

VICTORIA

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Auditor General  
Victoria

**Report of the  
Auditor-General on  
the Finances of the  
State of Victoria  
1999-2000**

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The President  
The Speaker  
Parliament House  
Melbourne Vic. 3002

Sir

Under the provisions of section 26 of the *Financial Management Act 1994*, I transmit my  
*Report on the Finances of the State of Victoria, 1999-2000.*

Yours faithfully

J.W. CAMERON  
*Auditor-General*

The Clerk  
Legislative Council  
Parliament House  
Melbourne Vic. 3002

Sir

Under the provisions of section 26 of the *Financial Management Act* 1994, I transmit my *Report on the Finances of the State of Victoria, 1999-2000*.

I should be grateful if you could arrange for the Report to be tabled as soon as possible.

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Yours faithfully

J.W. CAMERON  
*Auditor-General*

The Hon. Lynne Kosky, MP  
Minister for Finance  
1 Treasury Place  
Melbourne Vic. 3002

Dear Minister

Under the provisions of section 27 of the *Financial Management Act* 1994, I present my  
*Report on the Finances of the State of Victoria, 1999-2000.*

I should be grateful if you could arrange for the Report to be tabled as soon as possible.

Yours faithfully

A handwritten signature in black ink, appearing to read 'J.W. Cameron', with a large loop at the start and a horizontal line extending to the right.

J.W. CAMERON  
*Auditor-General*

13 November 2000

# **Part 1**

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# **Executive summary**



## OVERVIEW

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This Report outlines the results of our audit of the Financial Statements for the State of Victoria for the year ended 30 June 2000.

Although a clear audit opinion was provided on the Financial Statements for the year, the audit report drew attention to uncertainty regarding the valuation of the Victorian WorkCover Authority's outstanding claims liability. This uncertainty arose as a result of greater than initially anticipated common law claims being lodged with the Authority under the provisions of recent legislative amendments. At the time of preparation of the financial report, the impact of these claims on the State's liabilities and its operating surplus could not be reliably determined.

The Financial Statements report an operating surplus prior to abnormal items of \$1.8 billion in the year, and an overall operating surplus of \$1.2 billion after taking account of the disposal of transport business assets in the year under the transport reform program. Given the sensitivity of the State's revenue base to economic and financial market conditions, it will be important for the Government to monitor future trends in expenditure to ensure that the State's financial strength is maintained.

The State's financial position has improved during the year. As at 30 June 2000, the State held assets with an aggregate value of \$82.9 billion (30 June 1999, \$78.8 billion) and liabilities with an aggregate value of \$41.7 billion (30 June 1999, \$41.3 billion). Assets increased by \$4.1 billion, due mainly to the re-valuation of certain physical assets and an increase in the level of cash and investment holdings. State liabilities increased by \$403 million during the year, due mainly to increases in the value of unfunded superannuation liabilities and outstanding claims liabilities. These increases were partially offset by a decrease in the level of State debt.

Our past Reports have referred to the need for improved financial disclosures in the Government's Financial Statements of financial commitments arising from arrangements established in relation to outsourcing of service delivery and infrastructure development, given their prevalence and impact on the State's finances. While such disclosures have improved in the current year, through the presentation of the financial commitments associated with certain major private sector arrangements, it remains important that annual reporting requirements be made to provide transparency of the future impacts of all such arrangements on the State's finances.

Finally, a significant development during the year, which will undoubtedly contribute to the enhancement of transparency and accountability over the State's finances, was the enactment of the *Financial Management (Financial Responsibility) Act 2000*. Under this legislation, government operations are required to be conducted with reference to certain key principles of sound financial management, more frequent reporting on the State's financial affairs, and the Government's estimated financial statements which are incorporated in the State Budget are subject to scrutiny by my Office. In relation to the later of these initiatives, our short-form report on the Government's inaugural estimated financial statements was incorporated into the 2000-01 Budget Papers. These are welcomed developments, which will ensure that the Parliament is better placed to effectively perform its oversight role.

## SUMMARY OF MAJOR FINDINGS

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### OPERATING RESULT AND FINANCIAL POSITION

Page 19

- The State achieved an operating surplus, prior to abnormal items, of \$1.8 billion for 1999-2000; \$919 million lower than the result achieved in the previous year.  
*Paras 3.2 to 3.4*
- The operating surplus for the year after abnormal transactions was \$1.2 billion.  
*Paras 3.2 to 3.4.*
- As at 30 June 2000, the State held net assets of \$41.2 billion (30 June 1999, \$37.5 billion), comprising assets with an aggregate value of \$82.9 billion and liabilities with an aggregate value of \$41.7 billion.  
*Para. 3.5*
- The Government has been successful in meeting its short-term financial objectives, nevertheless, there remains the need for strong leadership to ensure that the full benefits of progress to date are maintained.  
*Paras 3.6 to 3.8*
- Consideration should be given by the Government to the presentation of a more comprehensive range of performance indicators in future Annual Financial Reports, to enhance the usefulness of these Reports in facilitating assessments of the Government's performance and stewardship.  
*Paras 3.9 to 3.12*
- The rate of increase in State expenditures has exceeded the increase in the Gross State Product, reflecting the Government's commitment to increased service delivery to health, education and public safety programs.  
*Para. 3.13*
- Our analysis of key financial performance indicators shows that the State's financial condition has strengthened during the 1999-2000 financial year. However, it will be important for the Government to monitor future trends in expenditure to ensure that the State's financial strength is maintained.  
*Para. 3.13*

**REVENUE****Page 33**

- The operating revenues of the State in the 1999-2000 financial year totalled \$28 billion; \$1.6 billion higher than the previous year.

*Paras 4.1 to 4.3*

- The major items contributing to this favourable outcome were increased collections from State taxation (\$920 million), increased investment income (\$437 million) associated with increased investment holdings and favourable market conditions, and higher grants from the Commonwealth Government (\$235 million).

*Paras 4.1 to 4.3*

- There has been a general upward trend in the level of taxation revenues collected by the State over the past 3 years. The taxation revenue per capita has increased in real terms by \$176 over this period. The reason for the increase has been the strong performance of the economy in general, and in particular the housing and financial markets.

*Paras 4.5 to 4.7*

- The Government estimated that, based on the latest available Commonwealth Grants Commission assessment of the relative revenue raising effort of all Australian States, Victoria's taxation revenue is slightly below the national average.

*Paras 4.8 to 4.10*

- During 1999-2000, State revenues from gambling activities amounted to \$1.5 billion, an increase of around \$112 million since the previous year.

*Paras 4.15 to 4.20*

- In the first year following the implementation of the national tax reform package, it is estimated that there will be an adverse impact on the State's finances of \$681 million as a result of these reforms. This shortfall is to be funded by way of additional financial assistance from the Commonwealth Government. The State's reliance on Commonwealth guarantee payments is expected to continue until the 2007-08 financial year.

*Paras 4.35 to 4.44***EXPENDITURE****Page 47**

- The operating expenses of the State, prior to abnormal items, totalled \$26.2 billion during 1999-2000; \$2.5 billion higher than in the previous year.

*Paras 5.1 to 5.5*

- The key factors contributing to the year's expenditure outcome were increased costs associated with employee superannuation and insurance claims associated with the State's workers' compensation and transport accident schemes (mainly resulting from a revaluation of these liabilities), and the delivery of health, education and public safety programs. Some of the increase was offset by lower borrowing costs resulting from reduced debt levels.

*Paras 5.1 to 5.5*

**EXPENDITURE - continued****Page 47**

- Departmental expenditure under the Parliamentary authority of Annual Appropriations was \$899 million below budget expectations. A significant factor contributing to this variation was under-expenditure in the year associated with debt and financing arrangements, and the restructure of the public transport system.  

**Para. 5.9**
- The net operating costs incurred by the State in relation to the Formula One and the Motorcycle Grand Prix events relating to the 1999-2000 financial year were \$8.55 million.  

**Paras 5.18 to 5.39**
- The net cost to the State associated with obtaining the right to stage the 2006 Commonwealth Games in Melbourne was \$6.1 million.  

**Paras 5.40 to 5.48**
- Since the awarding of the initial contract in 1993, Leeds Media has held an “exclusive” agreement with the State for the supply of media agency services as required by departments and agencies. The Department of Premier and Cabinet estimates that during the years 1993 to 2000, Leeds Media has placed in excess of \$400 million in government media advertising and other media-related business.  

**Paras 5.60 to 5.68**
- In our view, an adequate evaluation of the performance of Leeds Media was not undertaken prior to the decision to grant an extension of the contract in September 1999.  

**Paras 5.72 to 5.74**
- Receipts into the Community Support Fund from the period since its establishment in 1992 to 30 June 2000, totalled \$555 million of which \$413 million has been expended.  

**Paras 5.77 to 5.78**
- In recent years, amounts approved and expended from the Community Support Fund have focused on major construction projects, while the original purpose of the Fund was to prevent and treat gambling -related problems.  

**Para. 5.79**
- In June 2000, new guidelines were approved for the future operation of the Community Support Fund, with increased emphasis on the promotion of responsible gambling, and the provision of more funds towards problem gambling services including research, and programs of broader community benefit such as sport and the arts.  

**Paras 5.80 to 5.82**
- A review of assessment files of a selection of grants and projects approved for Community Support funding in the 1999-2000 financial year disclosed that 6 approved projects, including \$27 million to fund the construction of the State Hockey and Netball Centre, and \$20 million to partly fund the Federation Square Project, did not meet a desirable funding criteria relating to projects having significant non-government financial support.  

**Paras 5.85 to 5.86**

**STATE ASSETS****Page 71**

- At 30 June 2000, assets with an aggregate value of \$82.9 billion, were controlled by the Government; an increase of \$4.1 billion on the previous year.

**Paras 6.1 to 6.4**

- The major factors contributing to the increase in State assets were:
  - the re-valuation of physical assets across all sectors, contributing to an increase in the gross value of these assets of \$2.3 billion;
  - construction and acquisition of physical assets during the year, which were largely offset by the sale of the rolling stock infrastructure of the transport passenger businesses to private sector franchisees; and
  - increased investment holdings of \$1.8 billion.

**Para. 6.2**

- The State's cash and investment holdings increased from \$17.6 billion to \$19.4 billion, with a net amount of \$3.9 billion held by the Treasury Corporation of Victoria which is available for application towards the retirement of debt as it matures and for meeting the State's prudential liquidity requirements. A further amount of \$1 billion has been set aside for infrastructure investment over future years under the Government's "Growing Victoria" initiative.

**Paras 6.8 to 6.22**

- Under the sale arrangements of the State's 5 passenger transport businesses to 3 separate franchisees, the State received a nominal consideration of \$3 for the rail businesses' net assets (mainly rolling stock, plant and equipment) to the franchisees. This led to an abnormal loss of \$665 million for the write-off of the book value of these net assets in the State's operating statement.

**Paras 6.25 to 6.27**

- The aggregate cost to the State for the delivery of public transport services by the franchisees over the next 15 years, in net present value terms, will be around \$2.8 billion. This reflects a reduced level of subsidy following the transfer of the existing rolling stock units to the franchisees.

**Paras 6.29 to 6.31**

- The State received net sale proceeds of \$9.7 million for the sale of various residual assets of the Public Transport Corporation, some \$11.9 million less than their book value.

**Paras 6.41 to 6.49**

- While the State Netball and Hockey Centre was initially expected to be completed within a 12 month period, by late March 2000, the most current construction program indicates a completion date of early November 2000.

**Paras 6.71 to 6.105**

**LIABILITIES AND COMMITMENTS**

**Page 95**

- The liabilities of the State amounted to \$41.7 billion at 30 June 2000; an increase of \$403 million on the previous year. This is mainly due to an increase in unfunded superannuation liabilities (\$850 million) and outstanding claims liabilities (\$779 million), offset in part by a reduction in borrowings of \$998 million.

**Paras 7.3 to 7.6**

- The aggregate value of the State's operating and capital commitments as at 30 June 2000 was \$6.7 billion (30 June 1999, \$3.3 billion). These include the State's commitments under outsourcing contracts entered into for the provision of services and infrastructure to the public sector, such as transport, health and prison services. The increase mainly reflects the impact of the public transport franchising arrangements.

**Para. 7.8**

- The Financial Statements disclose for the first time the value of the commitments associated with private sector arrangements relating to the provision of services and infrastructure to the public sector. This additional disclosure represents a significant step forward in public sector reporting.

**Paras 7.114 to 7.120**

- As at June 2000, the State had outlaid a total of \$47.8 million associated with the winding-down of the financing and leasing arrangement associated with the Monash Medical Centre.

**Paras 7.22 to 7.31**

- The increase in unfunded liabilities of \$1 billion associated with the State Superannuation Fund was mainly attributable to:
  - the ageing membership profile of the Fund;
  - a higher proportion of members resigning prior to the age of 55 years (increase of \$597 million);
  - an improvement in pensioner mortality rates (increase of \$206 million);
  - the impact of the Goods and Services Tax on the CPI (increase of \$116 million); and
  - an offsetting reduction in the liability resulting from an additional contribution of \$325 million by the Government.

**Paras 7.38 to 7.54**

- Over the past 3 years, the outstanding claims liability mainly associated with the State's workers' compensation and transport accident schemes has increased by around 33 per cent, from \$6.6 billion at 30 June 1997 to \$8.8 billion at 30 June 2000.

**Paras 7.61 to 7.75**

- While the asset holdings of the Transport Accident Commission well exceed its liabilities, the Victorian WorkCover Authority had a net asset deficiency of \$423 million as at 30 June 2000.

**Paras 7.61 to 7.75**

**LIABILITIES AND COMMITMENTS - *continued***

**Page 95**

- The State Electricity Commission of Victoria previously provided interest-free loans to HRL Ltd (a research and development company) totalling \$8.5 million, which are due for repayment in 2002 and 2003. Substantial uncertainty exists concerning the recovery of these loans and, therefore, these amounts have not been recognised as an asset in the Government's Financial Statements.

***Paras 7.77 to 7.80***

- In April 2000, OneLink submitted a claim to the Public Transport Corporation relating to the implementation of the public transport automated ticketing system, amounting to \$132 million plus \$17 million per annum for ongoing maintenance of the equipment. This claim related to additional costs, change of scope, penalties and other types of damages arising from the contract.

***Paras 7.107 to 7.113***

- Under various arrangements established by the State for the development and operation of new facilities such as the Mildura Base Hospital, the Melbourne County Court and infrastructure projects at Regional Water Authorities, the private sector participants have assumed key risks associated with the design, construction, ownership and operation of the facilities. In return for the provision of the required services, the private sector participants will be entitled to receive specified fees from the State.

***Paras 7.121 to 7.276***

## **Part 2**

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# **Audit opinion on Statement**



## FINANCIAL ACCOUNTABILITY FRAMEWORK

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**2.1** The external financial reporting and audit arrangements which operate within the Victorian public sector and establish the Government's accountability responsibilities to the Parliament in relation to the State's finances are set out in the *Financial Management Act 1994*, *Audit Act 1994* and *Constitution Act 1975*.

**2.2** A key element of these arrangements is an obligation, under the *Financial Management Act 1994*, for the Government to prepare an Annual Financial Statement which must be audited by the Auditor-General and presented to the Parliament each year. Under the Act, **the Government's Annual Financial Statement must present fairly the transactions of the Public Account, which comprises the Consolidated Fund and the Trust Fund, and the other transactions of the State in respect of the financial year, and the financial position of the State as at the end of the financial year.**

**2.3** The Consolidated Fund represents the Government's core operating account and records all departmental revenues such as State taxes and grants received from the Commonwealth Government. Fundamental to the State's accountability 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.

**2.4** The Trust Fund, which also forms part of the Public Account, 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.

**2.5** Consistent with the financial reporting requirements of the *Financial Management Act 1994*, the Minister for Finance has determined that the Annual Financial Statement for the 1999-2000 financial year be presented in accordance with the relevant Australian Accounting Standards. Accordingly, the Statement represents the consolidated financial report of the Victorian Government and incorporates a statement of financial position, an operating statement, a statement of cash flows and accompanying notes.

## AUDIT OPINION ON THE GOVERNMENT'S ANNUAL FINANCIAL STATEMENT

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**2.6** The Government's Annual Financial Statement for the financial year ended 30 June 2000 has been audited as required by the *Financial Management Act 1994*. The audit has been undertaken in accordance with Australian Auditing Standards and my opinion on the Statement was issued on 19 October 2000 as follows:

*Audit scope*

The accompanying Annual Financial Statement for the year ended 30 June 2000 of the Government of Victoria (excluding local government bodies and universities), comprising the consolidated operating statement, the consolidated statement of financial position, the consolidated statement of cash flows and the accompanying notes contained in Section 2 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 to the Members of the Parliament, the responsible Ministers and the Secretary to the Department of Treasury and Finance 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 report is presented fairly in accordance with Australian Accounting Standards and other mandatory professional reporting requirements, and complies with the requirements of the *Financial Management Act 1994* so as to present a view which is consistent with my understanding of the financial position of the Government of Victoria, the results of its operations and its cash flows.

The audit opinion expressed on the Government's Annual Financial Statement has been formed on the above basis.

*Audit opinion*

In my opinion, the financial report presents fairly the financial position of the Government of Victoria as at 30 June 2000 and the results of its operations and its cash flows for the year ended on that date in accordance with Australian Accounting Standards and other mandatory professional reporting requirements and complies with the requirements of the *Financial Management Act 1994*.

*Inherent uncertainty  
regarding outstanding WorkCover claims*

Without qualification to the opinion expressed above, attention is drawn to note 25 to the Annual Financial Statement which refers to greater than initially anticipated claims lodged with the Victorian WorkCover Authority under the provisions of the *Accident Compensation (Common Law and Benefits) Act 2000*. At the time of preparation of the financial report, the impact of these claims on the State's liabilities and its operating surplus cannot be reliably determined.

## Scope of the Annual Financial Statement

**2.7** The Government's Annual Financial Statement has been prepared in accordance with the requirements of the *Financial Management Act* 1994, relevant Australian Accounting Standards and, in particular, Australian Accounting Standard AAS31 *Financial Reporting by Governments* which requires the presentation of general purpose whole-of-government financial reports, prepared on the accrual basis of accounting.

**2.8** In presenting the Government as a single economic entity, the Annual Financial Statement was prepared by consolidating the financial statements of government departments, public trading enterprises, government-controlled public financial institutions and not-for-profit public sector entities. Certain entities have not been consolidated, including local government bodies and universities.

**2.9** The Annual Financial Statement continues to exclude certain major assets which are difficult to measure, including land under roads which in accordance with the Australian Accounting Standards is required to be recognised by 31 December 2002, and the State's share of the net assets of the Murray-Darling Basin Commission which had not been valued. The Commission is responsible for the management and distribution of the water resources of the Murray River and related assets in accordance with the Murray-Darling Basin Agreement between the Commonwealth and the Governments of Victoria, New South Wales, South Australia and Queensland. To provide transparency and accountability of the State's share of the significant assets managed by the Commission, it is important that the Government take action to identify its share and value of these assets.

## Inherent uncertainty regarding outstanding WorkCover claims liability

**2.10** The audit opinion on the Government's Annual Financial Statement drew attention to an inherent uncertainty regarding the valuation of the Victorian WorkCover Authority's outstanding claims liability.

**2.11** This uncertainty, which relates to the impact of the greater than initially anticipated claims lodged under the provisions of the *Accident Compensation (Common Law and Benefits) Act* 2000, was disclosed in note 25 to the Government's Annual Financial Statement. These claims related to certain serious injuries incurred prior to November 1997 which were required to be lodged with the Authority prior to the statutory deadline of 1 September 2000.

**2.12** Due to the proximity of the statutory deadline to the date of the finalisation of the Victorian WorkCover Authority's accounts and the Government's Annual Financial Statement, the impact of the claims on the State's liabilities and its operating surplus could not be reliably determined.

**2.13** Further comment on the outstanding claims liability of the major State insurance schemes is provided in Part 7 of this Report.

## RECENT FINANCIAL ACCOUNTABILITY DEVELOPMENTS

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**2.14** As mentioned earlier in this Part of the Report, a key feature of the State's accountability framework in recent years has been the requirement for the Government to annually present to the Parliament the audited consolidated financial statements of the State. The presentation of these financial statements, together with the tabling of annual reports by individual public sector agencies, which include audited financial statements, provides comprehensive information to the Parliament on the financial operations and performance of the State as a whole and individual public sector agencies, to assist in its oversight of public sector operations.

**2.15** A major development in 1999-2000 which will undoubtedly contribute to the further enhancement of transparency and accountability over the State's finances, was the enactment of the *Financial Management (Financial Responsibility) Act 2000*. Among the significant initiatives introduced by this legislation were:

- the establishment within the *Financial Management Act 1994* of the key principles of sound financial management which the Government will be required to observe in its stewardship of State finances;
- more frequent reporting of the State's financial affairs, including the publication of quarterly budget sector financial reports, half yearly whole-of-government financial statements and a pre-election budget update once a general election has been called; and
- as part of the annual budget process, preparation of the Government's estimated financial statements for the budget sector, with these statements subject to review by this Office and incorporated into the Budget Papers.

**2.16** **These initiatives are welcomed and will assist in ensuring that the State's affairs are conducted in the context of a set of transparent financial management principles, and that the Parliament is better placed to effectively perform its oversight role through the availability of more timely and higher quality financial information.**

### Review of the Government's estimated financial statements

**2.17** As indicated above, a key element of the Government's financial responsibility reform has been the introduction of a requirement for the Government to annually present to the Parliament the estimated financial statements of the budget sector and the related widening of my mandate to encompass the review of this information, with the reporting of the results of the review to the Parliament at the time of Budget. This initiative complements the subsequent preparation of historical information on the State's finances via the Government's Annual Financial Report and establishes Victoria at the forefront of public sector financial reporting developments.

**2.18** **In this Part of the Report we outline the framework established for the preparation of the estimated financial statements and our review of the statements. This is done to facilitate a better understanding of the basis of preparation of the estimated financial statements, and the nature of the assurance provided by my Office on those statements.**

**2.19** Under the legislation, the estimated financial statements are required to be prepared on the basis of generally accepted accounting principles, covering a 4 year period incorporating the budget year plus 3 years forward, and must take into account government decisions and other circumstances that may have a material effect on the statements.

**2.20** Given that there is are no specific Australian Accounting Standards or other Australian authoritative pronouncements covering the preparation and presentation of prospective information, as stated in the notes to the estimated financial statements, the major requirements of New Zealand Financial Reporting Standard FRS29 *Prospective Financial Information* have been applied in presenting the estimated financial statements. This is consistent with the general requirements of Australian Accounting Standards which permit the application of pronouncements of other national standard setting bodies, where no other relevant pronouncements are available in Australia.

**2.21** My Office is required to conduct a review of the estimated financial statements and provide a report to Parliament on whether it appears that:

- the statements have been prepared on a basis consistent with the accounting policies on which they are stated to be based;
- the statements are consistent with the targets specified in the Government's current financial policy objectives and strategies statement for each key financial measure specified in that statement;
- the statements have been properly prepared on the basis of the assumptions contained in the accompanying statement to the estimated financial statements; and
- the methodologies used to determine those assumptions are reasonable.

**2.22** Based on these legislative requirements and consistent with the requirements of Australian Auditing Standards which my Office is required to observe, **it is not the objective of our review to express an opinion on whether the projected results will be achieved, given the prospective nature of the financial information contained within the estimated financial statements. Rather, appropriate review procedures are performed to provide a form of "negative assurance" to the Parliament on the technical construction of the statements.** That is, to confirm that, on the basis of review procedures performed and information provided, the statements have been prepared and presented consistent with the requirements of the Act. **Accordingly, the scope of the review does not extend to assessments of the merit of budget policy and resource allocation decisions made by the Government.**

**2.23** Our short-form report identifies that while evidence may be available to support the assumptions and underlying data upon which prospective financial information is based, such evidence is generally future oriented and therefore less certain in nature. As a result, we are not in a position to obtain the level of assurance necessary to express a positive opinion on those assumptions and the accompanying forecast information included in the estimated financial statements. Accordingly, an opinion is not expressed on whether the forecasts will be achieved and **the short-form report highlights that the actual results achieved are likely to be different than those forecast.**

**2.24** The conduct of the review is based on a risk-based methodology, with procedures limited primarily to inquiries of relevant personnel and assessments of the reasonableness of the key methodologies and processes followed to determine the assumptions and data upon which the estimated financial statements are based, and the conduct of appropriate analytical procedures. **These review procedures do not provide all the evidence that would be required in an audit, thus the level of assurance provided is less than that which would be given in an audit. Accordingly, as stated in our short-form report, an audit opinion is not expressed. However, the report provides assurance that, on the basis of procedures performed, nothing has come to our attention which would cause us to cast doubt on the veracity of the disclosures in the statements presented.**

**2.25** Notwithstanding the above professional and legislative limitations to the level of assurance we are able to provide to the Parliament on the Government's estimated financial statements, given the prospective nature of such information, our involvement in the review of this information is considered appropriate and useful in supporting the credibility of the technical development and presentation of such information which is included in the Budget Papers which are subject to the Parliament's deliberative processes.

**2.26** I am pleased to report that our inaugural review of the Government's estimated financial statements for the financial year ended 30 June 2001 and the 3 subsequent financial years was successfully completed, with the related short-form report issued in April 2000 and incorporated into the Government's 2000-01 Budget Papers.

## AUDITOR-GENERAL'S REPORT ON THE VICTORIAN GOVERNMENT'S FINANCES

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**2.27** As mentioned earlier, the Government's Annual Financial Statement discloses the financial operations and financial position of the State, including the financial transactions of the Public Account. In addition, commentary on the year's financial outcomes has been included in Part 1 of the Government's Financial Report, which is not subject to audit.

**2.28** To assist the Parliament in its analysis of the State's financial performance, this Report is presented in a format consistent with the Government's Annual Financial Statement. The Report provides independent commentary on various issues impacting on the State's financial performance and position including its revenues, expenditures, assets, liabilities and commitments. These comments are designed to compliment the analyses provided in the 1999-2000 Financial Report for the State of Victoria.

## **Part 3**

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# **Operating result and financial position**

## OPERATING RESULT AND FINANCIAL POSITION

**3.1** A summary of the operating result achieved by the State for the financial year and its financial position as at 30 June 2000, as disclosed in the Government's Annual Financial Statement, is presented in Table 3A.

**TABLE 3A**  
**STATE OF VICTORIA**  
**OPERATING RESULT AND FINANCIAL POSITION**  
((\$billion))

<i>Item</i>	<i>1999-00</i>	<i>1998-99</i>
<b>Operating result -</b>		
Revenues	28.0	26.4
Expenses	26.2	23.7
<b>Operating surplus for the year before abnormal items</b>	<b>1.8</b>	<b>2.7</b>
Net abnormal items	<i>(a)</i> (0.6)	<i>(b)</i> 4.0
<b>Operating surplus for year</b>	<b>1.2</b>	<b>6.7</b>
<b>Financial position -</b>		
<b>Assets -</b>		
Physical assets	59.0	56.6
Cash and investments	19.4	17.6
Other	4.5	4.6
<b>Total assets</b>	<b>82.9</b>	<b>78.8</b>
<b>Liabilities -</b>		
Borrowings	13.7	14.7
Unfunded superannuation	12.4	11.5
Employee entitlements	2.3	2.4
Other	13.3	12.7
<b>Total liabilities</b>	<b>41.7</b>	<b>41.3</b>
<b>Net assets</b>	<b>41.2</b>	<b>37.5</b>

*(a)* Represents the loss incurred from the sale of rolling stock for nominal consideration to the franchisees of the passenger transport businesses.

*(b)* Includes the net impact of privatisations of \$4 billion, the impact of a write-down of \$122 million in the value of certain bonds previously acquired by the Government as part of the termination of the accelerated infrastructure program, and a gain of \$107 million associated with a finance lease liability relating to the Monash Medical Centre, arising from a restructure of the associated arrangements by the State.

### Operating result for the year

**3.2** The operating result represents a major indicator of the Government's financial performance as it identifies the extent to which the costs of service delivery to the public are covered by revenues of the State. This information, when assessed over a number of years, provides an important indicator of the financial impact and sustainability of the Government's financial strategies and policies.



**3.3** The Consolidated Operating Statement discloses that the State achieved an operating surplus, prior to abnormal items, of \$1.8 billion for the 1999-2000 financial year, which was \$919 million lower than the result achieved in 1998-99. The overall operating surplus for the year, after abnormal transactions relating to the disposal of the passenger transport businesses' net assets, was \$1.2 billion (1998-1999, \$6.7 billion). Comment on the public transport passenger rail privatisation and franchising arrangements is provided in Part 6 of this Report.

**3.4** The key factors contributing to the lower operating result achieved in the 1999-2000 financial year were increased expenditures associated with employee entitlements (\$128 million), superannuation (\$899 million), supplies and services (\$1.5 billion), and grants and transfer payments (\$160 million). These increased expenses were mainly due to wages growth, the provision of additional health and education services, and the revaluation of the outstanding claims liabilities of the State's workers' compensation scheme (WorkCover) and unfunded superannuation liabilities. However, the impact of these items was partially offset by increased taxation revenues, Commonwealth Government grants, revenues from sale of goods and services and investment income, together with a reduction in interest costs mainly resulting from lower debt levels attained from the application of privatisation proceeds in prior years.

### Financial position

**3.5** The Consolidated Statement of Financial Position serves as an indicator of the Government's financial strength and discloses information on the level and composition of assets and liabilities held by the State as at 30 June 2000. The Statement shows that, as at 30 June 2000, the State had a net asset position of \$41.2 billion (30 June 1999, \$37.5 billion), comprising assets with an aggregate value of \$82.9 billion (30 June 1999, \$78.8 billion), and liabilities with an aggregate value of \$41.7 billion (30 June 1999, \$41.3 billion). The key factors contributing to the improvement in the State's financial position during the 1999-2000 financial year included:

- Increase in the State's asset holdings by \$4.1 billion, mainly due to an increase in the reported value of physical assets (\$2.4 billion), mostly resulting from revaluations undertaken during the year, and increased investment balances (\$1.8 billion). (Further analysis of the State's asset holdings is presented in Part 6 of this Report); and
- Increase in the State's liabilities by \$403 million, mainly due to an increase in the level of unfunded superannuation liabilities (\$850 million) and outstanding claims liabilities (\$779 million) mainly relating to the WorkCover Scheme, which was partially offset by a decrease in the level of State debt (\$998 million). (Further analysis of the State's liabilities is presented in Part 7 of this Report).

### Performance against key government objectives

**3.6** A significant element of the Government's recent financial management reforms has been the establishment within legislation of a number of key principles of sound financial management which are to underpin the management of the State's finances and budget strategies. Consistent with these principles, in the 1999-2000 Budget Papers, the Government established the following short-term and long-term financial objectives.

