality and within an acceptable risk profile;
- optimise returns to the Government;
- ensure the development makes adequate provision for Government car parking requirements; and
- ensure that the special interests and requirements of the Peter MacCallum Institute and other parties are met.

4.85 In July 1995, following the evaluation of 2 formal tenders received, the Government announced the successful developer of the Cathedral Place site.

Artist's impression of the proposed Cathedral Place development.

4.86 The development of the site, which will be completed by December 1997 at an estimated total cost of $100 million, will comprise a 240 suite hotel complex, an 845 space underground car parking facility (with 400 spaces reserved for leasing to the Government at market rates) and the construction of a palliative care facility for the Peter MacCallum Institute. In addition, negotiations are proceeding between the Catholic Archdiocese of Melbourne and the developer for the provision of additional car parking spaces and an apartment within the development as compensation for the removal of the height restrictions on the site.

Key conditions of sale

4.87 The agreement between the Urban Land Authority and the developer for the sale and development of the property, which is conditional upon a planning scheme amendment being made to enable the project to proceed, was completed in July 1995. Under the agreement, the consideration to be received by the Government for the sale comprises:

- a deposit of $50 000 paid to the Authority in March 1995;
- the purchase price to be paid to the Consolidated Fund in May 1996 less a management fee to be retained by the Authority;
- a bank guarantee of $1 million provided to the Authority to secure the payment of the balance of the purchase price; and
- provision by the developer to the Government of palliative care, hospital accommodation and training facilities (including title to the property), valued at $10 million, by December 1997.

4.88 **The sale result compares favourably with a Valuer-General valuation of the property at June 1995.**

4.89 In addition, under the sale agreement, the developer is required to grant the Minister for Finance a lease for the provision of 400 car parking spaces over a 10 year period, at market rates.

4.90 To ensure that the proposed project is completed and the specified hospital facilities delivered to the Peter MacCallum Institute, the sale agreement provides for:

- final settlement of the sale only to occur if adequate financing has been secured for the development;
- the developer not to sell the property without the written consent of the Authority;
- a covenant to be placed on the property's title, requiring the performance of the development agreement; and
- the developer to provide a further $1 million bank guarantee to the Authority in May 1996 as security against the performance of the development agreement.

4.91 **As the sale arrangements had not been finalised as at the date of preparation of this Report, details of settlement amounts and property valuations have not been disclosed and will be provided in a subsequent Report to the Parliament.**

Southern Cross Hotel site

4.92 In 1933, under the provisions of the *Melbourne Market and Park Lands Act* 1933, the Melbourne City Council was granted use of a Crown land site at the corner of Exhibition and Bourke Streets, Melbourne, for municipal purposes. The site, which was permanently reserved from sale, was used by the Council to operate the former Eastern Market.

4.93 In 1955, the Act was amended to allow the Council to use the site for commercial purposes. Consequently, in 1960, the Council entered into a lease with Southern Cross Properties Pty Ltd (the lessee) for the development of the site. The key terms of the development agreement included:

- 40 year lease term, with provision for a further 59 year extension;
- rental payments, most recently set at $560 000 per annum, subject to periodic rental reviews;
- the Council to be responsible for land tax levied on the site;
- the lessee to construct a hotel complex; and
- building improvements to transfer to the Council at the end of the lease.

4.94 In 1993, the lessee went into receivership and the lease was subsequently acquired by parties affiliated with the Republic of Nauru. The new owners initiated the redevelopment of the site which, at the date of preparation of this Report, remained in progress.

4.95 Prior to the transfer of the lease, the Council had commenced discussions with the former Department of Finance regarding the possible disposal of the site, due to its poor financial viability from the Council's perspective. The adverse financial impact of the site on the Council resulted from its inability to pass on land tax levied on the site to the lessee, the value of which exceeded the value of annual lease payments.

4.96 The enactment of the *Land (Revocation of Reservations) Act* 1994 removed the site's permanent reservation from sale and provided authority for the disposal of the property.

4.97 Following negotiations between the Government and the lessee, in September 1994, the property which was previously Crown land was sold to the lessee for $10 million. Under the sale arrangements, a deposit of $500 000 was paid into the Trust Fund of the Public Account at the date of sale, with the balance of $9.5 million payable into the Consolidated Fund in March 1996.

4.98 **The sale proceeds were $2 million less than a September 1993 valuation obtained from the Valuer-General. However, prior to the sale, the Valuer-General advised that, having regard to the unique features of the lessor's interest in the property and the protracted negotiations that had already taken place, the offer of $10 million was considered reasonable and acceptable.**

Educational properties

4.99 In the past 2 years, a major component of the Government' asset sales program has been the disposal of surplus properties by the Directorate of School Education. **During the 1994-95 financial year, $52.5 million was paid into the Consolidated Fund from the disposal during the year of 48 surplus properties and settlements relating to prior year property sales**.

4.100 Audit examination of a number of the property sales completed during the year revealed that the proceeds realised from the sales were generally in excess of the valuations and reserve prices assigned to the respective properties.

4.101 The Directorate has established a sales strategy aimed at maximising sale returns on its surplus properties. The first phase of the strategy commenced in early 1994 and involved the sale of properties with higher values which could be sold without undue delay. The second phase of the strategy, which was implemented in 1994-95, also focused on properties with high values, which previously had outstanding issues required to be resolved prior to sale. The final phase of the strategy is expected to commence in late 1995 and will focus on the remaining sites which have lower values.

4.102 **At 30 June 1995, 198 properties valued at approximately $47 million had been identified as surplus to present requirements and were awaiting sale.**

Employee housing

4.103 My October 1994 Report commented on a program initiated by the Government during 1993-94 to wind-down the operations of the Government Employee Housing Authority (GEHA), involving the progressive sale of its surplus housing assets. During that year, 830 properties were sold by GEHA which realised $48.5 million. Of the sale proceeds, $22.5 million was remitted to the Consolidated Fund as part repayment of the State's equity in the Authority, with the balance retained by the Authority and mainly applied towards the retirement of its outstanding borrowings.

4.104 During 1994-95, a further 761 surplus properties were sold, which the Authority advised realised approximately $35.5 million. Of the proceeds raised from these sales, $24 million was remitted to the Consolidated Fund as a further repayment of equity, with the balance retained by the Authority to finance its operations and, to the extent not utilised, to be remitted to the Consolidated Fund upon the wind-up of the Authority's operations.

4.105 At 30 June 1995, GEHA held 1 054 remaining properties. Of these properties, 656 were identified for use by departments and, in July 1995, were transferred to the respective departments for no cash consideration. However, the departments will be required to pay a capital charge to the Consolidated Fund on the value of these properties and to meet their ongoing costs. The Authority expects to dispose of the remaining 398 surplus properties by the end of December 1995.

4.106 The Government intends to abolish the Authority by 30 June 1996 through the enactment of legislation.

Identification of surplus property assets

4.107 The effective management of the State's assets is vital to the maximisation of the financial performance of the State. Since 1986-87, the operation of an asset sales program, involving the disposal of surplus and under-utilised property assets, has been a key element of the Government's asset management strategies. Since its inception, this program has raised proceeds in excess of $1.2 billion.

4.108 According to departmental records, at 30 June 1995 approximately 2 750 properties with an aggregate value of $205 million (30 June 1994, $230 million) had been identified as surplus to government requirements and were awaiting sale. Table 4B shows the periods in which these assets were identified as surplus to requirements and approved for sale.

TABLE 4B
ASSETS AWAITING SALE,
AT 30 JUNE 1995
($million)

Year approved for sale	*Estimated value*
Prior to 1990-91	16.7
1990-91	34.8
1991-92	37.8
1992-93	25.3
1993-94	61.4
1994-95	28.7
Total	**204.7**

4.109 According to the Department of Treasury and Finance, the key reasons for the delay in the sale of these assets were:

- the on going depressed state of the property market;
- low demand for development properties;
- poor quality of assets within the portfolio; and
- delays in the preparation of certain property titles and the finalisation of related legal matters.

4.110 The Government estimates that the disposal of certain of the surplus property assets in 1995-96 will generate revenue of $108 million to the Consolidated Fund.

Tax compensation for the sale of State-owned Business Enterprises

4.111 While the privatisation of State-owned business enterprises (GBEs) can result in significant benefits to the State's economy, and to public finances from the application of sale proceeds towards debt retirement, it also results in a loss of ongoing dividend streams to the State and a diversion of the tax equivalent stream from the State to the Commonwealth Government.

4.112 The Commonwealth Government in previous years has provided State Governments with compensation payments for revenues forgone on privatisation of GBEs. For example, in 1990-91, the Victorian Government received a $413 million compensation payment in relation to the sale of the State Bank of Victoria. However, subsequently the Commonwealth Government changed its policy in this area and determined that each State would be compensated for the privatisation of only one bank or insurance office. Due to this change, the State did not receive any tax compensation in relation to the sale of the State Insurance Office in 1992.

4.113 In order not to impede the privatisation process and the consequent benefits to the Australian economy, at the March 1994 Premiers' conference, agreement was reached on a *Statement of Policy Intent* which provides that the Commonwealth Government will provide tax compensation to the States, on a case-by-case basis, to ensure that no Government will be financially advantaged or disadvantaged in relation to the privatisation of GBEs.

4.114 As commented earlier in this Report, 2 substantial GBE privatisations have recently occurred in Victoria, namely, the July 1994 floatation of TABCORP and the August 1995 sale of United Energy Ltd. Further privatisations of substantial entities are planned, particularly in the electricity industry.

4.115 In accordance with the *Statement of Policy Intent*, in April 1995 the Treasurer of Victoria forwarded a submission to the Commonwealth Government seeking tax compensation in relation to the TAB privatisation. The submission, which is to be used as a test case, concluded that the federal tax system imposes a loss on Victoria when it privatises its GBEs and that the overall gain to the Commonwealth will be *more than sufficient* to meet proposed compensation on account of privatisation of GBEs.

4.116 At the date of preparation of this Report, a formal response to the State's submission for tax compensation had not been received.

PART 5

Consolidated Fund Receipts

VICTORIAN
AUDITOR-
GENERAL'S
OFFICE

Auditing in the Public Interest

Part 5

Consolidated Fund Receipts

KEY FINDINGS

- The Consolidated Fund gross receipts for the year, excluding borrowings, were consistent with overall budget expectations.

  Paras 5.1 to 5.4

- The Government has established as one of its 4 longer-term budget aims to bring Victoria's overall tax effort into closer alignment with the average of the Australian States.

  Paras 5.5 to 5.8

- The reduced level of public authority contributions in the year as compared with budget mainly reflects a Government decision not to proceed with a $300 million special dividend from the Transport Accident Commission due to the lower than projected investment returns experienced by the Commission.

  Paras 5.11 to 5.15

Summary of financial transactions

5.1 **The Consolidated Fund gross receipts for the year, excluding borrowings, totalled $16.1 billion, which was consistent with overall budget expectations.** Contributing to this outcome were higher than expected receipts from the Commonwealth Government ($75 million), property and equipment sales ($72 million), taxation collections ($38 million), and the proceeds from the sale of the Grain Elevators Board ($47 million). However, these increased collections were largely off-set by lower than anticipated contributions from public authorities ($190 million).

5.2 **The year's gross receipts were $221 million less than the level achieved in the previous year**. This result mainly reflects the collection in 1993-94 of a special dividend from the Transport Accident Commission ($1.2 billion) and proceeds relating to the wind-up of the Victorian Equity Trust ($437 million), and the offsetting effect of collections in the current year from the float of TABCORP ($609 million), increased gambling taxes from the operation of the Crown Casino and electronic gaming machines ($193 million), higher payroll tax receipts ($140 million) from employment and wages growth within the State, and the recoup of superannuation costs and capital charges from Departments ($493 million).

5.3 Table 5A provides a summary of the receipts (excluding borrowings) of the Consolidated Fund for the year.

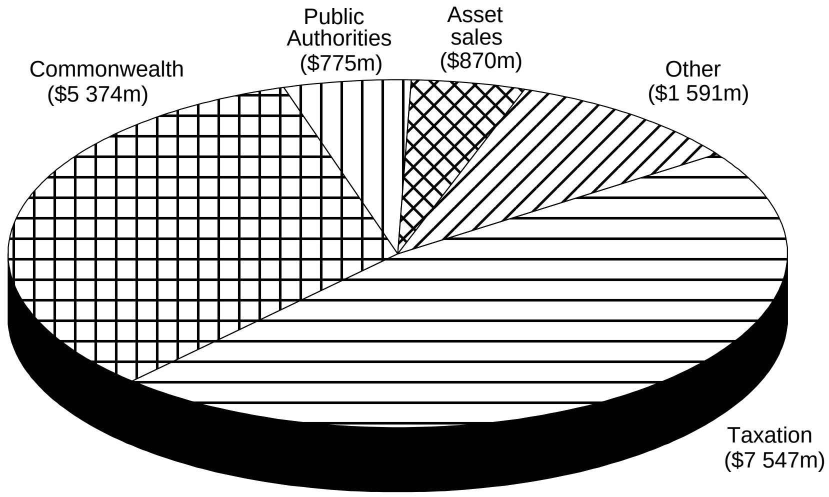
TABLE 5A
BUDGETED AND ACTUAL CONSOLIDATED FUND RECEIPTS
($million)

Item	*1993-94 Actual*	***1994-95 Actual***	*1994-95 Budget (a)*	***Variance from Budget***	***Variance from 1993-94 Actual***
Recurrent -					
Taxation	7 207	**7 547**	7 509	**38**	**340**
Commonwealth	4 627	**4 867**	4 785	**82**	**240**
Other	3 426	**2 299**	2 509	**(210)**	**(1 127)**
Total recurrent	15 260	**14 713**	14 803	**(90)**	**(547)**
Works and services -					
Commonwealth	671	**507**	514	**(7)**	**(164)**
Sale of assets	*(b)* 398	*(b)* **214**	142	**72**	**(184)**
Other	49	*(c)* **723**	*(c)* 667	**56**	**674**
Total works and services	1 118	**1 444**	1 323	**121**	**326**
Total receipts (excluding borrowings)	16 378	**16 157**	16 126	**31**	**(221)**

(a) Budget Estimates, *1994-95 Budget Paper No. 3.*
(b) Includes $200 million (1994-95, $26 million) fee received from the Crown Casino.
(c) Includes $609 million proceeds from the float of TABCORP.

5.4 The Consolidated Fund revenue outcome in any one year is significantly impacted by the quantum of receipts from taxation, grants and contributions from the Commonwealth Government, public authority contributions and asset sales (including business and property assets). Collectively, in 1994-95 receipts from these sources accounted for around 90 per cent of total Consolidated Fund receipts. Chart 5B shows the contribution of the above revenue sources to Consolidated Fund revenue.

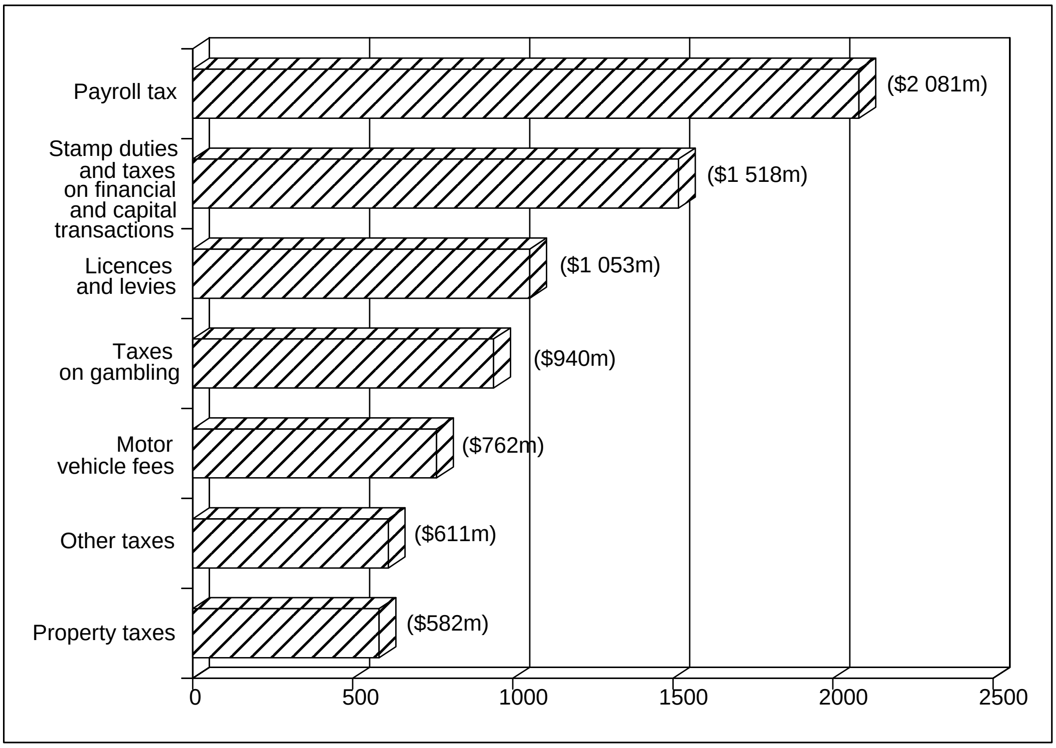
CHART 5B
MAJOR SOURCES OF CONSOLIDATED FUND RECEIPTS, 1994-95
($million)



Taxation revenue

5.5 Taxation receipts are the largest source of Government revenue and represent almost half of all Consolidated Fund revenue collections. These receipts 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 1994-95, taxation receipts totalled $7.5 billion (1993-94, $7.2 billion) and accounted for 47 per cent of total Consolidated Fund revenues**. Chart 5C illustrates the key taxation categories.

CHART 5C
KEY TAXATION CATEGORIES



5.6 In the 1994-95 Budget and the May 1995 *Autumn Economic Statement*, the Government noted that, based on estimates made by the Commonwealth Grants Commission of comparative revenue-raising efforts among Australian States, Victoria has maintained an effort above that of the other 3 largest States, namely, New South Wales, Queensland and Western Australia, which has impacted adversely on the State's competitiveness. To address this unfavourable situation, the Government has established as one of its 4 longer-term budget aims ... *to bring Victoria's overall tax effort into closer alignment with the average of the Australian States*.

Major variances

5.7 As indicated in Table 5A, **taxation receipts in 1994-95 were $38 million above the budget estimate and $340 million higher than the previous year**. Table 5D details the major items contributing to this favourable outcome.

TABLE 5D
TAXATION VARIATIONS
($million)

Revenue sources	*1993-94 Actual*	***1994-95 Actual***	*1994-95 Budget*	***Variance from Budget***	***Variance from 1993-94 Actual***
Payroll tax	1 940	**2 080**	2 048	**32**	**140**
Public Authority contribution - Gas and Fuel	287	**309**	290	**19**	**22**
Electronic gaming machines	259	**384**	352	**32**	**125**
Other taxes on gambling	47	**23**	24	**(1)**	**(24)**
Casino tax	-	**68**	56	**12**	**68**
Taxes on insurance	292	**302**	316	**(14)**	**10**
Marketable securities stamp duties	217	**195**	208	**(13)**	**(22)**

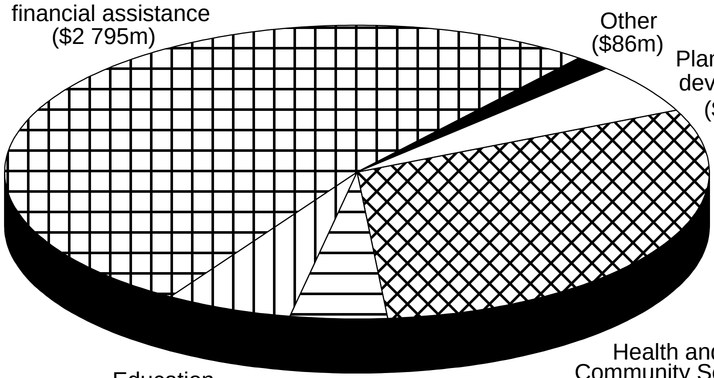
5.8 The key factors contributing to the major taxation variations, as advised by the Department of Treasury and Finance, were as follows:

- *Payroll tax* - increased employment and wages in the State, combined with a structural shift towards employment in firms with payroll thresholds that are subject to payroll tax;
- *Public Authority contribution (Gas and Fuel)* - higher domestic gas consumption due to a colder than anticipated 1994 winter;
- *Electronic gaming machines* - rapid growth from the progressive installation of gaming machines and higher than expected turnover;
- *Other taxes on gambling* - receipt of an initial gaming licence fee from Tattersalls not provided in the budget;
- *Casino taxes* - higher than expected turnover at the temporary Melbourne Casino;
- *Taxes on insurance* - lower than anticipated growth in general insurance business together with higher than forecast tax refunds following an adverse High Court ruling in relation to certain transactions; and
- *Marketable securities stamp duties* - lower than expected sharemarket activity.