**TABLE 3B  
GOVERNMENT'S KEY FINANCIAL OBJECTIVES**

<i>Long-term</i>	<i>Short-term</i>
<ul style="list-style-type: none"> <li>• Maintain a substantial budget sector operating surplus.</li> <li>• Provide capital works to enhance social and economic infrastructure throughout Victoria.</li> <li>• Provide improved service delivery to all Victorians.</li> <li>• Ensure competitive and fair taxes and charges to Victorian businesses and households.</li> <li>• Maintain State Government net financial liabilities at prudent levels</li> </ul>	<ul style="list-style-type: none"> <li>• Achieve an operating surplus of at least \$100 million in each year.</li> <li>• Establish a \$1 billion infrastructure reserve.</li> <li>• Provide expenditure priority on education, health and community safety.</li> <li>• Re-examine and improve Victoria's business taxation system.</li> <li>• Maintain a triple-A credit rating.</li> </ul>

**3.7** In the context of the above short-term objectives, the Government has:

- Achieved an overall operating surplus of \$1.2 billion for the 1999-2000 financial year;
- Set aside, under its Growing Victoria initiative, \$1 billion of financial assets for application towards the development of State infrastructure over the 4 year period to 2003-04;
- Maintained the State's triple-A long-term credit rating, with a major rating agency, Standard and Poor's;
- Established a review of the State's taxation system with a particular focus on business taxes, with the outcomes of the review to be reported to the Treasurer by December 2000 for consideration of reform options. In the 2000-01 Budget Papers, the Government also announced reductions of business taxes with an aggregate budget impact of \$400 million over the forward estimate period to 2003-04, conditional upon the maintenance of an operating surplus of at least \$100 million; and
- Approved additional funding allocations for education, health and public safety programs over the forward estimates period.

**3.8** These developments and achievements indicate that the Government has been successful in meeting its short-term financial objectives, nevertheless, there remains the need for strong leadership to ensure that the full benefits of progress to date are maintained.

## ANALYSIS OF THE STATE'S FINANCIAL CONDITION

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**3.9** Given the limitations of analyses purely based on the operating result and movements between years in the level of assets and liabilities, to provide a complete picture of the State's "financial condition" my previous Reports to the Parliament have presented a number of additional indicators and related analytical comment. These indicators of the State's financial health and strength focused on:

- **Sustainability** - indicating movements in the degree to which the Government can maintain existing programs and operations, and meet existing creditor requirements without increasing the debt burden on taxpayers;
- **Flexibility** - indicating movements in the degree to which the Government can increase its financial resources to respond to rising commitments, by either expanding its revenues or increasing its debt burden; and
- **Vulnerability** - indicating movements in the degree to which the Government is dependent on, and therefore vulnerable to, sources of funding outside its direct control or influence.

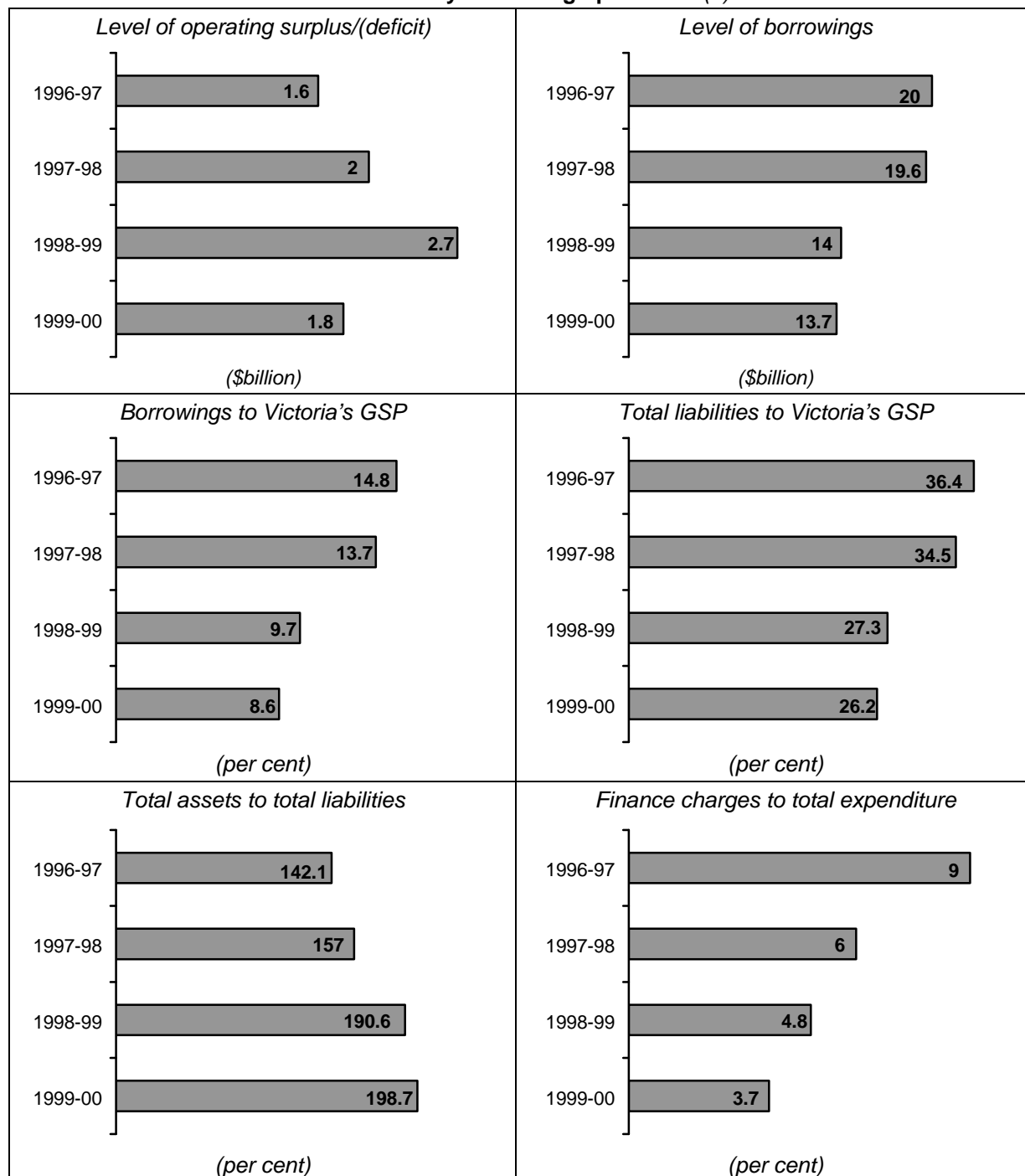
**3.10** It is pleasing to note that, in recognition of the usefulness of such indicators for meaningful analysis of the State's finances, certain of these indicators were presented in the Government's Annual Financial Report for the years ended 30 June 1999 and 2000. **Consideration should be given by the Government to the presentation of a more comprehensive range of performance indicators in future Annual Financial Reports, to enhance the usefulness of these Reports in facilitating assessments of the Government's performance and stewardship.**

**3.11** Table 3C presents the key financial indicators we have identified in relation to the State's finances for the 4 year period, 1996-97 to 1999-2000.

**3.12** It needs to be recognised that our analysis focuses on historical financial information and, accordingly, its scope does not extend to assessments of the effectiveness of government programs and their associated impacts on the State's revenues and expenditures. Also, given that audited whole-of-government accrual-based financial information is only available for the past 4 years, the analysis presented in this Report is necessarily limited to this time frame. As the base of audited information becomes available over future years, longer-term trend analyses of financial performance and condition will become possible.

**TABLE 3C  
STATE OF VICTORIA  
INDICATORS OF FINANCIAL CONDITION,  
1996-97 TO 1999-2000 FINANCIAL YEARS**

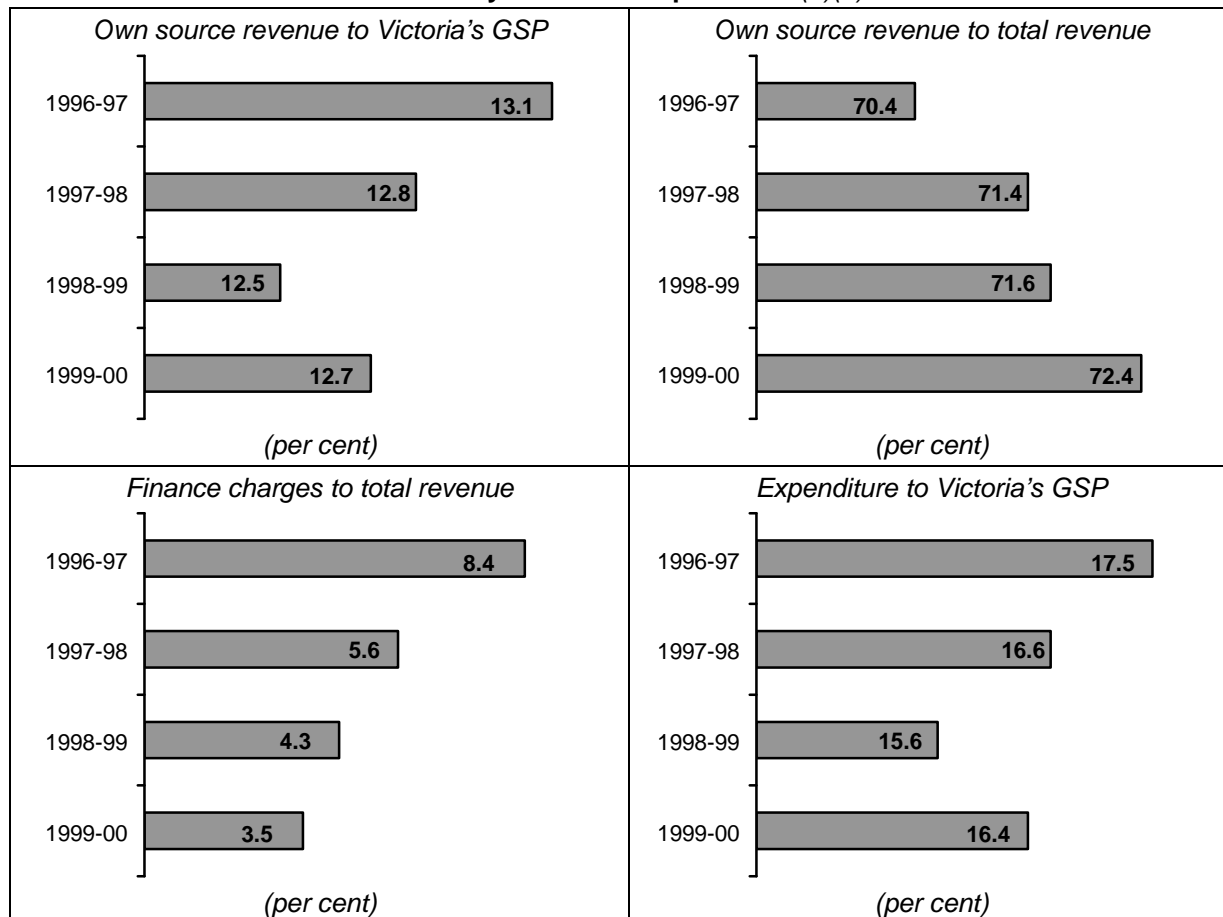
**Sustainability of existing operations (a)**



(a) A number of the indicators provide reference to Victoria's GSP. This reference relates to Victoria's Gross Domestic Product which is a measure of the size of the State economy and is sourced from statistics published by the Australian Bureau of Statistics for the 1996-97, 1997-98 and 1998-99 financial years, and estimates provided by the Department of Treasury and Finance for the 1999-2000 financial year. Borrowings comparatives have been adjusted to include re-classification of finance leases consistent with 1999-2000 classification.

**TABLE 3C**  
**STATE OF VICTORIA**  
**INDICATORS OF FINANCIAL CONDITION,**  
**1996-97 TO 1999-2000 FINANCIAL YEARS - continued**

**Flexibility in financial operations (a)(b)**

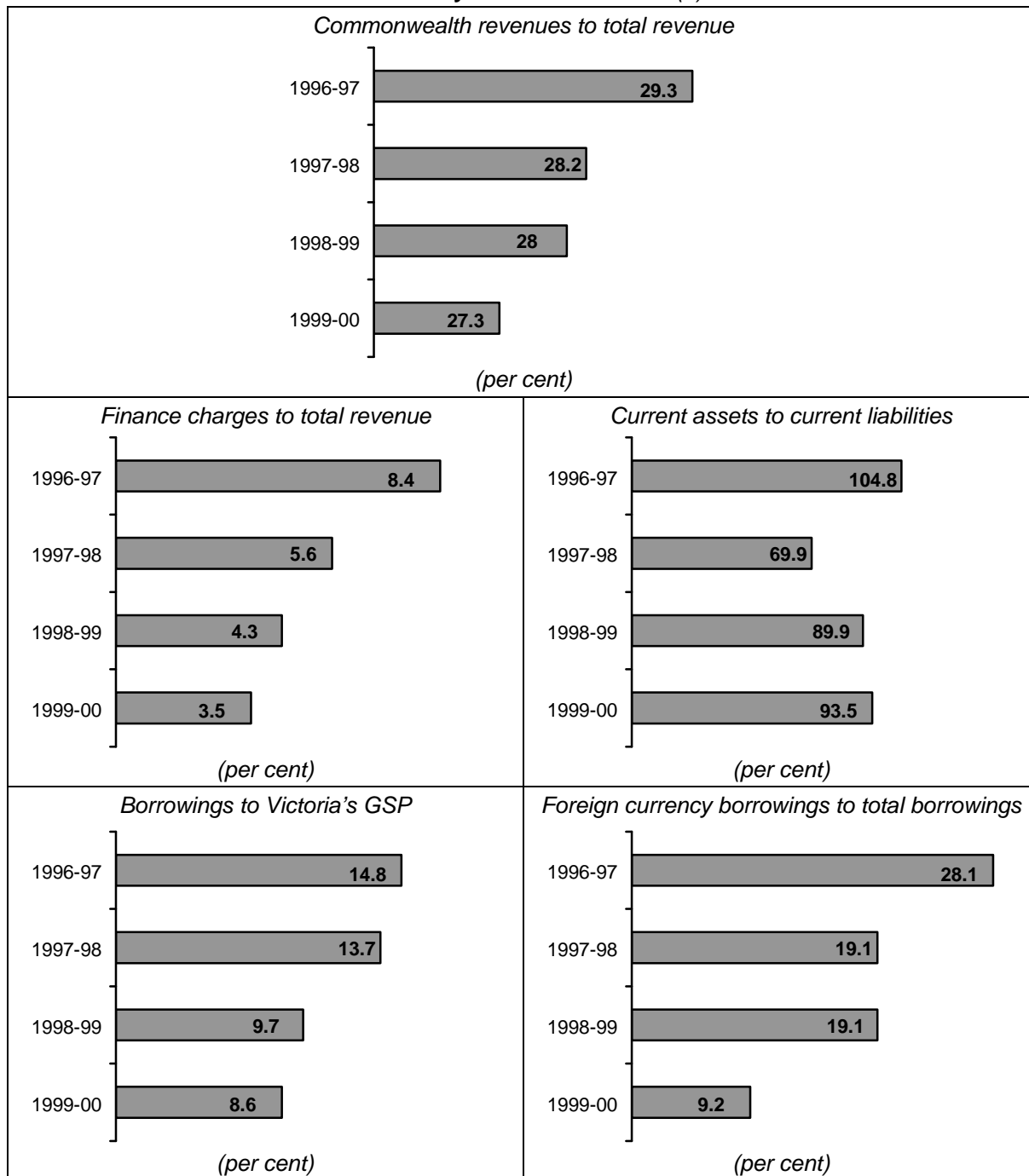


(a) A number of the indicators provide reference to Victoria's GSP. This reference relates to Victoria's Gross Domestic Product which is a measure of the size of the State economy and is sourced from statistics published by the Australian Bureau of Statistics for the 1996-97, 1997-98 and 1998-99 financial years, and estimates provided by the Department of Treasury and Finance for the 1999-2000 financial year.

(b) Own source revenue represents total operating revenue less total grants to the State.

**TABLE 3C**  
**STATE OF VICTORIA**  
**INDICATORS OF FINANCIAL CONDITION,**  
**1996-97 TO 1999-2000 FINANCIAL YEARS - continued**

**Vulnerability to external factors (a)**



(a) A number of the indicators provide reference to Victoria's GSP. This reference relates to Victoria's Gross Domestic Product which is a measure of the size of the State economy and is sourced from statistics published by the Australian Bureau of Statistics for the 1996-97, 1997-98 and 1998-99 financial years, and estimates provided by the Department of Treasury and Finance for the 1999-2000 financial year. Borrowings comparatives have been adjusted to include re-classification of finance leases consistent with 1999-2000 classification.

**3.13** The information contained in the above charts highlight that **the State's financial condition has strengthened during the 1999-2000 financial year, in that:**

- **The Government's capacity to maintain existing programs and operations has improved** as indicated by the improved net asset position, the reduced level of outstanding borrowings, the lower call on State revenues to meet financing charges, and the reducing proportion of State liabilities compared with the size of Victoria's economy. This improvement has occurred notwithstanding a reduction in the level of the operating surplus for the year;
- **The Government's flexibility in responding to future opportunities requiring increased financial resources has also improved**, as indicated by the reducing debt burden on State finances. However, the rate of increase in State expenditures has exceeded the increase in the Gross State Product, reflecting the Government's commitment to increased service delivery to health, education and public safety programs. While this has not adversely impacted on the Government's financial flexibility (as previously indicated), it will be important for the Government to monitor future trends in expenditure to ensure that the State's financial strength is maintained ; and
- **The State's vulnerability to funding sources not directly within its control has improved**, as reflected in the reducing debt burden on Victorian taxpayers and the improved working capital ratio as at 30 June 2000 when compared with the previous year, and as indicated by the reducing excess of current liabilities over current assets.

### State's credit rating

**3.14** A further indicator that may be used to assess the State's financial condition and any major shifts therein, is its credit rating as assigned by the major rating agencies. The State's credit rating is also a key determinant of the level of finance charges that are payable by the State on its borrowings, and on financial market and investor assessments of the strength and stability of State finances. In this regard, our previous Reports to the Parliament have tracked the former Government's progress towards achieving one of its key long-term financial targets, namely, to restore Victoria's former triple-A credit rating.

**3.15** As mentioned previously, this focus has been continued by the current Government which has identified as one of its financial objectives the maintenance of a triple-A credit rating.

**3.16** My previous Reports to the Parliament identified that as a result of major structural reforms within the Victorian public sector and the strengthening of the State's financial position, in April 1998 the Government achieved its long-term target of triple-A credit rating from the international credit rating agency, Standard and Poor's. In March 1999, another major international rating agency, Moody's Investors Service, revised the State's domestic currency debt rating outlook from "stable" to "positive".

**3.17** More recently, in December 1999, Standard and Poor's affirmed the State's triple-A long-term currency rating. The agency stated that *"The outlook is stable. The ... Government's modest campaign initiatives do not appear to place the strong budgetary position under strain. While the economy continues to grow strongly, thus boosting revenue, the minority position of the government in Parliament is unlikely to inhibit good fiscal outcomes"*.

**3.18** In February 2000, Moody's Investor Services upgraded the State's rating for domestic currency denominated bonds to Aaa from Aa1. The agency stated that *"The State's strong debt and fiscal position place it in good stead to face upcoming pressures ... [and] a commitment to prudent fiscal and debt management remains a key policy strategy of the Government"*.

**3.19** **The improved credit ratings reflect the Government's expressed commitment to responsible financial management, as espoused in the key financial management principles embodied in legislation, and which the Government will be required to observe.**

#### Consolidated Fund result for the year

**3.20** As outlined above in this Report, in addition to preparing an Annual Financial Statement of the State, the *Financial Management Act* 1994 requires the presentation of certain additional information relating to the financial operations of the Public Account, which comprises the Consolidated Fund and the Trust Fund. Note 31 to the Government's Annual Financial Statement provides these required disclosures.

**3.21** The Government's Annual Financial Statement discloses that **the overall Consolidated Fund cash-based result for the 1999-2000 financial year was a surplus of \$1.6 billion**. As previously explained in Part 2 of this Report, the Consolidated Fund represents the central Government's operating account and records only departmental receipts and payments, with payments reflecting Parliamentary Appropriations expended in the year. Table 3D presents the Consolidated Fund result for the year.



**TABLE 3D**  
**CONSOLIDATED FUND RESULT FOR THE FINANCIAL YEAR**  
 (\$million)

<i>Item</i>	<b>1999-00</b>	<b>1998-99</b>
<i>Receipts -</i>		
Operating activities	<b>19 865</b>	18 479
Investing and financing activities	<b>218</b>	280
<i>Total receipts, excluding borrowing transactions</i>	<b>20 083</b>	18 759
<i>Less – Payments (operating and capital transactions) -</i>		
Special Appropriations	<b>1 747</b>	1 849
Annual Appropriations	<b>15 842</b>	15 293
<i>Total payments, excluding borrowing transactions</i>	<b>17 589</b>	17 142
<b>Overall Consolidated Fund surplus, excluding abnormal items and borrowing transactions</b>	<b>2 494</b>	1 617
Add/(Deduct) - Net abnormal items,	(a) <b>(604)</b>	(b) 2 824
<b>Overall Consolidated Fund surplus for year, excluding borrowing transactions</b>	<b>1 890</b>	4 441
<b>Borrowing repayments</b>	<b>(269)</b>	(5 220)
<b>Surplus/(Deficit) for the year</b>	<b>1 621</b>	(779)

(a) Abnormal items for the 1999-2000 financial year included:

- once-off contribution to the Emergency Services Superannuation Scheme of \$271 million to fully fund the liability relating to Victoria Police; and
- additional superannuation contributions of \$333 million.

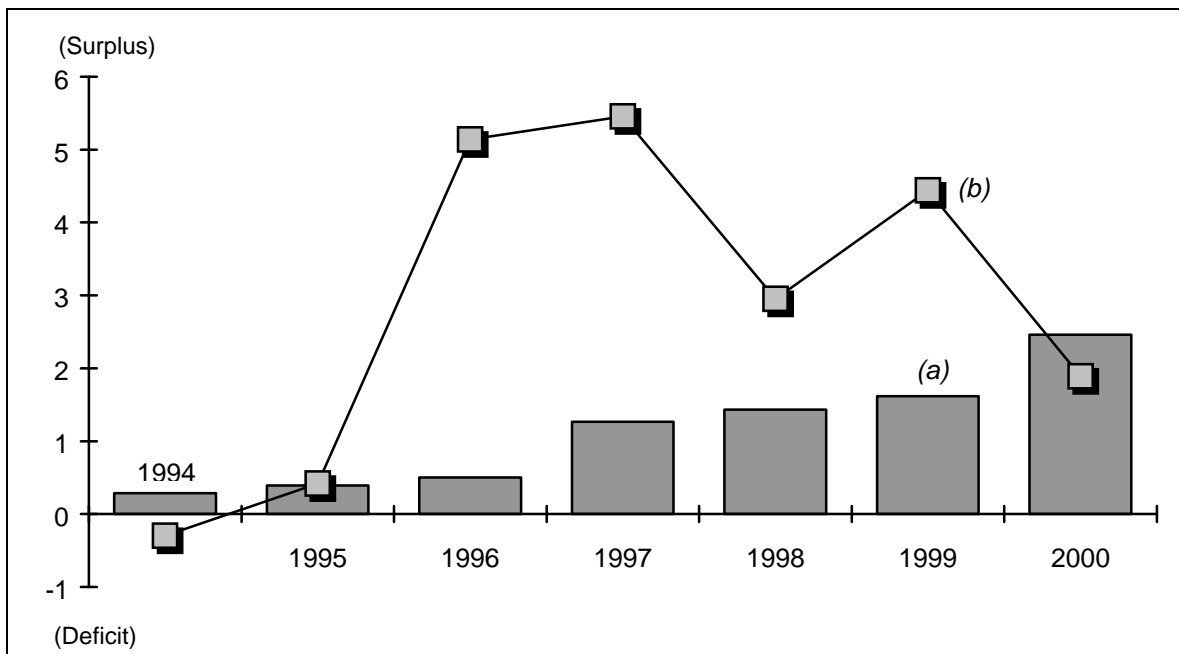
(b) Abnormal items for the 1998-99 financial year included:

- receipt of \$6.4 billion from the sale of State-owned business enterprises and costs of \$208 million associated with these privatisations; and
- additional superannuation payments of \$3.4 billion to public sector superannuation funds to reduce the State's unfunded superannuation liabilities.

**3.22 An analysis of the Consolidated Fund result indicates that the result for the year prior to abnormal items and borrowing transactions was a surplus of \$2.5 billion, compared with \$1.6 billion in the 1998-1999 financial year.** The improved outcome achieved in the 1999-2000 financial year was mainly due to higher revenues in the year from taxation receipts and increased grants from the Commonwealth Government which, in part, were offset with increased departmental expenditure.

**3.23** Chart 3E illustrates the significant improvement that has occurred over recent years in the Consolidated Fund results achieved by the Government, reflecting the positive impact of major budget and financial management reforms, and the improved economic conditions within the State.

**CHART 3E**  
**CONSOLIDATED FUND RESULT, PRIOR TO BORROWING TRANSACTIONS,**  
**1993-94 TO 1999-2000**  
 (\$billion)



(a) Consolidated Fund result before taking into account abnormal items.

(b) Consolidated Fund result after abnormal items.

## **Part 4**

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# **Revenue**

## SUMMARY OF STATE REVENUES

**4.1** The operating revenues of the State in the 1999-2000 financial year totalled \$28 billion, some \$1.6 billion higher than the revenues raised in the previous year.

**4.2** The major items contributing to this favourable outcome were increased collections from State taxation (mainly comprising higher revenues from payroll tax, gambling taxes and taxes on property and financial market transactions), increased investment income associated with increased investment holdings and favourable market conditions, and higher grants from the Commonwealth Government.

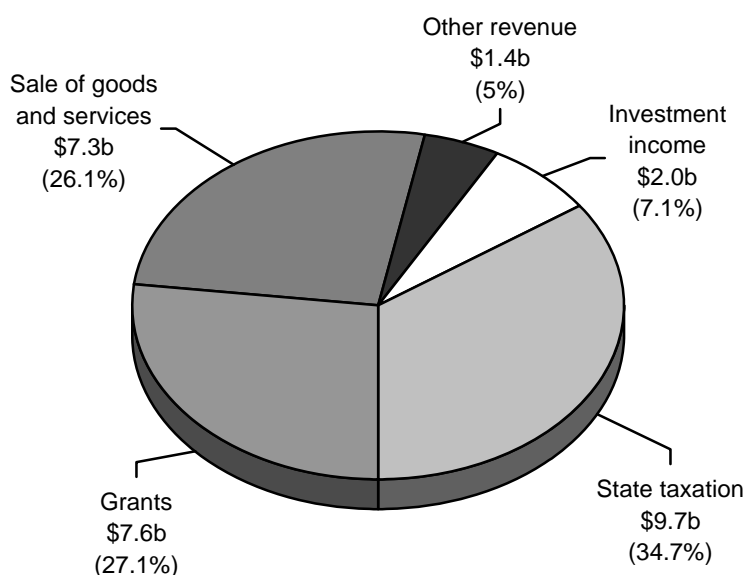
**4.3** Table 4A provides a summary of operating revenue collections for the year, while Chart 4B illustrates the contribution of the major revenue sources to total State collections.

**TABLE 4A**  
**OPERATING REVENUES OF THE STATE**  
(billion)

<i>Revenue source</i>	<b>1999-00</b>	<b>1998-99</b>
State taxation	<b>9.7</b>	8.8
Commonwealth grants	<b>7.6</b>	7.4
Sale of goods and services	<i>(a)</i> <b>7.3</b>	6.8
Investment income	<b>2.0</b>	1.5
Other	<i>(a)</i> <b>1.4</b>	1.9
<b>Operating revenue before abnormal items</b>	<b>28.0</b>	<b>26.4</b>

(a) Movement in the reported levels of revenue for these items in part reflects a reclassification of certain items from other revenue to sale of goods and services in the 1999-2000 financial year.

**CHART 4B**  
**MAJOR SOURCES OF STATE REVENUE, 1999-2000**  
 (\$billion)

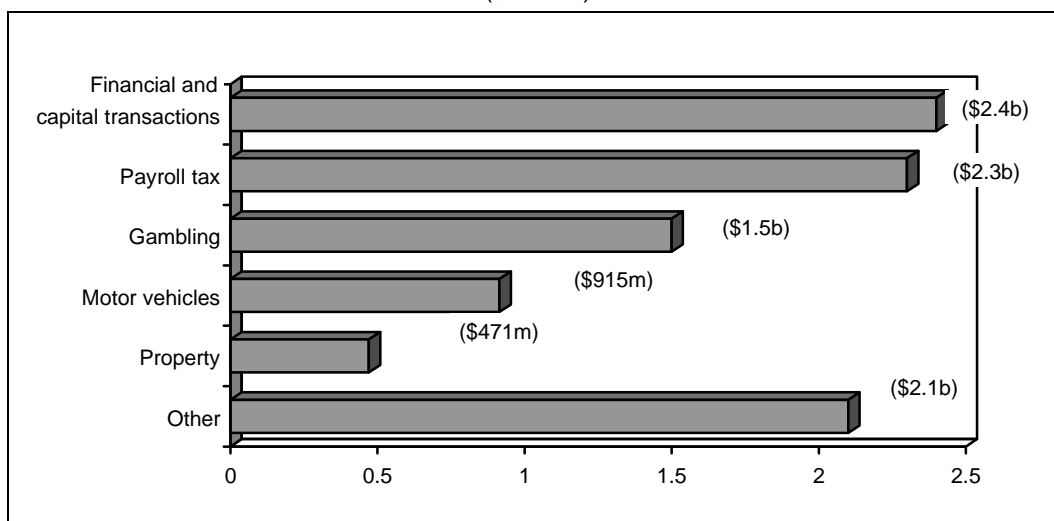


4.4 Comment follows on a number of issues impacting upon State revenues.

### Taxation revenues

4.5 Taxation represents the largest source of State revenues and principally comprises payroll tax, various stamp duties and taxes on financial and capital transactions, property holdings and gambling activities, motor vehicle fees, and other licences and levies. **In the 1999-2000 financial year, taxation collections totalled \$9.7 billion, an increase of \$920 million on the previous year.** The major items contributing to the increase in the year were higher collections from taxes and duties levied on financial and capital transactions, payroll and gambling activities. Chart 4C illustrates the key taxation categories.

**CHART 4C**  
**TAXATION REVENUES**  
 (\$million)



**4.6** An analysis of the level of taxation revenues collected by the State over the past 3 years indicates there has been a general upward trend in the level of this source of revenue in nominal and real terms over this period, as illustrated in Table 4D.

**TABLE 4D**  
**TAXATION REVENUE TRENDS, 1997-98 TO 1999-2000**

Year	Taxation revenue			Taxation revenue per capita		
	Nominal terms	Real terms	Percentage movement in real terms	Nominal terms	Real terms	Percentage movement in real terms
	(\$m)	(\$m)	(%)	(\$)	(\$)	(%)
1997-98	8 368.4	8 368.4	n.a.	1 798	1 798	n.a.
1998-99	8 776.8	8 698.9	3.9	1 863	1 846	2.6
1999-00	9 696.4	9 360.4	7.6	2 045	1 974	6.9

(a) Inflation index sourced from Australian Bureau of Statistics. In relation to the inflation index, 1997-98 is used as the base.

**4.7** The reason for the increase in the level of these revenues over this period has been the strong performance of the economy in general, and the housing and financial markets in particular.

**4.8** In recent years, our Reports to the Parliament and the Government's Budget Papers have highlighted the Government's longer-term aim of reducing the taxation burden on Victorian taxpayers by *bringing the State's tax rates into alignment with the national average*. To assist in the achievement of this aim, over a number of years the Government has introduced various tax reduction and expenditure management measures.

**4.9** In the 2000-2001 Budget Papers, the Government estimated that, based on the latest available Commonwealth Grants Commission assessment of the relative revenue raising effort of all Australian States, Victoria's taxation revenues in the 1989-99 financial year were around \$12 million below the national average and \$813 million below the level of New South Wales. However, these relativities do not take into account the impact of policy decisions impacting on future revenue levels. The Government estimated that, based on known policy decisions in the 1999-2000 budget and assuming no further tax changes in any jurisdiction in their respective 2000-01 budgets, Victoria's taxation effort is estimated to be \$63 million below the national average and \$674 million below New South Wales.

**4.10** Based on the above estimates, the State's tax competitiveness has improved.

### *Review of State business taxes*

**4.11** A major initiative by the Government which will impact on future State taxes is a review, which was announced at the time of the 2000-01 Budget, of the State's taxation system with a particular focus on business taxes. The review is being undertaken by a committee known as the State Business Tax Review Committee whose membership comprises the Commissioner of the State Revenue Office and 4 other members with experience in business and academia.

**4.12** The Committee is required to provide a report to the Treasurer by December 2000, which addresses the following issues:

- the implications of changes to the Commonwealth Government tax system for the design of Victoria's tax system; and
- the scope to achieve a State tax system that provides a more competitive environment for business, maintains State revenue more in line with economic growth, promotes simplicity and transparency in the design of taxes, and improves equity in the likely incidences of taxes.

**4.13** The review is required to make recommendations on the most appropriate distribution of the tax cuts that were announced by the Government in the 2000-01 Budget and on the appropriateness of:

- the mix between taxes and charges; and
- the existing guidelines for setting fees and charges.

**4.14** This review represents a positive development in the identification of opportunities to enhance the State's tax system and deliver the future tax reductions announced in the Budget.

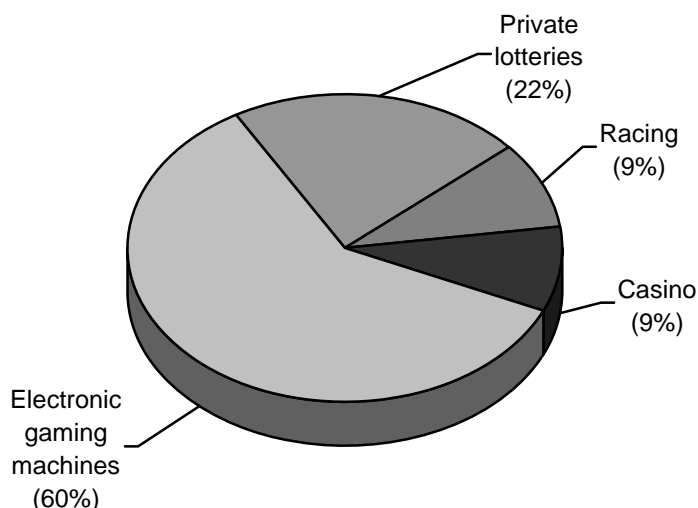
### *Gambling fees and taxes*

**4.15** A major component of State taxation, which has significantly augmented State revenues in recent years, is fees and taxes on gambling activities conducted within Victoria. The major sources of such revenue include fees and taxes levied on electronic gaming machine operations, private lotteries, racing and casino operations. **During 1999-2000, State revenues from gambling activities amounted to \$1.5 billion, an increase of around \$112 million since the previous year.**

**4.16** In the 2000-2001 Budget Papers, the Government foreshadowed that gambling revenue was expected to become the third most significant revenue source for the budget sector from the 2000-01 financial year, with revenues from payroll tax and taxes on property the only components generating more revenue for the State. However, the Budget Papers also outline that revenue from gambling activities is expected to decrease by around 20 per cent to \$1.2 billion in the 2000-2001 financial year, mainly reflecting an adjustment of tax rates following the introduction of the Goods and Services Tax (GST) by the Commonwealth Government.

**4.17** As illustrated by Chart 4E, around 60 per cent of revenue from gambling activities was derived from electronic gaming machines. In particular, in 1999-2000 the State collected \$932 million (1998-99, \$820 million) in taxation from around 27 500 electronic gaming machines located at approximately 280 clubs and 270 hotels throughout the State, and 2 500 further machines located at Crown Casino.

**CHART 4E  
MAJOR GAMBLING REVENUE SOURCES**



Source: 1999-2000 Annual Financial Report for the State of Victoria.

**4.18** The legislative framework governing the operation and regulation of electronic gaming machines within Victoria is contained primarily in the *Gaming Machine Control Act 1991* and the *Casino Control Act 1991*. In response to public concerns over the adverse social effects of gaming on local communities throughout the State, in May 2000 the Government amended this legislation to promote a stronger regulatory environment. The purpose of these amendments was to:

- cap the total number of electronic gaming machines in the State at the existing number of 30 000;
- provide for the determination of the maximum permissible number of electronic gaming machines to be located in particular regions throughout the State;
- ensure that local government bodies, on behalf of their local communities, have a greater say in the location and establishment of gaming venues;
- establish a Gaming Research Panel, independent of the Victorian Casino and Gaming Authority, to research the social and economic impact of gambling and the causes of problem gambling, as well exploring ways to minimise harm from gambling;
- compel gaming and casino operators to provide players with appropriate information about returns paid out and loss rates; and
- require 24 hour gaming venues in regional and rural Victoria to reduce their opening hours and operators in metropolitan Victoria to prove that there will be an economic and social benefit to the local community when applying for a 24 hour licence.



**4.19** The Department of Treasury and Finance has advised that while the amendments to the legislation are expected to affect revenue growth in the longer-term, no specific studies have been undertaken to reliably assess the specific impact that these changes may have on State revenues in future periods.

**4.20** In Victoria, electronic gaming machines are owned by 2 operators, namely TABCORP Holdings Ltd and Tattersalls, which are licensed by the State to 2012. In July 2000, the Government announced a review under the National Competition Policy of the gaming machine legislation. The outcomes of this review may have an impact on future licencing arrangements and revenues to the State from gaming machines. The Department of Treasury and Finance Steering Committee, which is responsible for this review, was expected to submit its findings and recommendations to the Minister for Gaming by 30 December 2000.

***Casino revenues – Liquidated damages associated with postponement of Crown Ltd hotel and theatre development***

**4.21** In November 1993, Crown Ltd was granted a 40 year licence by the Government to operate the Casino complex. An associated Management Agreement set out a number of design and financial obligations for Crown Ltd over the term of the licence.

**4.22** Since the granting of the licence, the management agreement has been varied a number of times and, in June 1996, a third deed of variation to the Agreement reaffirmed a requirement for Crown Ltd to construct at the Casino complex a second hotel tower, comprising not less than 465 rooms, and the Lyric Theatre with a seating capacity of at least 1 800. Under this variation, Crown Ltd was required to pay liquidated damages at a rate of \$50 000 per day in the event that it failed to complete the construction by the agreed completion date of November 1999.



*Crown Casino complex.*

**4.23** In February 1998, Crown Ltd advised the Victorian Casino and Gaming Authority (VCGA) that due to the Asian economic crisis and its detrimental impact on tourism, it was not in a financial position to proceed with the above development projects. After considering the issue, the VCGA advised the then Minister for Gaming that deferral of the development would result in the best outcome for the State and the Victorian community. Subsequently, the Government agreed to defer the date of completion and, as a result, a fifth deed of variation to the Agreement was executed to defer construction of the second hotel tower and the Lyric Theatre until November 2003.

**4.24** Our November 1998 *Report on the Victorian Government's Finances* outlined the circumstances surrounding the deferral of the construction of the second hotel tower and theatre complex. At that time, we concluded that the decision to defer was equivalent to the waiver by the State of up to \$73 million (1998 dollars) in liquidated damages payable from November 1999 to November 2003, in the event that the tower and the theatre are not constructed prior to the revised completion date.

**4.25** The VCGA is currently in possession of a \$25 million letter of credit from Crown Ltd, held on behalf of the State, to secure the obligation to pay liquidated damages in the event that the construction of the projects is not completed by 30 November 2003.

**4.26** In June 2000, the Minister for Gaming was advised by Crown Ltd that plans for the second hotel tower were well advanced. However, Crown Ltd advised that, in its view, there are no commercial, social or community needs for a Lyric Theatre at the Casino complex, and have requested approval for an alternative capital project. Specifically, Crown Ltd considered that with the opening of the Colonial Stadium and the Melbourne Aquarium, and with further developments planned for the precinct, the future critical infrastructure shortcoming in the precincts will be the lack of available car parking. Accordingly, Crown Ltd has indicated that detailed plans for a new car park at the western end of the Casino complex have been prepared as an alternative development to the Lyric Theatre. It has also advised that construction of both the hotel and the car park will commence as soon as the relevant government approvals are obtained.

**4.27** **The Government is presently considering the request from Crown Ltd to vary the nature of further developments to be undertaken at the Casino complex.**

*"Mirror" State taxes at Commonwealth places*

**4.28** Our December 1999 *Report on the Victorian Government's Finances* commented on the impact of a ruling of the High Court in November 1996, which gave rise to a degree of uncertainty regarding the imposition of State taxes on activities conducted at locations of the Commonwealth Government. To rectify this situation, the Commonwealth Government in April 1998 enacted the *Commonwealth (Mirror Taxes) Act 1998* with effect from October 1997 to enable the levying of Commonwealth taxes which "mirror" the taxes imposed by the States in relation to Commonwealth places, and to ensure that each State would continue to receive revenue equivalent to the taxes that would have been received prior to the ruling. In addition, amendments were made to State taxation legislation in 1999 to facilitate the collection of these *mirror* taxes.

**4.29** At the date of preparation of this Report, bi-lateral agreements have been drafted between the Commonwealth and the States to provide for the operation of the new arrangements and the collection of these *mirror* taxes. The Department of Treasury and Finance has advised that these agreements will be finalised during the 2000-2001 financial year.

**4.30** Consistent with the disclosures adopted in the previous financial year, in the 1999-2000 financial year mirror taxes were disclosed in the Government's Annual Financial Statement as part of State taxation revenues. This position is based on the view that the proposed disclosure will be consistent with the economic substance of the legislative arrangements, under which the State will continue to have discretion over the taxation rates to be applied and will continue to oversee compliance with the legislation. **However, as previously advised to the Parliament, in my opinion such receipts are more appropriately classified as receipts or grants from the Commonwealth Government, given that these receipts are raised under the authority of Commonwealth legislation.**

*Impact of Supreme Court decision on payroll taxation  
revenues*

**4.31** In July 1993, the Commissioner of State Revenue refused a claim by a private employment agency to refund payroll tax paid by the agency to the State Revenue Office relating to services provided by temporary workers allocated under contract to clients of the agency from January 1984 to June 1992. The employment agency argued that such contract employees should not be considered as employees under the *Payroll Tax Act 1971*.

**4.32** In June 1998, the employment agency's objection to its tax assessment was upheld, in part, by the Supreme Court of Victoria. However, this decision was subsequently overturned by the Victorian Court of Appeal in June 2000 on appeal by the Commissioner of State Revenue. The Court held that contract temporary employees on-hired by the agency to its clients were employees of the agency and therefore the agency was liable to pay the associated payroll tax liability.

**4.33** As a result of the above, the Commissioner has commenced action to collect payroll tax arrears backdated to July 1998, estimated at \$12.4 million, from all employment agencies affected by the decision. The Commissioner is mediating with the agency and other industry representatives on this issue.

**4.34** Amendments to the *Payroll Tax Act 1971* which are effective from February 1999 now specifically require employers who engage the services of contract temporary employees to pay payroll tax. However, payroll tax is only payable by the employers if the term of the engagement of the temporary workers exceeds 8 days a month.

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*National tax reform****Initial Intergovernmental Agreement***

**4.35** In August 1998, the Commonwealth Government introduced a package of major legislative reforms (A New Tax System) aimed at fundamentally changing the Australian taxation system and Commonwealth-State financial relations. The centrepiece of this package was the introduction of a goods and services tax (GST) on 1 July 2000, with GST revenues to be distributed to the States and the abolition of the Commonwealth Government's wholesale sales tax and certain indirect State taxes.

**4.36** In the context of this reform program, at the Premiers Conference in April 1999 the Commonwealth, States and Territories entered into an Intergovernmental Agreement on the Reform of Commonwealth – State Financial Relations (IGA). However, following a subsequent decision by the Commonwealth Government to exempt basic food from the application of the GST, the IGA had to be re-negotiated.

**4.37** Consistent with the terms of the IGA, the States will receive revenues collected by the Commonwealth from the GST. The States will also benefit from a scheme established by the Commonwealth to provide rebates to off-road users of diesel fuel, which will eliminate the need for the State to continue to provide financial support to these users. In return for these benefits, certain indirect taxes (financial institutions duty and stamp duty on quotable marketable securities) imposed by the States will be progressively abolished commencing from 1 July 2001. The Commonwealth will also cease the payment of financial assistance grants and "safety net" revenues sourced from taxation levied on petrol, tobacco and liquor from 1 July 2000.

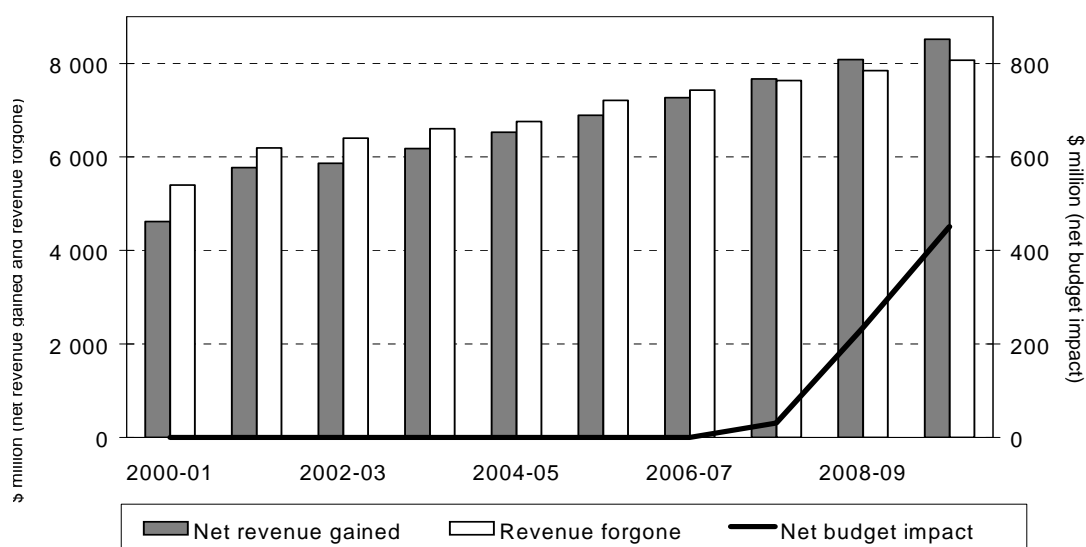
**4.38** Under the IGA, the States have also been required to assume responsibility for the funding of the local government sector and a new "First Home Owner Grant" scheme which commenced on 1 July 2000 to provide first home buyers with a specified lump sum payment to offset the net impact of the GST on the prices of new homes. In addition, the States will also be required to bear the cost of the Australian Taxation Office's administration of the GST.

***Impact of the reforms on State finances***

**4.39** Under the new taxation arrangements, the Commonwealth Government has provided an undertaking that the budgetary positions of the States would be not be adversely affected by the reforms. To assist States that may be adversely affected by the reforms, the Commonwealth will provide interest-free loans and grants to those States. In addition, those States whose budgetary positions improve as a result of the introduction of the national tax reform package would be required to "subsidise" other States which have been placed in an adverse position. For example, it is expected that Queensland will be contributing some of its GST revenue entitlement to other States in the 2001-2002 financial year.

**4.40** The 1999-2000 Budget Papers, which were prepared prior to the revision of the IGA, estimated that the net budgetary gain to Victoria from the implementation of the national tax reform program was equivalent to \$22 million in 2002-03, with this position increasing thereafter. However, as outlined in the Government's Budget Papers 2000-01, it is now expected that the State will not be in a position of net budgetary gain from the national tax reform until the 2007-08 financial year, with this position gradually increasing thereafter, as highlighted in Chart 4F.

**CHART 4F**  
**NET IMPACT OF THE NATIONAL TAX REFORM FOR VICTORIA**  
 (\$million)



Source: Department of Treasury and Finance, Budget Papers 2000-01.

**4.41** The key reason for the delay in Victoria achieving the position of a net budgetary gain as advised by the Department of Treasury and Finance was the impact of the revised IGA, which incorporated the exemption of basic food from the GST base. The exemption also resulted in the deferment of the abolition of a number of State taxes. **However, under the revised agreement, the Commonwealth agreed to extend the transitional guarantee arrangements for the States beyond the 2002-03 financial year, until they achieve a net gain position.**

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**Major issues influencing the ultimate effect of these reforms on  
the State finances**

**4.42** Under the revised agreement, the States are assumed to realise certain savings in the costs of government administration as a result of the embedded tax savings flowing from the national tax changes (principally, the abolition of the wholesale sales tax as from 1 July 2000). The estimates of the embedded tax savings to each State were calculated by the Commonwealth based on the impact of the wholesale sales tax and other indirect tax changes on goods, services and assets arising from the abolition of wholesale sales tax. For Victoria, the Commonwealth Government estimated embedded tax savings from \$100 million in 2000-01 up to \$123 million in 2003-04. **The Victorian Department of Treasury and Finance has estimated that the budget sector's savings will fall short of the Commonwealth projections in the 2000-01 financial year by up to \$27 million, but will be \$23 million higher than predicted in 2001-02, \$33 million higher in 2002-03 and \$27 million higher in 2003-04, which, if achieved, will represent a net gain for the State's finances.**

**4.43** The Department of Treasury and Finance has identified as a risk the possible failure by budget sector entities to achieve the targeted embedded savings in 2001-2002, especially with regard to the extraction of cost savings from suppliers to the Government. To assist in the development of appropriate strategies for the management of this risk, in December 1999 the Expenditure Review Committee of Cabinet requested that a review of the economy-wide experience of embedded tax savings be conducted by March 2001.

*Overall concluding comments*

**4.44** In the first year following the implementation of the national tax reform package, it is estimated that there will be an adverse impact on the State's finances of \$681 million as a result of these reforms. However, this shortfall is to be funded by way of additional financial assistance from the Commonwealth Government. The model that has been agreed between jurisdictions to determine the extent of such financial assistance is based on certain agreed estimates associated with, among other things, the achievement of embedded tax savings. Accordingly, to the extent which the embedded savings achieved by the State are lower than those assumed in the model, there is a risk that the State's finances will be adversely impacted. This represents a significant risk which requires ongoing assessment and management. The State's reliance on Commonwealth guarantee payments is expected to continue until the 2007-08 financial year, at which stage a net budgetary gain position is expected to be achieved and steadily improved thereafter.

## **Part 5**

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# **Expenditure**

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SUMMARY OF STATE EXPENSES

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**5.1** The operating expenses of the State, prior to abnormal items, totalled \$26.2 billion during the 1999-2000 financial year, some \$2.5 billion higher than in the previous year. The key factors contributing to this outcome were increased costs associated with employee superannuation (mainly resulting from a revaluation of the liability), insurance claims associated with the State's workers' compensation and transport accident schemes, and the delivery of health and education programs. Some of these increases however, were offset by lower borrowing costs resulting from reduced debt levels.

**5.2** Table 5A provides a summary of operating expenditures, prior to abnormal items, for the year.

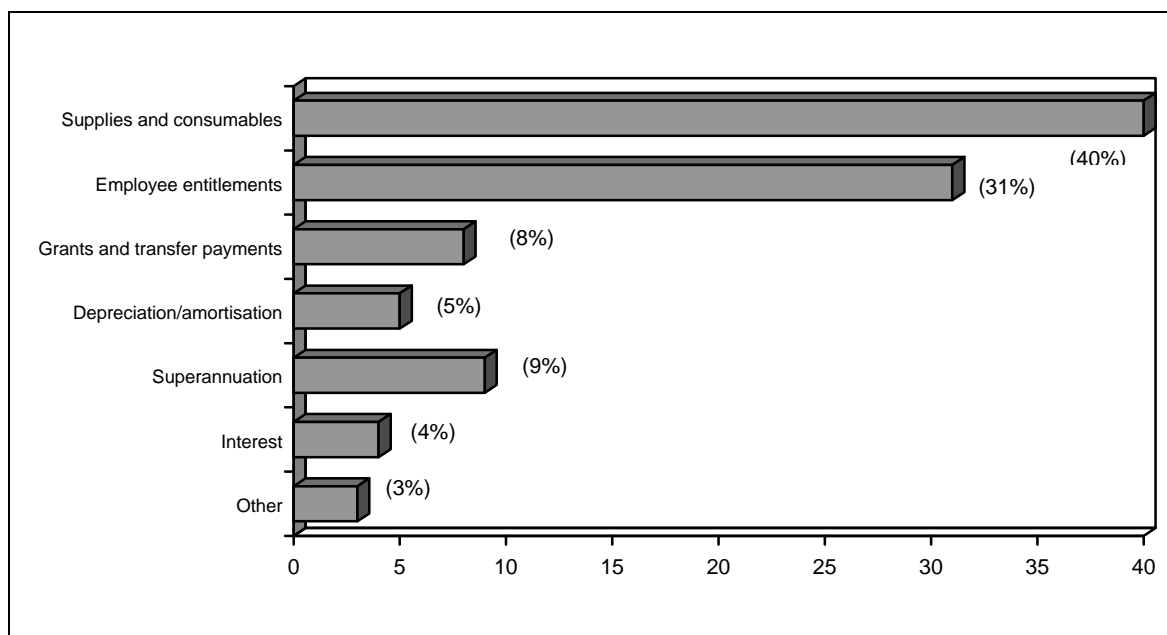
**TABLE 5A**  
**STATE OPERATING EXPENDITURE**  
**(PRIOR TO ABNORMAL ITEMS)**  
(billion)

<i>Item</i>	<b>1999-00</b>	<b>1998-99</b>
Supplies and services	<b>10.6</b>	9.1
Employee entitlements	<b>8.0</b>	7.9
Grants and other transfer payments	<b>2.2</b>	2.1
Superannuation	<b>2.3</b>	1.4
Depreciation and amortisation	<b>1.3</b>	1.4
Interest and other financing costs	<b>1.0</b>	1.1
Other expenses	<b>0.8</b>	0.7
<b>Operating expenses before abnormal items</b>	<b>26.2</b>	<b>23.7</b>

**5.3** Chart 5B illustrates the major expenditure categories of the State for the year.



**CHART 5B**  
**MAJOR OPERATING EXPENDITURE CATEGORIES, 1999-2000**  
(per cent)



**5.4** An analysis of State expenditure over the past 3 years as illustrated in Table 5C indicates that while there was a reduction in real terms in the level of expenditure between the 1997-98 and 1998-99 financial year, this trend was reversed in the current year which reflects the Government's policy of providing increased funding towards the delivery of government services and the impact of the increasing value of superannuation liabilities and outstanding claims liabilities associated with the State's workers' compensation and transport accident schemes.

**TABLE 5C**  
**EXPENDITURE TRENDS, 1997-98 TO 1999-00**

Year	Total amount (nominal value)	Total amount (real value)	Percentage movement in real terms	Per capita (nominal value)	Per capita (real value)	Percentage movement in real terms
	(\$m(a))	(\$m)	(%)	(\$)	(\$)	(%)
1997-98	23 632.4	23 632.40	n.a.	5 077	5 077	n.a.
1998-99	23 672.5	23 457.12	(0.7)	5 024	4 978	(1.9)
1999-00	26 189.5	25 282.05	7.7	5 524	5 332	7.1

(a) Figures exclude abnormal transactions.

(b) Inflation indices and population data sourced from Australian Bureau of Statistics publications.

**5.5** As commented on previously in this Report, it will be important for the Government to monitor future trends in expenditure to ensure that the State's financial strength is maintained.

## Summary of Consolidated Fund transactions

**5.6** The Consolidated Fund is the Government's main operating account and records revenue received and payments made by departments under the authority of Parliamentary appropriations.

**5.7** Table 5D reflects a summary of appropriation expenditures for the year.

**TABLE 5D**  
**1999-2000 ACTUAL AND BUDGETED PAYMENTS**  
((\$million))

<i>Item</i>	<i>1998-99 Actual</i>	<i>1999-00 Actual</i>	<i>1999-00 Budget (a)</i>	<i>Variance from Budget</i>
Special appropriations-				
Debt repayments	5 213	<b>269</b>	221	<b>48</b>
Superannuation contributions	3 928	<b>604</b>	496	<b>108</b>
Other	1 523	<b>1 747</b>	1 478	<b>269</b>
	10 664	<b>2 620</b>	2 195	<b>425</b>
Annual appropriations applied in the year -				
Provision of outputs	14 434	<b>15 134</b>	15 131	<b>3</b>
Additions to net asset base	376	<b>359</b>	369	<b>(10)</b>
Payments made on behalf of the State	1 439	<b>453</b>	1 345	<b>(892)</b>
Total annual appropriations applied in the year	16 249	<b>15 946</b>	16 845	<b>(899)</b>
Less applied appropriations remaining unspent at year-end	(949)	<b>(104)</b>	(215)	<b>111</b>
	15 300	<b>15 842</b>	16 630	<b>(788)</b>
<b>Total Consolidated Fund payments</b>	25 964	<b>18 462</b>	18 825	<b>363</b>

(a) Budget Estimates, 1999-2000 Budget Paper No. 3.

**5.8** The table shows that the Consolidated Fund payments for the year totalled almost \$18.5 billion, some \$363 million less than budgeted.

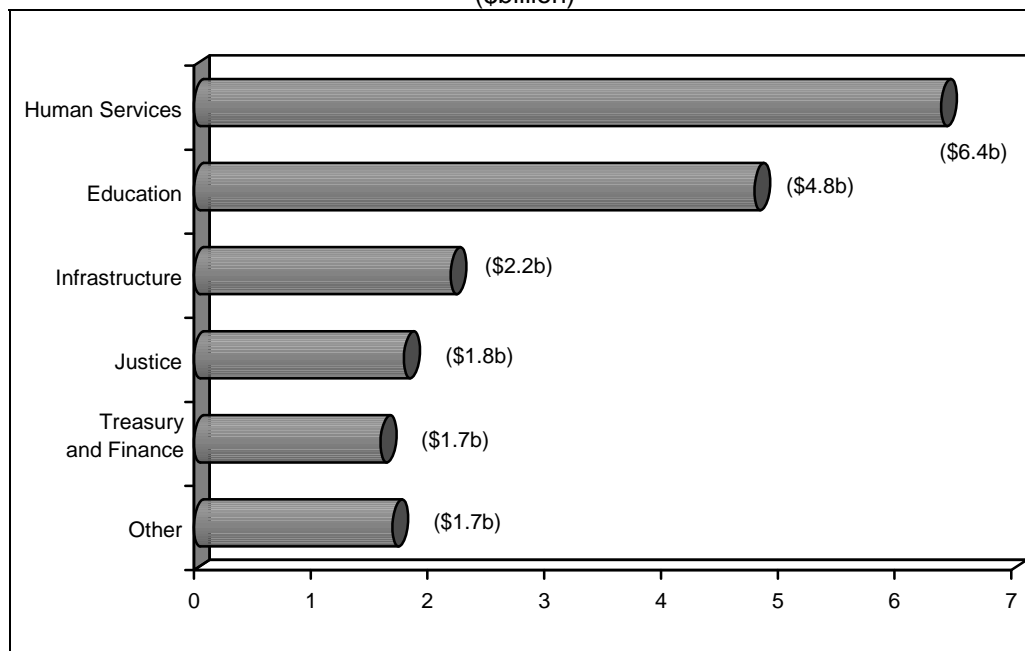
**5.9** Departmental expenditure under the parliamentary authority of Annual Appropriations was \$899 million below budget expectations. A significant factor contributing to this variation was under expenditure in the year associated with debt and financing arrangements and the restructure of the public transport system. However, under expenditure was to some extent offset by the following expenditures that were made in the year under special parliamentary appropriations that were not specifically provided for in the budget:

- application of higher than expected cash surpluses to debt retirement and reduction of superannuation liabilities (\$156 million); and
- expenditure of funds generated from prior year departmental profits (\$192 million).

*Major spending departments*

**5.10** The key departments accounting for parliamentary appropriations applied in the year were Treasury and Finance, Human Services, Education, Infrastructure and Justice. As illustrated in Chart 5E below, these portfolios collectively represent 91 per cent of total Consolidated Fund appropriations.

**CHART 5E  
PARLIAMENTARY APPROPRIATIONS APPLIED  
BY DEPARTMENTS, 1999-00 (a)**  
(\$billion)



(a) Represents gross applied appropriations.

**Accrual-based output appropriation arrangements**

**5.11** Our previous Reports to the Parliament over recent years have outlined various enhancements to the State’s financial administration as part of the Government’s Management Reform Program, including the replacement of the “cash-based” appropriation regime with “accrual-based” appropriations, and a greater focus on the management and delivery of outputs. Without doubt, **the commencement of “accrual-based” appropriation arrangements in July 1998 represented a positive step towards enhancing financial management within the budget sector by ensuring that the resource allocation processes and the accountability arrangements for departments to the Parliament are aligned.**

**5.12** The new appropriation arrangements are based on a purchaser/provider model, under which the Treasurer represents “the purchaser” and is responsible for the application of appropriations to departments for the purposes specified in the relevant Appropriation Acts. The application of appropriations occurs when the Treasurer is satisfied that the required services have been provided by departments.