Commonwealth receipts

5.9 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 1994-95 totalled $5.4 billion (1994-94, $5.3 billion), accounting for approximately 33 per cent of total Consolidated Fund revenues**. The overall level of these revenues increased by $75 million in the year, mainly due the receipt of a $55 million specific purpose contribution towards the cost of integration of the Heidelberg Repatriation Hospital into the State public health system as from January 1995. Chart 5E outlines the major components of Commonwealth receipts in the year.

CHART 5E
COMMONWEALTH RECEIPTS, 1994-95
($million)



5.10 The 1994-95 general financial assistance grant to the State accounted for 52 per cent of total Consolidated Fund receipts from the Commonwealth, with grants for funding for Health and Community Services programs the next largest, being 31 per cent of revenue from Commonwealth sources.

Public Authority contributions

5.11 Public Authority contributions represent dividends, tax equivalent payments and franchise fees from various Government Business Enterprises, which are collected under the authority of the *Public Authorities (Dividends) Act* 1983, the *State Owned Enterprises Act* 1992 and other specific legislation, and by virtue of the State's interest in certain companies. **During 1994-95, the Consolidated Fund received $775 million from this source, which was $190 million less than that budgeted for the year.** Table 5F provides a summary of Public Authority payments received by the Consolidated Fund in the past 2 years.

TABLE 5F
RECEIPTS FROM PUBLIC AUTHORITIES,
1993-94 AND 1994-95
($million)

Business enterprises	*Actual 1993-94*	***Actual 1994-95***	*Budget 1994-95*	***Variance from Budget***	***Variance from 1993-94 actual***
Transport Accident Commission	*(a)*1 274	**178**	386	**(208)**	**(1 096)**
Electricity sector	225	**286**	260	**26**	**61**
Water sector	224	**134**	135	**(1)**	**(90)**
Gas sector	*(b)* 245	**120**	120	**-**	**(125)**
Other	52	**57**	64	**(7)**	**5**
Total *(c)(d)*	2 020	**775**	965	**(190)**	**(1 245)**

(a) Includes a $1.2 billion special dividend from the Transport Accident Commission.

(b) Includes the one-off impact of the sale of Heatane.

(c) Excludes payments relating to the sale of TAB businesses and Grain Elevators Board assets, which are of a capital nature.

(d) Excludes statutory contributions relating to a share of natural gas revenues from Gas and Fuel, which are disclosed as taxation revenue in the Statement of Financial Operations.

5.12 **The reduced level of public authority payments in the year as compared with budget mainly reflects a Government decision not to proceed with a $300 million special dividend from the Transport Accident Commission due to lower than projected investment returns experienced by the Commission.** This shortfall was partly offset by a tax equivalent receipt of $88 million from the Commission, which was not anticipated at the time of the budget. Higher dividends were received from the electricity sector to finance Consolidated Fund payments of $24 million to municipal bodies, representing the income entitlements of such entities arising from the transfer of the former Municipal Electricity Undertakings to the newly established electricity bodies.

5.13 Public authority payments from the electricity sector have increased by some $61 million over the 2 year period to 30 June 1995, mainly due to the flow-on benefits realised from the major structural reforms within this sector. However, over the same period, payments from the water sector have decreased by $90 million, mainly due to a Government decision to permit the water sector to retain a greater portion of earnings to support the structural reforms currently underway within that sector.

Tax equivalent payments

5.14 The tax equivalent system was established by the Government in the 1993-94 financial year to ensure competitive neutrality between publicly and privately-owned businesses and to strengthen the financial discipline on Government Business Enterprises (GBEs) by factoring tax payments into their business decisions. There are currently 22 entities subject to this taxation system. However, it is the Government's intention consistent with an Inter-State agreement to progressively extend the coverage of the system to all GBEs. Under the system, tax equivalent payments of $188 million, which are included in the above Table, relating to the trading results achieved by the relevant GBEs for the 1993-94 financial year, were collected by the Consolidated Fund in 1994-95.

5.15 In April 1995, the Government introduced consistent with an Inter-State agreement a wholesale tax equivalent regime under which GBEs will be required in the future to remit to the Consolidated Fund amounts equivalent to sale tax exemptions provided by the Commonwealth Government. The purpose of the tax equivalent regime is to bring public bodies into line with the private sector by capturing the exemption such bodies enjoy as a result of their status as government-owned enterprises. In 1994-95, the wholesale tax was restricted to a small number of bodies, including water sector bodies and the Transport Accident Commission. However, it is the Government's intention that this tax equivalent regime is to be extended to other government business enterprises during 1995-96. Consolidated Fund collections of wholesale tax in 1994-95 totalled only $544 000.

Property and equipment sales

5.16 **In 1994-95, proceeds of $188 million were received by the Consolidated Fund from the sale of surplus or under-utilised properties and the privatisation of certain services previously provided by Government. The proceeds received were $72 million above the budget estimate.** Table 5G details the asset sales achieved by each agency.

TABLE 5G
ASSET SALES BY AGENCIES
($million)

Agencies	*Actual 1993-94*	***Actual 1994-95***	*Budget 1994-95*	***Budget variance***
Treasury and Finance	79	**59**	42	**17**
Directorate of School Education	99	**53**	45	**8**
Conservation and Natural Resources	4	**18**	13	**5**
Transport Authorities	11	**50**	9	**41**
Office of Major Projects	4	**5**	7	**(2)**
Other	1	**3**	-	**3**
Total	198	*(a)* **188**	116	**72**

(a) Does not include a $26 million receipt relating to the licensing arrangements for the casino.

5.17 The key factors contributing to increased asset sales in the year compared with budget expectations, as advised by the Department of Treasury and Finance, were:

- sale of the VicRoads Plant Hire and Technical Services business (of which $37 million of the proceeds was paid into the Consolidated Fund) which had not been included in budget estimates;
- higher receipts achieved by the Department of Treasury and Finance and the Directorate of School Education, due to the sale of a greater number of properties than anticipated and the achievement of favourable sale outcomes; and
- sale of plant and machinery by the Department of Conservation and Natural Resources higher than expected.

5.18 **In addition to the above sales, a further $679 million was collected by the Consolidated Fund from the following key sales:**

- **Totalizator Agency Board ($608.9 million);**
- **Grain Elevators Board ($46.6 million); and**
- **Employee housing sales ($23.5 million).**

5.19 Details of major Government asset sales are outlined in Part 4 of this Report.

Repayment of State Development Program advances

5.20 Due to concerns over the deterioration of the State's infrastructure, in 1982-83, an initiative was introduced to establish the State Development Program to finance additional departmental capital works. The Program involved the funding of capital works by the State from borrowings raised from the former Victorian Development Fund. While the borrowings were repaid centrally by the Department of Treasury and Finance, the interest and principal repayments were attributed to the individual departments undertaking the capital works to ensure that program costs more fully reflected the total cost of operations.

5.21 During 1993-94, the Victorian Development Fund was wound-up and the outstanding borrowings were repaid by the Consolidated Fund. However, repayments of State Development Program advances by agencies continued under the pre-existing arrangements, with half-yearly instalments payable on such advances.

5.22 In 1994-95, it was decided that all outstanding departmental advances would be repaid in the year. Accordingly, the Consolidated Fund recorded the payment and receipt of these outstanding advances which totalled $154.6 million. In relation to departmental advances, these transactions did not have any impact on the Consolidated Fund result for the year.

Dedicated State revenues

5.23 While the majority of State-sourced revenues are available to the Government for general application in the funding of programs and capital works, certain collections are required under legislative provisions to be applied only towards specified purposes. In addition, certain revenues have been dedicated by the Government for application towards specific capital projects.

5.24 In 1994-95, State-sourced revenues in the order of $1 billion (1993-94, $1 billion) were dedicated for specific application and mainly comprised:

- *Gambling and gaming revenues,* including a proportion of collections from activities, including Tattersalls, gaming machines, horse racing and Club Keno, which are required under various legislative provisions to be paid into the *Hospitals and Charities Fund* and the *Community Support Fund* of the Trust Fund, for application towards the funding of public health services and various projects and programs which will benefit the community;
- *Petroleum franchise fees,* relating to a special fuel levy established by the Government in 1993, which is required to be paid into the *Better Roads Victoria Trust Account* of the Trust Fund for application towards the construction and maintenance of roads; and
- *Casino revenues* - comprising collections relating to the net addition to budget revenues from the new casino in Melbourne, which the Government has dedicated towards the funding of a number of major public projects to be undertaken under its *Agenda 21* Program.

5.25 Comment on the extent of dedicated revenues of the State and the application of these collections follows.

Hospitals and Charities Fund

5.26 The Hospitals and Charities Fund is established under the *Health Services Act* 1988 to finance the provision of public health services in the State, including acute care, psychiatric and aged care services. The principal sources of revenue into the Fund, other than annual Consolidated Fund appropriations, include collections from Tattersalls, totalisators, gaming machines, the casino and Club Keno.

5.27 During 1994-95, contributions from the Consolidated Fund to the Hospitals and Charities Fund, which were sourced from dedicated State revenues, totalled $743 million (1993-94, $657 million). These contributions were supplemented with an annual appropriation from the Consolidated Fund of $1.6 billion.

5.28 Payments made during the year from the Hospitals and Charities Fund totalled $2.3 billion (1993-94, $2.3 billion). Table 5H provides a summary of the major programs financed by the Fund during the year.

TABLE 5H
HOSPITALS AND CHARITIES FUND, 1994-95 PAYMENTS
($billion)

Program	*Amount*
Acute health	1.9
Aged care	0.3
Primary care	0.1
Total	**2.3**

Community Support Fund

5.29 The Community Support Fund was established under the *Gaming Machine Control Act* 1991 to facilitate the allocation of a portion of electronic gaming machine revenue to the funding of programs and projects that will benefit the Victorian community.

5.30 The Act provides that 87 per cent of electronic gaming machine turnover must be returned to players in prizes, with the remaining balance allocated between venue operators, the gaming operators and the State. The amounts received by the State must be applied in accordance with the purposes set out in the Act, which include sport and recreation programs, various community services, and the promotion of arts and tourism.

5.31 During 1994-95, Consolidated Fund contributions of $53 million were paid to the Community Support Fund (1993-94, $38 million), while payments of only $13 million relating to around 30 projects (1993-94, $29 million) were made from the Fund in the year. **As at 30 June 1995, a balance of $55 million remained in the Fund, mainly due to the time lag between the approval of projects and the commencement of works.**

5.32 Examples of projects financed by the Community Support Fund during 1994-95 include:

- Construction of a new sports complex and associated swimming centre in Albert Park. The Fund will contribute around 87 per cent of the total estimated cost of the project of $65 million during the 1994-95 and 1995-96 financial years, with the balance of the project to be funded from the Consolidated Fund and contributions from local government bodies;
- Sponsorship of the America's Cup challenge ($1.5 million); and
- Government programs relating to:
  - compulsive gambling program ($1.3 million);
  - youth homelessness crisis accommodation program ($1.9 million); and
  - families in crisis program ($1.1 million).

5.33 My Office is currently conducting a performance audit of the management of the Community Support Fund, the outcome of which will be reported to the Parliament.

Better Roads Victoria Trust Account

5.34 My previous Report on the Finance Statement commented on the establishment by the Government in August 1993 of the Better Roads Fuel Levy to finance essential road construction and maintenance projects of strategic importance in urban and country areas.

5.35 Under the *Business Franchise (Petroleum Products) Amendment Act* 1993, the moneys raised by the Consolidated Fund from the imposition of the Levy are required to be transferred to the Better Roads Victoria Trust Account of the Trust Fund on a monthly basis, for application towards specified road construction and maintenance projects.

5.36 As at 30 June 1995, projects with an estimated accrued value of $367 million had been targeted for funding under the Better Roads Victoria Trust Account, including:

- extension of the Eastern Freeway to Springvale Road, to be completed by 1997 at an estimated cost of $250 million; and
- South Eastern Arterial separation works, to be completed by mid-1997 at a cost of $77 million.

5.37 During 1994-95, the Better Roads Fuel levy raised $165 million (1993-94, $148 million) which was paid into the Consolidated Fund and was subsequently transferred to the Better Roads Victoria Trust Account. Payments from the Account for the funding of works in 1994-95 totalled $195 million (1993-94, $41 million). At 30 June 1995, a balance of $77 million remained in the Trust Fund, mainly due to the time lag between the approval of projects and the commencement of works.

Agenda 21 Program

5.38 As noted in my October 1994 Report on the Finance Statement, the net addition to budget revenues from taxes imposed on the Melbourne Crown Casino has been dedicated by the Government towards the funding of major civic projects of strategic significance under its *Agenda 21* Program. Such revenues in 1994-95 totalled $55 million, of which $26 million relates to a fixed payment under the licence arrangements (1993-94, $200 million on account of the initial licence fee).

5.39 The estimated cost of projects to be funded under the *Agenda 21* Program as at 30 June 1995 totalled $474 million. Significant works which were currently under construction included the new Melbourne Exhibition Centre at Southbank ($140 million), the Museum of Victoria ($250 million), the redevelopment of the State Library ($39 million), and track and park improvements works at Albert Park for the forthcoming Australian Grand Prix ($45 million).

PART 6

Consolidated Fund Payments

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Part 6

Consolidated Fund Payments

KEY FINDINGS

- Actual payments from the Consolidated Fund in the year were $274 million below budget.
  Paras 6.1 to 6.3
- The impact of finance charges on the budget has declined in recent years, reflecting the favourable outcome of Government debt and budget management strategies.
  Paras 6.7 to 6.12
- Taxation rulings on certain prior year financing arrangements have increased the cost of those arrangements to the State by $158 million.
  Paras 6.13 to 6.20
- During 1994-95, the employee separation program funded the departure of 5 040 budget sector employees at an aggregate cost of $294 million.
  Paras 6.27 to 6.34
- The realisation of budget sector savings from the employee separation program is ultimately dependent on the success of government strategies to maintain the reduced workforce levels and effective management of consultants and contractors.
  Paras 6.35 to 6.43
- During the year, the Commonwealth Bank of Australia became liable for an amount of $5.5 million under the conditions of the Victorian Investment Corporation Ltd (VIC) sale agreement and lodged an equivalent claim on the State, which was paid.
  Paras 6.51 to 6.53

Summary of financial transactions

6.1 In the *1994-95 Budget Papers*, it was estimated that gross payments of the Consolidated Fund would be $17.3 billion, comprising $15.4 billion for annual appropriations and $1.9 billion for special appropriations. **Actual payments for the year totalled $17.1 billion, which was $274 million below budget**. Table 6A provides a summary of the year's gross payments.

TABLE 6A
1994-95 BUDGETED AND ACTUAL PAYMENTS
($million)

Item	*1993-94 Actual*	***1994-95 Actual***	*1994-95 Budget (a)*	***Variance from Budget***
Recurrent -				
Annual appropriations *(b)*	13 438	**12 967**	13 267	**(300)**
Special appropriations	1 939	**1 821**	1 882	**(61)**
Total recurrent	15 377	**14 788**	15 149	**(361)**
Works and services -				
Annual appropriations	2 188	**2210**	2 193	**17**
Special appropriations	-	**70**	-	**70**
Total works and services	2 188	**2 280**	2 193	**87**
Total payments	17 565	**17 068**	17 342	**(274)**

(a) Budget Estimates, *1994-95 Budget Paper No. 3*

(b) Does not include expenditure on finance charges of $123 million (1993-94, $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.

Major budget variances

6.2 The favourable expenditure outcome for the year compared with budget resulted from an under-expenditure of $361 million in the recurrent sector which was partially offset by higher than expected payments of $87 million in the works and services sector. The key items contributing to the favourable Consolidated Fund outcome for the year were:

- budget sector debt financing charges $173 million below expectations due to lower than anticipated interest rates and borrowing requirements in the year, and the non-utilisation of funds identified for a planned loan portfolio restructure;
- spending on employee departure programs $107 million below budget due to lower than expected cost of departure packages and fewer than anticipated requests for packages;
- flexible electricity tariff payments under the arrangements established in relation to the operation of the Portland and Point Henry aluminium smelters $48 million below budget, due to increased world aluminium prices and reduced electricity supply levels to the smelters;
- contributions to the State Superannuation Fund reduced by $29 million, due to lower than anticipated growth in pension payments; and
- majority of departments achieving expenditure results below budget.

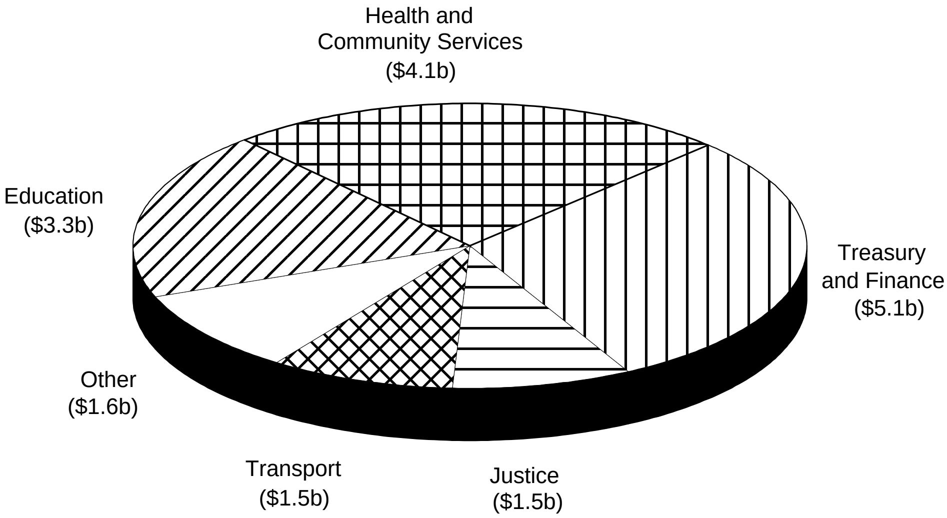
6.3 These savings were to an extent offset by the following expenditures that were not specifically budgeted for and were financed from the Treasurer's advance, special appropriations or other underspent annual appropriations:

- transfer of $200 million to the Treasury Corporation of Victoria to enable the repurchase of bonds previously issued to finance public sector projects undertaken under the Government's Accelerated Infrastructure Program (for further comment on this matter refer to Part 8 of this Report);
- payment of $129 million to the Hospitals Superannuation Board for the purpose of discharging the Government's unfunded superannuation liability to the Board in relation to the basic benefits accumulation scheme;
- contribution of $103 million to the Emergency Service Superannuation Scheme to repay prior year borrowings associated with financing the deferred employer contributions to the Scheme; and
- repayment of debt of $54 million assumed by the State in the year from the Grain Elevators Board prior to the sale of its net assets.

Major expenditure categories

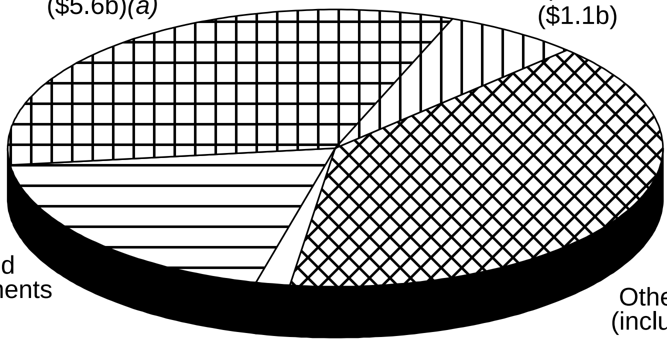
6.4 Analysis of the Consolidated Fund payments for the year reveals that around 91 per cent of these payments were managed by the major portfolios of Treasury and Finance, Health and Community Services, Education, Transport, and Justice. Chart 6B below illustrates this position.

CHART 6B
DEPARTMENTAL EXPENDITURE LEVELS, 1994-95
($billion)



6.5 Consistent with previous years, salaries and wages represented the major item of expenditure of the Consolidated Fund, accounting for around $5.6 billion or 33 per cent of total payments in 1994-95 (31 per cent, 1993-94). Debt charges, which amounted to $3.3 billion, accounted for a further 19 per cent of total payments. Chart 6C shows the major payment categories on a functional basis for the year.

CHART 6C
MAJOR FUNCTIONAL EXPENDITURE CATEGORIES, 1994-95
($billion)



(a) Represents budget sector wages and salary costs as reported in *1995-96 Budget Paper No. 3.*

6.6 A key goal of the Government's financial management policies is to reduce the burden of debt servicing on the budget, through implementation of various strategies aimed at reducing budget sector liabilities and the State's reliance on debt for the financing of programs. Improved debt management and workforce reductions, through the provision of employee departure programs, have been key strategies in the attainment of this objective. Further comment on developments in relation to these strategies are included throughout this Report.

Finance charges

6.7 Finance charges paid in the year from the Consolidated Fund totalled $2 billion. Table 6D provides details of interest paid and incurred in the period in relation to Public Account borrowings, together with interest accrued at year-end. The table also highlights the reduction in accrued interest in the year.

TABLE 6D
INTEREST CHARGES ON PUBLIC ACCOUNT BORROWINGS
($million)

Item	*Interest incurred but not paid at 1 July 1994*	*Add 1994-95 interest incurred*	*Less 1994-95 interest paid*	*Interest incurred but not paid at 30 June 1995*
Treasury Corporation of Victoria (TCV) borrowings	585	1 905	1 975	515
Other financing *(a)*	9	56	50	15
	594	1 961	2 025	530
Finance charges off-set against borrowings outside the Consolidated Fund by TCV	-	123	123	-
Accrued interest at 30 June	**594**	**2 084**	**2 148**	**530**

(a) Mainly comprises financing associated with the World Congress Centre and Public Transport Corporation leases.

Impact of borrowings on the Consolidated Fund

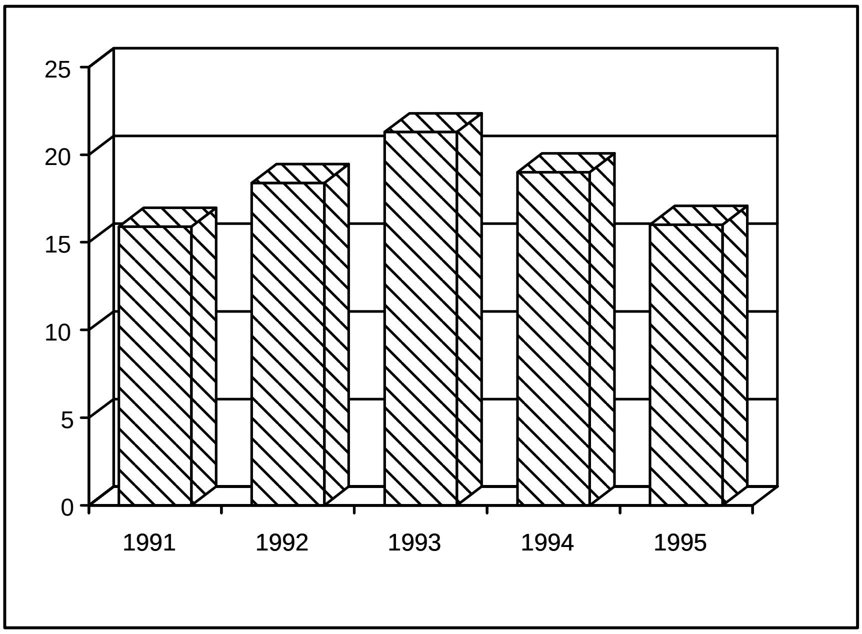
6.8 Finance charges reflect the present burden on taxpayers created by prior year borrowings undertaken by Governments to acquire assets and partly fund government programs. The Statement of Financial Operations discloses that **finance charges paid in 1994-95 amounted to $2 billion (1993-94, $2.2 billion) which is consistent to that shown in the above table.** 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.

6.9 Audit analysis revealed that **interest incurred in 1994-95 (calculated on an accrual basis) was $2.1 billion (1992-93, $2.4 billion).** The difference of $59 million between interest paid (as disclosed in the Statement of Financial Operations) 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 ($123 million); and
- the decrease in the year of interest incurred but not paid ($64 million).

6.10 Finance charges represent a substantial budget outlay, which adversely impacts on the level of funding available for allocation to programs. Chart 6E highlights the impact of finance costs on the budget, over the past 5 years.

CHART 6E
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.

6.11 The chart illustrates that the impact of finance charges on the budget has declined in recent years, reflecting the favourable outcome of Government debt and budget management strategies. The reduction of State liabilities and debt servicing ratios continue to be among the Government's key budgetary objectives.

6.12 Given the significant impact of financing costs on budget outcomes, I re-iterate my previous comments included in Reports to the Parliament, for the need to disclose in the Statement of Financial Operations consolidated information on finance charges incurred in the year and those paid. However, **while there has been improved disclosure in the Government's Budget Papers, the Department of Treasury and Finance has not taken action to improve the disclosure of this item in the Statement.**

Additional financing costs resulting from taxation ruling

6.13 My previous Reports on the Finance Statement have 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 insurance institution (the investor), to raise $92 million to fund certain requirements of the Public Transport Corporation. 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. Under the arrangement, VicFin and ultimately the State guaranteed the after-tax rate of return to the investor from this *annuity*.

6.14 A further financial arrangement between the same investor and VicFin was approved in 1987 by the then Treasurer, to raise $200 million predominantly in floating rate *gold loans* maturing in 2002. This arrangement was structured similar to the annuity, in that, below market interest rates were paid by the State in return for the realisation of tax benefits by the investor. Again, the State guaranteed the investor an after-tax rate of return from the gold loans and agreed to bear the risk of unfavourable tax rulings.

6.15 Following a Federal Court ruling on the taxation treatment of certain financing arrangements, the Australian Taxation Office (ATO) in 1993 issued amended taxation assessments to the investor, for taxation and penalties payable in relation to the *annuity* for the 1985-86 and 1986-87 financial years, totalling $70.4 million. As at 30 June 1994, Consolidated Fund payments of $54.9 million had been made ultimately to the ATO, with the balance of $15.5 million held in abeyance pending the outcome of an appeal lodged by the investor.

6.16 In January 1994, a consultant advised the Department of Treasury and Finance that, based on various taxation scenarios, considerable savings could be gained by the State through the refinancing of the *annuity* arrangement. Consequently, during the 1994-95 financial year, the Department approved the refinancing of the arrangement at a time when the prevailing market conditions were considered favourable. However, the refinancing did not proceed as a subsequent review by the Treasury Corporation of Victoria (the successor organisation to VicFin) concluded that, under certain tax scenarios, it was not conducive to refinance the arrangement.

6.17 In August 1995, revised income tax assessments were issued for the financial years 1988 to 1994 in relation to the *gold loan* and *annuity* arrangements, resulting in additional taxes and penalties totalling $68.7 million, comprising $56.9 million for the *gold loan* and $11.8 million for the *annuity*. To facilitate payment of the taxation liability, the Treasury Corporation of Victoria has advanced an interest-free loan of $33 million to the investor and the Government has reimbursed the Corporation for the taxation paid. The investor has paid an initial taxation instalment of $33 million from the amount advanced from the Corporation, with the balance of assessments of $35.7 million held in abeyance, without penalty, pending the outcome of an appeal lodged by the investor.

6.18 Further revised assessments for the financial years 1989, 1990 and 1992 were provided in late August 1995, resulting in further taxes and penalties of $19 million with respect to the *gold loan*. At the date of preparation of this Report, these assessments were under review by the Department.

6.19 **In summary, the impact of the taxation rulings on the annuity and gold loan arrangements has been to increase the financing costs of both arrangements by $158 million. Of this amount, $87.9 million had been paid by 30 September 1995 ($54.9 million by 30 June 1994), with the balance of $70.2 million held in abeyance without penalty pending the outcome of appeals lodged by the investor, or subject to review.**

6.20 The Department has recently commenced a review of these borrowing arrangements which are subject to taxation penalties. However, at the date of preparation of this Report, a decision had not been made as to any future action on these liabilities.

State's credit rating

6.21 A significant determinant of the level of finance charges is the State's credit rating which is normally assessed annually by rating agencies.

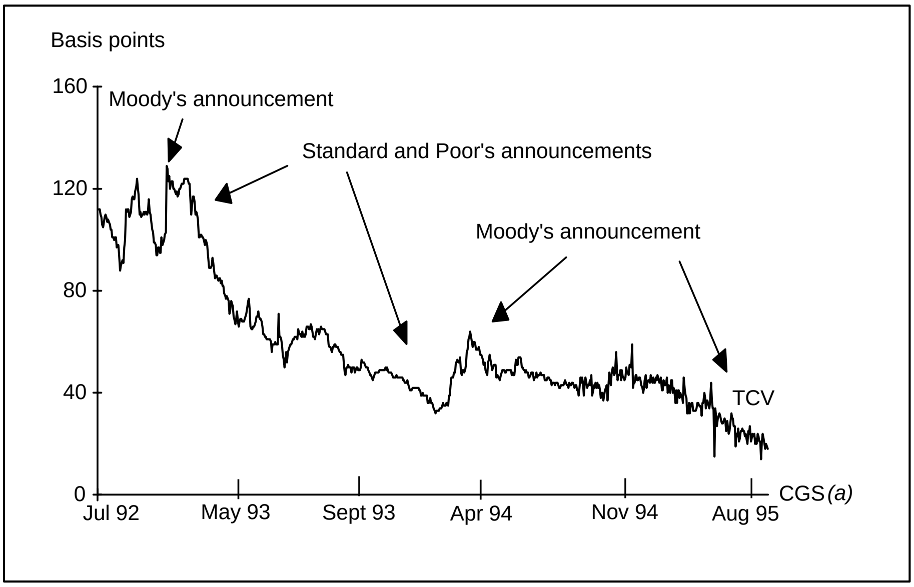
6.22 My previous Reports on the Finance Statement have commented on the downgradings of the State's long-term debt credit rating by 2 rating agencies and the consequent impact upon the State's borrowing costs. In particular, the Reports have highlighted that the State's rating was downgraded 4 levels by Moody's Investor Services, from Aaa in June 1990 to A1 in October 1992. When downgrading the State's credit rating, Moody's Investor Services stated that this was mainly 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*.

6.23 However, subsequent to the Government's October 1992 Budget, which announced substantial expenditure reduction and revenue raising measures, another rating agency, Standard and Poor's 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*.

6.24 In March 1994, the State's long-term debt credit rating was upgraded to Aa3 by Moody's Investor Services and in May 1995 to Aa2. The rationale provided by the credit agency for the May 1995 credit rating upgrade was that ... *the State's liabilities now appear to be under control and in some respects have begun to decline, [and] the government has adhered rather closely to the agenda it gave itself on taking office in October 1992, and this consistency provides further support for the view that the State's financial outlook has fundamentally improved*.

6.25 Chart 6F illustrates the impact of the credit rating reviews on the State's borrowing costs in comparison to the borrowing costs of the Commonwealth Government.

CHART 6F
HIGHER INTEREST RATES PAYABLE BY VICTORIA ON LONG-TERM BORROWINGS COMPARED WITH THE COMMONWEALTH GOVERNMENT, 1 JULY 1992 TO 23 AUGUST 1995
(basis points)



(a) Represents Commonwealth Government Securities (CGS).
Source: Treasury Corporation of Victoria (TCV).

6.26 The chart illustrates that the differential in borrowing costs between Victoria and the Commonwealth Government, which has a AAA credit rating, has fallen significantly since July 1992. Improvements in the State's credit rating and the enhanced financial position of the State, together with a continuing focus on enhanced financial management, have been key contributors to this favourable outcome.

Voluntary Departure Program

6.27 My previous reports on the Finance Statement have commented on the operation of various employee separation programs which have operated since 1991-92 and have funded in excess of 40 000 departures from the budget sector, at a cost to the Consolidated Fund of around $1.7 billion in the period July 1991 to June 1994. The key objective of these separation programs has been to reduce the size of the public sector workforce and the associated employment costs. In the 1994-95 financial year, the Government allocated a further $400 million towards the funding of employee departures from the budget sector.

6.28 The packages offered to employees under the 1994-95 program were similar to those provided in the previous year and comprised Voluntary Departure Packages (VDP) and Targeted Separation Packages (TSP). Direct package benefits payable to TSP recipients were less than those payable to employees accepting VDPs. However, TSP recipients were entitled to superannuation payments at a higher level.

6.29 Recipients of packages cannot seek re-employment and are not to be re-employed in any Victorian public sector agency for a period of 3 years from receipt of the package unless specifically approved, under exceptional circumstances, by the relevant departmental secretary or chief executive of a public sector agency. Consistent with previous programs, packages were not offered to employees in receipt of WorkCover weekly payments, or casual, temporary, contract or other limited tenure employees, for whom alternative means of compulsory separation already existed.

6.30 The Workforce Management Unit (WMU) of the Department of the Premier and Cabinet has overall responsibility for the management of the employee separation programs.

6.31 Given that budget sector agencies have now reduced their workforce levels to those generally consistent with current resourcing requirements, with the exception of the Public Transport Corporation whose reform program will be extended into the 1995-96 financial year, the Government intends to wind-down the operation of the employee separation program in 1995-96. Accordingly, a budget allowance of only $55 million has been made in the current year to finance budget sector workforce reductions of around 2 000 equivalent full-time positions.

Departures funded by the Program in 1994-95

6.32 **During 1994-95, the employee separation program funded the departure of 5 040 persons from the budget sector workforce (1993-94, 14 300 persons)**, including 3 300 recipients of VDP packages and 1 740 recipients of TSP packages, **at an aggregate cost of $294 million**. The Program expenditure in the year was $107 million below the budget estimate, principally due to the utilisation of less costly packages than expected, and fewer than anticipated departmental requests for packages.

6.33 Table 6G shows the number of departures funded by the program in the year and the costs associated with each separation package.

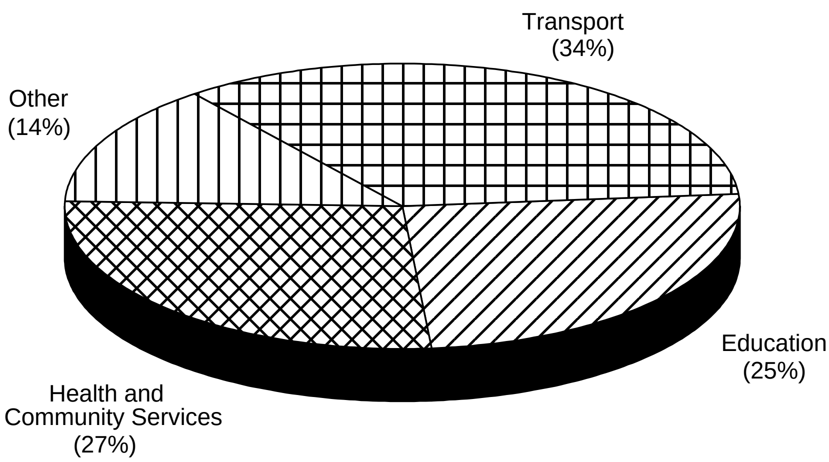
TABLE 6G
DEPARTURE PACKAGES AND COSTS, 1994-95 *(a)*

Element	*No. of departures*	*Cost*
	(persons)	*($m)*
Voluntary Departure Packages	3 300	107
Targeted Separation Packages	1 740	51
	5 040	158
Superannuation costs		*(b)* 135
Administrative costs		1
Total program	**5 040**	*(c)* **294**

(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 $112.6 million, Transport Superannuation Fund of $22.3 million and the State Employees Retirement Benefits Scheme of $100 000.
(c) Program costs did not include the cost of accrued leave, except for departures from the Public Transport Corporation.

6.34 The departures funded by the Program in 1994-95 were mainly related to employees in the Transport, Health and Community Services, and Education portfolios, as illustrated in Chart 6H.

CHART 6H
DEPARTURE PACKAGES, BY MINISTERIAL PORTFOLIO
(per cent)



Anticipated cost savings from the Program

6.35 While substantial up-front expenditure has been incurred by the Government to fund budget sector employee departures, these expenditures are expected to result in substantial ongoing budget savings. Table 6I shows the anticipated savings from the program each financial year since 1992-93, and the ongoing annual savings expected to be achieved, as advised by the Department of Treasury and Finance.

TABLE 6I
ANTICIPATED COST SAVINGS FROM DEPARTURE PROGRAM PER FINANCIAL YEAR
($million)

Financial year	*Program cost*	*Savings in year of expenditure*	*Annual ongoing savings*
1992-93	772	146	461
1993-94	732	187	429
1994-95	294	58	153
Total	**1 798**	**391**	**1 043**

6.36 As illustrated above, the Department of Treasury and Finance estimate that the operation of the Program in 1994-95, at a cost of $294 million, resulted in estimated savings of $58 million in the year and will result in ongoing future annual savings of $153 million. Based on these estimates, the Department has projected that the voluntary departure program expenditure for the 1994-95 financial year will be cost-neutral early in the 1996-97 financial year while the targeted separation program will be cost-neutral in 2.3 years.

6.37 The above table also indicates that, **over the past 3 years, the Government has outlayed around $1.8 billion towards the financing of employee separation programs and, as a result, expects to generate and maintain ongoing savings in excess of $1 billion per annum. However, the realisation of these budget sector savings is ultimately dependent on the success of government strategies to maintain the reduced workforce levels and effective management of the use of consultants and contractors.**

6.38 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 have accepted packages;
- a restriction against the re-employment of package recipients for 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 Workforce Management Unit within the Department of the Premier and Cabinet.

6.39 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 6J.

TABLE 6J
BUDGET SECTOR EMPLOYMENT LEVELS AND COSTS

	Employment (a)		Costs (b)	
Year	EFT (c)	% variation	$million	% variation
1991-92	195 347	-	6 582	-
1992-93	173 092	(11)	6 455	(2)
1993-94	159 168	(8)	6 017	(7)
1994-95	157 245	(1)	5 986	(1)
1995-96	(est.) 155 000	(1)	(est.) 6 372	6

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

(b) Represents budget sector current outlays on identified wages and salaries, as provided by the Department of Treasury and Finance, adjusted for employment costs of the Public Transport Corporation which, from 1993-94, was classified as a non-budget sector body.

(c) Represents equivalent full-time employees (EFT).