**5.13** The value of appropriations applied represents the price paid by the Treasurer for the purchase of departmental services, based on (but not necessarily equal to) the full "costs incurred" by departments including both the cash and non-cash components. Accordingly, in any one year, the value of appropriations applied may be higher than the expenses actually incurred by departments in the production of outputs (in which case the departments will record profits which may be applied in future years without further parliamentary sanction) or, conversely, may be lower than the costs incurred by departments (in which case the departments will record deficits which will need to be financed from future efficiency improvements in the production of outputs).

**5.14** Given that funds are appropriated to departments for the accrual-based cost of service delivery, a number of accounts within the Consolidated Fund (known as SAU accounts) have been established to record appropriated funds that have been applied by the Treasurer but remain unspent. The amounts recorded in these accounts represent a receivable of the department and are disclosed accordingly within departmental financial statements.

**5.15** Under the new framework, the initiated funding of departmental operations is dependent on the availability of "working capital" to departments, including the provision of advances to enable the incurring of expenditure to deliver outputs. This funding arrangement is outlined in the Directions of the Minister for Finance under the *Financial Management Act 1994* which state that the liquidity requirements of departments will be met by cash advances which are to be recognised as liabilities by departments until the parliamentary appropriations have been applied by the Treasurer. The overall administrative framework established for the operation of accrual based appropriations is set out in the *Accrual Accounting Manual* issued by the Department of Treasury and Finance.

**5.16** Our overview of the operation of the new appropriation arrangements over the past 2 years has identified a number of issues which impact on the extent of control exercised over the public purse. It is my intention to provide comment on the new arrangements in a future Report to the Parliament.

## GOVERNMENT-SUPPORTED INTERNATIONAL SPORTING EVENTS

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**5.17** A key element of government strategies to attract tourism and economic activity to the State in recent years has been the hosting of major international sporting and other events. In this regard, the State is currently hosting, or will host, a number of international sporting events including the Formula One Grand Prix, Australian Motorcycle Grand Prix, Melbourne 2006 Commonwealth Games and the Melbourne 2002 Masters Games. Comment follows on the State's financial commitments and other obligations and exposures relating to these events.

### Australian Grand Prix Corporation

**5.18** Our previous Reports to the Parliament have outlined the State's financial commitments, costs and exposures arising from the financial arrangements entered into by the Government for the staging of the Formula One Grand Prix event in Melbourne and the Australian Motorcycle Grand Prix at Phillip Island.

**5.19** The Australian Grand Prix Corporation was established in October 1994, under the provisions of the *Australian Grands Prix Act 1994*, to stage the Melbourne Formula One Grand Prix for a period of 6 years ending in 2001. In May 1995, the Government announced that it had also secured the Australian Motorcycle Grand Prix event at Phillip Island also ending in 2001, with this event also to be managed by the Corporation.

**5.20** In July 1998, the Government announced that it had successfully negotiated a 5 year extension for the staging of the Formula One Grand Prix in Melbourne until 2006 and, in August 2000, the Government announced a further extension of 4 years until 2010. In July 2000, an extension was also announced for the Australian Motorcycle Grand Prix for an additional 5 years to 2006.

**5.21** The Corporation advised that no changes to the existing contractual arrangement between the State and the Corporation were required as a result of the extensions of the Formula One Grand Prix and the Motorcycle Grand Prix.

**5.22** To facilitate the annual staging of the 2 Grand Prix events, the Government has provided an undertaking to underwrite any deficits incurred by the Corporation in relation to the events.

*Studies undertaken of Grand Prix events*

**5.23** The Australian Grand Prix Corporation's key objective is to successfully stage the Australian Formula One Grand Prix and Australian Motorcycle Grand Prix, and thereby stimulate and maximise actual and potential promotional and economic benefits for Melbourne and Victoria.



*Australian Formula One Grand Prix.*

**5.24** At the request of the Department of State and Regional Development, an evaluation was conducted in 1996 to assess the economic activity impact of the 1996 Formula One Grand Prix event on the Victorian economy. The conclusion of the study was that, as a result of the 1996, event economic benefits of \$95.6 million, including an estimated \$6.9 million generated from additional taxation receipts, were provided to the State. A similar study was not conducted for the 1997, 1998 and 1999 Formula One Grand Prix events as the Corporation has advised that it is not industry practice to conduct such studies on an annual basis.

**5.25** In July 2000, the Department of State and Regional Development commissioned an external economic and industry research body to undertake a similar study to assess the economic impact of hosting the 2000 Formula One Grand Prix event. This study concluded that the 2000 Formula One Grand Prix event:

- increased the Victorian Gross State Product by \$130.7 million in 2000 prices; and
- resulted in additional taxation receipts to the State Government of \$9.8 million.

**5.26** In relation to the Australian Motorcycle Grand Prix, a separate evaluation of its impact on the Victorian economy was first conducted in May 1995 by a consultant on behalf of the Department of Treasury and Finance. The evaluation estimated that the 1997 event would provide a \$63 million economic benefit to the State, and \$3.7 million in State Government tax receipts.

**5.27** A further study was conducted in 1997 of the actual impact of the 1997 event, which estimated a \$54 million economic benefit to the State, including an estimated regional benefit to the Bass Coast Shire of \$22.6 million and \$3.7 million in State Government tax receipts. A follow-up study has not been undertaken since that review. The Corporation has advised that this is consistent with the Formula One event, where a follow-up review was conducted 5 years after the initial review.

*Financial outcome of the Grand Prix events*

**5.28** The financial outcomes achieved in staging the events for the 1999-2000 financial year are outlined in Table 5F.

**TABLE 5F**  
**COSTS INCURRED BY THE STATE IN RELATION**  
**TO THE STAGING OF THE FORMULA ONE AND MOTORCYCLE**  
**GRAND PRIX EVENTS, 1999-2000 FINANCIAL YEAR**  
(\$million)

<i>Item</i>	<i>Formula One event (March 2000)</i>	<i>Motorcycle event (October 1999)</i>	<i>Total</i>
Operating loss in staging the event, <b>excluding</b> other costs detailed below	4.0	(a) 2.9	(e) 6.9
Net operating costs incurred by other public sector agencies (b)	0.05	0.1	0.15
<b>Operating cost, excluding depreciation</b>	<b>4.05</b>	<b>3.0</b>	7.05
Add Depreciation and amortisation costs (c)			1.5
Total operating cost to the State (d)			<b>8.55</b>

(a) Reflects the operating loss incurred by the Corporation during the 1999-2000 financial year, including components relating to both the October 1999 and 2000 Motorcycle events.

(b) Comprises costs of \$119 500 (including \$24 500 for the Formula One events and \$95 000 for the Motorcycle events) incurred by Vic Roads in relation to associated road works and \$25 800 incurred by the Department of Infrastructure towards the promotion of the public transport services to the event.

(c) Depreciation and amortisation costs have not been apportioned by the Corporation between the 2 events. While the total cost of holding the 2 events is disclosed in the table, until the apportionment occurs, the full costs associated with holding the individual events will not be available.

(d) A further amount of \$575 000 was contributed by public sector agencies relating to sponsorships, which were negotiated on a commercial basis.

(e) The Corporation paid a fee to the Department of Infrastructure (DOI) for the provision of public transport. The DOI, as a result of franchising arrangements for public transport, was unable to confirm whether the fee charged fully met the cost of running the transport service.

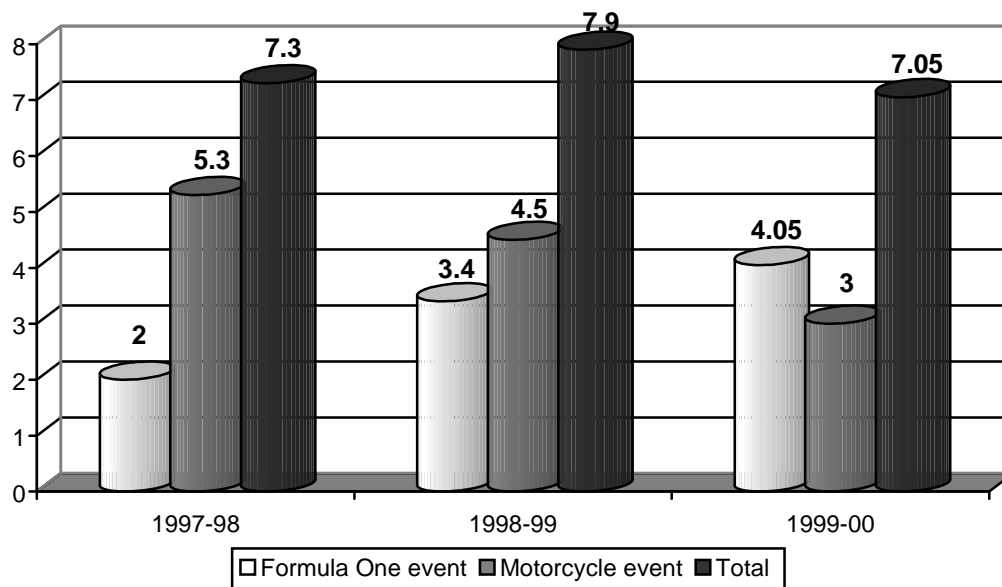
**5.29** As illustrated in the preceding table, the net operating costs incurred by the State in relation to the Formula One and the Motorcycle Grand Prix events relating to the 1999-2000 financial year were \$8.55 million. This amount includes depreciation and amortisation of \$1.5 million in relation to utilisation of associated infrastructure and other assets, and a net cost of \$145 000 incurred by other public sector agencies, which includes VicRoads and the Department of Infrastructure.

**5.30** This outcome compares favourably with the estimated economic benefits derived by the State as a result of the event, as assessed by studies undertaken by the Government.

**5.31** Since the inception of the events, the net aggregate operating costs incurred by the State amount to \$45.2 million, inclusive of set-up and establishment costs of an operating nature of \$4.8 million, and depreciation and amortisation of \$11.1 million.

**5.32** Chart 5G illustrates the net operating costs to the State associated with the staging events (excluding depreciation and amortisation) over the 1997-98, 1998-99 and 1999-00 financial years.

**CHART 5G**  
**GRAND PRIX EVENTS NET OPERATING COSTS**  
**TO THE STATE FOR THE PAST 3 FINANCIAL YEARS (a)**  
 (\$million)



(a) Excludes depreciation and amortisation as the Corporation has not allocated these expenditures between the 2 events.

**5.33** The chart highlights a decline in costs to the State, excluding depreciation and amortisation, over the 3 years in relation to the Motorcycle event. The Corporation advised that as a result of reduced attendances for the October 1999 event, the Corporation placed greater controls on operational expenditure to reduce the overall deficit. In addition, the Corporation benefited from a one-off foreign exchange gain of approximately \$985 000. However, the chart also highlights an increase in operating costs to the State, excluding depreciation and amortisation, over the 3 years in relation to the Formula One event.

**5.34** The Corporation advised that the major factor impacting on the 1999-2000 outcome was an increase in attendances, reflected in the increase of revenue from \$44 million to \$48 million, which had resulted in higher operating expenditure. These increased expenditures consisted of the cost of additional facilities and increased funding of track activities in order to increase the event experience and consolidate attendances for future events.

**5.35** In addition to the operating costs reflected in 1999-2000 for staging the Formula One Grand Prix, capital costs of \$161 000 were incurred by the Corporation under licence from Parks Victoria, which were funded by the Government. Further capital costs of \$831 000 associated with race infrastructure, which is utilised for both events, were also funded by the Government.

**5.36** As outlined in previous Reports to Parliament by this Office, there are a number of inherent risks that could potentially have an adverse impact on the Corporation's future finances. These include:

- exchange rate movements relating to fees payable to the international bodies involved in the promotion of the Formula One championship;



- poor weather on race days impacting on attendances and possibly causing race cancellation;
- tobacco advertising restriction possibly resulting in the cancellation of the event;
- 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 or otherwise impacting on the Corporation; and
- delays in the establishment of the required temporary facilities.

**5.37** However, consistent with prior years, the Corporation has taken action to address certain of these risks through:

- maintenance of insurances relating to certain commercial risks;
- 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; and
- maintenance of close liaison with individuals and organisations involved in the Formula One championship to protect the State's interests in the event.

**5.38** Also, as indicated in previous Reports to the Parliament, the Treasurer in March 1996 approved the provision by the Corporation of an indemnity in favour of the race promoter against any costs arising from certain third party actions against the promoter, employees, agents and race drivers. The State's exposure is mitigated by the Corporation's acquisition of public liability insurance for the 2000 Formula One event. Nevertheless, the State retains certain exposures, including claims in excess of the insurance policy limits and certain commercial risks.

**5.39** The financial risks in relation to the Australian Motorcycle Grand Prix event are similar to those relating to the staging of the Formula One Grand Prix. The Corporation has taken similar steps to those taken in relation to the Formula One Grand Prix to manage the key risks associated with the staging of this event.

### Melbourne 2006 Commonwealth Games

**5.40** Our previous Report to the Parliament commented on the formal announcement, in October 1999, by the Commonwealth Games Federation that Melbourne was selected as the city to host the 2006 Commonwealth Games.

**5.41** Consistent with the terms of the endorsement contract entered into between the Australian Commonwealth Games Association and the State, in July 1999 an organising committee company was established, known as the Melbourne 2006 Commonwealth Games Pty Ltd. Under the terms of this contract, the State is required to underwrite any shortfall between revenue and expenditure of the organising committee company until the winding-down of the company, which is to be no later than 18 months following the Commonwealth Games' closing ceremony. Following the wind-up of the organising committee company, the net assets of the company will be transferred to the Association.

**5.42** Our previous Report also outlined estimates, based on revenue and expenditure projections made by the former Melbourne 2006 Commonwealth Games Bid Pty Ltd, that the organising committee might incur an operating loss of around \$93 million (in 1998 dollars) from hosting the 2006 Commonwealth Games in Melbourne. It was estimated at the same time that the State would incur a cost of around \$102 million from the provision of services associated with the event and would undertake related capital works at a cost of \$97 million. Commonwealth and local governments will also incur expenditure estimated at \$58 million.

**5.43** An economic impact study undertaken by external consultants on behalf of the Commonwealth Games bid company estimated that the short-term financial impact of hosting the Games would be an increase in the Victoria's Gross Domestic Product of around \$373 million, and an increase in State taxation revenues of around \$14.5 million. The study also identified longer-lasting and intangible benefits to the State such as increased tourism, improved reputation of hosting "world class" events and an opportunity to foster long-term business relationships.

**5.44** In conjunction with the formal announcement of Melbourne's selection, a Host City Contract was also signed in October 1999 between Melbourne 2006 Commonwealth Games Pty Ltd (the organising committee company), the Commonwealth Games Federation and the Australian Commonwealth Games Association. Under the contract, the organising committee company has agreed to pay \$1.5 million pounds sterling for the right to host the Games and a further \$5 million pounds sterling to purchase the right to commercially exploit the Games on a worldwide basis, including rights relating to international sponsorship, the use of symbols and emblems, and broadcasting rights including television, radio and the internet. Key obligations of the State under the contract are:

- to provide specified facilities for the Commonwealth Games Federation Group;
- to fund travel expenses up to \$7.5 million for competitors and team officials attending the Games;
- within 12 months of the completion of the Games, the State and/or the Association to publish and deliver to the Federation a full report including audited financial statements and official results of the event. In addition, the State will provide to the Federation a recording of the broadcasted international signal, an electronic copy of all internet content and copies of all planning and operational documents, including the rights to exploit the television and internet archives;
- the organising committee company, together with the Association to provide an indemnity to the Federation for any third party claims arising from the event, with the organising committee company required to secure adequate insurance to cover agreed insurable risks associated with the organisation and staging of the Games; and
- the organising committee company to ensure that any remaining surplus resulting from the Games is transferred to the Association after discharging all financial commitments and other obligations of the Federation as provided in the constitution of the Federation.



*Signing of the Host City contract.*  
(Photo courtesy of Melbourne 2006 Commonwealth Games Pty Ltd.)

**5.45** A separate endorsement contract was entered into between the State and the Australian Commonwealth Games Association (ACGA) in October 1996. In subsequent amendments made to the contract in July 1999 and November 1999, the Melbourne 2006 Commonwealth Games Pty Ltd became a party to the contract. The contract sets out the proposed arrangements for organising the Games and for a joint marketing campaign. Key obligations of the State include:

- The organising committee company to pay the ACGA \$30 million over 6 years in consideration for the ACGA surrendering its marketing and fundraising rights to the company and to assist the ACGA in preparing the Australian team for the 2006 Games. The first payment of \$5 million was made in July 2000; and
- A covenant to underwrite any shortfall between the revenue and expenditure of the organising committee company associated with the organisation of the Games.

**5.46** The organising committee company is currently in the process of reviewing its budget prior to submitting it for State Government approval.

*Funding of the former bid company and the organising committee company*

**5.47** In order to support the operations of the former bid company, Melbourne 2006 Commonwealth Games Bid Pty Ltd (which was specifically established to participate in the bidding process for the Games), in January 1997 the State agreed to finance its operations from the Consolidated Fund. The actual funding provided by the State to the former company until its wind-up totalled \$7.2 million. The net assets of this company, which totalled \$1.1 million, were transferred to Melbourne 2006 Commonwealth Games Pty Ltd in July 1999. Accordingly, the net cost to the State associated with attaining the right to stage the 2006 Commonwealth Games in Melbourne was \$6.1 million.

**5.48** In January 2000, Melbourne 2006 Commonwealth Games Pty Ltd (the organising committee company) entered into a funding arrangement with the State acting through the Department of Premier and Cabinet under which the State agreed to provide grants totalling \$6.6 million in the 1999-2000 financial year for the purpose of the organisation of the Games.

Melbourne World Masters Games 2002

**5.49** The World Masters Games is a sporting event held every 4 years to promote and encourage mature age individuals from all over the world to participate in a multi-national and multi-sport event, regardless of sporting ability, gender or race.

**5.50** The rights to the World Masters Games are owned by the International Masters Games Association (IMGA), the governing international body that awards the right to host the Games following an extensive bidding process every 4 years, similar to that adopted for awarding the Commonwealth and Olympic Games. Melbourne will be hosting the World Masters Games over 8 days commencing on 5 October 2002.

**5.51** In September 1997, the Melbourne Major Events Company Ltd prepared and submitted Melbourne's bid to the IMGA for hosting the 2002 Masters Games and subsequently in October 1997, IMGA announced that Melbourne was successful in its bid to host the Games.

**5.52** The State incurred expenditure of \$158 000 from the commencement of the bidding phase to the establishment of the Melbourne 2002 World Master Games Ltd (the organising company) in June 1998. The organising company's sole purpose is to organise and conduct the Games for the State of Victoria.

**5.53** To support the operations of the organising company, in January 1998 a grant from the Consolidated Fund of \$4.7 million was provided to the company to fund its operations over the next 6 years. **The State also agreed to indemnify IMGA against any liabilities arising from the State's bid or organisation of the Games**, with the exception of any liabilities arising from the negligence or wilful default by IMGA. **Furthermore, the State is to effect all necessary insurance to cover any risk related to the staging of the Games and its obligations towards IMGA.** The organising company has arranged for public liability and property insurance and is in the process of arranging an insurance package associated with hosting the Games. In addition to the \$4.7 million grant, \$300 000 will be sought from local government bodies who will host events in their respective municipalities and various State Government agencies such as the Victorian Health Promotion Foundation.

#### *Host City Contract*

**5.54** Under the Host City Contract entered into between the State Government and IMGA in February 1998, the State is required to underwrite any shortfalls between revenue and expenditure of the organising company until it is wound-down, which is envisaged to take place in February 2003, 4 months after the closing ceremony. In the event of a cash surplus generated by the Games, the State is required to pay to IMGA 25 per cent of such surplus within one month after all expenses associated with the Games have been fully paid, but in any event not later than 12 months after the closing of the Games. Upon wind-up of the organising company, all the remaining assets including rights assets will be transferred to the State.

**5.55** The original Host City Contract required that the State must use its best endeavours to have no less than 25 000 participants in the Games of which 50 per cent are to be international participants. The contract was revised in May 1999 to reduce the required base participation rate to 16 000 participants on the recommendation of the organising company. At the date of preparation of this Report, the organising company had received 10 000 expressions of interest (50 per cent from overseas countries) and were confident of exceeding the amended participation quota. This event compares with 4 000 participants estimated for the 2006 Commonwealth Games and the 10 500 participants for the recent Olympic Games held in Sydney.

**5.56** Under the Host City Contract, the organising company is entitled to:

- to use relevant logos and mascots but must ensure that the logo, artistic and intellectual works of the World Master Games, which remain the property of IMGA, are protected under the Copyright Act of Australia;
- retain 100 per cent of ticket sales revenues;
- retain 100 per cent of "net cash sponsorship income" under US \$1 million dollars and 50 per cent of any proceeds above the US \$1 million benchmark;
- retain 100 per cent of media and broadcasting fees from national coverage and 50 per cent of fees from international rights; and
- retain 100 per cent of participants' registration fees for the first 16 000 participants and US \$50 per participant, thereafter.

**5.57** Following execution of the Contract, the organising company paid IMGA US \$625 000 in full settlement for payment of the right to host the Games.

### *Economic impact on the State*

**5.58** In July 1997, a consultant was engaged by the Melbourne Major Events Company to assess the estimated net economic impact of staging the World Masters Games on the Victorian and Australian economy. **The consultants projected that the Games would increase the State's Gross State Product by around \$38.75 million and increase State taxation revenues by around \$1.88 million.** Further, the consultant's report identified that the hosting of the Games would enhance the State's reputation as a tourism destination and Melbourne's reputation as Australia's sporting capital. The hosting of the Games is expected to also provide the opportunity to "showcase" new facilities and establish new world class sporting facilities that will enable Melbourne to hold feature events without further major large sporting infrastructure requirements and development.

### *Financial projections*

**5.59** Based on revenue and expenditure projections included in the organising company's business plan, which assumed a base level of 16 000 competitors, it was estimated that hosting of the Games will require \$9.25 million of direct expenditure. The cost is projected to be funded by a \$4.7 million State Government grant, competitor fees of \$2.6 million, sponsorship of \$660 000, in-kind donations of \$600 000, and other income comprising of merchandising and ticket sales totalling \$700 000.

### Advertising services - Leeds Media

**5.60** In March 1993, Leeds Media and Communications Pty Ltd (Leeds Media) was awarded a 3 year Master Agency Media Service (MAMS) contract by the Government, which essentially required Leeds Media to provide all media agency advertising services for government departments and agencies. Public sector organisations in both the budget and non-budget sectors were instructed that it was compulsory to place all media advertising through Leeds Media.

**5.61** The Department of Premier and Cabinet was given the responsibility for managing the MAMS contractual arrangements under which the annual cost to the Government of producing advertisements and acquiring media space has been around \$65 million.

**5.62** Leeds Media has provided media services to the Government for the past 7 years under various contractual arrangements and contract extensions as outlined below:

<i>March 1993</i>	Leeds Media awarded a 3-year media-advertising contract
<i>August 1995</i>	Department initiated public tender process to establish new advertising contract
<i>October 1995</i>	Tender process delayed due to a need to clarify certain industry accreditation issues, with Leeds Media contract extended to September 1996
<i>July 1996</i>	Public tender process initiated for new contract
<i>August 1999</i>	Leeds Media was the successful tenderer and was awarded a further 3-year media-advertising contract
<i>September 1999</i>	Leeds Media contract extended to September 2000
<i>April 2000</i>	Public tender process initiated to establish a new contract but at the date of preparation of this Report this process had not been finalised

**5.63** Our Special Report No. 39, which was tabled in Parliament in March 1996, provided an analysis of the tender and probity procedures followed in respect of the awarding of the 1993 and 1996 contracts. The Report outlined a number of deficiencies in the process to support the awarding of the initial media agency service contract in 1993, including the following:

- Procedures followed for the selection and appointment of the successful tenderer were poorly documented;
- There was no evidence that certain criteria, which should have been major considerations in the selection process, were evaluated to ensure appropriate public sector accountability standards were met;
- While recognising that the procedures followed were aimed at expediency, the absence of a public tender for the appointment may have disadvantaged the Government in obtaining the best value-for-money and ensuring all prospective tenderers were treated equitably;
- A lack of “media” industry accreditation was noted as a factor against the appointment of one of the tenderers. However, the successful tenderer was also not accredited at the time of appointment; and
- Evaluation of tender submissions was undertaken solely by the former Director of Communications rather than by a selection panel. This situation led to accusations in Parliament of conflict of interest due to the Director’s previous working relationships with Leeds Media.

**5.64** Following the expiration of the initial contract with Leeds Media at the end of 1995, the Victorian Government Purchasing Board (VGPB) commenced the evaluation of tenders for media services for the Government. The significant matters identified by my Office in respect to the initial contract were largely addressed in the 1995 tender process. However, there were a number of matters that were still not addressed in the 1995 process, including the assessment of tenders against all relevant selection criteria.

**5.65** Due to an impending decision of the Australian Competition and Consumer Commission regarding media industry accreditation requirements, the finalisation of the tender process was deferred. In the meantime, the initial contract with Leeds Media was extended for a further 12 months to September 1996. The tendering process was recommenced in July 1996 with Leeds Media chosen as the preferred tenderer resulting in a new contract being entered into with Leeds Media in October 1996. This contract provided for a 3-year term which was due to expire in September 1999, with an option for VGPB to extend the contract for 2 further periods each of one year’s duration.

*Extension of contract in the 1999 year*

**5.66** In March 1999, the Department of Premier and Cabinet recommended that the VGPB extend the contract with Leeds Media for a period of one year to September 2000 on the following basis:

- *“A strong contractual relationship has been established between the Victorian Government and Leeds Media. The agreement has operated successfully and an independent audit [undertaken by the Department’s contracted internal audit service provider in conjunction with a private consultant] has confirmed that the contract has delivered a range of benefits including substantial cost savings, additional community services activity and campaign bonus activity;*

- “Feedback from users regarding Leeds’ service and the contract benefits has been positive and it would be counter productive to end the alliance at this time;
- “The implications of the Goods and Services Tax on the media industry will be better understood by the Victorian Government and the media in 12 months time ensuring a more robust tendering activity in 2000; and
- “The Department is currently undertaking a review of the reporting requirements in conjunction with Government agencies. Any improvements or alterations to the reporting mechanisms will be incorporated into the extended contract.”

**5.67** Subsequently, the VGPB accepted the Department’s recommendation and extended the contract for a period of one year expiring on 30 September 2000.

**5.68** Since the awarding of the initial contract in 1993, Leeds Media has held an “exclusive” agreement with the State for the supply of media agency services as required by departments and agencies. The Department of Premier and Cabinet estimates that during the years 1993 to 2000, Leeds Media has placed in excess of \$400 million in Government media advertising and other media-related business. The VGPB advised that similar exclusive master agency media service arrangements with a sole supplier are in place in every other State Government and the Commonwealth Government, given the benefits they deliver in terms of enhanced negotiating power and consequently reduced rates.

**5.69** In June 2000, the Victorian Government advertised its intention to seek public tenders for this contract and it is anticipated that the tender process will be completed and the successful tenderer announced by VGPB in November 2000.

#### *Annual customer survey*

**5.70** Leeds Media conducts an annual survey of its customers to identify levels of customer satisfaction with the results of these surveys forwarded to the Department for the purpose of monitoring the contractor’s performance. The annual survey reports for the 3 years to 1999 have assessed that the performance of Leeds Media is above average in respect to overall quality, however, there is scope for improvement in various areas including service range and delivery, communication with customers, invoicing and pricing, and promotion of available services. In addition, the surveys indicated that similar customer complaints appeared each year, without any apparent action by the contractor to resolve customer concerns.

**5.71** To effectively discharge its contract oversight and monitoring responsibilities, we believe that the Department should conduct its own surveys of departments and agencies to evaluate the contractor’s service delivery performance rather than rely on surveys initiated and managed by Leeds Media.



### *Assessment of contractor performance*

**5.72** In assessing the performance of Leeds Media for the purpose of extending the contract, the VGPB has relied on the following 3 reports prepared by private consulting firms:

- *Effectiveness review of MAMs service.* This report was prepared in April 2000 and focused on the type of services delivered under the contract;
- *Evaluation of savings and benefits arising from activities of the VGPB – 1998-99.* This report provided an analysis of cost savings identified in all contractual arrangements initiated by the VGPB in the 1998-99 financial year. The report highlighted activities undertaken by the VGPB in implementing a number of wide ranging reforms within the Department of Treasury and Finance ranging from tactical purchasing to strategic procurement; and
- *MAMs Contract – Internal Audit Report, 1997-98.* This report was prepared in April 1998 and focused on compliance issues associated with the contract with Leeds Media and identified a number of areas of non-compliance.

**5.73** However, these reports did not focus specifically on the performance of Leeds Media as a service provider.

**5.74** **The VGPB could not provide sufficient documentary evidence that a formal comprehensive evaluation of the performance of Leeds Media was undertaken prior to the decision to grant an extension of the contract.**

### Community Support Fund operations

**5.75** The *Gaming Machine Control Act 1991* provides for the establishment in the Public Account of a Trust Fund known as the Community Support Fund.