6.40 The above table indicates that the level of budget sector employment reduced by around 2 000 equivalent full-time employees (EFT) during 1994-95, while salary and wages costs declined by around $31 million during the same period. The staff reduction was achieved despite the need to absorb an additional 2 600 EFT staff mainly resulting from restructuring initiatives implemented by the State and Commonwealth Governments in the health sector, including the transfer of 1 620 EFT staff arising from the integration of the Heidelberg Repatriation Hospital into the State public hospital system during the year.

6.41 The Government has projected annual ongoing savings of $1.1 billion arising from the operation of the July 1991 to June 1994 employee separation programs. Over the same period, aggregate salary and wages costs have declined by $596 million.

6.42 The difference between the estimated savings from the operation of the program and the actual reduction in budget sector wages and salaries, as advised by the Department of Treasury and Finance, is mainly attributable to increases in wages and transfer to the State of Commonwealth responsibilities ($470 million) and various State Government initiatives ($51 million) over the 3 year period.

6.43 It is projected by the Government that, during the 1995-96 financial year, budget sector employment levels will fall by a further 2 245 EFT. However, the Department of Treasury and Finance advised that savings achieved by the Program during the current year will be more than offset by expected increases in wage rates in 1995-96, the full year effect of 1994-95 wage rate increases and additional spending on both Commonwealth and State initiatives. The net result is an expected increase in budget funded wages and salaries in 1995-96 of $386 million.

Buy-back of Gas and Fuel Corporation preference shares

6.44 The Gas and Fuel Corporation of Victoria commenced operations in 1950 with the primary objectives to produce gas from the State's brown coal reserves and to revitalise and consolidate the gas industry throughout Victoria. In 1965, natural gas was discovered in Bass Strait which totally transformed the Victorian gas industry. The Corporation, since its establishment, progressively purchased interests in other gas companies and, by 1973, became the sole supplier of reticulated gas in Victoria.

6.45 The enactment of the *Gas Industry Act* 1994 has resulted in the restructuring of the Victorian gas industry through the establishment of 2 new public corporations, namely, the Gas Transmission Corporation and GASCOR, to assume responsibility for the gas transmission and distribution functions, respectively, of the former Gas and Fuel Corporation of Victoria. As a result of the restructure, the Government offered to acquire the preference shares in the Gas and Fuel Corporation of Victoria held by the public.

6.46 Table 6K outlines the capital structure of the Corporation prior to its restructure.

TABLE 6K
GAS AND FUEL CORPORATION
CAPITAL STRUCTURE

Type of shares	*No. of shares*	*State ownership*
	('000)	(%)
Ordinary Shares	4 000	100.0
4% Preference Shares	3 941	99.6
6% Preference Shares	3 010	-

6.47 In September 1994, independent advisers valued the 6 per cent preference shares in a range between $1.79 and $2.36 per share, which took into account future maintainable dividends and the current market price of the shares. The 4 per cent preference shares were also valued at a price of $2.00 per share, which was the price that these shareholders were obligated to sell their shares to the State.

6.48 In October 1994, the Government provided both classes of preference shareholders with the option, by December 1994, to either:

- continue to receive dividends from the Corporation, with the added benefit of a government guarantee; or
- sell their 6 per cent and 4 per cent preference shares at $2.36 and $2.00 per share, respectively.

6.49 By the end of December 1994, payments from the Consolidated Fund of $6.8 million were made to buy back shares from those shareholders who accepted the offer. This represented an acceptance level in excess of 95 per cent. In February 1995, the Government announced that the Corporation would be wound-up under the *Gas and Fuel (Repeal) Act* 1995 and the capital returned to the remaining shareholders, based on the same price as the initial offer less any dividends paid (in the case of the 6 per cent preference share holders). Consequently, further payments of $300 000 were made to acquire the remaining shares.

6.50 **The total cost to the Consolidated Fund to buy back the Corporation's preference shares, including consultant costs of $280 000, amounted to $7.4 million.**

Indemnity payment under the sale of State Bank of Victoria arrangements

6.51 As part of the State Bank of Victoria (SBV) sale arrangements, the Government agreed to indemnify the Commonwealth Bank of Australia in respect of, inter alia, any claims becoming payable in relation to the prior sale of the Victorian Investment Corporation Ltd (VIC) to a private sector company.

6.52 As part of the sale, the private company acquired tax losses relating to VIC which could provide a future tax benefit to the company of approximately $2.8 million. As part of the terms of sale, SBV agreed to pay to the company the tax benefit assumed which was not recouped prior to January 1995, indexed at a rate of 15 per cent per annum on a compounding accruing basis.

6.53 **In January 1995, the Commonwealth Bank of Australia became liable for an amount of $5.5 million under the conditions of the VIC sale agreement and lodged an equivalent claim against the State. This claim was paid by the Government in accordance with the indemnity provisions of the *State Bank (Succession of Commonwealth Bank Act)* 1990.**

PART 7

Assets of the State

VICTORIAN
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Part 7

Assets of the State

KEY FINDINGS

- While the Statement of Financial Operations does not present the State's total asset holdings, it discloses that its financial assets at 30 June 1995 totalled $14.6 billion.
  Paras 7.1 to 7.3
- The focus on improved asset recording, reporting and management needs to be maintained to assist in the enhanced financial management of the State's resources.
  Paras 7.4 to 7.11

LEVEL OF FINANCIAL ASSETS

7.1 Financial assets included in the Statement of Financial Operations can be broadly described as those assets that can be readily liquidated by public sector agencies and generally do not include items of a fixed asset nature. The major categories of financial assets include investment holdings, loans and advances by public sector agencies to external parties, and cash and deposit balances.

7.2 The financial asset holdings of the public sector at 30 June 1995 stood at $14.6 billion (30 June 1994, $15 billion). Table 7A shows the composition of these balances.

TABLE 7A
FINANCIAL ASSETS OF THE STATE
($billion)

Type	*Budget sector*	*Non-budget sector*	*Public financial enterprises*	***Total 1994-95*** *(a)*	*Total 1993-94 (a)*
Loans and advances	1.7	0.4	33.9	**1.7**	1.8
Investments	0.5	0.3	8.1	**8.8**	8.6
Accounts receivable	1.0	1.3	1.1	**2.1**	2.3
Cash and deposits	0.8	0.6	0.2	**1.6**	2.0
Other	0.1	0.2	0.3	**0.4**	0.3
Total financial assets	**4.1**	**2.8**	**43.6**	**14.6**	**15.0**

(a) The total balances are presented net of inter-entity eliminations, that is, after deducting amounts receivable or invested in other public sector agencies.

7.3 The reduction during the year in the level of the State's financial assets mainly occurred within the budget and non-budget sectors. The Department of Treasury and Finance has advised audit that this movement, in part, reflects the liquid nature of these assets. Also contributing to the reduced balance was a lower level of cash held, arising from borrowings being raised ahead of requirements in the prior year.

BUDGET SECTOR ASSETS

Developments in asset recording, reporting and management

7.4 For many years, my reports to the Parliament have advocated the need for prompt Government action to establish comprehensive and accurate records of the budget sector's asset holdings. The delay in establishing such records has hampered the preparation of comprehensive consolidated financial statements for the sector, in accordance with Australian Accounting Standards, and has hindered meaningful assessments of the sector's financial position and performance.

7.5 As commented in my previous Report on the Finance Statement, the former Department of Finance commenced action in 1992-93 to establish a comprehensive central register of physical assets controlled by budget sector bodies, in order to address the deficiency in the recording and reporting of budget sector assets. The register, which is expected to be completed by June 1996, will facilitate the enhanced management of the State's assets and will be used for central resource allocation and budget decisions.

7.6 The implementation process for the central asset register involves 4 stages. The first 2 stages, involving the collation and recording of information relating to individual assets, were completed by 30 June 1994. Stage 3 is currently underway and involves the collation and recording of further information in relation to the above assets, including their condition and utilisation. The final stage of the project, which involves the validation of all asset register information, including valuations, is due to be completed by June 1996, to coincide with the full implementation of accrual accounting by all government departments.

7.7 To provide guidance to departments and public bodies on issues relating to the recognition and valuation of assets, the former Department of Finance in January 1995 issued a technical information paper entitled *Recognition and Valuation of Non-Current Physical Assets.* The paper, which sets out key criteria and principles to be applied by public sector agencies in the recognition and valuation of assets, will assist in ensuring consistency across all organisations in accounting for assets.

7.8 In addition, as part of the Government's Management Improvement Initiative, the Department of Treasury and Finance has, over the past 2 years, co-ordinated the conduct of extensive work in the area of asset management. A key product of this work has been a paper entitled *Asset Management Principles*, which was issued to all agencies in November 1994, setting out the purposes and fundamental principles underlying effective asset management. The Department plans to build on this guidance through the issue to agencies in late 1995 of additional material focusing on asset management policies and practices.

7.9 For the purpose of raising departmental awareness of assets they control and the costs associated with their retention, from 1 July 1994 the Government introduced a capital charge. This charge was levied on each department's State-funded capital outlays, however, departments were fully compensated for the charge to prevent any adverse impact on service delivery. In future years, departments will be compensated for the capital charge on capital outlays which provide new or improved services but will be required to meet the charge from their own resources in respect of capital outlays intended to provide efficiency gains relating to current services.

7.10 Under another initiative introduced from the 1994-95 financial year, departments were also able to retain a portion of asset sale proceeds, in order to encourage the disposal of under utilised assets. As from 1996-97, it is proposed that the capital charge will be based on departmental balance sheets to facilitate enhanced asset management.

7.11 **Given the importance of effective asset management to the financial performance of the budget sector and indeed the State, it is vital that the momentum for improved asset recording, reporting and management be maintained.**

Managed Insurance Fund

7.12 As part of the Government's strategy to enhance budget sector asset management, in March 1995 the Managed Insurance Fund was established, which is a centralised fund to provide insurance protection to departments and budget sector agencies by eliminating the need for these agencies to externally purchase insurance cover. The Government anticipates that the Fund will facilitate improved efficiency and accountability as it requires the full identification of each insured agency's exposure to risk.

7.13 The Fund is controlled by an Advisory Panel, comprising external insurance industry experts and representatives from the Departments of Education, and Treasury and Finance. The Government has entered into a management agreement with a firm of risk consultants to assist in the identification and assessment of insurance risks at client agencies.

7.14 Under the strategy, premiums received from agencies will be paid into a trust account established in relation to the operation of the Fund, with these moneys applied towards future insurance claims. If the Fund generates excessive reserves, then insured agencies will be entitled to receive a refund. It is anticipated by the Department of Treasury and Finance that all departments and budget sector agencies will be insured by the Managed Insurance Fund by 1996-97.

Status of accrual accounting by departments

7.15 One of the Government's key financial management reforms in recent years has been the implementation of accrual-based financial reporting by departments. Under the framework established to facilitate the implementation of this initiative, all departments will be in a position to prepare accrual financial statements, in a form suitable for audit, by the 1995-96 financial year.

7.16 To assist departments in the implementation process, the Department of Treasury and Finance has issued guidance material to departments covering specific accounting and reporting issues, through regular *Accrual Guidance Releases* and an *Accrual Accounting Manual*.

7.17 For the 1994-95 financial year, all but 3 departments will present audited accrual-based financial statements as their primary financial statements in their Annual Reports to be tabled in the Parliament. These financial statements will be prepared in accordance with Australian Accounting Standard AAS29 *Financial Reporting by Government Departments*. The remaining 3 departments will present primary audited accrual-based financial statements for the 1995-96 financial year, consistent with the timetable established by the Government.

7.18 **As commented in my previous Report on the Finance Statement, accrual accounting, once fully implemented will lead to significant improvements in budget sector financial accountability and performance monitoring. In addition, the audited financial statements of departments and other public sector agencies will form the basis of preparation of whole-of-government financial reports for the State.**

Whole-of-government reporting

7.19 In previous years, my Reports on the Finance Statement to the Parliament have advocated the benefits that would flow from the preparation and presentation of consolidated whole-of-government financial reports for the State, and the need for the Government to establish a firm timetable for the implementation of this initiative. The significant benefits that should accrue from this form of financial reporting include:

- provision of transparent reporting, enabling taxpayers to determine how their taxes are spent and what their future obligations are 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;

- 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 and liabilities; and
- presentation of a single set of concise and meaningful financial statements, which allow assessments to be made on the government stewardship of public resources and, therefore, providing enhanced accountability to the Parliament and taxpayers.

7.20 In recognition of these benefits, the Government has commenced a program for the implementation of whole-of-government reporting for the State. Under the program, by March 1996, whole-of-government financial statements are to be prepared on a trial basis by the Department of Treasury and Finance for the 1994-95 financial year, which will not be subject to audit. If the whole-of-government financial statements for the 1995-96 financial year comply with appropriate accounting standards, it is the Government's intention to consider publishing such statements.

7.21 **The developments in the implementation of whole-of-government reporting for the State present a positive step towards the enhanced management of State resources and accountability over government financial operations.**

PART 8

Liabilities and Commitments

VICTORIAN AUDITOR-GENERAL'S OFFICE

Auditing in the Public Interest

Part 8

Liabilities and Commitments

KEY FINDINGS

- The total liabilities of the State at 30 June 1995 stood at $67.6 billion.

  Paras 8.1 to 8.6
- While the liabilities of the State have declined by around $400 million during the 1994-95 financial year, it is anticipated that these liabilities will be reduced significantly in the future due to the positive impact of the Government's privatisation program on debt levels.

  Paras 8.6 to 8.7
- Based on current expectations of future aluminium prices and inflation levels, the present value of the State's exposure under the flexible electricity tariff arrangements is estimated to be $1.6 billion.

  Paras 8.27 to 8.31
- Under the arrangements established for the provision of the new emergency services call-taking and dispatch facilities, the provider of the facilities bears the financing risk as under certain specified circumstances the Government has a right to terminate the arrangements.

  Paras 8.32 to 8.43
- Given the critical nature of the services provided through the emergency services call-taking and dispatch facilities, the Government, if it terminated the arrangement with the private sector provider, would have to obtain immediate alternative service delivery to safeguard the health and security of the community.

  Para. 8.43
- The arrangements relating to the new women's correctional centre at Deer Park provide for a special purpose private sector company to build, own and operate the new facility, which will be situated on Crown land, and the Government is to receive prison accommodation services over a period of 20 years under a service agreement.

  Paras 8.46 to 8.57

KEY FINDINGS *- continued*

- St Vincent's Hospital had raised $119 million at 30 June 1995 to finance the Hospital's redevelopment, the repayment of which will in substance be financed by the State over a 25 year period.

  Paras 8.58 to 8.61

- Due to the future exposures to the State arising from the financing arrangements under the Accelerated Infrastructure Program, the Government commenced action to wind-up the Program through the purchase of bonds issued to finance the Program.

  Paras 8.69 to 8.77

- Even though the Government during the year took specific action to reduce the liabilities of public sector superannuation funds by around $520 million, the State's unfunded superannuation liabilities nevertheless increased in the period by $454 million to total $15.1 billion at 30 June 1995.

  Paras 8.78 to 8.98

- A key responsibility of the SECV "shell" is to administer unallocated electricity industry debt, which has a market value of $2.6 billion at 30 June 1995.

  Paras 8.107 to 8.113

- After taking into account contributions paid to the Consolidated Fund, together with dividends paid to the SECV, the Victorian electricity industry paid net contributions of $319 million during the year, compared with $225 million in 1993-94.

  Paras 8.114 to 8.116

- It is critical that prompt action is taken to complete the implementation of various initiatives previously commenced, to ensure the effective recording, reporting and management of the State's contingent liabilities.

  Paras 8.122 to 8.129

- During the year, the Government contributed around $21 million to meet operating and capital expenditure associated with the Formula One Grand Prix.

  Paras 8.139 to 8.149

- As part of the financial arrangements associated with the Australian Motorcycle Grand Prix, the Government has agreed to underwrite any annual deficits associated with the staging of this event.

  Paras 8.150 to 8.154

- The consortium associated with the delivery of the automated ticketing system has lodged various notices of delay with possible cost implications for the State. However, the State has a right to receive compensation from the consortium for the late commissioning of the system.

  Paras 8.155 to 8.162

- A detailed audit assessment of the City Link arrangements, including an examination to determine the risks and financial exposures to the State resulting from the project, will not be undertaken until the arrangements are finalised.

  Paras 8.163 to 8.170

AGGREGATE LIABILITIES OF THE STATE

8.1 The key focus of the financial management policies introduced by the Government in recent years has been to contain the growth in public sector liabilities through the implementation of various strategies aimed towards debt reduction and enhanced liability and risk management. Given the critical importance of effective liability management to public sector financial operations, a principal focus of my previous Reports to the Parliament on the Finance Statement has been the presentation of a comprehensive analysis of the State's future financial obligations and financial commitments, particularly those relating to the budget sector which directly impact on the Government's present and future capacity to finance program expenditure.

8.2 While the Government in recent years has achieved substantial improvement in the State's finances, mainly through the implementation of significant revenue enhancement and expenditure reduction measures, and major superannuation and structural reforms involving a substantial privatisation program, according to the most recently published data, Victoria remained the most indebted State on the Australian mainland. Specifically, at 30 June 1994, the proportion of debt to Gross State Product for Victoria was 28.7 per cent, which was well in excess of that achieved by New South Wales of 15.3 per cent, and 0.9 per cent greater than the next highest State which was South Australia. The Government anticipates that the State's ratio of debt to Gross State Product will decline to 27.1 per cent as at 30 June 1995.

8.3 As recognised in the Government's 1995-96 Budget Papers, **the State's high level of debt will continue to demand significant government attention, with its effective management critical to the achievement of key government strategies, including the improvement of the State's competitiveness through the closer alignment of Victoria's tax burden with other States.**

8.4 **The audited Statement of Financial Operations discloses liabilities of the State totalling $67.6 billion at 30 June 1995.**

8.5 The notes to the Statement of Financial Operations disclose that the presentation of the State's liabilities does not include Universities as these bodies are principally funded by the Commonwealth Government and are not considered to constitute part of the State reporting entity. Furthermore, the Statement does not include the liabilities of public bodies which have either liabilities or financial assets with a value less than $5 million, as these are not considered to have a material impact on the reported figures.

8.6 Table 8A illustrates the composition of the State's liabilities at 30 June 1995.

TABLE 8A
COMPOSITION OF STATE LIABILITIES
AS AT 30 JUNE
($billion)

Sector	***1995***	*1994*
Budget	**39.4**	39.3
Non-Budget	**21.3**	21.3
Public Financial Enterprises	**42.9**	42.5
Inter-sector eliminations	**(36.0)**	(35.1)
Total liabilities of the State	**67.6**	*(a)* 68.0

(a) Includes $205 million relating to the Accelerated Infrastructure Program.

8.7 **While the liabilities of the State have reduced by around $400 million during the 1994-95 financial year, it is anticipated that these liabilities will be reduced significantly in the next financial year due to the positive impact of the Government's privatisation program on debt levels.**

8.8 In addition to the above liabilities, the State also has quantifiable contingent liabilities of around $2 billion. These liabilities, which are contingent in nature, represent potential commitments the occurrence of which is dependent on future events or outcomes.

BUDGET SECTOR LIABILITIES AND COMMITMENTS

8.9 The financial obligations and commitments of the State can be broadly dissected between those relating to reporting entities within the budget sector, non-budget sector and public financial enterprises. While assessments of the State's overall financial standing needs to focus on the consolidated position of these 3 sectors, the financial obligations and commitments of the budget sector warrant specific attention as these have a direct impact on the Government's budgetary policies and strategies, and the Government's capacity to finance programs. Furthermore, the major contributor to the growth in the State's liabilities in recent years has been the increasing level of budget sector financial obligations. Consequently, the effective management of these liabilities has been a key focus of Government financial management strategies.