**5.76** The legislation requires 8.33 per cent of the total daily net cash balances (i.e. the total amount wagered less the sum of all prizes paid) derived from electronic gaming machines in hotels to be paid into the Consolidated Fund, and an equivalent amount transferred to the Fund by way of a standing appropriation. From 1 July 1998 and for each of the following 5 financial years, the amount to be transferred into the Fund is \$25 million less than amount previously payable under the above formula. In addition, there shall also be paid into the Fund interest derived from the investment of the balance of the Fund. The responsible Minister may apply money in the Fund towards the:

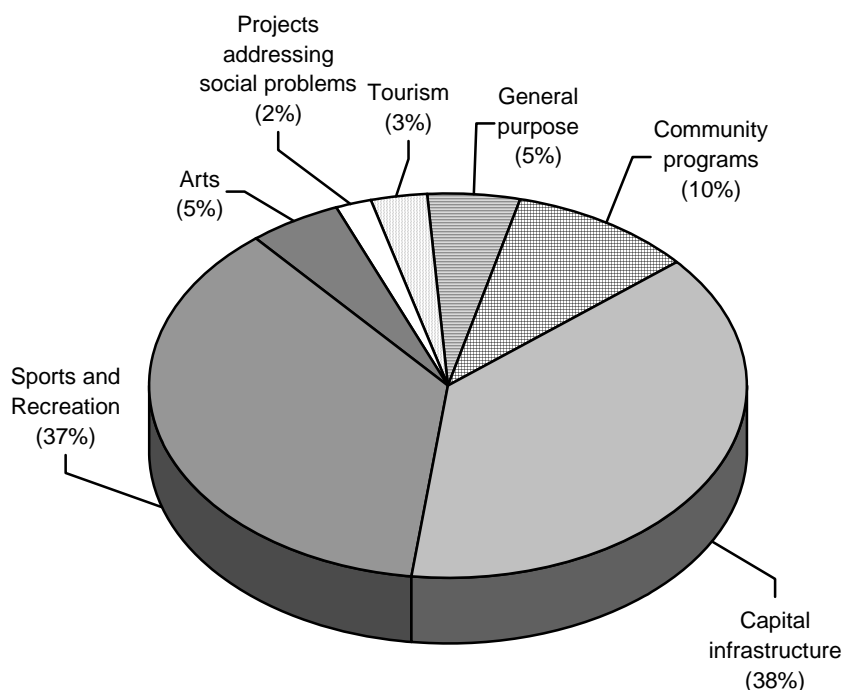
- activities of a gambling research panel;
- provision of programs including prevention of problem gambling, drug rehabilitation, families in crisis and the benefits of youth, and programs for the benefit of sports, arts and tourism; and
- costs incurred in administering and managing the Fund.

*Financial activities of the Fund*

**5.77** From the period since its establishment in 1992 to 30 June 2000, receipts into the Fund totalled \$555 million of which \$413 million has been expended. The balance held in the Fund at 30 June 2000 was \$142 million. The major recipients of funding have included the Melbourne Sports and Aquatic Centre (\$55 million), the Royal Park Hockey and Netball Centre (\$27 million), the Immigration Museum (\$21 million) and the Federation Square Development (\$20 million).

**5.78** During the 1999-2000 financial year, an amount of \$106.5 million was approved to fund various community programs and projects. As detailed in Chart 5H below, the majority of the Fund money approved for allocation during the 1999-2000 financial year was for capital infrastructure projects. Although around 2 per cent (\$2 million) was applied during the year to new projects addressing social problems such as family breakdowns, drug use and problem gambling, a number of previously funded multi-year programs were still in operation, including - *Problem Gambling Strategy 1999-2002* (\$21 million), *Turning the Tide Drug Strategy 1997-2001* (\$100 million) and *Community Education on Problem Gambling 1999-2000* (\$5 million).

**CHART 5E  
COMMUNITY SUPPORT FUND GRANT APPROVALS (BY CATEGORY)  
1999-2000 FINANCIAL YEAR**



Source: Department of Premier and Cabinet, Annual Report, 1999-2000.

**5.79** In recent years, amounts approved and expended from the Fund have focused on major infrastructure projects, while the key purpose of the Fund was to prevent and treat gambling-related problems. A review undertaken by the Department in July 2000 found that although around 40 per cent of all grants approved from the Fund have been allocated to drug and gambling-related programs and youth and family services the projects funded have not been directed towards addressing the causes of the disadvantaged or prevention of gambling problems. The balance of the approvals were directed to community advancement programs for sport and recreation, arts, tourism and other purposes as determined by the Government.

*New guidelines for the operations of the Fund*

**5.80** In June 2000, the Premier approved new guidelines for the future operations of the Fund and, at that time, indicated that the Fund would promote responsible gambling (with an increased emphasis on prevention), provide more funds towards problem gambling services including research, and provide funding for programs of broader community benefit such as sport and the arts.

**5.81** A key element of the new guidelines is a revised set of criteria upon which applications for funding from the Fund are to be assessed. In revising the criteria, the Government has indicated that a greater proportion of Fund moneys will be directed towards researching the causes of problem gambling. In addition, an emphasis has been placed on developing projects which bring together various sectors of the community and promote the building of stronger community partnerships particularly in the areas of socio-economic disadvantage.

**5.82** The revised guidelines apply to applications approved on or after 1 July 2000. At the date of preparation of this Report, the Fund was refining its assessment and monitoring procedures to conform with the revised guidelines and it was anticipated that these processes would be fully implemented by July 2001.

*Approval and monitoring framework*

**5.83** Under the arrangements established for the operation of the Fund, senior staff of the Department are responsible for the initial assessment of all applications for grant funding which culminates in a written recommendation to the Community Support Fund Committee of Cabinet chaired by the Premier for final approval. The Premier has policy responsibility for the Fund and associated decisions relating to the allocation of expenditure from the Fund.

**5.84** In July 2000, the Government established the Community Support Fund Community Advisory Council which consists of 9 community representatives with broad and diverse backgrounds, including ethnic, community, welfare, sport, tourism, arts, local government and private sector. The Council's function is to advise Government on various aspects of the Fund's operations to ensure that it stays in touch with community needs, is transparent in its operations and maintains a balanced approach to funding.

*Audit review of assessment files*

**5.85** A review of assessment files of a selection of grants and projects approved in the 1999-2000 financial year disclosed that 6 approved projects, including \$27 million to fund the construction of the State Hockey and Netball Centre, and \$20 million to partly fund the Federation Square Project, did not meet a desirable funding criteria relating to projects having significant non-government financial support.

**5.86** Given the above observations, we support the recent initiatives to strengthen the monitoring and assessment framework associated with the Fund's operations.

## **Part 6**

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# **State assets**

## SUMMARY OF STATE ASSETS

**6.1** The State's assets comprise physical assets (including Crown and freehold land, buildings, plant and equipment, roads and other infrastructure), investments, receivables and cash at bank. These assets, together with the resources provided by employees and other service providers, are available for application towards the provision of services and the delivery of programs.

**6.2** The Government's Annual Financial Statement discloses that, at 30 June 2000, assets with an aggregate value of \$82.9 billion, were controlled by the Government - an increase of \$4.1 billion on the previous year. The major factors contributing to the improved reported asset position were:

the re-valuation of physical assets across all sectors, contributing to an increase in the gross value of these assets of \$2.3 billion;

construction and acquisition of physical assets during the year, which were largely offset by the sale of the rolling stock infrastructure of the transport passenger businesses to private sector franchisees; and

increased investment holdings of \$1.8 billion reflecting the additional funds available resulting from the year's operating surplus.

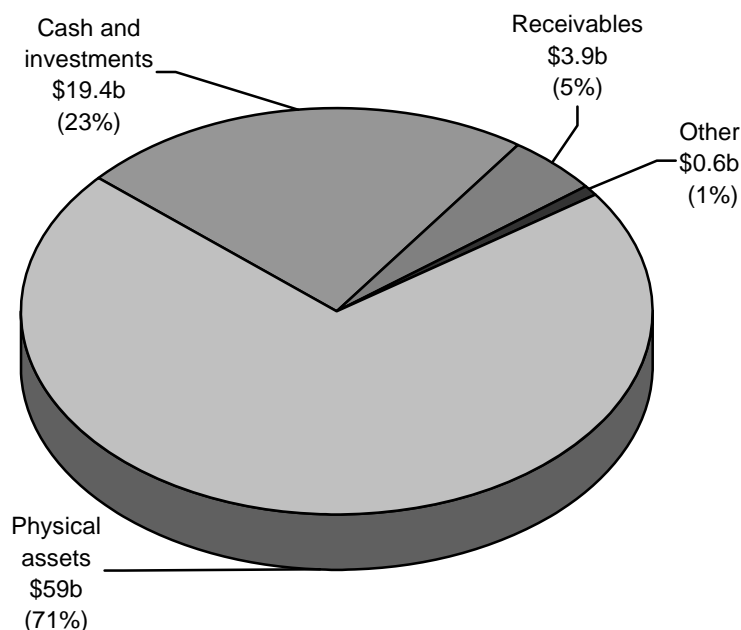
**6.3** Table 6A presents a summary of the assets controlled by the Government as at 30 June 2000.

**TABLE 6A**  
**SUMMARY OF STATE ASSETS**  
((\$billion))

<i>Type of assets</i>	<i>1999-00</i>	<i>1998-99</i>
Physical assets -		
Land and buildings	<b>26.3</b>	24.3
Plant, equipment and infrastructure systems	<b>19.0</b>	19.3
Roads and earthworks	<b>12.0</b>	11.3
Other	<b>1.7</b>	1.7
	<b>59.0</b>	56.6
Financial and other non-physical assets	<b>23.9</b>	22.2
<b>Total State assets</b>	<b>82.9</b>	78.8

**6.4** Physical assets represent by far the largest asset category, accounting for around 71 per cent of total assets. Chart 6B further illustrates the major components of the State's assets.

**CHART 6B  
COMPOSITION OF STATE ASSETS  
(\$billion)**



### Physical assets

**6.5** The State's physical assets mainly comprise Crown and freehold land, buildings, roads, infrastructure systems, and other plant and equipment. While the general government and public trading enterprises sectors are responsible for the control and management of the vast majority of land and buildings, the majority of plant, equipment and infrastructure assets are held by the public trading enterprises sector, reflecting their role in providing key services to the community, including water and health services.

**6.6** The enhanced management of these resources has been a major focus of government reforms over many years, upon which comment has been made in my previous Reports to the Parliament.

**6.7** Certain assets of the State continue to remain unrecognised in the State's Balance Sheet, mainly including the State's share of assets and liabilities managed by the Murray-Darling Basin Commission, and land associated with the State's road network. Comment on this matter is included in Part 2 of this Report.

### Financial and other non-physical assets

**6.8** Financial assets included in the Government's Annual Financial Statement can be broadly described as those assets that can be 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, receivables from external parties, and cash and deposit balances.

**6.9** The financial and other non-physical asset holdings of the public sector at 30 June 2000 stood at \$23.9 billion - an increase of around \$1.7 billion on the previous financial year. Table 6C shows the composition of these balances as at 30 June 2000.

**TABLE 6C**  
**FINANCIAL AND OTHER NON-**  
**PHYSICAL ASSETS OF THE STATE**  
((\$billion))

<i>Type</i>	<i>1999-00</i>	<i>1998-99</i>
Investments	<b>18.2</b>	16.3
Receivables	<b>3.9</b>	4.0
Cash	<b>1.2</b>	1.3
Other assets	<b>0.6</b>	0.6
<b>Total State assets (a)</b>	<b>23.9</b>	<b>22.2</b>

(a) The total balances are presented net of inter-entity eliminations, i.e. after deducting amounts relating to other public sector agencies.

**6.10** As previously commented on in this Part of the Report, the increase during the financial year in the level of the State's financial assets mainly reflects the additional funds available resulting from the 1999-2000 financial year's operating surplus.

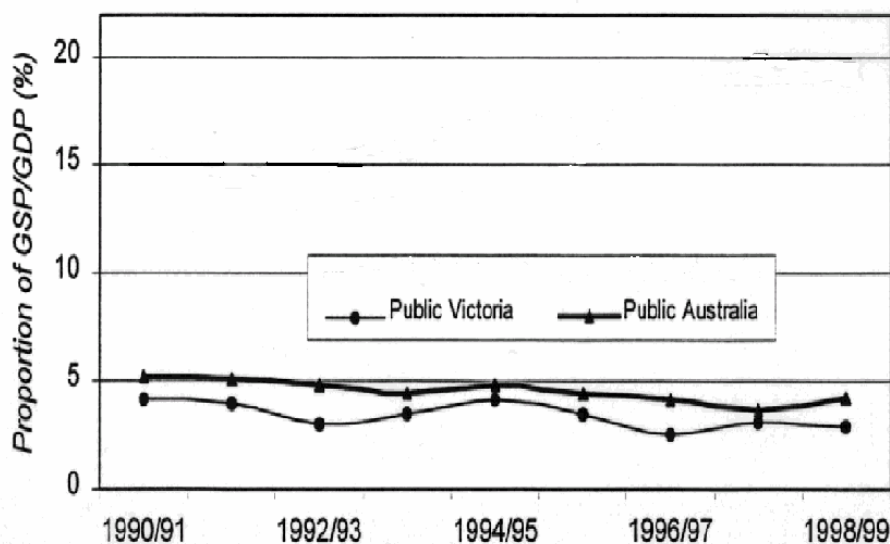
**6.11** The State's cash and investment holdings increased from \$17.6 billion to \$19.4 billion with a net amount of \$3.9 billion held by the Treasury Corporation of Victoria, which is available for application towards the retirement of debt as it matures and for meeting the State's prudential liquidity requirements. A further amount of \$1 billion has been set aside for infrastructure investment over future years under the Government's "Growing Victoria" initiative.

### Infrastructure development

**6.12** As illustrated in Chart 6D, the State's investment levels in public infrastructure have been consistently below the national average over the past decade.



**CHART 6D**  
**PUBLIC CAPITAL SPENDING AS A PROPORTION OF GROSS STATE PRODUCT (GSP) /**  
**GROSS DOMESTIC PRODUCT (GDP) – VICTORIA AND AUSTRALIA**  
(per cent)



Source: Department of Infrastructure. Based on source date compiled by the Australian Bureau of Statistics.

**6.13** One of the long-term financial objectives of the Government, which in part aims to address this trend, is to undertake capital works to enhance social and economic infrastructure throughout Victoria. A short-term initiative to improve the State's infrastructure asset base, without incurring additional borrowings, has been the establishment of a \$1 billion "Growing Victoria" infrastructure reserve, funded through the 1999-2000 budget surplus.

#### *"Growing Victoria" Reserve*

**6.14** The key purpose of the Government's "Growing Victoria" initiative is to increase budget sector asset investment expenditure with the aim of contributing to an improved and modern State infrastructure. The \$1 billion allocated for this purpose is expected to be utilised to support asset investment expenditure totalling around \$64 million in 2000-2001 and a projected \$312 million per annum over the 3 year period to 2003-2004.

**6.15** Eligible projects for funding under this initiative include:

- major transport infrastructure projects;
- modernisation and replacement programs in the education sector; and
- information and communications technology facilities and capabilities.

**6.16** The 2000-2001 Budget Papers indicated that \$190 million had been allocated over the next 3 financial years to fund school modernisation and rail infrastructure projects.

**6.17** Allocation of the balance of the funding relating to "Growing Victoria" will be approved as part of the Government's annual budget process.

*Regional Infrastructure Development Fund*

**6.18** In addition to the "Growing Victoria" initiative, in December 1999, the Regional Infrastructure Development Fund was established as a Trust Fund within the Public Account under the authority of the *Regional Infrastructure Development Fund Act 1999*. The Fund is administered by the Department of State and Regional Development.

**6.19** The Fund has been established to provide \$170 million over the next 3 financial years (\$50 million in 2000-2001, \$50 million in 2001-2002 and a further \$70 million in 2002-2003) towards infrastructure developments in regional communities, including:

- industry development, including physical works to facilitate economic development;
- transport improvements, including roads, rail, ports or airports of strategic regional significance;
- tourism-related capital works for new and improved facilities; and
- strategic education, and information and communication technologies infrastructure.

**6.20** As at June 2000, the Department of State and Regional Development had approved only one project for funding under this program (cattle underpass initiative which is to receive \$4 million) from approximately 100 applications received at that time. (At the date of preparation of this Report the Department was in the process of assessing a further 50 applications for funding.)

*Partnership Victoria*

**6.21** In recognition of the contribution that the private sector has made to date to the development of public sector infrastructure, in June 2000, the Government announced the Partnership Victoria policy. This policy applies to the provision of public infrastructure and any related ancillary services which involve private investment or financing, under which the present value of government payments is in excess of \$10 million over the period of the partnership.

**6.22** At the date of preparation of this Report, the Government was in the process of developing detailed guidelines and documentation to support implementation of this new policy framework. **Collectively, these infrastructure initiatives are designed to assist in improving the State's infrastructure so as to enhance service delivery and the State's competitiveness.**

## GOVERNMENT ASSET SALES PROGRAM

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**6.23** In recent years, a major component of the public sector reform program has been the privatisation of government business enterprises and the sale of surplus and underutilised properties. The application of privatisation proceeds towards the reduction of State debt has been a major factor contributing to the strengthening of the State's financial position.

**6.24** This Part of the Report outlines the major business and property sales undertaken or completed by the Government during the 1999-2000 financial year and up to the date of preparation of this Report including:

- Public passenger transport businesses;
- Residual assets of the Public Transport Corporation;
- Bourke Street, Melbourne property;
- Baryn Street, Heatherton property; and
- Todd Road, Port Melbourne property.

### Public transport passenger rail privatisation

**6.25** My June 2000 *Report on Ministerial Portfolios* commented on key developments associated with the public transport reform program of the former Government, including a detailed analysis of the privatisation of certain assets and liabilities of the passenger transport businesses (the former business units of the Public Transport Corporation) and related franchising arrangements. Below is a summary of these arrangements, which were outlined in detail in that Report.

#### *Sale process and arrangements*

**6.26** Following an extensive bid and selection process, which was administered by the former Transport Reform Unit of the Department of Treasury and Finance, in June 1999 the Public Transport Cabinet Committee accepted the recommendations of the evaluation teams established to assess the bids (comprising representatives from the Departments of Treasury and Finance and Infrastructure, financial and engineering advisers), with the exception of Hillside Trains. The bidders for Hillside Trains were requested to re-submit their bid in early July 1999 to address particular areas of concern and having regard to the more favourable results achieved by the State for the other rail passenger businesses. Shortly after, the Committee also approved the bid relating to Hillside Trains.

**6.27** Under the sale arrangements of the 5 passenger transport businesses to the 3 separate franchisees, the State received a nominal consideration of \$3 for the transfer of the rail businesses' net assets, which mainly comprised rolling stock and plant and equipment, to the franchisees. As a result, an abnormal loss of \$665 million for the sale of the net assets of the businesses was reported in the State's operating statement. The sale arrangements excluded the software and equipment associated with the automated ticketing system. This is operated by OneLink Transit System Pty Ltd (OneLink). **Although the State only received a nominal consideration for the transfer of these net assets, the State nevertheless received a right to receive future services from each franchisee at a reduced subsidy payment from the State.**

*Franchise arrangements*

**6.28** The Director of Public Transport of the Department of Infrastructure entered into agreements with each franchisee for the purchase of passenger services, over a franchise period of between 10 to 15 years. Under these agreements, the franchisees are required to meet minimum operational requirements such as the minimisation of overcrowding, safety standards and adequate levels of maintenance of the rolling stock units and infrastructure. In addition, the franchisees will be required to maintain the number of train and tram annual kilometres travelled at a level of at least that existing at the commencement of the franchise period, and introduce additional services during the franchise period.

*Subsidy payments to franchisees*

**6.29** As the projected revenues from the sale of fares will be insufficient, particularly in the initial stages of the franchise periods, to operate the public transport businesses the State has agreed to provide a number of subsidies to the franchisees. **Over the franchise period it is anticipated that the State will provide subsidies to the franchisees with an aggregate value of \$2.8 billion in net present value terms, comprising fixed subsidies of \$1.9 billion and variable subsidy payments of \$934 million, with the latter including concession fare top-up payments of \$501 million.**

**6.30** Table 6E outlines the major components of the fixed subsidy amounts payable by the State to the franchisees over the franchise periods. The **real annual franchise sum** represents the core subsidy paid by the State to the franchisees and is subject to certain adjustments which are outlined in my June 2000 *Report on Ministerial Portfolios*. As part of the subsidy arrangements, the State has also agreed to make:

- rolling stock adjustment payments** to the franchisees in order to fund the lease costs incurred by each franchisee for the procurement of new rolling stock;
- refurbishment rolling stock payments** which are equivalent to more than 90 per cent of the cost to be incurred by the franchisees based in the metropolitan area for the refurbishment of the existing (Comeng trains) rolling stock; and
- other **mandated work payments**, representing specified amounts to be paid for other required works on the franchisees' existing rolling stock and the State-owned infrastructure.

**TABLE 6E**  
**TOTAL FIXED SUBSIDY PAYMENTS UNDER THE**  
**FRANCHISE ARRANGEMENTS (a)**  
(\$million)

<i>Component</i>	<i>Amount</i>
Annual franchise payments (b)	923.6
Rolling stock adjustment payments (c)	801.9
Capital grants - infrastructure lease	136.2
Capital grants – franchise agreement (d)	70.8
Core infrastructure lease rental (e)	(2.4)
Non-core infrastructure lease rentals (e)	(58.0)
<b>Net cost to the State</b>	<b>1 872.1</b>

(a) All amounts expressed in net present value terms as at 30 June 1999, using a discount rate of 4.5 per cent which was the rate used by the Department of Treasury and Finance for the assessment of bids.

(b) The real annual franchise sum will be subject to movements in the CPI and has been based on the assumption that fares will increase by 5 per cent, in real terms, to take into account the introduction of the GST.

(c) The rolling stock adjustment payment to the franchisee of Hillside Trains will be subject to the impact of the GST (capped at 5 per cent) and movements in the CPI.

(d) Capital grants under the franchise agreements payable to the franchisees of Bayside Trains, Swanston Trams and Yarra Trams will be subject to the impact of the GST (capped at 5 per cent) and the payments to the latter will also be subject to movements in the CPI. These payments include works valued up to \$38 million and will be undertaken in the event that feasibility studies prove that the proposed works will generate a commercial rate of return.

(e) Represents rental payments for the use of the core infrastructure such as the track and signalling equipment and non-core infrastructure such as certain depots and buildings.

Source: Department of Treasury and Finance.

**6.31** In return for these fixed subsidy payments from the State, the franchisees have broadly accepted the financial risks associated with the day-to-day operations of the franchise businesses, including expenditure in excess of the costs of operating each franchise. However, this risk is to an extent mitigated by the fact that the Director has retained the financial risk associated with movements in the CPI and his obligation to fund any change to the scope of operations.

#### *Rolling stock units*

**6.32** Under the franchise arrangements, the train franchisees have agreed to refurbish a specified number of rolling stock units by December 2003, which they acquired under the abovementioned sale arrangements for a nominal amount. The Director has agreed to provide fixed subsidy payments totalling \$104 million in net present value terms, to the franchisees for this purpose. **The franchisees bear the risk of any overruns in refurbishment costs and penalties may be imposed by the Director for any failure of franchises to complete agreed refurbishment works.**



*Example of tram rolling stock sold to franchisees.*

**6.33** In addition, the franchisees are required to provide, on terms approved by the Director, a specified number of new rolling stock units (committed rolling stock) and take possession of these units so that they are in regular service by September 2004 (trams) and December 2004 (trains). The estimated acquisition price of the new rolling stock units will be in excess of \$1.09 billion.

**6.34** The franchisees have provided the State with additional performance bonds totalling \$60 million to ensure compliance with their obligation to bring into regular service the committed rolling stock. These performance bonds will be extinguished once the acquisition and associated funding arrangements, and other direct agreements with the Director of Public Transport, for the committed rolling stock are finalised. Consistent with the security arrangements established in relation to existing rolling stock, the lessors are required to provide a security interest in favour of the Director over the committed rolling stock.

**6.35** The Director has the power to impose significant penalties on franchisees in the event that the committed or option rolling stock is not in regular service by the required dates. If the stock is not introduced within 12 months of the required date, then this will constitute a franchise breach and a termination event.

**6.36** Under the arrangements, the key risks associated with the procurement and delivery of the committed rolling stock units have been effectively transferred to the franchisees. These risks relate to the franchisees' responsibility to procure and commission the units by specified timeframes, consistent with projected costs. In addition, the lessors of the committed rolling stock units have accepted the following key risks associated with the construction and ongoing ownership of the units:

**Risk of movements in the cost of financing the purchase price of the units;**

**Risk of movements in the value of currencies, as certain units or components thereof may be purchased from non-Australian sources; and**

The residual risk of the units at the end of the lease period. The Department of Treasury and Finance advised that certain franchisees have purchased insurance to mitigate this risk.

**6.37** To protect the State's interest in respect of the committed rolling stock units, the Director has provided an undertaking to the lessor that the State will ultimately be responsible for the minimum lease payments for the units over the entire lease period which ranges up to 15 years for units which have estimated useful lives of 30 years. Therefore, in the event of early termination of the franchise arrangements where the Director is unable to procure a successor franchisee to perform the required obligations to the relevant lessor, the Director may be required to directly fund the minimum lease payments.

**6.38** As a result of this obligation, the Annual Financial Statement and the financial statements of the Department of Infrastructure recognise a contingent liability associated with the remote possibility of the Director being required to meet these lease payments.

#### *Overall assessment of arrangements*

**6.39** In summary, under the arrangements, the State has retained ownership of the infrastructure associated with the public transport train and tram network, except the rolling stock, and has transferred the responsibility for the day-to-day management and operation of the network, including its ongoing maintenance to the franchisees in accordance with documented mandatory performance guides, over the contracted term of each franchise. To ensure the maintenance of appropriate operating capacity, the franchisees have agreed to procure and commission a specified number of new rolling stock units and to perform various works such as the refurbishment of the existing units and the upgrade of the infrastructure.

**6.40** The aggregate cost to the State for the delivery of these services by the franchisees over the next 15 years, in net present value terms, will be around \$2.8 billion. This level of subsidy has been impacted by the transfer and sale of the existing rolling stock units which had a book value of \$663 million to the franchisees for a nominal consideration, which is reflected in the reduced level of subsidy.

#### Residual assets of the Public Transport Corporation

**6.41** As part of public transport reform program, the Public Transport Corporation has been actively seeking to dispose of residual public transport assets which are no longer required. This activity resulted in the sale of a number of workshops and other facilities. While the Preston Workshops were included in the sale process they did not attract satisfactory bids and, at the date of preparation of this Report, remained unsold.

*Overview of sale processes*

**6.42** The workshops and the multi-user service facilities that were offered for sale or lease provided a variety of maintenance and repair services to the metropolitan train and tram network, and the rural passenger and freight rail network. The sale of the facilities, which were located in both Melbourne and regional centres, broadly included plant and equipment, land and buildings, existing service contracts, including vehicle maintenance agreements and mechanised infrastructure maintenance agreements with the public transport businesses, together with guaranteed minimum workloads to ensure the short-term viability of the facilities. Where land and buildings were specifically excluded from the sale, these were available for lease to the successful tenderer.

**6.43** The State's specific objectives relating to these sale of these residual assets were to:

- maximize the value realised by the State from the sale of each facility;
- provide improvements to, and continuity of, the services to the public transport businesses;
- provide continuing employment with comparable conditions to the maximum number of staff; and
- in the case of the Ballarat Workshops, to realise a long-term commitment to develop the business through diversification.

**6.44** In December 1998, the Transport Reform Unit of the Department of Treasury and Finance offered these assets for sale or lease, calling for registrations of expressions of interest to purchase the workshops, maintenance operations and multi-user facilities and in March 1999 proceeded to issue tender documentation to the pre-registered bidders. This process had 3 stages: expressions of interest; the receipt and evaluation of indicative bids; and assessment of final binding bids.

**6.45** The indicative and final bids were assessed against the following key criteria:

- the net present value of the sale proceeds and other related cash flows to the State;
- the bidders' ability to operate and manage the business, including the bidders' understanding of the obligations to maintain the rolling stock and infrastructure assets of the public transport businesses;
- the bidders' commitment to renewing the current service contracts;
- the number of employees to be transferred with each facility; and
- the extent of any risk transferred to the State, having regard to the State's ongoing exposure to residual risks and liabilities associated with the facilities.

**6.46** At the end of July 1999, final bids were received and evaluated by the Transport Reform Unit which ultimately resulted in the sale of :

- Ballarat Workshop;
- Mechanised Track Maintenance and Audit Facility;
- Bendigo Locomotive Depot;
- Newport Workshop;
- Geelong Locomotive and Maintenance Facility; and
- Scientific Services Facilities and Training Facilities.



**6.47** In August 1999, a probity auditor appointed by the Transport Reform Unit to oversee the bid selection and evaluation process for the sale of the residual assets reported that there were no issues of probity outstanding associated with the disposal of the residual assets of the Public Transport Corporation.



*Newport Workshop.*

### *Sales arrangements and results*

**6.48** Under the sale arrangements for the residual assets between the Public Transport Corporation and the approved bidders the key obligations of the respective parties were as follows:

each employment offer made by a purchaser to the existing employees was for terms and conditions no less favourable than the terms and conditions which the nominated employee received prior to the completion date;

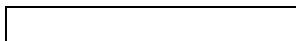
the purchasers agreed to reimburse the State agreed sums if they engaged a former employee who within a period of 12 months prior to the sale completion date received a redundancy payment from the State;

from the date of sale completion, the purchasers were required to assume responsibility for the performance of specified contracts and provide an indemnity to the State against all liabilities emanating from any breach or failure by the purchaser to fulfil any such contract;

the purchasers agreed that they were not entitled to make any claim for any breach of any representation, warranty or obligation until the total of such claims exceeded \$50 000; and

where a claim is made against the Public Transport Corporation and within 12 months of the sale completion date, the liability of the State is limited to specified amounts which range up to a maximum of \$1 million.

**6.49** Under the sales agreements, the State received net sale proceeds of \$9.7 million for the sale of these residual assets, some \$11.9 million less than their book value.



#### Baryn Street, Heatherton property

**6.50** Our 1998-99 *Report on Victorian Government Finances* commented on the sale of the former Heatherton Hospital site and part of the Kingston Centre site, as part of a government reform program to transfer the delivery of health services from institutional-based bodies to community-based settings.

**6.51** Following these sales, a site totalling 40.2 hectares, which formed part of the former Heatherton Hospital, remained in State ownership. This site included an area of native growth which was considered worthy of preservation.

**6.52** In March 1999, the Kingston Heath Golf Club submitted an offer to the Department of Treasury and Finance to purchase an additional 8.54 hectares of land located at Baryn Street, Heatherton for \$6.4 million. The offer price was based on a valuation obtained by the Golf Club.

**6.53** As a result of the valued area of native growth on the site, effectively restricting any other form of development, the Minister for Finance agreed not to offer the sale of the site to the public and to negotiate directly with the Kingston Heath Golf Club.

**6.54** In March 1999 valuations were obtained from the Valuer-General and an independent valuer for this area. The valuations ranged from \$6.5 million to \$6.8 million and the valuers concluded that the highest and best use of the site would be as a residential subdivision if the adjoining Golf Club did not purchase the property. After taking all factors into account, the Valuer-General considered the proposed offer as not unreasonable and recommended that it should be accepted. The Minister for Finance subsequently accepted the offer and approved the sale of the site to the Kingston Heath Golf Club for \$6.4 million.

**6.55** Subsequently, as part of the intended sale arrangements the Minister for Finance approved the purchase of a 3 187 square metre site from the Kingston Heath Golf Club for \$239 000, for future disposal by the State following its re-zoning to residential purposes. The purchase price was equivalent (on a per square metre basis) to the price offered by the Golf Club for the acquisition of the site at Baryn Street, Heatherton.