8.10 The budget sector broadly comprises entities which are either wholly or substantially funded from the budget. To assist in the assessment of the budget sector's total financial obligations, a detailed analysis of the key components of sector's liabilities is presented in this Part of the Report.

8.11 **The liabilities of the budget sector at 30 June 1995 stood at around $39.4 billion, which is broadly consistent with the position as at 30 June 1994.** These liabilities include the unfunded superannuation obligations of public sector superannuation funds totalling $12.1 billion at 30 June 1995 ($11.4 billion, 30 June 1994), which excludes those obligations relating to employees engaged outside the budget sector, which at 30 June 1995 totalled $3 billion (30 June 1994, $3.2 billion).

8.12 A more detailed analysis of the key components of budget sector liabilities at 30 June 1995 is included in the following sections:

- Budget sector borrowings;
- Other budget sector liabilities; and
- Unfunded superannuation liabilities.

8.13 Table 8B 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 8B
BUDGET SECTOR LIABILITIES AND COMMITMENTS
($billion)

Item	***1995***	*1994*
Liabilities -		
Borrowings *(a)*	**22.2**	22.1
Accrued interest on borrowings	**0.5**	0.6
	22.7	22.7
Unfunded superannuation liabilities *(b)*	**12.1**	11.4
Flexible electricity tariff obligations to Portland and Point Henry aluminium smelters	**1.6**	1.6
Employee-related entitlements	**1.5**	1.2
Creditors and other liabilities *(c)*	**1.2**	1.1
Infrastructure projects (World Congress Centre and St Vincent's Hospital)	**0.3**	0.2
Tricontinental Group deficiency	**-**	0.9
Accelerated Infrastructure Program	**-**	0.2
Total budget sector liabilities	**39.4**	**39.3**
Financial commitments *(d)*	**2.1**	**2.0**
Contingent liabilities *(e)*	**19.5**	**20.5**

(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. This amount excludes $3 billion (30 June 1994, $3.2 billion) relating to employees engaged within the non-budget sector.

(c) Mainly includes creditors of departments and other liabilities of budget sector public bodies.

(d) Comprise operating leases and works unperformed under existing contracts.

(e) From a Statewide perspective, only $2 billion (1993-94, $1.8 billion) of this amount constitutes contingent liabilities of the State, as $17.5 billion (1993-94, $18.7 billion) relates to the debt and other financial obligations of non-budget sector agencies and public financial enterprises, which is eliminated on consolidation.

BUDGET SECTOR BORROWINGS

Level of budget sector borrowings

8.14 **The budget sector's accumulated borrowings at 30 June 1995 amounted to $22.2 billion, a net increase of $60 million since the previous year**. Table 8C provides a summary of the major movements in the level of budget sector borrowings during the year.

TABLE 8C
MOVEMENTS IN BUDGET SECTOR BORROWINGS
($million)

Item			*Amount*
Public Account -			
Borrowings at 1 July 1994 *(a)*			21 862
Add -			
New borrowings paid to Public Account	**877**		
Movement in borrowings held by TCV on behalf of the State for future application	**(579)**		
Assumption of borrowings during 1994-95 *(b)*	**925**		
Indexation, (premium) and discount	**(52)**		
Capitalised finance charges on borrowings refinanced during the year *(c)*	**123**		
Borrowings arising from interest swap transactions	**6**	1 300	
Less -			
Debt redemptions by Consolidated Fund *(d)*	**1 080**		
Debt redemptions outside Consolidated Fund	**97**	1 177	123
Total Public Account borrowings at 30 June 1995			21 985
Budget sector statutory authorities -			
Borrowings at 1 July 1994		293	
Net borrowings in 1994-95		(49)	
Total budget sector statutory authority borrowings at 30 June 1995			244
Less inter-sector balances			(14)
Total budget sector borrowings at 30 June 1995			**22 215**

(a) Represents the historical capital value of borrowings (capital proceeds plus amortised discount/premium). The difference of $25 million between this balance and the closing balance disclosed in the previous year mainly results from a change in the Department of Treasury and Finance loan amortisation policy during 1994-95.

(b) Includes borrowings assumed from Tricontinental ($890 million) and the Office of Major Projects of the Department of Planning and Development ($35 million) relating to the borrowings previously raised in relation to the Bayside Development project.

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

(d) Does not include a $52 million repayment of Grain Elevators Board debt, which was included as part of the non-budget sector debt repayments.

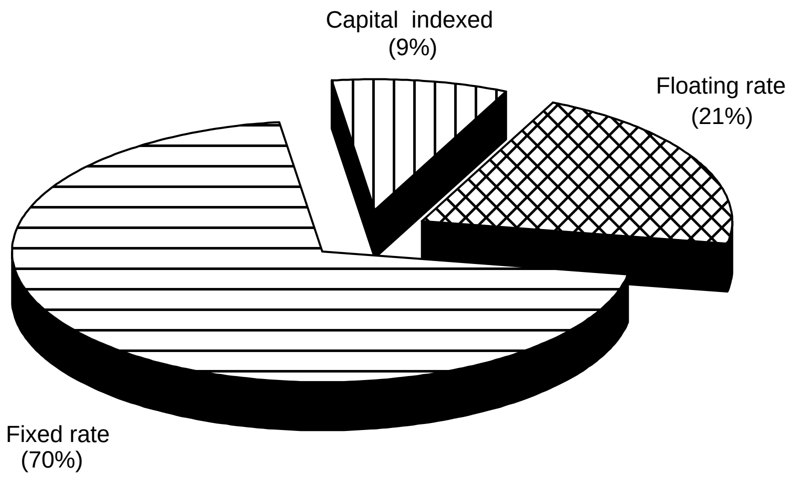
Borrowing composition and maturity profile

8.15 The Government's overall debt management objectives are to minimise borrowing costs, ensure access to financial markets in order to satisfy financing requirements and ensure the effective management of the financial risks associated with debt. As explained in my 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. Accordingly, the management of the portfolio mix and maturity structure is critical to the achievement of the Government's debt management objectives.

8.16 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. The maintenance of a diversified debt portfolio and the smoothing of the maturity profile are key strategies implemented by the Government in the management of the State's debt portfolio.

8.17 Chart 8D shows the composition of budget sector borrowings at 30 June 1995.

CHART 8D
COMPOSITION OF BUDGET SECTOR BORROWINGS, AT 30 JUNE 1995
(per cent)



8.18 As illustrated above, the budget sector debt portfolio predominantly comprises fixed rate instruments, with these instruments accounting for 70 per cent of the debt portfolio at 30 June 1995. This position 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.

8.19 To facilitate the achievement of a diversified budget sector debt portfolio, the Treasurer in 1993 approved a 3 year portfolio management plan which, inter alia, establishes targets to be achieved by the Treasury Corporation of Victoria, which is responsible for the management of the portfolio, in relation to the mix of debt raisings over the period to 30 June 1996. Table 8E shows the targeted mix of borrowings to be raised on behalf of the budget sector during 1994-95, and the mix of borrowings actually raised during the year.

TABLE 8E
TARGETED AND ACTUAL MIX OF BORROWINGS RAISED IN 1994-95
(per cent)

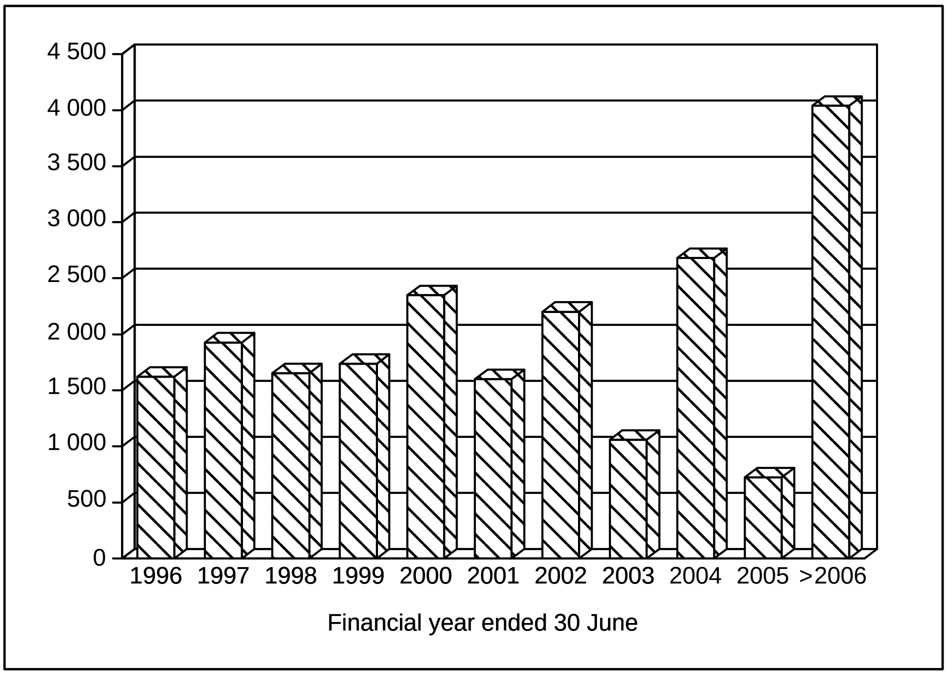
Type of borrowing	*Targeted*	*Actual 1994-95*
Fixed rate	60	100
Capital indexed	25	-
Floating rate	15	-

8.20 The Department of Treasury and Finance advised that the decision to acquire only fixed rate instruments in the year occurred mainly due to the unfavourable market conditions for the raising of capital indexed and floating rate borrowings, and the lower than anticipated borrowing requirements.

Maturity profile

8.21 An analysis of the budget sector borrowings portfolio at 30 June 1995 indicates that around 81 per cent or $17.5 billion (face value) of the portfolio will mature and require repayment or refinancing in the next 10 years. **During 1995-96, $1.6 billion will require repayment or refinancing**. Chart 8F illustrates the maturity profile.

CHART 8F
MATURITY PROFILE OF BUDGET SECTOR BORROWINGS AT 30 JUNE 1995 *(a)*
($million)



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

Treasury management guidelines

8.22 A key objective of the Government's debt management strategy is to enhance the management of the State's liabilities and the associated financial risks. The establishment of the Treasury Corporation of Victoria as the State's central borrowing authority and the introduction of a prudential supervision framework over its operations, in 1993-94, were significant initial steps in addressing this objective.

8.23 In June 1995, the Department of Treasury and Finance issued the *Treasury Management Guidelines* to enhance the management of financial risks associated with treasury functions undertaken within Government Business Enterprises which are not subject to prudential supervision frameworks.

8.24 Specifically, the guidelines prescribe a framework for the development and management of treasury functions by relevant public bodies, and are designed to ensure that the debt management objectives and strategies adopted by all bodies across the public sector are consistent with the State's overall debt management strategy. For public bodies that maintain separate treasury functions, the guidelines require the establishment of:

- a policy and management framework which, inter alia, clearly addresses the overall objectives of the treasury function, its roles and responsibilities, the financial risks to be managed and the maximum acceptable levels of risk;
- a financial risk management strategy, which outlines the financial risks faced by the organisation and the processes for their identification, reporting and management; and
- a comprehensive internal management control system to ensure the effective operation and management of the treasury function.

8.25 For bodies that do not maintain debt portfolios sufficient enough to justify the establishment of separate treasury functions, the guidelines prescribe certain prudential limits and practices that need to be observed to ensure the effective management of associated risks.

8.26 The development and issue of the *Treasury Management Guidelines* represents a positive step toward the enhanced management of the financial risks associated with the State's debt portfolio.

OTHER BUDGET SECTOR LIABILITIES

Flexible electricity tariff arrangements

8.27 My previous reports on the Finance Statement have outlined the flexible electricity tariff arrangements established by the Government in 1984 in relation to the Portland and Point Henry aluminium smelters, which have imposed significant financial obligations on the State. Under the arrangements, which extend to the year 2017, the Consolidated Fund is responsible for meeting the Government's obligation to make payments to the SECV when aluminium prices fall below a stipulated level, a situation that has occurred consistently in recent years.

8.28 **Payments made by the Consolidated Fund under the flexible electricity tariff arrangements in 1994-95 totalled $147.2 million (1993-94, $211 million), which was $47.8 million less than budget expectations.** The favourable budget result in the year was mainly attributable to:

- the termination by the Government, in January 1995, of the Supplementary Power Sale Agreement with Alcoa, which was previously utilised by the company to purchase additional electricity for its smelters, which attracted subsidy payments; and
- increased world aluminium prices, which were not anticipated at the time of budget preparation.

8.29 **Based on current expectations of future aluminium prices and inflation levels, the present value of the State's exposure under the arrangements is estimated by the Department of Treasury and Finance to be $1.6 billion at 30 June 1995.** However this exposure is significantly dependent on future aluminium prices and inflation levels. This amount has been included in the Statement of Financial Operations as a part of budget sector liabilities.

8.30 In order to manage the State's financial exposure under the flexible electricity tariff arrangements, the Government has recently pursued various strategies, including attempts to renegotiate the original terms and conditions of the flexible tariff arrangements with Alcoa.

8.31 **However, given Alcoa's reluctance to re-negotiate the terms of the existing flexible electricity tariff arrangements, the State is faced with a substantial budgetary burden in relation to these arrangements, which extend for another 21 years.**

Emergency services: Call-taking and dispatch facilities

8.32 The Public Bodies Review Committee of the Parliament in February 1993 commenced an inquiry into the operations of the Metropolitan Fire Brigades Board with terms of reference to examine, inter alia, the effectiveness of the Board's computer-aided call-taking and dispatch facilities and the potential for the sharing of major support activities among the State's emergency service organisations. In the Committee's October 1993 interim Report following the inquiry, it was recommended that joint call-taking and dispatch facilities be established under the control of the Minister for Police and Emergency Services, which would service all emergency service organisations and enhance the effectiveness and efficiency of current service provision. The Committee also recommended that an independent body, reporting directly to the Minister, be created to provide those services.

8.33 An independent consultant was engaged by the Committee through the former Department of Finance in September 1993 to assess the feasibility and costs of implementing shared facilities for all Victorian emergency service organisations. The Committee's consultant concluded that savings ranging from $46 million to $111 million over a 7 year period could be achieved from the implementation of shared facilities.

8.34 In December 1993, following a tender process, the Metropolitan Ambulance Service appointed Intergraph Corporation Pty Ltd as the preferred supplier of the Service's computer-aided call-taking and dispatch facility. The Government endorsed this decision on the condition that the Service gave a commitment to fully participate in the joint facilities, and that the Service understood that its proposed investment was only an interim arrangement which would not exempt it from assisting in the development and participation of a joint facility. In addition, the Metropolitan Ambulance Service is required to cover any cost associated with its integration into the joint facility.

8.35 In March 1994, the Ministerial Steering Committee for Emergency Services Telecommunications, supported by an Executive Unit within the Department of Justice, formed the Bureau of Emergency Services Telecommunications to co-ordinate and facilitate the implementation of integrated call-taking and dispatch facilities across all emergency service organisations. The Bureau proceeded to seek registrations of interest for the provision of the joint facilities and associated services.

Appointment of the service provider

8.36 Following a detailed assessment of proposals received, the Government in December 1994 approved Intergraph Corporation Pty Ltd as the preferred provider for shared call-taking and dispatch facilities to Victorian emergency service organisations. An interim agreement was entered into between the Minister for Police and Emergency Services and Intergraph to enable works on the facilities to commence before the formal contracts were finalised.

8.37 **In May 1995, the Victorian public sector emergency service organisations, excluding regional services, entered into a 7 year master service agreement with Intergraph Public Safety Pty Ltd, a subsidiary of Intergraph Corporation Pty Ltd, for the supply, installation, testing, maintenance, ownership, operation and financing of the joint call-taking and dispatch system, for an estimated nominal cost in the order of $170 million (present value of $120 million).**

8.38 The joint facilities became operational in September 1995, with the Victoria Police and the Victorian State Emergency Services commencing utilisation of the facilities at that time. The fire emergency services are anticipated to join the system by mid-1996, with the regional emergency service organisations by late 1996, and the integration of the Metropolitan Ambulance Services by February 1996.

8.39 The new system will progressively replace the call-taking and dispatch services currently undertaken through the existing communication centres which are separately maintained by the State's emergency service organisations. The project involves the **installation of equipment at 2 locations costing Intergraph some $30 million** and the provision of the required call-taking and dispatch services to the respective emergency services, using staff employed by Intergraph. It is anticipated that the emergency service organisations will pay Intergraph a combined **fee in the order of $24 million per annum for the provision of services over the 7 year contract period.**

8.40 As at 30 June 1995, the total capital cost of the system met by Intergraph was around $25 million.

Contract arrangements

8.41 The operating and financial arrangements relating to the provision of the joint communications and dispatch service are set out in a series of complex agreements between Intergraph and the emergency service organisations. The key provisions under the agreements include:

- Ownership of the equipment and the system software licences to rest with Intergraph at all times during the project term. However, under certain events, the Government is entitled to "step in" and gain ownership and/or operational control of the system. These events include major service defaults by the company, a change in Government policy and the expiry of the project term. Under these circumstances, the agreements specify the purchase price to be paid by the Government to acquire the facility, which generally equates to the present value of unamortised system capital costs plus, under certain circumstances, loss of profits and employee redundancy costs;
- Intergraph to fully finance the establishment of the facility from its own funds. However, the company may at any stage utilise external project finance, provided that the facility remains free of encumbrances;
- Intergraph to provide a $5 million bank guarantee to the Government to ensure the full commissioning of the system by June 1996;
- Service fees to be paid by the emergency service agencies over an initial 7 year period. However, the contract term may be extended by these organisations for a further term of 7 years;
- Key operational and performance risks associated with the delivery of the required services in accordance with specified standards to be assumed by Intergraph, with emergency service organisations able to reduce or stop fee payments under certain default conditions;
- If service defaults are not rectified by Intergraph, the contract may be terminated and compensation sought from Intergraph, and/or the facility transfer rights exercised by the Government;
- Fees payable by the emergency service organisations may be adjusted where activity levels vary in excess of set benchmarks, equipment requirements are varied by these organisations, labour pay rates alter in accordance with a set index or occupancy or telecommunications costs vary;
- Claims by emergency service organisations against Intergraph to be limited to a predetermined level, whether due to negligence or otherwise; and
- Public liability insurance to be maintained by Intergraph. The company is required to indemnify the organisations against any actions brought against them by third parties, to the extent that the claims result from negligence or non-performance by the company.

8.42 In summary, the emergency service organisations have entered into performance-based agreements with Intergraph for the provision of call-taking and dispatch services over an initial 7 year period. These agreements provide for the transfer of certain risks to Intergraph, including those relating to service availability and operational performance. However, a number of risks have been retained by the State, including exposure to certain cost variations and claims by participating organisations against Intergraph to the extent that these exceed a predetermined monetary level. To ensure the on going availability of this critical joint communication service, the State has retained a right to *step-in*, in certain cases of service default by Intergraph, where there is a change in government policy and at the end of the project term, and has the option in those instances to acquire the call-taking and dispatch system.

8.43 **Under the arrangements, while the Government has a right to *step-in* and gain ownership of the facility in certain cases of service default and at the end of the project term, it is not compelled to do so and, therefore, Intergraph bears the financing risks as it will retain the facility and responsibility for any associated financing costs. However, given the critical nature of the services provided through the facility, the Government if it terminated the arrangement with Intergraph would have to immediately obtain alternative service delivery to safeguard the health and security of the community.**

Budget implications

8.44 While it was initially anticipated by the Public Bodies Review Committee that the establishment of joint call-taking and dispatch facilities would improve the cost-efficiency of providing these services for the State's emergency service organisations, the following outcomes indicate some uncertainty in the realisation of this expectation:

- an accounting firm in December 1994 advised the Bureau of Emergency Services Telecommunications that supplementation funding of $12 million will be required in the period 1995-96 and 1996-97 to finance the contractual and transitional costs of the new system;
- a consultant engaged by the Department of Justice reported in March 1995 that an additional aggregate recurrent Government subsidy of around $35 million (in present value terms) will be required to support the new facilities over the 7 year term of the contract, with further capital and employee redundancy funding estimated at $1 million; and
- in August 1995, the Government announced that the 1995-96 budget allocation to the Justice portfolio would include a subsidy of $8 million above previous emergency call-taking and dispatch costs, to offset current contract costs associated with the operations of the joint services.

8.45 **The Department of Treasury and Finance and the Department of Justice have advised that despite the above factors, the new system is likely to generate significant savings through the reduction in personnel required to operate the new system, and will allow the redeployment of senior qualified emergency officers to more relevant duties, therefore improving their productivity. However, management have also stated that the savings and the productivity improvements will only be achieved progressively as all phases of the system are implemented.**

New Prisons Project

8.46 In December 1993, the Government announced a New Prisons Project under which private sector participation would be sought for the delivery of 3 new prisons in Victoria to replace Pentridge, the Metropolitan Reception Prison and Fairlea Women's Prison. The 3 new facilities, which are to accommodate approximately 60 per cent of the female prisoners and 50 per cent of the male prisoners of the State, are to comprise:

- a 125 bed metropolitan women's prison;
- a 600 bed male medium-security facility to be located in country Victoria; and
- a 600 bed male maximum-security and remand facility to be located in the Melbourne metropolitan area.

8.47 The key objectives of the program are to:

- replace inadequate and ageing prisons with new facilities and increase the capacity of correctional facilities to meet projected demand;
- reduce the costs of infrastructure development;
- ensure the scope and quality of services to prisoners is maintained and/or enhanced without compromising security and safety;
- meet Government policy objectives for private sector involvement in prison operations;
- establish competition among private and public sector providers of correctional services; and
- introduce new approaches to the design, construction and management of prisons.

Metropolitan Women's Correctional Centre

8.48 In July 1994, the Government issued a project brief for the establishment of the new metropolitan women's correctional centre at Deer Park. Following a detailed assessment of the 3 tenders received, in December 1994, a private sector consortium was selected as the preferred tenderer to build, own and operate the new facility. In June 1995, the arrangements for the establishment of the correctional centre were finalised following further negotiations with the consortium, the proposed builder of the new facility and the consortium's financier.

8.49 The financial and operating arrangements relating to the new women's correctional centre are set out in a series of complex agreements between the relevant parties. The primary agreements comprise a Ground Lease Agreement, a Prison Services Agreement and a Tripartite Agreement. The key terms of these agreements include:

- The prison to be constructed on a Crown land site, which is to be leased by the company from the Government for a term of 40 years. Lease rentals are set at commercial rates and are subject to regular reviews, based on Valuer-General valuations;
- Construction of the new facility, in accordance with Government specifications, by a special purpose company established by the consortium, at a total estimated project cost of $20.9 million. The facility is to be completed by mid-1996, with construction costs to be met by the company from $16.8 million debt financing and $4.1 million equity contributions;
- Facility to be owned by the company, with the payment of an annual performance-linked fee to the company based on the achievement of specified service delivery outcomes, which will provide a return on the equity investment;
- Provision of specified prison accommodation services by the company over a 20 year period, with allowance for a further 10 year extension. An accommodation service charge will be payable by the Government for the delivery of these services;
- Provision of specified correctional services and programs by the company over an initial 5 year period and the payment of a correctional services fee by the Government for the delivery of these services. The contract for this service delivery is renewable for 5 further terms of 3 years or could be put to tender by the Government at the end of the initial term or upon expiry of each term thereafter; and
- The company's financier to hold a security interest in the new facility.

8.50 The arrangements for the new correctional centre have been structured by the Government to facilitate the substantial transfer of key risks associated with the construction, ownership and operation of the facility to the private sector. In particular:

- The Government can withdraw from the prison service agreement with the company in the event that construction is not completed by the targeted date. Furthermore, risks associated with construction cost overruns are borne by the company;
- The company bears the risk of maintenance, repair and refurbishment of the facility;
- If the facility is damaged or destroyed during the term of the service agreement, the company and its financiers are responsible for its re-instatement;
- While the site lease term extends for 40 years, the service agreement with the company covers 20 years. At the end of the initial lease term, the Government has no commitment to purchase or continue utilisation of the site and the company may use the site for other purposes or "remove" the correctional facility;
- The company has direct responsibility for the day-to-day operations of the correctional centre, consistent with Government-established standards;
- The accommodation services charge payable by the Government over the period of the service agreement, which is designed to finance the company's debt servicing obligations, site lease payments and the provision of certain other accommodation services, may be reduced or stopped in the event the company does not provide specified levels and standards of accommodation. Furthermore, under certain default conditions, the Government may terminate the service agreement and sue the company for compensation; and
- The provision of correctional services by the company covers an initial term of only 5 years. Thereafter, the services may be put to tender by the Government. Also, if the operator defaults on the provision of such services, the Government may require the company to appoint a new operator or may terminate the service agreement. However, if the service agreement for the provision of correctional services is terminated, the Government is required to pay a level of compensation.

Tax deductibility of project expenses

8.51 The deductibility for taxation purposes of certain project expenditure can impact on a project's financial viability. Given the potentially significant impact of the taxation status of the financial arrangements relating to the new prison, in December 1994, the Government commenced discussions with the Australian Taxation Office to facilitate the development of a tax ruling application on this matter.

8.52 A preliminary tax ruling was applied for and a favourable ruling was received by the consortium in May 1995, in accordance with the Australian Taxation Office practice for infrastructure of this type. In July 1995, the consortium lodged an application with the Australian Taxation Office for a formal tax ruling on this project. However, at the date of preparation of this Report, the formal ruling remained outstanding.

8.53 **In summary, the arrangements relating to the new women's correctional centre provide for the special purpose private sector company to build, own and operate the new facility which will be situated on Crown land and the Government to receive prison accommodation services over a period of 20 years under a service agreement. The fees payable by the Government for these services are designed to enable the company to meet its debt servicing and lease obligation, and provide a return on equity.**

8.54 **The arrangements are anticipated by the Government to result in substantial benefits to the State, through the achievement of service provision costs of around 14 per cent less than the benchmark costs of the existing Fairlea Women's Prison.**

Rural and Metropolitan Men's Prisons

8.55 In November 1994, the Government issued a project brief for the establishment, by early 1997, of the second prison under the New Prisons Project, at Fulham near the City of Sale. Following a detailed evaluation of tenders received, in May 1995, the Government selected the preferred tenderer for the construction, ownership and operation of this facility. At the time of preparation of this Report, negotiations were nearing finalisation relating to the financial and other contractual arrangements for this facility.

8.56 In relation to the proposed Metropolitan Men's Prison, a project brief was issued in August 1995 for the design, construction, ownership and operation of the facility. At the date of preparation of this Report, 3 bidders had been short-listed to provide detailed tender submissions by November 1995. The Government anticipates an announcement of the successful tenderer by mid-1996.

8.57 The arrangements established in relation to these new prison facilities will be examined and reported upon in a future Report to the Parliament.

St Vincent's Hospital redevelopment

8.58 As outlined in my previous Reports on the Finance Statement, in August 1991, the Government entered into a series of complex financial arrangements to finance the redevelopment of part of the St Vincent's Hospital, which is owned by the Sisters of Charity religious order. The redevelopment project commenced in January 1993 and was completed in October 1995 at an estimated cost of $146 million.

8.59 The financing arrangements associated with the redevelopment provide for the project to be initially funded from a combination of borrowings raised by the Hospital and equity finance provided by banks. The servicing of the financial obligations are 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.

8.60 Under the financing arrangements the State, in substance, will fund the redevelopment of the Hospital, provided that health services continue to be provided to the public over the 25 year period. Ownership of the redevelopment is to rest with the banks for the first 15 years of the arrangement and, following a settlement payment, will pass to the Sisters of Charity.

8.61 **The Hospital had raised $119 million as at 30 June 1995 to finance the redevelopment**, comprising $80 million raised through the issue of bonds and $39 million in equity financing provided by the banks. This amount has been included as part of budget sector liabilities.

Residual obligations relating to Tricontinental

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

8.63 To assist in the orderly realisation of Tricontinental's loan portfolio, in 1991-92, the State commenced the provision of an operating subsidy to the Corporation, to finance the shortfall arising between income earned on the portfolio and amounts payable on borrowings. **The total subsidy paid by the Consolidated Fund to Tricontinental to 30 June 1995 totalled $365 million, including an amount of $38.5 million paid to the Corporation during 1994-95.**

8.64 Up to and including the 1993-94 financial year, the State assumed $1.1 billion of Tricontinental's borrowings and loans and in September 1994, the Treasurer approved the assumption of the balance of Tricontinental's debt portfolio which had a face value of $940 million (market value, $890 million), comprising short-term loans and medium-term notes. The debt assumed during the 1994-95 financial year was repaid by the Consolidated Fund in November 1994. As a result of these debt assumptions, the Government expects that further subsidy payments to Tricontinental will not be required in future years.

8.65 **Principally, as a result of the State debt assumption, the financial position of the Corporation significantly improved during the year from a net deficiency of $856 million at 1 July 1994 to a net asset position of $128 million at 30 June 1995.**

8.66 **Table 8G details the aggregate cost to Victorian taxpayers of Tricontinental's financial demise, which as at 30 June 1995 totalled $2.3 billion.**

TABLE 8G
AGGREGATE COST TO VICTORIAN TAXPAYERS OF TRICONTINENTAL, AT 30 JUNE 1995
($million)

Items		*Amount*
Debt/loans assumed by the State *(a)*	1 903	
Cost of servicing debt assumed	111	
Operating subsidy provided by the Consolidated Fund	365	
		2 379
Net assets at 30 June 1995		(128)
Total cost to Victorian taxpayers		**2 251**

(a) Debt/loans assumed by the State comprises $576 million assumed prior to the sale of the State Bank less $63 million subsequently recovered on this portfolio, plus $500 million debt assumed during 1993-94 and $890 million assumed during 1994-95.

8.67 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 1995 comprised:

- guarantees and letters of credit of $4 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.

8.68 In January 1995, a management agreement was entered into between Tricontinental and the Rural Finance Corporation, under which the Corporation will provide administrative and accounting services to Tricontinental, in return for a management fee, to facilitate the realisation of the balance of the loan portfolio.

Accelerated Infrastructure Program

8.69 In previous years, I have commented on the significant financial obligations of the budget sector arising from the Accelerated Infrastructure Program, which was established in the 1990-91 financial year by the then Government in conjunction with a major private bank to provide accommodation for certain government agencies, principally for police stations and law courts.

8.70 The arrangements under the Program involved 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 involved:

- the company borrowing funds, through the issue of capital indexed bonds which would 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 covered 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.

8.71 As at 30 June 1995, the total amount raised under the Accelerated Infrastructure Program was $205 million. These funds, in the main, were used for the construction of 12 properties which are now leased to the Government, and which have lease expiry dates in the years 2011 to 2013. As at 30 June 1995, the financing company held some $85 million in uncommitted funds previously raised through the issue of bonds.

8.72 In 1992-93, the Government initiated a review of the future operation of this Program. While this review was in progress, the Treasurer was advised in March 1995 by the bank (the owner of the financing company) that an offer had been received for the acquisition of the property assets controlled by the company under the Program. However, the bank advised that the offer was below the most recent market valuation of the property assets and that the sale proceeds, plus the premature liquidation of current investments, were not sufficient to extinguish the Treasurer's liability under the indemnity to bond holders. **The bank estimated a deficit of $33.8 million if the offer was accepted, which would result in a call on the Treasurer's indemnity. Subsequently, the offer was rejected by the bank.**

8.73 The review of the Program was completed by the Department of Treasury and Finance in May 1995. The key findings of the review were that:

- the current values of program property assets, as assessed by property consultants engaged by the Department, were below construction costs;
- the financing company would have an estimated funds deficiency of $147 million (present value of $25 million) at the end of the initial Government lease period in 2013, which would give rise to a call on the Treasurer's indemnity;
- the Program arrangements were entered into without any detailed evaluation of all risks, which could ultimately result in a financial exposure to the State; and
- if the Program was to be wound-up, the net cost to the State would be substantial.

8.74 **Due to the future exposures of the State arising from the financial arrangements under the Program, in May 1995, the Treasurer approved commencement of action to wind-up the Program. As a first step, in June 1995, a payment of $200 million was made from the Consolidated Fund to finance the acquisition by the Treasury Corporation of Victoria of a significant portion of the bonds issued by the financing company in association with the Program.**

8.75 Since 30 June 1995, a further $33 million of bonds were acquired by the Treasury Corporation of Victoria on behalf of the State. At the date of preparation of this Report, action was in progress to acquire the balance of the bonds which had a face value of $13 million. In addition, the Government was considering the framework to be used to collapse the current program arrangements.

8.76 The value of the bonds not yet acquired by the Government as at 30 June 1995 is disclosed in the Statement of Financial Operations as a contingent liability.

8.77 **The action taken by the Government to unwind the Program, including the decision to purchase the bonds, reaffirms my view which I have expressed in my previous Reports to the Parliament, that the financial obligations under the Accelerated Infrastructure Program should have been disclosed as part of budget sector liabilities.**

UNFUNDED SUPERANNUATION LIABILITIES

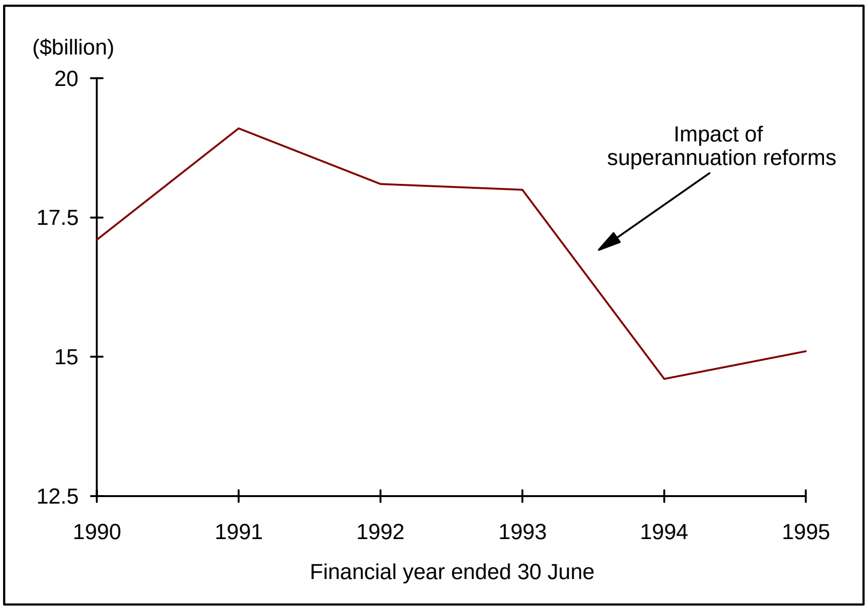
8.78 Unfunded superannuation liabilities represent the second largest component of budget sector liabilities. These financial obligations comprise employer superannuation contributions yet to be paid by the Government, and certain public sector bodies, to superannuation schemes of the public sector,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

8.79 As disclosed in the Statement of Financial Operations, **the unfunded liabilities of public sector superannuation funds at 30 June 1995 totalled $15.1 billion, representing an increase of $454 million or 3 per cent since the previous year**. The unfunded superannuation liabilities relate to the following sectors:

- Budget - $12.1 billion (30 June 1994, $11.4 billion); and
- Non-budget - $3 billion (30 June 1994, $3.2 billion).

8.80 Chart 8H shows the movement in the level of the State's superannuation liabilities since 1990.

CHART 8H
MOVEMENT IN UNFUNDED LIABILITIES
OF PUBLIC SECTOR SUPERANNUATION FUNDS



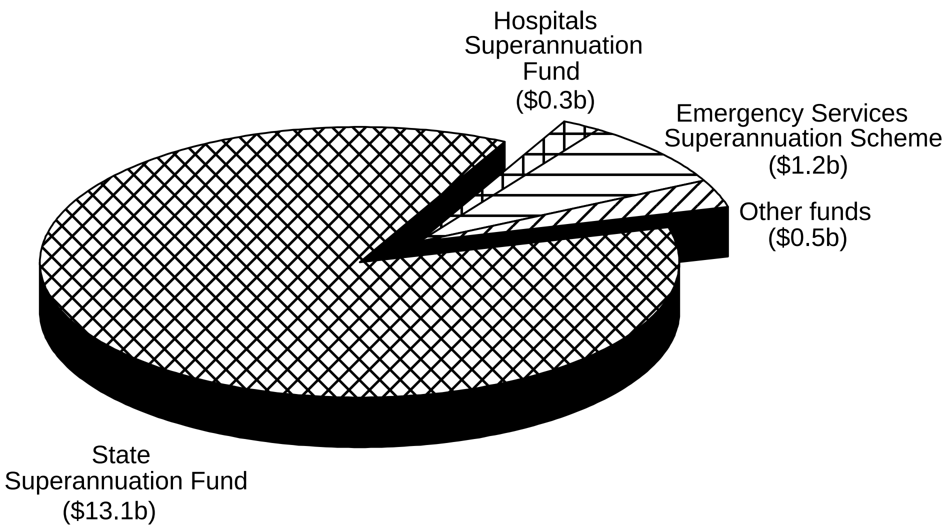
8.81 As explained in my previous Report on the Finance Statement, the substantial reduction in the level of public sector unfunded superannuation liabilities in 1993-94 was principally due to:

- a substantial reduction in the budget sector workforce since 30 June 1992, resulting from the operation of the Government's employee departure programs;
- the low rate of growth in wages and salaries over this period;
- 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 1993-94 to meet the Government's liability for deferred employer contributions.

8.82 The increase in the level of these liabilities in 1994-95, as advised by the Department of Treasury and Finance, was mainly due to employer superannuation contributions failing to keep pace with the increase in the accruing liabilities of the superannuation funds.

8.83 Chart 8I illustrates the superannuation funds principally responsible for managing the unfunded liabilities of the State at 30 June 1995.

CHART 8I
UNFUNDED LIABILITIES OF PUBLIC SECTOR SUPERANNUATION FUNDS, 30 JUNE 1995
($billion)



Additional superannuation payments to improve funding levels

8.84 **Consistent with the Government's policy for discharging unfunded superannuation liabilities, in 1994-95, additional Consolidated Fund payments of $320 million were made to superannuation funds to enhance their funding position.**

Hospitals Superannuation Board

8.85 Due to insufficient employer contributions, in prior years, the unfunded superannuation liability of the Hospitals Superannuation Board's basic benefits accumulation scheme had increased significantly. In order to progressively discharge this liability, employer organisations were required to pay in recent years a surcharge on employee salaries.

8.86 In June 1995, a Consolidated Fund payment of $129 million was made to the Board to discharge the unfunded liability relating to its basic benefits accumulation scheme.

8.87 In relation to the Board's contributory scheme, employer organisations are still required to pay an aggregate contribution rate to fund the outstanding liabilities and future benefits over the life of the scheme.

Emergency Services Superannuation Scheme

8.88 As commented in my previous Reports to the Parliament, in 1989, the then Treasurer agreed to a financial plan under which the Emergency Services Superannuation Scheme's borrowings, which had been raised to cover amounts due to the Scheme from the Consolidated Fund, would be extinguished by the year 2000, through additional employer contributions.

8.89 During 1994-95, the Consolidated Fund made payments totalling $146 million to the Scheme to repay the outstanding employer contributions and the Scheme's borrowings, of which $103 million represented additional contributions in the year.