**6.56** In accordance with the terms of these arrangements, a deposit of \$616 000 was paid into the Consolidated Fund in July 1999 and the net balance of \$5.54 million was paid in October 1999. The land transferred to the Kingston Heath Golf Club will be restricted for golf course use only for a period of 3 years from the date of settlement.

#### Bourke Street, Melbourne property

**6.57** A property located on the south-eastern corner of Bourke Street and King Street was declared surplus to the Government's requirements in July 1998. The property, comprising a 10 storey commercial office building and basement car parking, covered a total area of around 8 300 square metres. The property, which accommodated the Enforcement Management Unit of the Department of Justice and the Traffic Camera Office of the Office of the Chief Commissioner of Police, no longer met current building codes and regulations.

**6.58** Prior to the commencement of the marketing of the property, in February 1999 the Department of Treasury and Finance received a valuation from the Valuer-General which estimated the value of the property at \$5.2 million. A private valuation obtained at the same time indicated a lower value of \$4.5 million. Overall, the valuers agreed that interest in the property would be minimal as it was located at the western end of the Melbourne Central Business District and it was being offered for sale on the basis of vacant possession.

**6.59** At that time, the Department of Treasury and Finance was advised by consultants that the buildings contained minor levels of asbestos and that the estimated cost of removing the asbestos would be around \$600 000.

**6.60** In February 1999, the Department received only one expression of interest for the purchase of the property. Subsequently, 2 offers were received in March 1999 from one interested party. The first offer of \$4.6 million conformed with the Department's tender requirements and was unconditional. The second offer was set at a higher purchase price of \$5.2 million but was conditional on a delayed interest-free settlement period.

**6.61** Following further negotiations between the Department and the interested party, in April 1999 the Minister for Finance approved the sale of the property for \$5.3 million and agreed to an extended settlement period.



*601 Bourke Street. Melbourne.*

*Key terms of the sale*

**6.62** The Minister for Finance and the purchaser immediately entered into a contract of sale, with a deposit of \$1.06 million paid into the Consolidated Fund in April 1999 and the balance of \$4.24 million paid at settlement, in April 2000. The key terms of the sale agreement included:

the purchaser was exempted from the payment of stamp duty (which would have been equivalent to \$291 500); and

the purchaser will be required to retain a camera on the building, which belongs to VicRoads and is used for traffic management purposes.

**6.63** Our analysis of the sale result shows that the net proceeds from the sale of the property, after taking into account costs of sale of \$57 000, were \$5.24 million and the purchase price were consistent with the valuations received by the Department of Treasury and Finance and the recorded book value of the property.

Todd Road, Port Melbourne property

**6.64** A former tip site of the City of Port Phillip which was situated on Crown land at Todd Road, Port Melbourne ceased operations in the early 1990s. This site was originally a quarry for sand extraction and has been operating as a waste disposal facility for both industrial and domestic refuse since the early 1930's. The 6.9 hectare site which also has frontage on to Williamstown Road is encumbered by a series of easements affecting around 25 per cent of the site.

**6.65** Following the declaration of the site as surplus to the Government's requirements by the Minister for Finance, in June 1998 the Department of Treasury and Finance sought expressions of interest in the site's sale and in the following month received 6 conditional bids. The Department proceeded to short-list 2 bids and entered into private treaty negotiations with the relevant parties.

**6.66** Prior to the assessment of the final bids, in June 1998 the Department of Treasury and Finance commissioned 2 valuations of the site, including one by the Valuer-General. The Valuer-General estimated the market price of the site at \$4 million and a private valuer provided an estimate of \$4.1 million. Both valuers concurred that the valuation of the site was discounted by approximately 15 to 20 per cent due to the site's heavy easement restrictions and the level of site contamination requiring special design elements and compliance with long-term safety protocols.

**6.67** Following the completion of negotiations, in December 1998 the Minister for Finance approved sale of the site to the Melbourne Grammar School for a purchase price of \$4.3 million which was consistent with the valuations obtained for the site. However, the sale was conditional upon an environmental assessment of the site and the provision of relevant town planning approval for the development of the site for the purpose of playing fields and associated sporting facilities.

**6.68** In October 1998, the Department of Treasury and Finance and the Melbourne Grammar School jointly engaged an independent environmental consultant to assess the suitability of the land given its past use by the City of Port Phillip and the proposed usage of the site. As a result of these investigations, the environmental consultant concluded that the groundwater at the site was contaminated with heavy metals and other pollutants. Nevertheless, the consultant concluded that the environmental condition of the site was suitable for the open space and recreational purposes planned by the Melbourne Grammar School through the application of certain design, construction and management controls.

**6.69** In November 1999, consistent with the recommendations of the environmental consultant, the Melbourne Grammar School agreed to acquire the site. The City of Port Phillip issued a planning permit for the development of the site to the School in February 2000.

**6.70** The Melbourne Grammar School paid a deposit of \$42 600 into the Consolidated Fund in June 1998 and the balance of \$4.2 million in February 2000. The key terms of the sale contract are outlined below:

- from the date of settlement, the purchaser assumed all risks of ownership, including any loss or damage to any person, corporation or property through the use of the site, site improvements or the presence of any site contaminants;
- the State is not required to undertake any site remediation activities; and
- the State provided no assurance that the site would be suitable for the construction of any improvements.

### Redevelopment of the State Netball and Hockey Centre

**6.71** The Office of Major Projects in association with the Department of State and Regional Development, is in the process of redeveloping the existing State Netball Centre and State Hockey Centre facilities on an elevated area west of Royal Park adjacent to the Melbourne Zoo, into a combined State Netball and Hockey Centre. The Centre will include 5 indoor netball courts with seating for up to 3 000 spectators, 4 outdoor netball courts, an upgrade of the existing hockey pitch, the development of a second pitch and a grandstand with fixed undercover seating for 1 000 spectators. It will also include sports offices, a gymnasium, function rooms and café, bar and retail facilities.

**6.72** The key development objectives of the Centre are:

- provision of player, administrative and spectator facilities that can support local, State, national and international fixtures for both netball and hockey;
- increased use of the complex compared with current facilities including those of other compatible sporting codes;
- support for Melbourne's bid for the 2006 Commonwealth Games with the provision of netball and hockey facilities that can easily be adapted or upgraded for Commonwealth Games use; and
- a complex that will operate on a financially sound basis in accordance with a business plan that seeks to maximise operational efficiencies and opportunities.

**6.73** The Centre is a project nominated under the *Project Development and Construction Management Act 1994* with the Secretary of the Department of Infrastructure nominated as the facilitating “agency”. The facilitating agency has the ability to enter into contracts and agreements and other arrangements with any person for the purposes of the nominated project. The principal purpose of nominating projects under the Act is to facilitate the development of projects that are significant to the State.

**6.74** As a result of amendments to the *Project Development and Construction Management Act 1994*, currently before the Parliament, the functions of the Office of Major Projects are proposed to be transferred from the Department of Infrastructure to the Department of State and Regional Development effective from 1 January, 2001.

**6.75** The overall operational management responsibility for the new Centre is to be undertaken by the State Sport Centres Trust (formerly, the Melbourne Sports and Aquatic Centre Trust).

*Feasibility study for the construction of a State Netball  
and Hockey Centre and its funding*

**6.76** A Royal Park Master Plan was prepared by the City of Melbourne in 1996, which incorporated a proposed new integrated State Netball and Hockey Centre, and detailed the submission and consultation process to be followed prior to the Master Plan being endorsed.

**6.77** Following the public release of the Master Plan, the Department of State and Regional Development engaged an external consultant in March 1997 to conceptualise the redevelopment of the State Netball and Hockey Centre followed by a feasibility study in August 1997. The feasibility study highlighted a number of deficiencies with the present netball and hockey facilities at Royal Park, including amenities for players and spectators and the overall ability of the respective associations to attract major events with the existing facilities.

**6.78** The Melbourne City Council endorsed the Royal Park Master Plan in November 1997 following a 4 month consultation period involving various stakeholders included residents, the Melbourne Zoo and interest groups. The endorsed Master Plan included the redevelopment of the existing State Netball Centre and State Hockey Centre into a combined Centre similar in location and nature to the current development.

**6.79** The feasibility study estimated the total redesign cost to be \$23.8 million for the redevelopment of the Centre. Subsequently, a cost review was undertaken at the request of the Office of Major Projects, which revised the cost estimate of the proposal to between \$30 and \$31 million. The differences in cost included, adjusting costs for retractable seats, landscaping, and an upward revision of consultants fees to a more realistic level. In addition, the feasibility study made no allowance for preliminaries and contingencies for external works, common works and for cost escalation if the construction exceeded a 12 month period. **The Office of Major Projects advised the Department of State and Regional Development, in December 1997 that a total budget of \$28 million would be a more realistic cost to deliver the project. However, the budget was reduced to \$24.5 million by significantly reducing the quality of finishes, external appearance, start-up costs, and furniture and equipment.**

**6.80** In May 1998, the administrators of the Community Support Fund approved a funding submission from the Department to fully fund the construction of the Centre to a cost of \$24.5 million and the State Government publicly announced that it was proceeding with the redevelopment of the State Netball and State Hockey Centre at Royal Park.

**6.81** A Project Control Group comprising representatives from the Department, officers administering the Community Support Fund and Office of Major Projects was established in May 1998. The Project Group's major responsibilities are to provide high level policy direction in the planning and funding of the facility and to oversee the project's delivery within agreed timelines, budget constraints and the agreed briefing requirements. The Project Group is assisted by a Project Working Group consisting of representatives from the Department and the Office of Major Projects.

**6.82** The Working Group and design team identified a number of operational and capital cost savings and efficiencies of between \$50 000 to \$100 000 if all sections of the central infrastructure for both hockey and netball were integrated. The Minister for Planning and Local Government endorsed the Working Group's recommendation to consolidate the operations and provide a fully integrated Centre on the site.

#### *Operational and viability issues*

**6.83** The Department prepared a business plan for the Centre with the assistance of external financial advisers. The plan, completed in April 1999, concluded that:

operational viability was largely dependent on the Centre generating a specified level of patronage;

the base case patronage projections required only a marginal increase in utilisation of the new facilities as compared with the previous facilities to meet targets;

expenditure projections were consistent with industry standards and facilities of comparable type; and

further sensitivity analysis was needed to identify the implications of reduced patronage or utilisation on the ability to achieve the business plan.

**6.84** In April 1999, the Melbourne Sports and Aquatic Centre Trust provided approval in-principle to a variation of its business and financial model to take on the responsibility for the Centre, on the understanding that the Sports would meet their financial commitments as outlined in their Business Plan that had been developed by the Department. It proposed that under a licence agreement to be established, various aspects of the facility will be licenced by the Trust to the State netball and hockey sporting associations.

**6.85** The Government introduced the *Melbourne Sports Aquatic Centre (Amendment) Act* 1999 to rename the Melbourne Sports and Aquatic Centre Trust as the State Sport Centres Trust and to extend the powers of the Trust to enable it to manage the State Netball and Hockey Centre and other sports, recreation and entertainment facilities and services. The legislation also provided for the establishment of a State Netball and Hockey Centre Advisory Committee to provide advice to the Trust and the Minister on operational and management issues, especially relating to the Centre's interface with the other Royal Park stakeholders.

*Tender selection and appointment process*

**6.86** In June 1998, the Office of Major Projects appointed a project architect following a selective tender process. The appointment of specialist sub-consultants to the project design team was the responsibility of the project architect. Tender specification and briefings were prepared by the Office of Major Projects for the construction of the Centre which were made public in October 1998.

**6.87** During the tender period, interested parties were advised that the Office of Major Projects had selected the supplier of the existing hockey pitch for the redeveloped courts for a specific sum which took account of outstanding warranty obligations with that supplier in relation to the existing hockey pitch. An agreement was reached with the supplier to surface 1 of the 2 redeveloped pitches at no cost. The Office of Major Projects estimated the final negotiated price with the existing supplier achieved a saving of between \$150 000 to \$250 000 compared with other quotes obtained. In addition, the Department's desire would be to have identical surfaces on both pitches at the new Centre and that the carpet would be identical to that being used for the Sydney 2000 Olympics and would therefore support Melbourne's bid to host pre-Olympic events.

**6.88** In December 1998, following the close of tenders, the Office of Major Projects short-listed 5 bidders. A tender assessment panel evaluated the submissions based on tender price, ability to comply with technical and contractual requirements, preliminary planning information, record of past performance, suitable experience and expertise, and financial capacity to undertake the works. The lowest tender was some \$2.3 million over the agreed original budget. Consequently, the Office of Major Projects requested the 2 lowest tenderers to price a range of scope variations to generate savings. The lowest revised tender price was still \$470 000 over budget and the panel believed that the priced scope reductions would deliver an inferior product, with the project contingency reduced to an unacceptably low level.

**6.89** The Project Control Group recommended to the Minister of Sport that additional funds be sought to enable the acceptance of the original lowest bid with minor scope variations and to maintain an appropriate contingency provision, so as to deliver a sports facility to a quality consistent with other similar Centres. The Project Group negotiated an extension of the tender validity period to the end of January 1999 in order to resolve the funding issue. **At the request of the Minister for Sport, in February 1999, the Community Support Fund provided an additional \$2.5 million over the previously approved budget. The total projected cost of the project was revised to \$27 million and was to be fully funded from the proceeds from the Community Support Fund.**

**6.90** Following the approval of additional funding, the tender assessment panel recommended the appointment of Multiplex Constructions Pty Ltd as the preferred tenderer. A contract between Multiplex Constructions Pty Ltd (the contractor) and the Secretary to the Department of Infrastructure was entered into in March 1999. **Construction was required to be completed within 12 month, by March 2000, for a construction contract sum of \$22.5 million.**



**6.91** A probity auditor was not appointed to oversee the tender process. While we would have expected that such an assessment process should have been established for this major tender, the Office of Major Projects informed my Office that it felt that such a process was not necessary due to the involvement of a number of committees, including representatives of a number of State Government agencies.

*Enactment of the Royal Park Land Act 1999*

**6.92** Under the *Planning and Environment Act 1987*, the Minister has the legislative power to appoint himself as a planning and/or responsible authority. In his capacity as the planning and/or responsible authority, he may undertake all planning functions required under the legislation such as preparing, approving, administering and enforcing planning schemes and approving planning permits.

**6.93** As a result of exercising his power to call-in or intervene in planning cases and to appoint himself as a planning and/or responsible authority, the planning responsibilities of councils are effectively transferred to the Minister.

**6.94** In September 1998, approval for the new Centre was sought by the Office of Major Projects from the Minister for Planning and Local Government to a Ministerial amendment to the Melbourne Planning Scheme without exhibition. **The “fast tracking” approval process was undertaken on the basis of the State significance of the Centre, the tight construction program, the need for substantial progress to be achieved in time for assessment by the 2006 Commonwealth Games Evaluation Panel in mid-1999 before the selection of the successful host city, and on the basis that the proposed use and development had been publicly exhibited via the Royal Park Master Plan in 1997. In November 1998, the Minister for Planning and Local Government provided planning approval under the *Planning and Environment Act 1987*.**

**6.95** Following the planning approval, the Office of Major Projects identified that the landscape plan, which was one of the many plans to be approved, had been excluded. As a result, the Minister for Planning and Local Government approved a further amendment to the scheme under the *Planning and Environment Act 1987* in December 1998.

**6.96** In May 1999, legal action commenced from an interest group to stop the redevelopment at Royal Park on the grounds that the planning permit and development of the Centre was inconsistent with the purpose of the Crown land reservation. The Office of Major Projects and Department of State and Regional Development, consistent with advice received from the Department of Natural Resources and Environment were of the opinion that as the new Centre was to be partly developed on the existing hockey and netball site, no legislation would be required to clarify the land use issue raised by the interest group.

**6.97** The Office of Major Projects sought approval from the Minister for Natural Resources and Environment to legislate and clarify the purpose of the reserve to include the proposed development and use as a State Netball and Hockey Centre. **Subsequently, the *Royal Park Land Act 1999* was passed, thereby eliminating the principal basis of the objections by the interest groups to the development and use of the land for the purposes of a State Netball and Hockey Centre. This action eliminated any doubt that may have existed concerning the use of the land and avoided disruption possible from lengthy legal battles. In addition, the Act removed any right for compensation arising from the construction and use of the land as a Netball and Hockey Centre.**

*Environmental impact studies*

**6.98** A noise survey was undertaken by an external consultant in September 1998 which concluded that the noise levels from the operation of the new Centre would not increase beyond existing levels and, therefore, would not adversely impact on the Melbourne Zoo.

**6.99** Concerns were raised, as early as 1995, by interest groups and the nearby Melbourne Zoo as to the impact of the light towers on the surrounding environment and the Melbourne Zoo inhabitants. **The Office of Major Projects consulted with the Melbourne City Council and the Melbourne Zoo on the proposed development. On this basis and given that the redevelopment complied with the Royal Park Master Plan the Minister of Planning determined that an environmental impact statement would not be required as redevelopment would have no significant effect on the environment. In addition, the project was a redevelopment of existing facilities and fixtures not a new use within Royal Park.** The existing hockey facility included one pitch and 8 light towers, while the new facility would have 2 hockey pitches with 4 light towers each. The existing outdoor netball facility had 6 light towers, while the new facility will have the same number of light towers.

**6.100** **Following concerns raised by the interest group and unions, the Minister for Planning and Local Government appointed an independent consultant in February 2000 to review all the design work regarding the outdoor sports lighting after all the relevant planning permits had been approved.** The Report prepared by the consultants concluded that the proposed lighting design for the external hockey and netball courts were reasonable, the environment surrounding the Centre will not be affected above and beyond the effects of the pre-existing system with respect to the level of light spill at the Melbourne Zoo boundary wall, however, the levels of sky glow will be higher for televised modes (during the televising of major sporting events) of operation. The consultant estimated that the televised modes would only account for 2 per cent of the proposed total usage time during non-daylight hours. The Report concluded in that the new higher lighting masts would reduce the luminance and incident illumination at the Melbourne Zoo boundary below that which would have been provided from lower mast heights of the pre-existing system.

**6.101** The Minister for Planning and Local Government subsequently approved an amendment to the Melbourne Planning Permit in May 2000 to allow installation of the sports lighting proposal as designed.

**6.102** The contractor also commissioned a study that concluded that the lighting supplier's proposal would be able to achieve the stated design outcomes.

**6.103** The Melbourne Zoo has agreed in writing that the design of the proposed light towers and related light spills was satisfactory, provided that there will be no additional light spill at the Melbourne Zoo boundary wall above and beyond the effects of the original lighting system in place. In the event that the light spill is greater than claimed, the contractor and supplier of the lighting system will be in breach of the contract and would be required to rectify the problem at their own cost.

### *Construction of the Centre*

**6.104** A review of contract administration records by our Office indicates that the Office of Major Projects identified a number of concerns relating to the due process and administration control of the construction of the Centre. One of the concerns related to the commencement of the construction of the netball light towers prior to the planning approval being obtained. The issues involved were taken up with the contractor during the construction phase for rectification.



*Construction of the State Netball and Hockey Centre.  
(Photo courtesy of the Office of Major Projects.)*

**6.105** The intent of nominating the project under the *Project Development and Construction Management Act 1994* was to assist with the timely and effective delivery of the project. Under the terms of the construction contract, the Centre was to be completed within a 12 months period, by late March 2000. As at October 2000, the most current construction program submitted by the Contractor indicates a completion date of early November 2000 and the costs incurred in relation to the construction contract was \$22.9 million.

**RESPONSE** provided by the Acting Secretary of the Department of State and Regional Development

*The Office of Major Projects has confirmed that its tender processes conform to the Victorian Government Code of Practice for the Building and Construction Industry. The Code, which is current government policy, does not require the use of a probity auditor for this type of tender process.*

## **Part 7**

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# **Liabilities and commitments**

## AGGREGATE LIABILITIES OF THE STATE

**7.1** Our previous Reports to the Parliament have provided detailed comment on the significant improvements in liability management, flowing from the substantial privatisation program and various other initiatives that have been implemented in recent years which have led to the substantial reduction in the level of State liabilities and an improvement in the budgetary position of the State.

**7.2** In this Part of the Report, we analyse the State's financial obligations and commitments as at 30 June 2000, and provide an assessment of the impact of the year's activities on the State's financial position.

**7.3** The Government's Annual Financial Statement reports liabilities of the State totalling \$41.7 billion at 30 June 2000 - an increase of \$403 million in the level of liabilities when compared with the previous year. This is mainly due to an increase in unfunded superannuation liabilities (\$850 million) and outstanding claims liabilities (\$779 million), offset in part by a reduction in borrowings of \$998 million.

**7.4** As mentioned earlier in this Report, our audit opinion on the Government's Annual Financial Statement contained an emphasis of matter surrounding the inherent uncertainty regarding the quantification of outstanding WorkCover claims. This arose because the Victorian WorkCover Authority and its actuaries could not, in the time available, determine the financial effect, on the outstanding claims liability of a substantial number of serious injury claim applications received in the latter part of August 2000. This uncertainty impacts on the reported value of the State's liabilities and has resulted in an "emphasis of matter" audit opinion being expressed on both the Victorian WorkCover Authority's financial statements and the Government's Annual Financial Statement.

**7.5** Table 7A illustrates the composition of the State's liabilities at 30 June 2000.

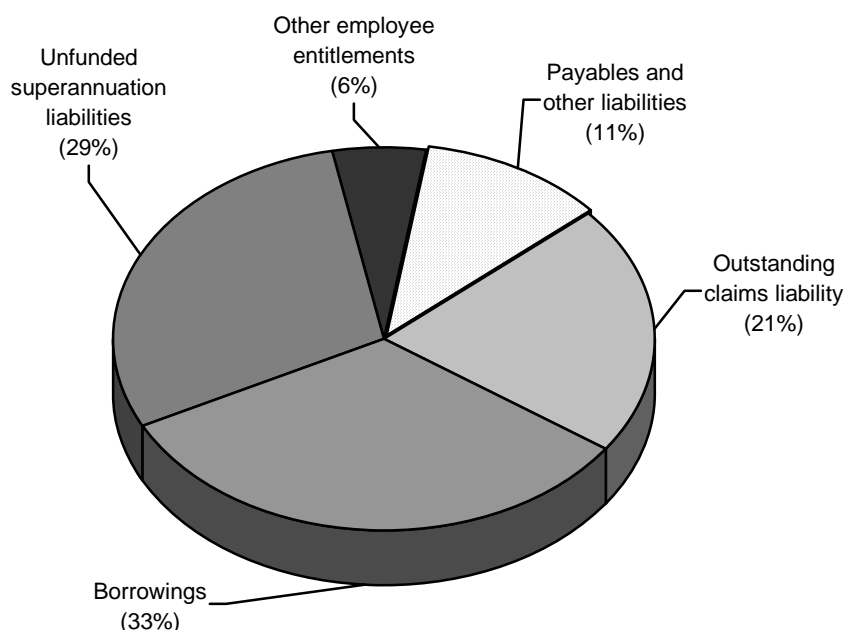
**TABLE 7A**  
**COMPOSITION OF STATE LIABILITIES**  
(\$billion)

<i>Type of liability</i>	<i>General government</i>	<i>Public trading enterprises</i>	<i>Public financial institutions</i>	<b>Total June 2000</b>	<i>Total June 1999</i>
Borrowings	6.4	3.2	14.4	<b>13.7</b>	14.7
Unfunded superannuation liabilities	12.3	0.1	-	<b>12.4</b>	11.5
Outstanding claim liabilities	-	-	8.8	<b>8.8</b>	8.0
Payables and other liabilities	1.6	2.9	1.3	<b>4.5</b>	4.7
Other employee entitlements	2.2	0.1	-	<b>2.3</b>	2.4
<b>Total State liabilities</b>	<b>22.5</b>	<b>6.3</b>	<b>24.5</b>	<i>(a)</i> <b>41.7</b>	<i>(a)</i> 41.3

(a) The total balances are presented net of inter-entity eliminations, i.e. after deducting amounts payable to other public sector agencies.

**7.6** As indicated in the previous table, as at 30 June 2000, borrowings, unfunded superannuation and outstanding claims were the largest components of the State's liabilities, accounting for 83 per cent of total liabilities. Chart 7B further illustrates this position.

**CHART 7B**  
**COMPOSITION OF STATE LIABILITIES,**  
**AT 30 JUNE 2000**  
(per cent)



**7.7** In addition to the liabilities shown above, **the State also has quantifiable contingent liabilities of around \$813 million** (1998-99, \$951 million). These liabilities, which are contingent in nature, represent potential commitments the occurrence of which is dependent on future events or outcomes.

**7.8** Furthermore, the State has entered into various arrangements giving rise to operating and capital commitments, which are not included as part of State liabilities as the relevant goods or services had not been received or consumed at balance date. **The aggregate value of the State's operating and capital commitments as at 30 June 2000 was \$6.7 billion** (30 June 1999, \$3.3 billion). These include the State's commitments under outsourcing contracts entered into for the provision of services and infrastructure to the public sector, such as transport, health and prison services. The increase in the year in the value of these commitments mainly relates to the impact of the public transport franchising arrangements.

## BORROWINGS

### Level of State debt

**7.9** Borrowings represent the largest component of State liabilities and predominantly comprise public sector debt raised domestically and overseas through the Treasury Corporation of Victoria, loans and advances from the Commonwealth Government, and finance leases entered into by various public sector bodies.

**7.10** As indicated in our previous Reports to the Parliament, the reduction of the borrowings component of State liabilities was a key element of the previous Government's overall financial strategies. A key financial objective of the current Government is to maintain State net financial liabilities at "prudent" levels and, in turn, maintain the State's current credit rating.

**7.11** At 30 June 2000, the State's borrowings totalled \$13.7 billion (8.59 per cent of GSP), compared with \$14.7 billion (9.72 per cent of GSP) at 30 June 1999.

**7.12** Table 7C illustrates the major sectors that contribute to the State's overall debt levels.

**TABLE 7C**  
**STATE DEBT, 1999-2000**  
(\$billion)

<i>Sector</i>	<i>1999-00</i>	<i>1998-99</i>
General government	6.4	7.1
Public trading enterprises	3.2	3.3
Public financial institutions	14.4	15.3
Inter-sector eliminations	<b>(10.3)</b>	(11.0)
<b>Total State debt</b>	<b>13.7</b>	14.7

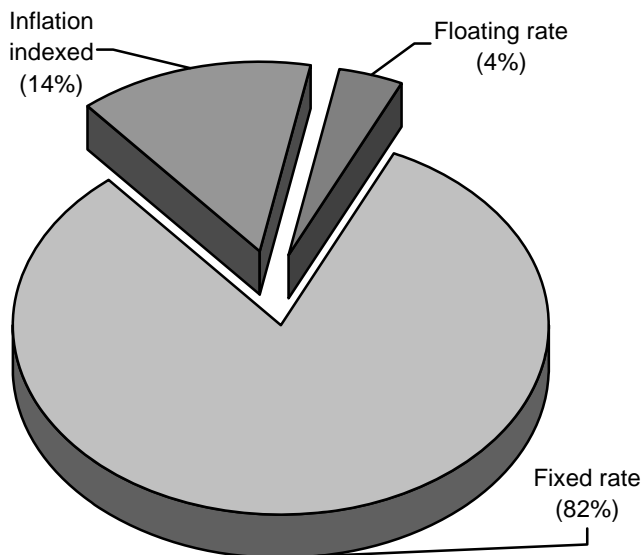
### Composition of State borrowings

**7.13** The effective management of the mix and maturity of the State's debt portfolio is critical to the achievement of the debt management objectives established at an individual public sector agency level and at a Statewide strategic level by the Government.

**7.14** To minimise refinancing costs and exposures to specific financial markets, the State borrows domestically and overseas, and in various forms, commonly referred to as fixed rate, floating rate and inflation indexed borrowings. These borrowings are complemented, as appropriate, by the use of various financial risk management instruments known as derivatives. At 30 June 2000, the State held \$19.3 billion in derivatives (notional value) of which the majority related to interest rate and currency swap agreements to minimise currency and interest rate exposures on State debt. Debt maturities are also spread over future years to minimise the State's exposure to adverse interest rate movements that may prevail in any particular year in which debt is due for refinancing or retirement.

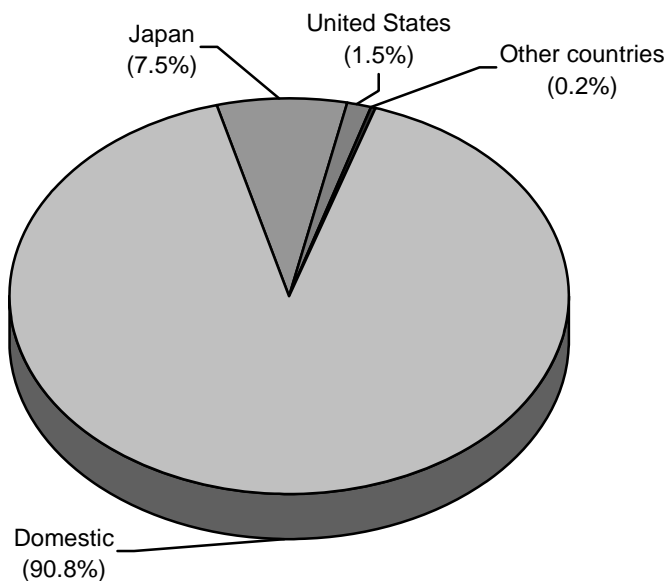
**7.15** Charts 7D and 7E show the composition of State debt at 30 June 2000 in terms of the types of physical borrowing, and the markets in which they are raised.

**CHART 7D**  
**COMPOSITION OF STATE DEBT,**  
**BY INSTRUMENT TYPE, AT 30 JUNE 2000 (a)**  
(per cent)



(a) Based on market value.

**CHART 7E**  
**COMPOSITION OF STATE DEBT,**  
**BY MARKET IN WHICH RAISED,**  
**AT 30 JUNE 2000 (a)**  
(per cent)



(a) Based on book value.