State Superannuation Fund

8.90 In previous years, the Victorian Superannuation Board had adopted the practice of recouping the employer share of superannuation payments from the Department of Treasury and Finance, on a regular basis, once payments relating to pensions were made.

8.91 In May 1995, departments were requested by the Department of Treasury and Finance to inform the Board of all employees ceasing employment prior to 30 June 1995, including those accepting redundancy packages. Based on the information submitted, in late June 1995, the Board requested the Department of Treasury and Finance to fund the employer share of the expected superannuation payments to 30 June 1995. Consequently, in June 1995, an advanced Consolidated Fund contribution compared with previous years of $88 million was made to the Board.

Introduction of superannuation charge

8.92 To ensure that departmental program costs more fully reflect the total cost of service provision, thereby enabling managers to make more informed decisions, as from July 1995 the Government introduced a superannuation charge to facilitate the attribution of accrued employer superannuation costs to departments.

8.93 In 1994-95, departmental global budgets were increased to take account of the superannuation charge. However, this arrangement had a neutral impact on the budget outcome as the superannuation charge met by departments was paid back into the Consolidated Fund.

8.94 As foreshadowed in the 1995-96 Budget Papers, from November 1995, departments will be required to pay the employer's share of accruing superannuation costs, which equate with the superannuation charge directly to the State Superannuation Fund. In addition, audit has been advised that the Government will continue to make additional payments in future years to progressively reduce the unfunded liability relating to employee past service.

8.95 This initiative represents a positive step towards increased departmental accountability over the cost of service provision and enhanced management of the State's unfunded superannuation obligations.

State Superannuation Fund - change in tax status

8.96 During 1994-95, the State Superannuation Board elected to change the taxation status of the State Superannuation Fund, from a Fund paying untaxed superannuation benefits to a Fund paying taxed benefits, to take advantage of recent changes in taxation laws.

8.97 The change in tax status means that the Fund is now liable for taxation on all employer contributions received. Consequently, the gross benefits payable to members will be reduced. However, it is anticipated by the State Superannuation Board that the after-tax benefits to the majority of members will in fact increase.

8.98 **The impact of this change, as advised by the Department of Treasury and Finance, is a net reduction of around $200 million in the level of the Fund's unfunded liabilities at 30 June 1995.**

Prudential supervision of public sector investment activities

8.99 In 1987, the *Borrowing and Investment Powers Act* 1987 and the *Investment Management Guidelines* were introduced by the Government to establish a consistent management framework for public sector superannuation funds and public bodies with significant investment portfolios and long-term liabilities. To enhance the management framework in relation to these bodies, in December 1994, the Department of Treasury and Finance issued the *Prudential Statement - Victorian Public Sector Investments*, which replaced the previous *Investment Management Guidelines* and established a revised framework for the prudential supervision of these investment activities.

8.100 The bodies that are subject to the prescribed requirements of the Prudential Statement, as from January 1995, include the large public sector superannuation funds, the Victorian Funds Management Corporation, the Construction Industry Long Service Leave Board, the Transport Accident Commission and the Victorian WorkCover Authority.

8.101 The overall objective of the Statement is to ensure that investments are prudently and responsibly managed, that the relevant bodies have access to a wide range of investment products and that maximum advantage is taken of available returns within acceptable risk parameters. Broadly, the Statement requires the bodies to:

- Establish investment objectives which form the basis for the establishment of investment strategies;
- Develop investment strategies, consistent with adopted organisational objectives, which, inter alia, establish a recommended portfolio composition and parameters within which tactical variations may be made;
- Observe maximum exposure limits relating to the investment portfolio composition;
- Establish appropriate internal controls for the management of the key risks, and policy and procedures manuals to ensure the effective implementation of the investment objectives and strategies; and
- Regularly report to the Treasurer to provide assurance that the investment portfolios are prudently and professionally managed. Such reports are to include details of the investment objectives and strategies (including progress towards their implementation), quarterly analytical performance reports and annual board of management certifications of compliance with the Statement.

8.102 To provide independent assurance to the Treasurer as to the compliance by bodies subject to these requirements, individual annual reports are to be provided to the Treasurer by the Victorian Financial Institutions Commission which has responsibility for assessments of the appropriateness of internal controls under the prudential supervision activity.

8.103 **Given the significant impact of the investing activities of large superannuation funds and other bodies with long-term liabilities on the State's future financial obligations and fees and charges levied on taxpayers, the establishment of the prudential supervision framework represents a positive step towards the enhanced management of these activities.**

LIABILITIES OF THE NON-BUDGET SECTOR AND PUBLIC FINANCIAL ENTERPRISES

8.104 In addition to the liabilities of the budget sector, the overall financial obligations of the State include the liabilities of non-budget bodies and public financial enterprises. While these bodies are not reliant on the budget to finance their operations, they nevertheless constitute part of the public sector as they are engaged in the delivery of services to the public and are subject to Government control.

8.105 The total gross liabilities of non-budget sector bodies and public financial enterprises prior to inter-entity eliminations at 30 June 1995 stood at $21.3 billion and $42.9 billion respectively. Table 8J illustrates the composition of these liabilities.

TABLE 8J
NON-BUDGET SECTOR AND PUBLIC FINANCIAL ENTERPRISE LIABILITIES
($billion)

Item	***1995***	*1994*
Non-budget sector -		
Borrowings	**14.1**	15.1
Unfunded superannuation liabilities	**3.0**	3.2
Other employer liabilities	**0.7**	0.6
Miscellaneous accruals	**3.5**	2.4
Total non-budget sector liabilities (gross)	**21.3**	**21.3**
Public financial enterprises -		
Borrowings	**35.5**	35.1
Claims liabilities	**5.0**	4.7
Deposits	**0.7**	1.0
Other	**1.7**	1.7
Total public financial enterprise liabilities (gross)	**42.9**	**42.5**

8.106 The above table shows that the liability positions of both the non-budget sector and public financial enterprises remained consistent in the past 2 years, in line with the Government's financial management objective of stabilising and reducing the level of public sector liabilities.

Financial obligations of the SECV

8.107 In my previous *Ministerial Portfolios Reports* I have commented on the Government’s substantial reform program of the Victorian Electricity Supply Industry. In brief, the initial stages of the reform program involved:

- establishment of the *Electricity Supply Industry Reform Unit* within the Department of Treasury and Finance to drive the Government reform agenda;
- creation of 3 new entities, each to manage a core sector of the operations of the former State Electricity Commission of Victoria (SECV), namely:
  - *Generation Victoria* - to operate the brown coal mines, thermal, gas and hydro power stations, and the associated power generation facilities;
  - *National Electricity* - responsible for the high voltage transmission of electricity from the power stations to the distribution networks, and to supply electricity to the wholesale market; and

    - *Electricity Services Victoria* - to operate the State's low voltage distribution network and to supply electricity at the retail level; and
- retention of the SECV, under the control of an Administrator, to manage the residual functions not allocated to the newly created entities.

8.108 Stage 2 of reform program involved the further disaggregation of the newly created bodies and, in particular, the establishment of:

- *5 regionally-based distribution and retail companies,* to take over the functions of Electricity Services Victoria and the 11 Municipal Electricity Undertakings previously managed by municipal councils;
- *PowerNet Victoria,* to manage the high voltage transmission network for the transfer of electricity from power stations to the distribution companies;
- *Victorian Power Exchange*, to monitor and control the wholesale electricity market and ensure the security of the electricity supply system;
- *4 new generation entities* to assume part of the role of Generation Victoria; and
- *the Office of Regulator-General,* to independently regulate the Victorian electricity industry.

8.109 The SECV was retained as a so-called *shell* to manage the assets and obligations not allocated to the newly created entities. To establish a secure financial base for the financing of the residual SECV responsibilities, inter alia, the Treasurer in June 1995 transferred the ownership of all shares in the new electricity generation and distribution entities to the SECV Administrator, for nil consideration. This was designed to ensure that the Administrator’s obligations were serviced by the cashflows to be generated from electricity industry dividends determined by the Treasurer and future industry privatisation proceeds.

8.110 The first of the industry privatisations occurred in August 1995, with the sale of the United Energy distribution business. Detailed comment on this sale is provided in Part 4 of this Report.

8.111 The Gas and Fuel Corporation of Victoria and the Coal Corporation of Victoria were dissolved by statute in June 1995, with the residual assets and liabilities of the former Corporations which were not transferred to other entities allocated to the SECV shell. Audit was advised that the allocation by the Government of responsibilities to the SECV is continuing as further policy decisions on the allocation of assets and liabilities to the various electricity and gas companies are made.

Role and responsibilities of SECV

8.112 The SECV *shell* is the same statutory corporate entity as the former SECV. Under the reform program, significant financial management responsibilities have been assigned to, or retained within the organisation, and these responsibilities are likely to remain in the foreseeable future. The SECV Administrator's role is to effectively manage and, where appropriate, dispose of the assets and resolve the residual obligations of the entity, and to ensure that the Government remains informed of all issues under his control. At the time of the preparation of this Report, the key responsibilities of the SECV included:

- administration of unallocated electricity industry debt, which had a market value of **$2.6 billion** at 30 June 1995;

- management of the rights and obligations under electricity supply contracts with the wholesale electricity market relating to the Loy Yang B power station, the Snowy Mountains power consortium inter-connecting agreement and the flexible electricity tariff arrangements relating to the Portland and Point Henry aluminium smelters;
- completion of a fixed price construction and commissioning contract for Unit 2 of the Loy Yang B power station, which is due to be handed over to a joint venture of Mission Energy Australia Pty Ltd and Loy Yang Power Pty Ltd in September 1996;
- disposal of various properties, including a CBD building purchased by the SECV from a developer in July 1994, which was previously intended by the former Commissioners to be utilised as head office accommodation and is now surplus to requirements;
- resolution of legal proceedings against the former Gas and Fuel Corporation of Victoria by Gleem Pty Ltd, relating to alleged damages arising from the withdrawal by the Corporation from a lease of proposed new head office accommodation;
- demolition of the decommissioned power station at Yallourn;
- management of surplus commercial and contaminated vacant land of the former Gas and Fuel Corporation of Victoria; and
- resolution of litigation and other claims relating to residual issues of the electricity and gas industries.

8.113 **The position of the SECV as at 30 June 1995, not including its interest in the State's electricity distribution and generation businesses of $4.8 billion, was a net deficiency of $2.9 billion which has been included as part of the non-budget sector liabilities in the Statement of Financial Operations.**

Financing of SECV responsibilities

8.114 The responsibilities allocated to the SECV impose substantial financial obligations on the organisation which require on going income sources to finance. The key sources of revenue to the SECV include:

- proceeds from industry privatisations;
- dividends received from the new electricity generation and distribution bodies, in which the SECV holds all shares;
- wholesale electricity net sales income relating to operations not transferred to the new electricity bodies; and
- service charges on electricity accounts, receivable from all the distribution companies which is utilised to cover the additional cost of purchasing electricity from Loy Yang B relative to the price received from the sale of this electricity to respective distribution companies.

8.115 During the 1994-95 financial year, after the transfer of ownership of the distribution and generation companies from the Treasurer, the SECV received dividends totalling $57.2 million and net proceeds from the sale of Energy Information Technology Company Pty Ltd of $37.5 million.

8.116 **After taking into account contributions paid to the Consolidated Fund during the year, together with the dividends paid directly to the SECV, during the 1994-95 financial year the Victorian electricity industry paid net contributions of $319 million compared with $225 million in the 1993-94 financial year.**

Home Opportunity Loans Scheme

8.117 The operations of the Home Opportunity Loans Scheme (HOLS), which was established in 1988 and administered by a company known as Home Opportunity Loans Limited, have been widely commented upon in my previous Reports to the Parliament.

8.118 Under the Scheme, housing finance was provided to low and middle income earners who normally would not have the opportunity to borrow from traditional finance sources. The financial assistance provided by HOLS was mainly financed from funds raised by Victorian Housing Bonds Limited through the issue of Victorian housing bonds. All funds raised by this company were subject to a Government indemnity under the *Housing Act* 1983, with the indemnity supported by first mortgages over the properties subject to housing finance. **The State's liability in relation to Victorian housing bonds issued as at 30 June 1995 amounted to $904 million (face value, $885 million), which have been included as part of the liabilities of public financial enterprises in the Statement of Financial Operations.**

8.119 In recent years, the Scheme's loan portfolio has become exposed to significant losses, mainly due to mortgage discharges by borrowers seeking better refinancing options outside the Scheme, and mortgage discharges initiated by the Scheme where borrowers have defaulted on loan repayments, coupled with the inflexibility under the financing arrangements for equivalent debt prepayment. In view of these losses and the consequential increase in costs of the Scheme to the State, the Government in April 1995 announced that the Scheme would be restructured by the end of 1995, to enhance the management of its asset and liability portfolios.

8.120 Under the Treasury Corporation of Victoria (Housing Finance) Bill, which at the time of preparation of this Report had not been proclaimed, the Government proposes to transfer the Scheme's capital market liabilities (the housing bonds) issued by Victorian Housing Bonds Limited to the Treasury Corporation of Victoria and to transfer the assets and non-capital market liabilities of the Scheme to the Director of Housing.

8.121 The Department of Planning and Development, in conjunction with the Treasury Corporation of Victoria, is currently involved in the development of an asset and liability risk management strategy for the future operation of the Scheme.

CONTINGENT LIABILITIES OF THE STATE

8.122 Contingent liabilities of the State do not represent actual liabilities but rather 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.

8.123 Through the provision of guarantees, the State is obligated to meet commitments to third parties in the event that organisations in receipt of guarantees are unable to meet their commitments in the first instance. The provision of indemnities, on the other hand, generally impose a primary obligation on the Government to protect entities in receipt of indemnities against certain financial losses.

8.124 **While instruments giving rise to contingent liabilities place no immediate demand on public finances, they are nevertheless significant as the Government may be required to honour its undertakings many years after such undertakings are given.**

8.125 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 departmental records and the Department of Treasury and Finance's processes for recording and monitoring contingent liabilities. However, as indicated in my previous Report on the Finance Statement, in recognition of these deficiencies, in 1993-94, the Department of Treasury and Finance commenced corrective action. Specifically:

- all departmental Secretaries were requested to establish registers of contingent liabilities, placing the onus for the maintenance of comprehensive and accurate information on individual departments;
- work commenced on the development of a policy and procedures manual for the control and monitoring of guarantees and other contingent liabilities; and
- the Department's central database was to be upgraded during 1994-95, to improve the recording and monitoring of the State's contingent liabilities.

8.126 As part of this year's review of the Statement of Financial Operations, audit assessed the progress made on the implementation of these initiatives. The review found that **the momentum established in 1993-94 to improve the recording, reporting and management of the State's contingent liabilities had not been maintained during 1994-95**. In particular, the audit review identified that:

- despite further requests by the Department of Treasury and Finance to all departmental Secretaries to establish registers of contingent liabilities, a significant number of departments had not established such registers during the 1994-95 financial year;
- a policy and procedures manual for the control and monitoring of guarantees and other contingent liabilities had, at the date of preparation of this Report, not been issued to departments; and
- the Department of Treasury and Finance had not yet completed the upgrade of its central contingent liability database.

8.127 **To ensure the effective recording, reporting and management of the State's contingent liabilities, it is critical that prompt action is taken to complete the implementation of the above initiatives**.

8.128 In order to form an opinion as to whether the contingent liabilities of the State are fairly presented in the Statement of Financial Operations in accordance with the *Financial Management Act* 1994, audit performed the following key verification procedures:

- as part of the financial audits of all major public sector entities, a review was undertaken of procedures in place for the identification, recording and reporting of contingent liabilities;
- examination, on a test basis, of documentation supporting the major contingent liabilities of each agency, as disclosed in surveys returned to the Department of Treasury and Finance which were used in the preparation of the Statement of Financial Operations, to assess the completeness and accuracy of disclosure;
- review of the procedures adopted by the Department of Treasury and Finance for the recording and monitoring of contingent liabilities; and
- confirmation of the accuracy and completeness of contingent liabilities disclosed in surveys used to prepare the Statement, through the receipt of appropriate certifications from departmental secretaries and chief executive officers of major public bodies.

8.129 Based on the results of these procedures, I am satisfied that the contingent liabilities of the State have been presented fairly in the Statement of Financial Operations.

Extent of the State's contingent liabilities

8.130 **The Statement of Financial Operations discloses that the estimated contingent liabilities of the State at 30 June 1995 arising from Government guarantees and indemnities were around $2 billion.** In addition, various other contingent liabilities existed at 30 June 1995 which could not be reliably quantified. These contingent liabilities are summarised in the Statement of Financial Operations. Comments follow on the more significant contingent liabilities of the State.

Petroleum Resources Rent Tax

8.131 As outlined in my May 1995 Report on Ministerial Portfolios, natural gas in Victoria is supplied mainly from the gasfields in the Gippsland basin in Bass Strait which are operated as a joint venture by ESSO and BHP. The extracted gas, in the main, is purchased by GASCOR (part of the former Gas and Fuel Corporation of Victoria) and Generation Victoria (part of the former State Electricity Commission of Victoria). GASCOR in turn supplies natural gas to industrial, commercial and domestic consumers, while Generation Victoria utilises the acquired gas in the operation of its power stations.

8.132 The terms and conditions for the supply of gas, including prices payable by the purchasers (GASCOR and Generation Victoria) are set out in a series of long-term agreements.

8.133 Prior to July 1990, Bass Strait gas production was subject to taxation under the Commonwealth Government's excise and royalty regime which attracted a royalty of 10 per cent. This royalty was paid by the gas producers and was implicit in the price of gas provided under the supply agreements. However, on 1 July 1990, the Commonwealth Parliament imposed a Petroleum Resources Rent Tax (PRRT) on Bass Strait oil and gas production. The new tax regime imposed a 40 per cent taxation rate on the producer's taxable profit from the extraction of gas and oil. Consequently, BHP and ESSO immediately invoiced a portion of the PRRT to GASCOR and Generation Victoria, after allowing for an amount equivalent to that which would have been paid for royalties. However, the purchasers have not accepted ESSO's and BHP's right to pass on the cost relating to the PRRT.

Nature and status of dispute

8.134 The purchasers do not believe that the action taken by BHP and ESSO to pass on the cost relating to the PRRT is permitted by the gas supply agreements. Specifically, the purchasers are of the view, inter alia, that the PRRT is a tax on the total profits made by the gas producers and that the gas supply agreements only permit the producers to pass on new taxes attributable directly (in the case of GASCOR) or attributable (in case of Generation Victoria) to the supply of gas to GASCOR or Generation Victoria, while the PRRT does not satisfy these requirements. Furthermore, even if an amount of PRRT can be passed on, both purchasers dispute the producer's method of calculating the amount to be passed on. Accordingly, the purchasers have not paid the amounts invoiced.

8.135 Arbitration proceedings relating to this dispute commenced in early 1992 and, in November 1994 the panel dealing with Generation Victoria's dispute agreed with ESSO's and BHP's right to pass on the gross PRRT cost of $38 million for the period July 1990 to February 1992 to Generation Victoria. While an award was not made for the period subsequent to February 1992, ESSO and BHP have advised Generation Victoria that they intend to rely on the arbitrator's decision to pass on this cost for the period March 1992 until the expiry of the gas supply agreement in December 1996.

8.136 Generation Victoria has sought leave to appeal the award made by the arbitration panel in the Supreme Court on the grounds that the panel acted contrary to the requirements of the *Commercial Arbitration Act* 1984 and, if the award is found to be valid, that the Supreme Court separately hear the matter. In relation to the dispute involving GASCOR, the arbitration panel hearings are continuing.