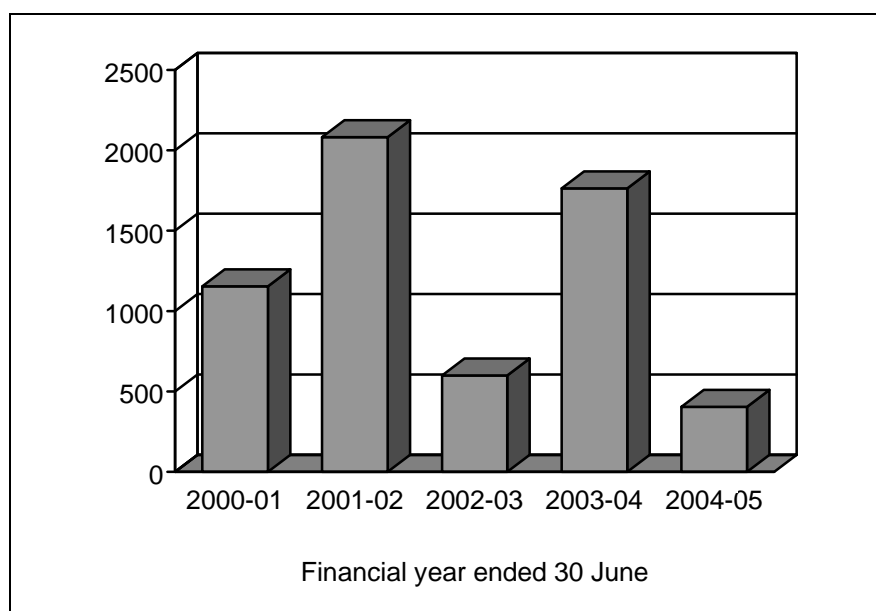


**7.16** As illustrated in Chart 7D, fixed rate instruments account for 82 per cent of the State's debt portfolio at 30 June 2000. As a result of holding this type of instrument, the State's exposure to increases in interest rates in relation to the total portfolio has been minimised. While borrowings have been raised in both domestic and foreign markets, the State's exposure to foreign currency fluctuations has also been minimised through the establishment of appropriate hedging arrangements for all foreign currency borrowings.

### State debt maturity profile

**7.17** An analysis of the State's debt portfolio at 30 June 2000 indicated that around 52 per cent or \$6 billion (book value) of the portfolio will mature and require repayment or refinancing in the next 5 years. Chart 7F illustrates the maturity profile for the next 5 years.

**CHART 7F**  
**STATE DEBT MATURITY PROFILE FOR THE NEXT 5 YEARS,**  
**AT 30 JUNE 2000 (a)**  
 (\$billion)



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

**7.18** As indicated in the chart, **\$1.15 billion of debt will require repayment or refinancing during the 2000-2001 financial year.** The Treasury Corporation of Victoria's current investment holdings are sufficient to enable this amount to be repaid. As stated previously in this Report, at 30 June 2000, the Corporation held a net amount of \$3.9 billion which is available for application towards the retirement of debt as it matures and for meeting the State's prudential liquidity requirements.

## State's debt management strategy

**7.19** The past decade has seen significant change in the management of the State's debt portfolio as a result of:

- the application of privatisation proceeds to debt retirement;
- changes in financial markets;
- new management strategies; and
- improvement in the State's credit rating.

**7.20** In 1992-1993, the former Government centralised debt management under the responsibility of the Treasury Corporation of Victoria. The Corporation subsequently facilitated the diversification of the State's funding base, created price tensions between markets and, as a consequence, reduced borrowing costs. Due to application of the proceeds of privatisation to maturing debt and the early retirement of securities, the State's gross debt has been reduced from \$34 billion in 1995 to \$13.7 billion at 30 June 2000.

**7.21** Overall, actions to reduce debt levels have led to improvements in the State's credit ratings culminating, most recently in:

- Standard and Poor's, in December 1999, affirming the State's triple-A long-term currency rating, and its "A-1+" for local and foreign currency short-term rating; and
- Moody's Investors Services, in February 2000, upgrading the State's rating for domestic-currency denominated bonds to Aaa from Aa1.

## Termination of Monash Medical Centre financing arrangements

**7.22** Our previous Reports on the Victorian Government's Finances have outlined the complex leasing and financing arrangements entered into by the State in 1983 to finance the construction of the Monash Medical Centre, and the commencement, in October 1998, of government strategies aimed at terminating these financing and leasing arrangements.

**7.23** South Eastern Medical Complex Limited (SEMCL) was created to finance the construction of a new hospital complex in the south-eastern region of Melbourne. The construction of the complex was funded from conventional borrowings of around \$120 million and \$30 million obtained through a unit trust structure. The Treasurer guaranteed the borrowings of the company under the *Queen Victoria Medical Centre (Guarantee) Act 1982*.

**7.24** The SEMCL leased a parcel of land from the former Queen Victoria Medical Centre, a wholly-owned State entity, for a 15-year period with a renewal option. In exchange, the SEMCL agreed to construct a hospital on the leased site and subsequently leased the completed hospital back to the Queen Victoria Medical Centre. In substance, the leasing arrangement effectively transferred all of the risks of ownership and operation of the public hospital to the Queen Victoria Medical Centre, and consequently the State as the primary stakeholder.

**7.25** The Queen Victoria Medical Centre was amalgamated with certain other hospitals to form the Monash Medical Centre in late 1996. The Monash Centre was then consolidated to form part of the Southern Health Care Network following the enactment of the *Health Services (Metropolitan Hospitals) Act 1995*.

*Status of the termination process*

**7.26** As referred to above, my 1999 Report outlined the commencement of strategies to terminate these finance and leasing arrangements. Key matters outlined in that Report were:

- Approval in August 1998 by the then Treasurer of a strategy to facilitate termination of the arrangement following an assessment by the Department of Treasury and Finance of the risks to the State associated with the arrangement;
- An undertaking by the Treasurer to SEMCL to consider the provision of any necessary funding for the company to remain solvent. A key element of the termination arrangement involved a reduction in the value of the lease payments made by the State to the company from \$21.6 million to \$2.4 million per annum. In the 1998-1999 financial year, \$3.07 million was provided by the State by way of a \$320 000 cash injection and a \$2.75 million loan;
- Repayment of the company's "conventional" debt with the banks, of \$35.5 million, through a loan provided by the State;
- Commencement of action to terminate an additional \$30 million loan associated with a complex unit trust based financing structure; and
- Purchase by the State of shares held in the company by external parties at a nominal cost of approximately \$750, giving the State full ownership of SEMCL.

**7.27** During the 1999-2000 financial year, negotiations were concluded in relation to the early termination of the unit trust financing arrangement. In April 2000, both the Department of Treasury and Finance and the other parties associated with the arrangement agreed to:

- a negotiated settlement payment by SEMCL of \$7.15 million in full settlement of its obligations under the unit trust financing arrangements;
- funding of the repayment by a loan of equal amount provided by the Department of Treasury and Finance and approved by the Treasurer; and
- payment by SEMCL of \$174 000 in stamp duty associated with the repayment of the loan.

**7.28** The settlement arrangements eliminated the Treasurer's guarantee on the original \$30 million loan to SEMCL.

**7.29** In December 1999, the Treasurer approved an additional loan payment of \$2.1 million to SEMCL to meet its obligations and facilitate the termination of the financing arrangements. The immediate obligations of the company include payments under the existing unit trust financing arrangements and final tax instalments.

**7.30** As at June 2000, the State had outlaid a total of \$47.8 million associated with the winding-down of the financing and leasing arrangement. This amount comprised:

- \$40.35 million in loans provided to SEMCL by the Department;
- a \$320 000 cash injection provided by the Department; and
- a \$7.15 million negotiated settlement payment by the Department to relinquish the original \$30 million loan of the unit trust.

**7.31** As at the date of preparation of this Report, the parties to the Monash Medical Centre leasing arrangements were reviewing various sub-leasing arrangements that apply to the Centre's site and the remaining steps required to wind-up SEMCL. The Department of Treasury and Finance expects that the termination of the financing arrangements will be completed in 2001.

### Accelerated Infrastructure Program

**7.32** The Accelerated Infrastructure Program was established in the early 1990s to provide accommodation for certain government agencies, mainly police stations and law courts. Under the arrangements, a private sector company was established to build and subsequently lease properties to the Government, with the construction costs funded through the issue of various bonds which matured over a period of 20 years. The provision of a government indemnity effectively transferred the financing risk associated with this arrangement to the State.

**7.33** Following a government decision to un-wind the arrangements associated with the Program, from the 1995-96 financial year the Department of Treasury and Finance commenced the purchase of all bonds that were issued by the company. The total cost incurred by the Consolidated Fund for these purchases was \$258 million.

**7.34** As at 30 June 2000, the net book value of the bonds, as disclosed in the Annual Financial Statement and in the financial statements of the Department of Treasury and Finance, was \$132.9 million. This amount reflects the net expected value from the liquidation of the Program's assets following the restructuring and termination of the arrangements, after taking into account a provision of \$122 million, established in the 1998-99 financial year, relating to the expected diminution in the value of the investments.

**7.35** As part of the un-winding arrangements, in April 1999 the Department established the Arada Trust to facilitate the acquisition of the private sector company's shares for a nominal amount of \$5. These shares were purchased from the 3 private sector shareholders on 31 March 2000.

**7.36** The Department is currently in the process of terminating the existing lease arrangements between a private sector company and the Minister for Finance for each property financed under the Program and implementing new operating lease agreements with normal commercial terms. The Department has indicated that the majority of properties will subsequently be sold to the private sector.

**7.37** As referred to in my *Report on Victorian Government's Finances, 1998-99*, **the ultimate cost to be borne by the State in relation to the termination of the Program will be dependant upon a number of external factors, which include the:**

- values achieved by the State from the sale of the company's properties; and
- satisfactory and timely resolution of contingent issues to facilitate the ultimate termination of the financing arrangements.

## UNFUNDED SUPERANNUATION LIABILITIES

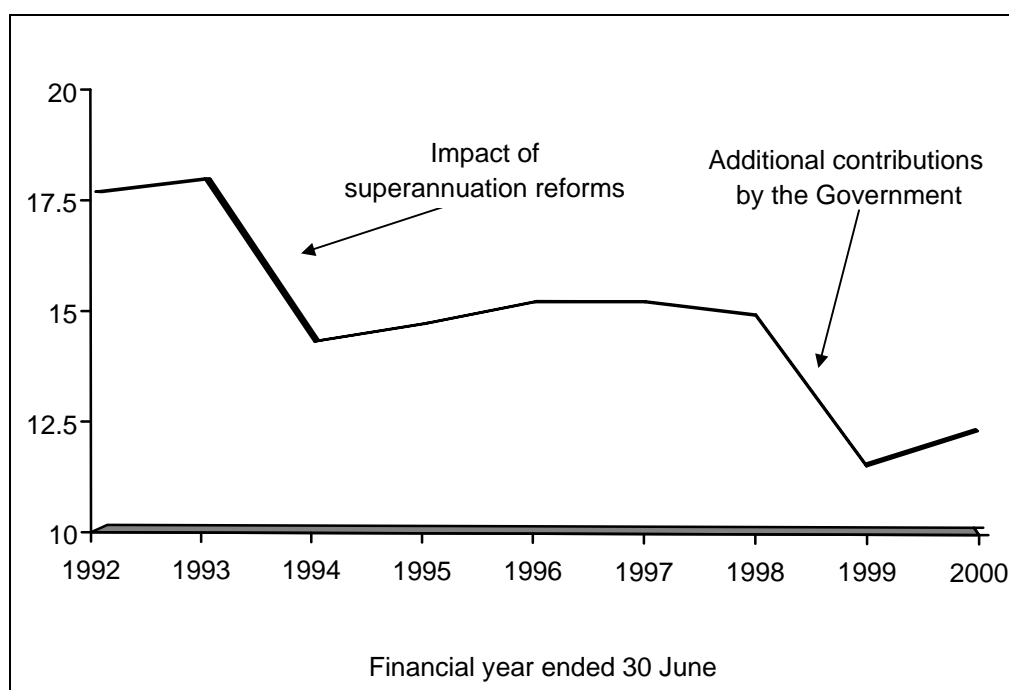
**7.38** Unfunded superannuation liabilities represent the second largest component of the State's liabilities. These comprise employer superannuation contributions yet to be paid by the Government and certain public sector bodies to superannuation schemes in respect of services previously provided by employees. The liabilities have resulted from decisions of previous governments to progressively meet the employer share of superannuation benefits when or after employees retire, (i.e. on a "pay as you go" basis) rather than as benefit entitlements accrue over the working lives of employees.

**7.39** The Government's Annual Financial Statement disclosed unfunded liabilities of public sector superannuation funds as at 30 June 2000 totalling \$12.4 billion, compared with \$11.5 billion at 30 June 1999. The unfunded superannuation liabilities relate to the following sectors:

- General Government - \$12.3 billion (30 June 1999, \$11.4 billion); and
- Other - \$88 million (30 June 1999, \$84 million).

**7.40** Approximately 99 per cent of the State's unfunded superannuation liabilities are attributable to the State Superannuation Fund. Chart 7G shows the movement in the level of the State's unfunded superannuation liabilities since 1992.

**CHART 7G**  
**MOVEMENT IN THE STATE'S UNFUNDED**  
**SUPERANNUATION LIABILITIES (a)**  
((\$billion))



(a) All figures are presented in nominal values.

**7.41** Our previous Reports to the Parliament have commented on unfunded superannuation liabilities trends, including:

- the substantial reduction in the overall level of public sector unfunded superannuation liabilities between the 1991-92 and the 1993-94 financial years as a result of:
  - a reduction in the budget sector workforce and a low rate of wages and salaries growth over that period;
  - substantial one-off Consolidated Fund contributions to various superannuation schemes to meet the Government's liability for deferred employer contributions; and
  - various superannuation reforms introduced by the Government with effect from the 1993-94 financial year.
- a subsequent overall upward trend, during the period up to 1997-98, in the level of unfunded superannuation liabilities, due mainly to government superannuation contributions failing to keep pace with the increase in the accruing liabilities of the superannuation funds; and
- a substantial reduction in the level of the unfunded liabilities in the 1998-99 financial year mainly due to additional contributions totalling \$3.4 billion from the Consolidated Fund to the State Superannuation Fund.

**7.42** As indicated above, **the unfunded superannuation liability increased by around \$850 million in the 1999-2000 financial year.** This was mainly attributable to the increase in unfunded liabilities associated with the State Superannuation Fund. Key factors impacting on the unfunded balance of the Fund at 30 June 2000 were:

- The ageing membership profile of the Fund, which is now closed to new members;
- Changes in actuarial assumptions including:
  - a higher proportion, than previously envisaged, of Revised Scheme members assumed to resign prior to the age 55 years resulting in an increase of \$597 million in the unfunded liability as at 30 June 2000;
  - an improvement in pensioner mortality rates resulting in an increase in estimated future pension payment of \$206 million; and
  - the impact of the Goods and Services Tax on the CPI, which affects future pension payments, estimated at \$116 million.
- An offsetting reduction in the liability resulting from an additional contribution of \$325 million by the Government in June 2000. This amount represented “top-up” contributions that would normally have been paid by the Government in the 2000-2001 financial year.

**7.43** In April 2000, the Minister for Finance accepted the recommendations of the actuary appointed by the Board of the Government Superannuation Office. These included:

- the Government should aim to fully fund the State Superannuation Fund by the year 2035;
- annual Consolidated Fund payments to the Fund including any additional payments, should not exceed \$600 million, in real terms, to ensure that the payment profile to achieve a fully-funded position is shared equitably by future governments; and
- the unfunded liability should not be permitted to increase in real terms.

**7.44** The actuary advised that the achievement of these targets is dependent on actual experiences relating to investment returns, salary growth and employer contributions.

### Emergency Services Superannuation Scheme

**7.45** The Emergency Services Superannuation Scheme provides superannuation benefits to emergency services employees in Victoria, including Victoria Police, the Country Fire Authority, the Metropolitan Fire and Emergency Services Board, and Ambulance Service Victoria. The Scheme also includes the Victorian Electricity Industry Fund relating to the former employees of the State Electricity Commission of Victoria in receipt of superannuation pensions. This group of pensioners were transferred to the Scheme in June 1996.

**7.46** Since the establishment of the Scheme, participating employers have been required to meet, on an ongoing basis, the full employer share of superannuation contributions. The *Emergency Services Superannuation Act* 1986 requires separate accounts to be maintained for each participating employer thereby allowing the funding status to be determined at an individual employer level. Under the arrangements established over a number of years, the employing agencies have been required to meet the employer share of superannuation contributions.

**7.47** In recent years, the assets in respect of certain participating employer schemes have exceeded the accrued superannuation liabilities relating to their scheme members. As at 30 June 2000, the total value of schemes in a over-funded position was \$266 million (\$213 million in 1998-99). Table 7H discloses the key entities whose share of the Scheme assets exceeded their superannuation liability.

**TABLE 7H**  
**AGENCIES WITH SUPERANNUATION ASSETS IN EXCESS OF**  
**THEIR SUPERANNUATION LIABILITIES,**  
**30 JUNE 1999 AND 30 JUNE 2000**  
(\$million)

<i>Agency</i>	<i>Excess of assets</i>	
	<b>30 June 2000</b>	<i>30 June 1999</i>
State Electricity Commission of Victoria	<b>58</b>	66
Ambulance Service Victoria	<b>64</b>	49
Country Fire Authority	<b>52</b>	42
Metropolitan Fire and Emergency Services Board	<b>69</b>	56
Victoria Police	<b>20</b>	(398)
Other	<b>3</b>	0
<b>Total</b>	<b>266</b>	(185)

**7.48** As indicated in the table, the position in regard to Victoria Police has changed from an unfunded liability of \$398 million at 30 June 1999 to a surplus position of \$20 million at 30 June 2000. This change resulted mainly from a payment of \$271 million from the Consolidated Fund in the 1999-2000 financial year and improved investment performance.

**7.49** In the previous financial year, the Scheme had accepted an actuarial recommendation to reduce the employer contributions for certain of the agencies for the 1999-2000 financial year in order to reduce the "over-funded" positions. Based on this decision, the Metropolitan Fire and Emergency Services Board contribution rate was reduced from 20.5 per cent to 17 per cent in the 1999-2000 year and the Country Fire Authority contribution rate is to be reduced from 9 per cent to zero in the 2000-2001 year, while Ambulance Service Victoria will maintain its current contribution rate of 9 per cent. Following the 1999-2000 surplus, a decision has also been made to reduce the Victoria Police contribution rate from 27.5 per cent to 15.5 per cent for the 2000-2001 year.

**7.50** The aggregate surplus of superannuation assets over superannuation liabilities of the Fund as at 30 June 2000, of \$266 million, is not recognised in the Government's Annual Financial Statement on the basis that the Government has no recourse to repatriate these surplus assets at balance date.

### State obligations relating to the funding of universities' superannuation

**7.51** Under the *State Grants (General Purpose) Act* 1994, the State is required to make annual payments to the Commonwealth Government, as determined by the Commonwealth Minister for Education, to assist in the funding by the Commonwealth Government of costs incurred by universities located in Victoria in relation to the unfunded superannuation liabilities related to staff who are members of the State Superannuation Fund.

**7.52** The State is required to contribute 24 per cent of the costs associated with the universities' obligations as employers. As at 30 June 2000, the aggregate value of Victorian universities' unfunded liabilities was \$913 million of which \$220 million represented the State's obligation to the Commonwealth Government. (As at 30 June 1999, the State's share was \$203 million.)

**7.53** An inter-jurisdictional steering committee is currently addressing the task of developing a revised and simplified set of funding arrangements to take effect from July 2001. The Steering Committee, intends to submit its proposals for a revised set of arrangements to the Heads of Treasuries at its first meeting in 2001.

**7.54** In addition, discussions are also taking place between the States and the Commonwealth on a proposed Memorandum of Agreement to provide an alternative mechanism for the Commonwealth's recovery of the States' share of higher education costs, as the *State Grants (General Purpose) Act* 1994 was repealed in July 2000 as part of the implementation of the National Taxation Reform Program.



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OTHER EMPLOYEE ENTITLEMENTS

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**7.55** In addition to the State's obligation to meet unfunded superannuation liabilities, the State has an obligation to meet other employee entitlements, including accrued annual leave and long service leave.

**7.56** The State's financial obligations in respect of accrued employee entitlements, excluding unfunded superannuation liabilities, amounted to \$2.3 billion at 30 June 2000 (\$2.4 billion, 30 June 1999). Table 7I outlines the key components of these obligations.

**TABLE 7I**  
**OTHER EMPLOYEE ENTITLEMENTS,**  
**AS AT 30 JUNE**  
(billion)

<i>Type of entitlement</i>	<b>2000</b>	1999
Long service leave	<b>1.7</b>	1.8
Recreation leave	<b>0.4</b>	0.4
Other employee entitlements	<b>0.2</b>	0.2
<b>Total</b>	<b>2.3</b>	2.4

**7.57** The overall reduction in the level of employee entitlements is mainly due to the franchising of the State's public transport system, which involved the transfer of approximately 4 500 staff to private sector franchisees (employee entitlements at the time of sale totalled \$136 million) and the provision of separation packages to approximately 830 public transport staff not offered employment with the franchisees. In addition, a further 600 staff were transferred to the private sector as a result of associated sale of residual assets (maintenance businesses) of the Public Transport Corporation. The effect of these reductions was partly offset by the impact of wages growth during the year.

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## PAYABLES AND OTHER LIABILITIES

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**7.58** The State's financial obligations disclosed in the Government's Annual Financial Statement as part of *payables and other liabilities* mainly relate to outstanding claims for transport accident and workers' compensation, amounts payable under the flexible electricity tariff arrangements established in relation to the operation of the Portland and Point Henry aluminium smelters, accrued interest on State debt and amounts owing to trade creditors.

**7.59** The financial obligations of the State in respect to payables and other liabilities at 30 June 2000 totalled \$13.3 billion, compared with \$12.7 billion in the previous year. Table 7J outlines the key components of these obligations.

**TABLE 7J**  
**PAYABLES AND OTHER LIABILITIES,**  
**AS AT 30 JUNE**  
(billion)

<i>Type of obligation</i>	<i>Total</i> <b>1999-00</b>	<i>Total</i> 1998-99
Outstanding claims	<b>8.8</b>	8.0
Flexible electricity tariff obligations	<b>1.3</b>	1.3
Payables and other accrued expenses	<b>3.2</b>	3.4
<b>Total payables and other liabilities</b>	<b>13.3</b>	12.7

**7.60** As indicated in the table, these financial obligations of the State have increased during the current year principally as a result of an increase in the value of outstanding claims liabilities, which are mainly managed by the Transport Accident Commission and the Victorian WorkCover Authority.

### Outstanding claims liabilities

**7.61** As mentioned above, the level of outstanding claims liability has risen by around 10 per cent in the past year to \$8.8 billion at 30 June 2000. The majority of these obligations are managed by the Transport Accident Commission (motor vehicle personal injury), Victorian WorkCover Authority (personal workplace injury) and Victorian Managed Insurance Authority (public sector agencies' insurance cover). The respective proportion of the total outstanding claims liability relating to each of these agencies at 30 June 2000, as reflected in note 25 to the Government's Annual Financial Report, are detailed in Table 7K.

**TABLE 7K**  
**COMPOSITION OF OUTSTANDING CLAIMS LIABILITIES**  
(\$million)

<i>Entity</i>	<i>Current</i>	<i>Non-current</i>	<i>Total</i>	
			<b>2000</b>	1999
Victorian WorkCover Authority (VWA)	1 107	3 833	<b>4 940</b>	4 384
Transport Accident Commission (TAC)	487	3 013	<b>3 500</b>	3 348
Victorian Managed Insurance Authority (VMIA)	21	279	<b>300</b>	229
Other agencies	22	10	<b>32</b>	32
<b>Total outstanding claims liabilities</b>	<b>1 637</b>	<b>7 135</b>	<b>8 772</b>	<b>7 993</b>

**7.62** Over the past 3 years, the outstanding claims liability has increased by around 33 per cent, from \$6.6 billion at 30 June 1997 to \$8.8 billion at 30 June 2000, as reflected in Table 7L. However, the Victorian WorkCover Authority is the only entity in this group that does not hold sufficient assets to cover all its liabilities with an excess of liabilities over assets of \$423 million as at 30 June 2000.

**TABLE 7L**  
**SUMMARY OF TOTAL OUTSTANDING CLAIMS LIABILITIES,**  
**1 JULY 1996 TO 30 JUNE 2000**  
(\$million)

<i>Entity</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>	<b>2000</b>
Victorian WorkCover Authority (VWA)	3 538	3 930	4 384	<b>4 940</b>
Transport Accident Commission (TAC)	3 006	3 259	3 348	<b>3 500</b>
Victorian Managed Insurance Authority (VMIA)	83	96	229	<b>300</b>
Other agencies	11	18	32	<b>32</b>
<b>Total outstanding claims liabilities</b>	<b>6 638</b>	<b>7 303</b>	<b>7 993</b>	<b>8 772</b>

**7.63** The types of claim payments for each entity differ according to the nature of the claims made. While weekly payments represent a major component of the payments profile for the VWA, the TAC incurs large amounts by way of medical and rehabilitation costs related to the management of serious injuries.

**7.64** For both entities, common law payments, which result from legal settlements, are significant. The unfavourable common law claims experience at VWA led to legislative changes in November 1997 whereby such remedy for injury was removed. Recourse by employees to a revised common law entitlement was re-instated from October 1999.

*Nature and extent of coverage*

**7.65** The 3 entities' operating activities are governed by various legislative requirements, which provide for the Boards of those entities to be accountable to the Government.

**7.66** The VMIA was established in 1996 primarily as the insurer for departments and other “participating bodies” (predominately budget sector agencies), providing cover for industrial special risk, products liability and contract works. The risk in these areas, outside the reinsurance arrangements entered into by the VMIA, is borne by the State. From 1 July 1998, the VMIA took on responsibility, from the State Electricity Commission of Victoria, for residual quantifiable claims (mainly asbestos-related) and, from the Department of Human Services, for the public healthcare agencies insurance program.

**7.67** The remaining insurance entities, TAC and VWA, deal with specific insurable interests, viz personal injury associated with motor vehicles and workplace injury respectively, and have been in place since the late 1980s. The operating performance and financial position of these 2 entities have been referred to in various Auditor-General Reports to the Parliament over the years. Recently, particular attention has been given in those Reports to the significant increase in the outstanding claims liability of the VWA, which has resulted from the rise in serious injury common law applications, and has led to a deterioration in the VWA's funding position.

#### *Actuarial assessments*

**7.68** The methodology utilised to compile the figures for the outstanding claims liability is similar for the major 3 entities and accords with the requirements of Australian Accounting Standards. External independent actuaries undertake full assessments at June and December each year, which support the preparation of financial statements at those dates, and these assessments are supplemented by quarterly reviews. The assessments cover claims reported but not yet paid and claims incurred but not reported.

**7.69** In assessing the outstanding insurance claims liabilities, the actuaries have taken into account projected inflation rates to arrive at expected future payments, which are then discounted using a combination of risk-free and market-adjusted rates. Within these calculations, allowance is made by the actuaries for the anticipated direct and indirect costs of settling the claims including the impact of the goods and services tax.

**7.70** An important further inclusion in the actuarial assessment is the addition, in the case of the TAC and the VMIA, which have longer “tail” obligations of differing levels of prudential margin to the central estimate arrived at by the actuaries. The extent of the “tail” for the State's insurance obligations is indicated by weighted average expected term to settlement for claims, which varies, at 30 June 2000, from 4.3 years for the VWA to 9.0 years for the TAC and 9.2 years for the VMIA.

**7.71** The decision on the margin to be attached is made by each insurance entity's governing board. For the VWA, no prudential margin is included in the actuarial assessment and reliance is placed on the central estimate of the outstanding claims liability being adequate to reflect the inherent uncertainty in the estimation process.

**7.72** The total prudential margin for the insurance entities at 30 June 2000 has exceeded \$500 million and effectively represents an additional 6 per cent on the gross outstanding claims liability of \$8.2 billion, the figure assessed by the external independent actuaries as being the central estimate for the outstanding insurance claims liabilities for those entities.

*“Emphasis of matter” in relation to VWA outstanding claims liability*

**7.73** As mentioned previously in this Report, the most significant recent development impacting on the valuation of the VWA’s outstanding claims liabilities has been the enactment in May 2000 of the *Accident Compensation (Common Law and Benefits) Act 2000* which introduced revised common law remedies to employees from October 1999. This legislation also imposed a 1 September 2000 statutory deadline, for serious injury certification in respect of claims incurred prior to November 1997, the date at which common law claims were previously disallowed.

**7.74** While the actuaries had built into their valuation of the outstanding claims liabilities provision for pre-November 1997 claims, in the lead-up to the 1 September 2000 deadline the number of applications increased significantly beyond the expectations incorporated in the valuation.

**7.75** **At the time of preparing its financial statements for the year ended 30 June 2000, the VWA and its actuaries had not determined the financial effect of these recent claims applications. The fact that an actuarial assessment had not been made of the value of these claims has led to uncertainty as to the impact of these recent claims on the VWA’s financial results for the year and its financial position, and accordingly the State’s overall financial result and financial position. Because of its significance, this uncertainty has resulted in an “emphasis of matter” audit opinion being expressed on both the VWA financial statements and the Government’s Annual Financial Statement.**

### Financial obligations of the SECV

**7.76** Previous Reports to the Parliament have commented on the disaggregation of the electricity and gas industries and the effect on the operation of the State Electricity Commission of Victoria (SECV). The SECV has been retained as a “shell” to manage the assets and obligations not allocated to the electricity distribution and generation businesses which are now in private ownership. An administrator is responsible for the management and, where appropriate, the disposal of the remaining assets and the resolution of the obligations retained by the SECV. At the date of the preparation of this Report, the key obligations of the SECV included:

- administration of the electricity arrangements relating to the Portland and Point Henry aluminium smelters;
- management of the rights and obligations under electricity supply contracts with the wholesale electricity market relating to the Snowy Mountains power entitlement; and
- resolution of residual issues associated with the electricity, gas and ports reform program, under which the residual assets and obligations of the previously State-owned businesses within these industries were vested in the SECV.

*HRL Ltd*

**7.77** In June 1997, the SECV sold its residual interest in HRL Ltd, an entity whose activity was to undertake research and development relating to a method of generating electricity from brown coal, referred to as the *Integrated Drying Gasification Combined Cycle Process*, on behalf of a syndicate. The company also performed research into the commercialisation of new products from brown coal, carried out consulting tasks and provided other energy advisory services to electricity industry participants.

**7.78** The SECV had acquired a minor shareholding interest in the above-mentioned research and development syndicate of 0.18 per cent and had licensed certain technology to the syndicate in return for the rights to licence fees, which are secured by a debenture over the rights and entitlements of other investors in the syndicate. **The SECV also provided interest-free loans to HRL Ltd totalling \$8.5 million, which are due for repayment in 2002 and 2003. It was considered that substantial uncertainty exists concerning the recovery of these loans and therefore these amounts have not been recognised as an asset in the Annual Financial Statement.** The SECV has advised that there has not been significant commercialisation of the technology and accordingly, any benefit which may accrue to the SECV over future years, is difficult to determine at this time.