Possible exposure to the State

8.137 The potential impact of a court ruling in favour of the right of ESSO and BHP to pass on the PRRT costs to Generation Victoria and GASCOR is significant. **As at 30 June 1995, Generation Victoria recognised as a liability a possible exposure to that date of around $169 million, while GASCOR identified a contingent liability of around $327 million.**

8.138 However, as commented in my May 1995 Report on Ministerial Portfolios, GASCOR and Generation Victoria have **estimated a total PRRT exposure of around $1 billion** (net present value of $897 million) under the gas supply agreements, excluding any interest that may become payable on outstanding amounts. **Consequently, if ESSO and BHP are successful in passing on the PRRT cost, the above substantial exposure ultimately will be met by the gas and electricity consumers, or the taxpayers generally.**

Australian Grand Prix Corporation

Formula One Grand Prix

8.139 My October 1994 Report on the Finance Statement commented on the State's financial commitments and exposures under the financial arrangements entered into by the Government for the staging of the Formula One Grand Prix event in Melbourne.

8.140 In the 1993-94 financial year, the Melbourne Major Events Company Limited (MMEC), a company established by the Government to assist in identifying and attracting major sporting and cultural events to the State, secured the Formula One Grand Prix race for Melbourne for a number of years. In April 1993, the Government authorised MMEC to establish a wholly-owned subsidiary company, now known as Melbourne Grand Prix Promotions Pty Ltd (MGPP), to be solely responsible for the promotion and staging of the event. The operations of MGPP were principally funded from the Consolidated Fund, with contributions in the 1993-94 financial year totalling $599 000.

8.141 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 objectives set out in the Memorandum of Association, with further indemnities also provided to the Directors of the Company against liability arising in certain circumstances. In addition, the Government committed funding in the order of $45 million towards Grand Prix infrastructure and other works in the Albert Park area where the event is to be held. Such improvement works are to include expenditure on new roads, ovals, and park infrastructure and services.

8.142 In October 1994, the Australian Grand Prix Corporation was established under the provisions of the *Australian Grand Prix Act* 1994. Under the Act, the Corporation was given the authority, with the approval of the Minister, to assume the rights, assets and liabilities of MGPP and, inter alia, to perform the following functions:

- negotiate, enter into and vary agreements for the staging of Formula One events;
- promote Formula One events;
- construct a temporary motor racing circuit and facilities at Albert Park for Formula One events;
- undertake the financial and commercial management of each Formula One event promoted by the Corporation; and
- negotiate and enter into agreements for the conduct, management and promotion of other motor sport events, as approved by the Minister.

8.143 **In addition, the Act provides an exemption to the Corporation from publicly disclosing information relating to certain agreements entered into in relation to the staging of the Grand Prix events.**

8.144 In November 1994, the Corporation assumed certain rights, assets and liabilities of MGPP by agreement with the company.

Financial developments and exposures

8.145 The State's commitments and exposures in relation to the staging of the Formula One Grand Prix event include:

- funding of any liabilities or losses incurred by MGPP which cannot be funded from its own revenues and other resources;
- provision of initial operating contributions to the company and the Corporation; and
- funding of certain works in the Albert Park area and the acquisition of Grand Prix infrastructure.

8.146 **During the 1994-95 financial year, the Consolidated Fund contributions of an operating nature to both MGPP and the Corporation in relation to the staging of the Grand Prix event totalled $5.3 million.** In addition, without any admission of liability, **the Government paid $161 000 during the year to Albert Park residents on account of claims lodged for the repair of property damage allegedly caused by compaction works in Albert Park.** In the period 1 July 1995 to 31 August 1995, a further $100 000 was paid in relation to such alleged damage, with further claims pending.

8.147 **In addition to the above contributions, Government expenditure of a capital nature on Albert Park and Grand Prix works and infrastructure as at 30 June 1995 totalled $15.5 million,** with a further $8.3 million expended by August 1995. As referred to previously, the Government has commited total funding in the order of $45 million for this purpose.

8.148 The financial projections incorporated in the Corporation’s 3 year business plan approved by the Treasurer in March 1995, provide for the Corporation to generate a cash surplus in relation to the events without the need for further Government support. The Corporation's operations are to be principally funded from sponsorships, ticket sales and revenues from corporate entertainment facilities. In relation to ticket sales, the Corporation proposes to indemnify the appointed ticketing agency for the refund of any revenue paid to the Corporation, should the event be cancelled.

8.149 There are a number of risks that could potentially have an adverse impact on the Corporation's financial projections, including exchange rate movements relating to fees payable to the international bodies involved in the promotion of the Formula One championship for staging rights for the event; poor weather on race days impacting on attendances and possibly causing race cancellation; tobacco advertising restrictions possibly resulting in reduced promotional revenues or the cancellation of the event; and any revisions to the contractual arrangements between the international bodies involved in the promotion of the Formula One championship and racing teams, resulting in event cancellation. The Corporation has taken action to address certain of these risks through:

- establishment of a hedging contract to manage its exposure to exchange rate movements impacting on fees payable to the international bodies involved in the promotion of the Formula One championship;
- consideration of insurance options relating to protection against adverse weather conditions resulting in event cancellation;
- application to the Commonwealth Government for exemptions from tobacco advertising restrictions, which have now been provided; and
- maintenance of close liaison with individuals and organisations involved in the Formula One World Championship to protect the State's interests in the event.

Australian Motorcycle Grand Prix

8.150 Following the conclusion of extensive negotiations between MMEC, MGPP and the race promoters, in May 1995, the Government announced the return of the Australian Motorcycle Grand Prix to Phillip Island. The event is also to be managed by the Australian Grand Prix Corporation and will be held at Phillip Island in the period 1997 to 2001.

8.151 An evaluation by a consultant of the impact of the event on the Victorian economy was undertaken in May 1995 and concluded that the direct benefit of the event to the State would be an increase in economic activity in the order of $63 million per annum.

8.152 The key agreements in relation to this event include an agreement with the race promoters to secure the event, which was entered into in December 1994, and an agreement with the owner of the Phillip Island circuit for the use of the track during the race periods and the provision of track management services, which was entered into in May 1995.

8.153 **As part of the financial arrangements, the Treasurer has agreed to underwrite the annual deficits associated with the staging of this event. These annual deficits are estimated by the Corporation to be in the order of $3.5 million in relation to the first event, and potentially rising to $5.1 million by the year 2001. However, the study conducted by the consultant on behalf of the Department of Treasury and Finance concluded that the event will provide additional revenues in the order of the annual deficits.**

8.154 The financial risks in relation to this event are similar to those relating to the staging of the Formula One Grand Prix. The Corporation is preparing a supplement to its business plan in relation to this event and proposes to take similar steps to those taken in relation to the Formula One Grand Prix to manage the key risks associated with the staging of the Australian Motorcycle Grand Prix.

Automated ticketing system

8.155 My October 1994 Report on the Finance Statement commented on an agreement entered into by the Public Transport Corporation in May 1994 for the installation by a private sector consortium of automated ticketing dispensers and validation machines on all trams, buses and railway stations.

8.156 Under the agreement, the consortium will be responsible for the supply, installation, testing, commissioning, maintenance and management of a new ticketing system at an estimated nominal cost to the Corporation in the order of $300 million. Ownership of the system equipment will rest with the consortium and the company will also be fully responsible for the maintenance of the equipment and the collection of revenues on behalf of the Corporation. In addition, the Corporation is not obliged to make payments under the agreement **until** the consortium can demonstrate to the Corporation that it has successfully installed and commissioned the equipment.

8.157 In May 1994, the Treasurer provided a guarantee to the consortium which obligates the State to honour the Corporation's financial obligations under the service agreement if it defaults on the payments for services provided.

8.158 The key milestones that were to be met by the consortium under the service agreement comprised:

- prototypes of ticket validation and vending machines to be delivered to the Corporation by December 1994;
- automated ticketing system to be tested within a defined geographical area by February 1995; and
- the system to be fully commissioned across the entire transport system by February 1996.

8.159 In March 1995, the Government announced that the consortium could loose their contract for failing to complete the commissioning of pilot machines by February 1995. The consortium disputed that this was the case. In April 1995, the Government commenced negotiations with the consortium to refocus the project to delivering prototype machines from which the automated ticketing system could be satisfactorily implemented.

8.160 **In September 1995, the Corporation and the consortium entered into a collateral agreement which suspended certain rights of both parties under the service agreement in relation to any disputed matters, to allow the consortium to concentrate on delivering a fully commissioned pilot system by November 1996, some 20 months later than originally planned.** The suspended rights are to be re-instated on completion of the collateral agreement, or if the collateral agreement is terminated prior to its completion.

8.161 The consortium has lodged notices of delay with possible cost implications. At the time of preparation of this Report, the Corporation had not admitted any responsibility for delays and consequently any resulting liability, nor made any payments to the consortium, consistent with the terms of the collateral agreement.

8.162 **Under the service agreement, the notices of delay will be dealt with by the Corporation, following delivery of the pilot stage of the system. While the Corporation may incur additional costs, the Corporation has the right to receive compensation from the consortium for the late commissioning of the system.**

Melbourne City Link Project

8.163 For some time, Governments have identified the need to significantly upgrade the Tullamarine Freeway and the South Eastern Arterial, and to link these 2 key roads with the Westgate Freeway in order to significantly improve Melbourne's road network.

8.164 In May 1992, the then Government called for expressions of interest from the private sector to build, own and operate the Southern and Western By-passes, now known as the Melbourne City Link project. Five submissions were received from interested parties and following the evaluation of these submissions, in September 1992, the Government announced that 2 consortia had been short-listed. At the same time, the Government initiated the preparation of an Environmental Effects Statement to examine the proposed By-passes. This Statement, which was finalised in March 1995, concluded that the implementation of this project would provide the best solution to Melbourne's current traffic problems while allowing for environmental enhancements to be incorporated in the project.

8.165 In July 1994, the then Government, announced, that an "in-principle" decision had been made to proceed with the project, with a scheduled completion date in the year 2000. Consequently, in September 1994, the 2 short-listed consortia were issued with project briefs which detailed the project requirements and evaluation criteria. Key aspects of the project brief included:

- construction and future operational and maintenance costs to be funded by the successful consortia;
- government operational and financial support to be minimal; and
- key project risks to be transferred to the successful consortium, in accordance with the Government's infrastructure investment policy.

8.166 In December 1994, the *Melbourne City Link Authority Act* 1994 was enacted which established the Melbourne City Link Authority to facilitate the development and construction of the City Link By-pass.

8.167 Final project submissions were received from the 2 short-listed consortia in January 1995. Following the evaluation of the submissions, the Government announced in May 1995 that Transurban City Link Pty Ltd was the preferred consortium to design, build, finance and operate the City Link By-pass.

8.168 In July 1995, the Authority and Transurban signed a Memorandum of Understanding. While this document outlines key principles which will be the basis of the Concession Deed which will detail the responsibilities and obligations of the State and Transurban in relation to the project, it does not constitute a legally binding agreement. In accordance with the Memorandum of Understanding, once the Concession Deed is executed, the project will proceed on the following basis:

- Transurban has responsibility to construct the City Link By-pass;
- Related property acquisitions, specified road works and landscaping to be financed by the State at an estimated cost of $290 million;
- The land on which the project is constructed to be leased to Transurban by the State, with the State receiving additional revenue if actual cash flows exceed pre-determined projected figures; and
- Transurban to collect road tolls over a 34 year period for public usage of the 22 kilometre length of the City Link By-pass. At the end of this period, the ownership of the City Link By-pass is to revert to the State at no cost.

8.169 In July 1995, the Government announced details of the road works associated with the City Link project, which comprised:

- Western link section, which involves the upgrading and widening of the Tullamarine Freeway to 8 lanes between Bulla Road and Flemington Road, and the construction of a new 6 lane freeway from the city end of the Tullamarine Freeway to the Westgate Freeway, including the construction of a bridge across the Yarra River; and
- Southern link section which involves the construction of a 6 lane freeway to link the Westgate Freeway with the South Eastern Arterial, involving 2 tunnels under the King's Domain and the Yarra River.

8.170 As at the date of preparation of this Report, formal agreements had not been entered into between the City Link Authority and Transurban in relation to the project. The Authority anticipates that the Concession Deed which will set out the financial arrangements for the project will be completed in October 1995. **A detailed assessment of these arrangements will be undertaken by audit, including an examination to determine the risks and financial exposures of the State resulting from the project, when the arrangements are finalised.**

OTHER FINANCIAL COMMITMENTS OF THE STATE

8.171 In addition to the financial obligations commented upon earlier in this Part of the Report, public sector bodies have entered into a number of arrangements which will impact on the future financial operations of the State. At 30 June 1995, the public sector had financial commitments relating to operating leases and works unperformed under existing contracts, valued at $2.1 billion (1993-94, $2 billion).

Operating lease commitments

8.172 The public sector's financial commitments include future obligations under operating lease arrangements. Audit examination revealed that such commitments, at 30 June 1995, amounted to $980 million ($1 billion, 30 June 1994). Table 8K details the timing and extent of these commitments.

TABLE 8K
OPERATING LEASE COMMITMENTS
($million)

Year	*Budget sector*	*Non-budget sector*	*Public financial enterprises*	***Total 1994-95***	*Total 1993-94*
1995-96	224	42	14	**280**	287
1996-97	137	29	14	**180**	236
1997-98	169	32	32	**233**	209
1998 onwards	232	33	22	**287**	279
Total commitments	**762**	*(a)* **136**	**82**	**980**	**1 011**

(a) Includes lease commitments totalling $40 million, which were not included in the explanatory information provided in the Statement of Financial Operations.

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

Capital commitments

8.174 The Statement of Financial Operations does not disclose public sector capital commitments. Such commitments, in respect of works not yet carried out under existing contracts at 30 June 1995, amounted to $1.1 billion (30 June 1994, $1 billion). Table 8L details the amount and likely timing of these commitments.

TABLE 8L
CAPITAL COMMITMENTS
($million)

Year	*Budget sector*	*Non-budget sector*	*Public financial enterprises*	***Total 1994-95***	*Total 1993-94*
1995-96	632	246	15	**893**	959
1996-97	32	106	-	**138**	21
1997-98	33	30	-	**63**	23
1998 onwards	9	2	-	**11**	-
Total commitments	**706**	**384**	**15**	**1 105**	**1 003**

8.175 While certain information on the capital commitments of the budget sector is provided in the Budget Papers, I re-iterate the recommendation of my previous Reports that, **to provide the Parliament with comprehensive information regarding total public sector financial obligations, information on capital commitments should be disclosed within the Statement of Financial Operations**.

PART 9

Other matters

VICTORIAN
AUDITOR-
GENERAL'S
OFFICE

Auditing in the Public Interest

Part 9

Other matters

KEY FINDINGS

- While under the former *Public Account Act* 1958, the receipts of the Consolidated Fund (including borrowings) were required to equal the payments in any one year, under the *Financial Management Act* 1994 the Trust Fund balance can be applied towards financing Consolidated Fund deficits.

Paras 9.1 to 9.2

Balances of Public Account

9.1 The transactions recorded in the Public Account for the past 2 years and the investment of the resultant balances are summarised in Table 9A.

TABLE 9A
RECEIPTS AND PAYMENTS OF THE PUBLIC ACCOUNT
($million)

Item	*1994-95*	*1993-94*
Balance 1 July	584	404
Receipts -		
Consolidated Fund	16 234	17 628
Trust Fund -		
Works and Services Account	-	1 100
Other trust accounts	23 129	50 483
Borrowings to finance Consolidated Fund deficits	1 037	-
	40 984	69 615
Payments -		
Consolidated Fund	17 068	17 628
Trust Fund -		
Works and Services Account *(a)*	78	1 070
Repayment of Trust Fund borrowings	164	-
Other trust accounts	23 068	50 333
	40 378	69 031
Balance 30 June	**606**	**584**
Represented by the following investments -		
Trust Fund -		
Cash at bank	4	7
Fixed deposit accounts	485	494
Stocks and securities	113	74
Advances -		
Consolidated Fund	833	-
Departments and other purposes	4	9
Trust Fund	1 439	584
Consolidated Fund deficit *(a)*	(833)	-
Total investments at 30 June	**606**	**584**

(a) This balance differs from the Consolidated Fund deficit in Part 3 of this Report by $78 million, representing the balance of the Works and Services Account paid into the Consolidated Fund in 1994-95.

9.2 **The net effect of the year's transactions was an increase of $22 million in the total balances of the Public Account**, brought about by an increase of $855 million in the balance of the Trust Fund and a $833 million decrease in the balance of the Consolidated Fund. This movement largely reflects the changed arrangements in 1994-95 for funding of Consolidated Fund deficits. Specifically, **while under the former *Public Account Act* 1958, the receipts of the Consolidated Fund (including borrowings) were required to equal the payments in any one year, under the *Financial Management Act* 1994 the Trust Fund balance can be applied towards financing Consolidated Fund deficits.**

Trust Fund

9.3 The *Financial Management Act* 1994 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;
- 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.

9.4 A summary of the transactions and balances of the various trust accounts comprising the Trust Fund are provided in the Statement of Financial Operations. Details of new accounts opened within the Trust Fund in 1994-95 and their specified purposes are set out in Table 9B.

TABLE 9B
NEW TRUST ACCOUNTS

Account or Fund	*Purpose for which established*
Agriculture Projects Trust Account	To receive funds and make payments associated with various departmental activities provided on a fee-for-service basis. This Account replaces a number of specific purpose trust accounts which were closed during the year.
Arts 21 Commissions Trust Account	To record the receipt of funds, including those received from the Community Support Fund and interest on investments, and the expenditure of available funds for the commissioning of various works of art.
Commercial Forests Working Account	To record the receipt of Appropriations and the expenditure of these funds towards the maintenance of roads used for logging and log production cartage costs.
Managed Insurance Fund	To record the transactions of the Managed Insurance Fund which was established to provide centralised insurance cover to budget sector agencies.
Regional Councils of Adult, Community and Further Education Trust Account	To record the receipt and disbursement of mainly Commonwealth funds received relating to the operations of Regional Councils of Adult, Community and Further Education.
State Digital Map Working Account	To record the receipt of Appropriations and the disbursement of funds for operational and maintenance costs associated with the State Digital Map Database.

9.5 Table 9C details of accounts closed within the Trust Fund in the 1994-95 financial year.

TABLE 9C
TRUST ACCOUNTS CLOSED

Account or Fund	*Reason why the account was closed*
Agriculture Various Short Courses Trust Account DARA Research Projects Trust Account Stock Trading Account - DARA	The accounts were replaced with the Agriculture Projects Trust Account.
Cash Management Account Public Authorities Trust Account State Development Account Works and Services Account	The repeal of the *Public Account Act* 1958 on 30 June 1994 resulted in the closure of these accounts with any remaining balances transferred into the Consolidated Fund.
Country Racing Clubs Fund Country Racing, Harness Racing, Greyhound Racing Assistance Fund Country Harness Racing Clubs Fund Greyhound Racing Clubs Fund Greyhound Racing Grounds Development Fund Metropolitan Harness Racing Fund Metropolitan Racing Clubs Fund Racecourses Development Fund	The accounts were closed in August 1994, in accordance with the *Gaming and Betting Act* 1994, with all moneys standing to the credit of the accounts transferred to either the Victorian Racing Club, Harness Racing Board and Greyhound Control Board.
Totalisator Unclaimed Dividend Fund	The account was closed in August 1994, in accordance with the *Gaming and Betting Act* 1994, with unclaimed dividends transferred into Consolidated Revenue.

Availability of reports

Copies of all Reports issued by the Victorian Auditor-General's Office are available from:

- Corporate Communications Section
  Victorian Auditor-General's Office
  Level 14, 222 Exhibition Street
  Melbourne Vic. 3000
  Phone: (03) 9651 6059 Fax: (03) 9651 6361

- Information Victoria Bookshop
  318 Little Bourke Street
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