**7.79** The SECV also advised my Office that the Australian Taxation Office is investigating the syndicate and the validity of the deductions claimed by the related private sector investors. Due to the complexity of the arrangements, the SECV has advised that it may possibly become involved in the investigation and its consequences.

**7.80** In June 1998, the SECV provided a short-term interest-bearing advance of a net amount of \$16.7 million to a subsidiary of a bank. These funds were used to terminate a complex series of arrangements associated with the construction of laboratory and research buildings occupied by HRL Ltd which are located on land owned by the SECV. The advance was due for repayment in September 1998, however, in October 1999 these arrangements were terminated and the SECV obtained unencumbered ownership of the property with the SECV incurring an estimated loss of \$847 000 associated with the un-winding of the arrangements. At the date of preparation of this Report, the SECV advised that it had appointed agents to prepare the property for sale. The property, valued at \$9.5 million, is currently leased on a commercial basis to HRL Ltd.

*Other residual matters*

**7.81** As at the date of the preparation of this Report, the significant residual matters being managed by the SECV were:

- In an agreement entered into between the Treasurer of Victoria and Power Partnership Pty Ltd (a Victorian electricity retailer) in February 1998, the company paid to the SECV an amount of \$186.5 million between April 1998 and June 1999. This amount represented a prepayment of franchise fees payable to the State progressively until January 2001. Under the terms of the agreement, the SECV is required to make quarterly franchise fee payments to the Consolidated Fund on behalf of the company concluding in January 2001. As at 30 June 2000, the SECV held \$22 million relating to this pre-payment which will be paid into the Consolidated Fund during the 2000-2001 financial year;

- The SECV continues to own a site in the LaTrobe Valley, which is known as the Loy Yang 3-4 Bench site. It is intended that the site will be sold once approval is obtained;
- The demolition of the Yallourn Power Station was successfully completed in December 1999 and the SECV now has the new freehold titles to the property. The SECV has commenced action to sell the site; and
- The SECV together with GASCOR and certain other public sector entities have been named as cross-respondents in a representative proceeding (class action) before the Federal Court. The proceeding against Esso Australia Ltd and Esso Australia Resources Ltd was initiated on behalf of gas users and stood down workers who suffered losses during the Longford gas incident in September 1998. The SECV, along with certain other cross respondents, have issued a cross claim in relation to this issue. SECV has denied any liability in respect of Esso's cross claim. However, to the extent that SECV may be liable for certain liabilities of the former Gas and Fuel Corporation of Victoria, the SECV believes that those liabilities were transferred to other entities. The SECV is vigorously defending the action.

## CONTINGENT LIABILITIES OF THE STATE

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**7.82** Contingent liabilities of the State represent potential commitments, the occurrence of which is dependent upon future events or outcomes. Such commitments, which are not required to be included as part of the liabilities of the State as disclosed in the Statement of Financial Position, arise from the provision of guarantees, indemnities, sureties, letters of comfort and other forms of financial support.

**7.83** Guarantees oblige the State 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. Indemnities, on the other hand, generally impose a primary obligation on the Government to protect entities in receipt of indemnities against certain financial losses.

**7.84** 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.

**7.85** **The Government's Annual Financial Statement discloses that the estimated quantifiable contingent liabilities of the State at 30 June 2000 were around \$813 million (\$951 million, 1998-99).**

**7.86** **Contingent liabilities related to guarantees and indemnities amounted to \$678 million at 30 June 2000 (\$736 million, 30 June 1999).** The major guarantees and indemnities include insurance programs managed by the Victorian Managed Insurance Authority (\$65 million), guarantees over extendable floating rate stock associated with the former State Bank of Victoria (\$300 million) and indemnities to co-operative housing societies incorporated under the *Co-operative Housing Societies Act 1958*, in respect of capital indexed loans with the Director of Housing (\$43 million).

**7.87** **The value of other quantifiable claims against the Government was estimated at \$136 million at 30 June 2000 (\$214 million, 30 June 1999).** The decrease in these contingencies on the previous year largely reflects the impact of a favourable ruling by the Supreme Court of Victoria (refer to Part 4 of this Report), relating to the payroll taxation liability associated with temporary workers allocated by employment agencies.

**7.88** Various other contingent liabilities existed as at 30 June 2000, which could not be reliably quantified. These contingent liabilities are summarised in note 29 of the Government's Annual Financial Statement. Comment follows on 3 of the matters reported as non-quantifiable contingent liabilities of the State.

### Transmission of business issues

**7.89** The notes to the Government's Annual Financial Statement disclosed a contingent liability of the State emerging from Federal Court decisions which have indicated that, under the provisions of the Commonwealth *Workplace Relations Act 1996*, former public sector award rates and conditions may apply to a contractor's employees performing what were previously government functions prior to the implementation of outsourcing arrangements or the privatisation of State-owned business enterprises.



**7.90** The Federal Court decision specifically relates to the application of a principle under the Act requiring the transfer of part of a business (in this case from the State to the contractor) and the test that is generally applied is whether there is “substantial identity” between the activities undertaken before and after implementation of the outsourcing arrangement. Where applicable, this principle may cause increases in employment costs for the contractor.

**7.91** As at the date of the preparation of this Report, the State had, pending before the High Court, an application for leave to appeal the Federal Court decision. The financial implications on the State of the transmission of business provisions under the *Workplace Relations Act 1996* will therefore continue to be unclear, pending the outcome of the appeal process.

### Melbourne City Link

**7.92** Our previous Reports to the Parliament have provided a detailed analysis of the highly complex arrangements established between the Government and Transurban, a private sector consortium, for the financing, construction and operation of the Melbourne City Link.

**7.93** The Melbourne City Link project represents one of the largest infrastructure projects ever undertaken in Australia and has an estimated total cost in excess of \$2 billion. The Project’s contractual arrangements are overseen by the Melbourne City Link Authority under the *Melbourne City Link Authority Act 1994* and the *Melbourne City Link Act 1995*.

**7.94** The City Link project covers approximately 22 kilometres of road, tunnel and bridge works, and involves the linking of 3 of Melbourne’s most important freeways, namely, the Monash (previously known as the South-Eastern), West Gate and Tullamarine Freeways, together with the upgrading of parts of the Monash and the Tullamarine Freeways. The key elements of the development include:

- *Southern Link* - 8 kilometres of freeway connecting the West Gate Freeway east of Kings Way to the Monash Freeway, and involving the construction of 2 tunnels under the Kings Domain and the Yarra River;
- *Western Link* - 13 kilometres of new and upgraded freeway-standard roadway, connecting the Tullamarine Freeway to the West Gate Freeway, via a new elevated roadway and a bridge over the Yarra River; and
- *Exhibition Street Extension*, which is located south-east of Melbourne’s central business district and includes:
  - *Section 1* (known as the *Punt Road end*), comprising works from Burnley to Batman Avenue, east of Swan Street, with this section being developed by Transurban for inclusion in the existing City Link project; and
  - *Section 2* (known as the *City end*), comprising works along Batman Avenue including the Swan Street and Batman Avenue intersection, and along a new alignment and structure over the rail-yards to Flinders Street, with this section operated by Transurban’s subsidiary – Clepco, on a similar basis as the existing City Link project. However, the State retained responsibility for the design and construction of this section, with the operator required to make a financial contribution to the State covering its design, construction and delivery.

**7.95** The primary contractual document establishing the basis upon which the Melbourne City Link project is to proceed is the *Concession Deed* entered into between the Government and Transurban in October 1995. The *Melbourne City Link Act 1995*, which incorporated the Concession Deed, provided the Melbourne City Link Authority with certain powers in relation to land and roads affected by the project, and empowered the charging and collection of tolls on the City Link.

**7.96** Under the arrangements, once the City Link is completed, Transurban will operate the roadway as a public tollway for an estimated period of 33 years, with toll revenues collected from motorists to be mainly applied towards the cost of its construction, financing, operation and maintenance, with a return on investment available for the investors in the project. At the end of the specified period, ownership of the City Link will revert to the State at no cost and in a fully maintained condition.

**7.97** We have previously reported that, **while certain project responsibilities and risks were assumed by the State, substantial risks and exposures were also transferred to Transurban and users of the City Link.** In particular, the State has accepted certain obligations, mainly relating to the maintenance of the current overall operating environment for the project. The State has also undertaken to implement certain traffic management measures involving specific changes to the existing road network in the vicinity of the Link (known as *Agreed Traffic Management Measures*) to enable the most efficient use of the overall road network and provide benefits to local communities.

**7.98** Under the contractual arrangements, while the users of the City Link via toll payments will, in substance, be the financiers of the project, Transurban has accepted substantial obligations associated with the delivery and operation of the City Link, including traffic and revenue risks.

#### *Recent amendments to operating deeds*

**7.99** In the period September 1999 to August 2000, the Minister for Transport, on behalf of the State, entered into a number of amending deeds and statements of variation to the Concession Deed with Transurban in relation to the operation of the entire City Link. These amendments related to:

- the opening of certain sections of the Southern Link, being the Monash Freeway and the Domain Tunnel, and continuing construction work on the Burnley Tunnel and the Southbank interchange;
- adoption of a new property schedule for the Southern Link and the division of the Southern Link into 5 distinct sections;
- amendments to the Western Link property schedule;
- amendments to the definition of “start-date” (as defined in the Concession Deed) for the tolling provisions of the Concession Deed; and
- various changes to project scope and technical requirements and State approval for detailed tolling strategies.

*Costs incurred in relation to the project*

**7.100** Expenditure incurred by the Authority on the total City Link project during the period ended 30 June 1995 to 30 June 2000 has amounted to \$403 million or around 18 per cent of the total project cost, of which \$75 million related to the Exhibition Street Extension Project which was refunded by Transurban to the State. The expenditure incurred to 30 June 2000 in relation to the City Link project, excluding the Exhibition Street Extension Project, comprised: \$94 million expended towards the acquisition of land; \$167 million expended towards specified State works; and \$67 million for other costs, including salaries and administrative expenditure, consultancies and contractor services, global settlement costs and other project costs.

**7.101** In relation to the cost of \$75 million incurred by the Authority for the Exhibition Street Extension Project, \$47.6 million related to the *Punt Road end* of the extension while \$27.4 million related to the *City end* of the extension. In the year to June 2000, Transurban had fully refunded the cost of the Exhibition Street Extension Project to the State.

**7.102** At 30 June 2000, the State's capital commitments in relation to the City Link project amounted to \$8.8 million (30 June 1999, \$28 million), and are included as part of the State's capital commitments in the notes to the Government's Annual Financial Statement.

*Disputes between the various parties*

**7.103** In August 1999, an agreement was reached between the State, Transurban and its contractor and sub-contractor to resolve all outstanding construction issues relating to the Western Link. Under the terms of settlement, the State agreed to pay Transurban and its contractors a total of \$10 million as full settlement of claims against the State in relation to works conducted on that section of the City Link. On completion of the settlement, the Minister for Transport engaged an independent Queen's Counsel in November 1999 to provide an independent assessment of the Western Link settlement. The counsel provided a report to the Minister in December 1999 and concluded that:

- having regard to the contractual arrangements, the State did have an exposure to Transurban and its contractors arising from the Western Link component of the City Link works;
- the decision to settle (and the related amount), rather than defend litigation was commercially justified; and
- in relation to the Western Link settlement, the City Link contract sufficiently protected the interests of the State and the taxpayers.

**7.104** In June 1999, the Transfield - Obayashi Joint Venture submitted claims against the State in relation to a range of matters relating to the Southern Link, including:

- alleged delay claims due to industrial action;
- alleged changes to tunnel ventilation requirements; and
- "material adverse effect" claims relating to industrial action.

**7.105** The State has consistently taken the view that the claims were not sustainable, but offered \$500 000 in the interests of reaching a settlement of all claims. This settlement figure was subsequently agreed, with contract documentation being signed in February 2000, and the \$500 000 paid in March 2000. In return for the agreed settlement, the contracted parties agreed to discharge and indemnify the State against all future claims in relation to works associated with the Southern Link.

*Valuation of concession fees*

**7.106** The Government's Annual Financial Statement includes concession fee notes (promissory notes) at a net present value of \$103.3 million as part of non-current assets. The net present value has been determined assuming that concession fee note payments will be deductible for income tax purposes by the issuer of the notes. We have been advised that the Australian Tax Office has issued a tax assessment to the issuer of the notes without the fee notes being claimed as a deductible expense. The note issuer has subsequently lodged an objection to the tax assessment. Based on the assessment and the known position at this point of time, the first encashment date for the notes becomes November 2026 rather than November 2014, which reduces the net present value of the notes to \$40.6 million. Accordingly, concession fee notes (promissory notes) which form part of non-current asset are overstated by \$62.7 million. While I issued a qualified audit opinion on the financial statements of the Melbourne City Link Authority, due to materiality considerations this issue was not referred to in the audit opinion issued on the Government's Annual Financial Statement.

Automated Ticketing System

**7.107** We have reported previously on the establishment of an Automated Ticketing System (ATS) by the Public Transport Corporation under an arrangement with OneLink Transit System Pty Ltd signed in May 1994. The purpose of the ATS is to provide automated ticketing and fare collection services to the metropolitan public transport system over a period of about 8 years from the date of commissioning which occurred in December 1998.

**7.108** Under the agreements with Onelink, the State will pay around \$300 million for the provision of the ATS over the term of the arrangements, which present a "service contract" under which the Treasurer of Victoria has provided a guarantee for the payment obligations of the Public Transport Corporation to OneLink.

**7.109** As mentioned in our *Report on Ministerial Portfolios, June 2000*, the fare revenue collection activities of the Public Transport Corporation were transferred to a company called Revenue Clearing House Pty Ltd wholly-owned by the State in July 1999. As part of the franchising arrangements of tram and train services, ownership of the revenue clearing house was transferred in August 1999 with the company jointly owned by the franchisees, and the Secretary of the Department of Infrastructure on behalf of private bus operators.

**7.110** OneLink has agreed to the assignment of the Public Transport Corporation's rights, interests and obligations under the ATS agreements to the Revenue Clearing House Pty Ltd on the basis that the Treasurer of Victoria continues to provide a guarantee for the payment obligations of Revenue Clearing House Pty Ltd under the service contract. **However, as at the date of the preparation of this Report, this formal assignment had not occurred and the Department of Treasury and Finance advised that the Government was drafting a revised guarantee acceptable to OneLink and the State.** In May 1999, the Public Transport Corporation and Revenue Clearing House Pty Ltd entered into an interim agreement, under which, generally speaking, the Corporation continues to manage the service contract, PTC receives fare revenue as agent of Revenue Clearing House Pty Ltd and Revenue Clearing House Pty Ltd is responsible to pay certain costs incurred by the Corporation under the service contract. These interim arrangements will cease to be necessary once the service contract is formally assigned to the Revenue Clearing House Pty Ltd.

#### *Monetary claims*

**7.111** Our *Report on the Annual Financial Statement, 1996-97* referred to an arrangement between the Public Transport Corporation and OneLink, signed in March 1997, which established the basis for the commissioning of the pilot stage of the project within a modified time frame and for the administration of claims between the parties. Under this agreement, OneLink waived its right to claim for any costs or monetary compensation for any extension of time previously claimed by it for the performance of its obligations under the previous agreements, where the delay was caused by the Public Transport Corporation. In addition, the Public Transport Corporation released OneLink from any claim for compensation resulting from any delay in performance of the service agreement prior to 21 April 1997, including the non-achievement of the pilot stage commissioning or commissioning of the remainder of the ATS. OneLink retained the right to claim for variations to specifications lodged between May 1994 and March 1997, however, these rights were suspended until after commissioning of the pilot stage.

**7.112** From the date of commissioning to 30 June 2000, the Public Transport Corporation has paid quarterly service charges totalling \$85.4 million to OneLink, comprising a capital (equipment) component of \$30.1 million and an operating component of \$55.2 million.

**7.113** As indicated in note 29 to the Government's Annual Financial Statement, in April 2000, OneLink submitted a claim to the Public Transport Corporation, amounting to \$132 million plus \$17 million per annum in the cost for ongoing maintenance of the equipment. This claim related to additional costs, change of scope, penalties and other types of damages arising from the contract. At the date of preparation of this Report, the Public Transport Corporation has assembled a task force consisting of legal advisors, financial consultants, engineers and ATS project staff to investigate the claim.

## OTHER FINANCIAL COMMITMENTS OF THE STATE

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**7.114** 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 2000, the public sector had operating and capital commitments of \$6.7 billion (30 June 1999, \$3.3 billion) including:

- operating lease commitments of \$1.2 billion;
- capital commitments associated with works not performed under existing contracts of \$1.4 billion; and
- other commitments arising from commercial arrangements of \$4 billion.

**7.115** As commented earlier in this Report, the increase in the year in the value of these commitments mainly relates to the impact of the public transport franchising arrangements associated with the provision of services and infrastructure to the public sector.

**7.116** As detailed in our previous Reports to the Parliament, over recent years, the Government has entered into various private sector financing arrangements commonly referred to as BOO/BOOT arrangements relating to the provision of services and infrastructure to the public sector. These arrangements allow for the establishment of the necessary infrastructure for public service provision without incurring public borrowings to finance large-scale capital intensive projects, with the transfer of various construction and operating risks to the private sector.

**7.117** Essentially, a BOOT project provides for a private sector organisation to Build a facility, Own it, Operate it during a concession period, and then Transfer it back to government. These projects differ from a BOO project under which Ownership is retained by the private sector. In both cases, the Government is required to pay fees to the private sector under long-term operating contracts, in many cases in excess of 20 years.

**7.118** Although BOO/BOOT arrangements generally do not result in the value of such arrangements being recognised as liabilities in the Statement of Financial Position, the transaction may give rise to rights and obligations which require appropriate disclosure. BOO/BOOT arrangements lead to long-term operating commitments which impact on public spending plans of current and future governments. **As a result, Parliament should always be fully informed of the extent of the associated commitments. In this regard, the Government's Annual Financial Statement has disclosed for the first time the value of the commitments associated with these arrangements. This additional disclosure represents a significant step forward in public sector reporting.**

**7.119** The total value of the disclosed commitments was \$4.04 billion which related to public infrastructure and associated services for prisons, hospitals, the water sector, the county court, public transport, the Traffic Camera Office, prisoner transport services and emergency services telecommunications.

**7.120** In my view, Parliament's understanding of the potential future expenditure would be assisted by disclosing the estimated payments for services over the contract period, similar to the disclosures provided for operating lease commitments, as a separate note to the accounts. This disclosure would be consistent with the international reporting trends for such arrangements.

**7.121** Detailed comment on certain of these arrangements entered into by the Government is provided in the following paragraphs.

### Mildura Base Hospital

**7.122** The former Mildura Base Hospital provided services to the Sunraysia region of Victoria since 1892. The hospital operated 120 in-patient beds over 2 campuses, located at Mildura and Red Cliffs, and was also a major referral centre for the Northern Mallee sub-region of Victoria and the south-west region of New South Wales.

**7.123** Over recent years, the hospital experienced financial difficulties and, despite the implementation of various cost reduction strategies initiated by its management, continued to perform below its financial targets. Management of the hospital attributed the deteriorating financial position to a shortfall in funding from the Department of Human Services under the casemix funding arrangements introduced in July 1993.

**7.124** A health consultant, commissioned by the Department of Human Services, undertook an initial review of the hospital in October 1995 and concluded that the hospital should assume a leadership role in the north-west region of the State through the encouragement of appropriate patient care and the development of new facilities and technologies. The consultant recommended the establishment of a new hospital under a build, own and operate (BOO) model to significantly improve health services in the region by overcoming the inefficiencies that existed from the operation of the ageing and inappropriately configured campus. The consultant identified that under the BOO model all major risks would be transferred to the private sector operator of the new facility.

**7.125** Following an assessment of the hospital's financial condition by the Department of Human Services in December 1996, it was concluded that the hospital was unable to cope with the needs of the Sunraysia region due to the dispersed locations of its campuses and the age of its buildings which constrained improvements in service delivery to patients. Late in 1996, the former Minister for Health commissioned further reviews of the former hospital to determine the most efficient and effective mode of patient service delivery in the Sunraysia region over the long-term.

**7.126** In January 1997, the Department of Human Services completed a service plan and market demand study which examined the needs and planning issues of the Hospital and concluded that a redevelopment of the existing hospital site would cost around \$18 million. At the same time, financial advisors estimated that the construction of a new hospital on a separate site would cost \$38 million.

**7.127** The Department of Human Services, commissioned the preparation of a Master Development Plan by a team of architects and engineers for the provision of hospital services in the Sunraysia Region. The Master Development Plan was completed in February 1997 and identified the following key matters contributing to financial difficulties:

- the inefficient layout and age of the physical facility;
- additional costs associated with isolation; and
- a visiting medical officers (VMO) dispute.

**7.128** Four options were developed as planning solutions, with the report recommending that the Department of Human Services redevelop the current Hospital site as the preferred option.

**7.129** At that time, the Department also appointed a firm of health specialists from the private sector to evaluate the feasibility of various options for a new hospital development and to compare these options against the proposals submitted to the Department. The feasibility study examined the 2 principal alternatives for the development of a new hospital: one on a section of the existing hospital site and the second on a new site in Mildura. The report detailed the works associated with the “Greenfield” options and estimated the physical planning, functional proposals and costs to provide a basis for comparison with the redevelopment option suggested in the 1997 Master Development Plan. The proposal for a new site in Mildura was selected.

*Bid evaluation and selection process*

**7.130** In May 1997, the Minister for Health approved the development of a tendering process for the establishment of a new hospital, to be located in Mildura, by the private sector for the provision of various health services to the community in the Sunraysia region. The Minister also requested that the bid evaluation and selection process should permit the bidders to include any new site in their bid including a site proposed by the Government.

**7.131** A Mildura Base Hospital Steering Committee, comprising representatives from the Departments of Treasury and Finance, and Human Services and a private sector accounting firm, was established in June 1997 to investigate and recommend to Government the most appropriate form of private sector involvement in the development of the hospital, and to oversee the bid selection and evaluation process.

**7.132** The Committee immediately proceeded to investigate the best possible option for the development of the hospital and appointed a firm of consultants to prepare a series of cost/benefit analyses and site valuation reports. These reports identified the following benefits that could flow to the public sector from private sector participation in a new hospital on a new site:

- all health service facilities would be located in a single storey construction;
- the Department of Human Services would benefit from operational cost savings of an estimated \$4.2 million per annum (compared with around \$1 million savings for the redevelopment of the existing hospital site);
- lower staffing costs would occur due to improvements in ward design, location of departments and reduction in travelling time;
- additional savings would be generated from changed organisational structures and practices such as improved management of theatres and maintenance arrangements;
- accountability for quality of service delivery could be ensured under a service agreement between the Department of Human Services and a private provider, and in the longer-term ownership of the Hospital could revert back to the Government; and
- the private operator could assume the risks associated with the planning, design and construction of a new hospital.

**7.133** The consultants also identified certain disadvantages such as the cost to government for retrenchment payouts of existing staff of the former hospital and local community opposition to the private sector model.



**7.134** In February 1998, the financial adviser to the Steering Committee of the Mildura Base Hospital determined a financial benchmark to assess whether it would be feasible to allow private sector participation in the project on the basis of a BOO arrangement. The benchmark represented the net present value of the cost to the Department, after allowing for grants from the Commonwealth Government, to operate and maintain over the term of the proposed arrangements, an equivalent public hospital in an equivalent setting with the same service profile. The financial benchmark was equal to \$211.3 million (in net present value terms).

**7.135** In September 1997, the Steering Committee recommended to the Minister for Health and the Treasurer of Victoria that registrations of capability should be sought from the private sector to undertake the Mildura Base Hospital project. In late November 1997, in response to an advertisement for registrations of capability, 6 expressions of interest were received by the Committee.

**7.136** An Evaluation Panel, comprising members of the Committee, was formed to assess the bids in accordance with the following evaluation criteria:

- Health services management (to ensure equity of access, deliver quality health services and maintain effective links with other service providers);
- Design, construction and implementation (to ensure functionality, technical process, service and quality, operational serviceability, relationship between recurrent and capital costs, relationship of facilities to surrounding natural and cultural environment);
- Finance (commitment and certainty of funding, degree of financial risk, financial capacity of the consortium, extent of financial contingency plans, cost to government service payments, capability and experience in successfully constructing and operating hospital projects); and
- General considerations (demonstrated ability to meet specified outcomes, certainty of project delivery, probity assessment of consortium members, demonstrated experience of consortia, conformity with objectives and project brief and acceptance of government policy).

**7.137** In December 1997, the Panel concluded that 4 consortia possessed the capacity to respond to the requirements of the project brief. The project brief was released to the shortlisted consortia in March 1998 and identified the following key project objectives:

- deliver a comprehensive hospital and health service, which meets the identified needs of the Sunraysia community;
- ensure optimal and seamless integration of services with other hospitals and health services provided in Mildura, tertiary referral centres, Sunraysia and neighbouring cross-border towns in New South Wales and South Australia;
- ensure that services are delivered at a reduced operating cost (compared with the existing hospital) while utilising standard funding mechanisms of the Department of Human Services such as casemix;
- ensure that the project meets government policy objectives and is implemented in accordance with the principles of the Infrastructure Investment Policy of the previous Government and effectively transfers risk (including those of owning the buildings and facilities) to the private sector where the private sector is best able to manage such risk; and

- ensure that all of the services and facilities of the new hospital are available for undergraduate education and professional training of medical students, doctors, nurses and other health professionals.

*Bid evaluation results*

**7.138** In September 1998 the Evaluation Panel, after considering the various bids received, concluded that the highest ranked bid be selected as the preferred consortium primarily on the basis that this consortium offered the greatest savings to the State.

**7.139** Shortly after, in response to a direction by the Minister for Health, the Department of Human Services commissioned a probity assessment of the highest ranked bidder to ensure the company's satisfactory standing for the granting of a licence to construct and operate the new Mildura Base Hospital. However, prior to the completion of this assessment, this consortium withdrew its bid. **In February 1999, the Minister announced the selection of Ramsay Health Care Ltd (the company), the second ranked bidder, as the selected private sector provider to build, own and operate the new hospital.**

**7.140** A probity auditor, appointed by the Steering Committee, to ensure the equitable treatment of private sector proponents during the tendering process, concluded in September 1999 that the processes followed in assessing the bids were fair and equitable and that there were no adverse findings arising from the probity assessment.

*Mildura Base Hospital Services Agreement*

**7.141** A Mildura Base Hospital Services Agreement, dated in March 1999 was executed between the Minister for Health on behalf of the State and the Mildura Base Hospital Pty Ltd. Consistent with the requirements of the Agreement, the Hospital was fully commissioned in September 2000.

**7.142** The Agreement detailed the specific conditions covering the design and construction of the hospital and the subsequent provision of services to public hospital patients in the region for a duration of 15 years, with an option for a further term of 5 years. In consideration for the receipt of service charges from the State, the company will operate and maintain the hospital and provide services to public hospital patients for the term of the Agreement, in line with prescribed performance standards. The specific services to be provided are as follows:

- acute health services;
- aged care services; and
- mental health services.



*The Mildura Base Hospital.*  
(Photo courtesy of the Department of Human Services.)

**7.143** As part of the agreed arrangements, the company purchased a new site for the hospital development including fit-out which in total cost \$33 million. The company also entered into an arrangement with the Department of Human Services requiring the company to transfer the ownership of the land to the State, with a 99 year lease granted to the company. At the end of the term of the Agreement, the State does not have a commitment to purchase or continue to utilise the hospital and the company may use the site for other purposes subject to the prior written consent of the State.

**7.144** The company provided the State with an indemnity for any claims relating to the design, construction and commissioning of the Hospital. The actual value of the works performed to design and construct the new Hospital was \$26.3 million, which was in accordance with budget estimates. There were no State contributions to the company for the construction of the hospital.

**7.145** The payments to the company for the delivery of services include charges in accordance with the Hospital Services Agreement and are projected to total \$211.3 million (in net present value terms) over the 15 year term of the Agreement.

**7.146** The company is responsible entirely for the costs associated with the ownership, operation and maintenance of the hospital. In addition, it is obligated to own or lease the essential equipment for the operation of the hospital and maintain, repair and replace plant and equipment as required. The company was also given the opportunity to purchase from the State, plant and equipment, machinery, appliances and office equipment owned by the State and used by the former hospital.

**7.147** Overall, the company will be solely responsible for delivering the services as specified and for any claims or damages, which may arise from the operation of the new hospital. Furthermore, the company is required to obtain and maintain all consents, approvals and accreditations required for operating the new hospital and will comply with all relevant laws and regulations.

**7.148** In addition, the company has assumed all demand risk associated with the number and type of patients using the hospital during the term of the Agreement. However, this risk is mitigated by the fact that the State has agreed not to utilise the former hospital site to provide health services to public hospital patients and has agreed not to enter into any agreement to purchase services from any other health facility in the Sunraysia region or to construct a new facility in the region for the term of the agreement. Furthermore, the State has agreed not to impose any laws or taxes, which may discriminate between the company in relation to the hospital, and other health facilities.

**7.149** Under the arrangements, in the event of an operating default which, includes failure to provide any of the agreed services to the required quality standard, abandonment, failure to obtain or maintain accreditation and clinical licenses, insolvency, breach of project documents and any threat to public health and safety which has not been successfully resolved, the State may demand monetary compensation from the company, appoint a replacement operator, assume management of the hospital or terminate the agreement where a suitable replacement operator cannot be found at the same price.

**7.150** Where the State has used its resources to provide public patient care as a result of an operating default of the company, the State is entitled to compensation for the equivalent amount it incurred in purchasing or providing required services from other hospitals. In the event that the operating default endangers the health or safety of the patients, the State is able to step-in and operate the hospital on a temporary or partial basis and again the State will be able to retain costs incurred during its intervention.

**7.151** If the State elects to permanently replace the operator or to require the sale of the hospital and the surrender of the hospital site (together with the plant, equipment, furnishings and fittings) to the State, the State must pay an agreed market value to be determined by an experienced and registered valuer.

**7.152** Other key terms of the agreement are outlined below:

- in the event that there are changes in law or government policy, which have a material adverse effect on the ability of the company to perform its obligations, the parties have agreed to consult with each other with a view to jointly resolving any hardships;
- the company is required to submit to the State periodic reports in line with reporting requirements of public hospitals and an annual report on the hospital's activities;
- in the event that the hospital is damaged or destroyed as a result of a *force majeure* event and the relevant event was not insured, the company will be responsible for the payment of all costs associated with the repair or rebuilding of the hospital; and
- the company has assumed the risk of industrial disputation, other than industrial disputation directed at the State.

**7.153** In summary, under the arrangements established by the State for the development and operation of the new Mildura Base Hospital, a private sector company has assumed all key risks associated with the design, construction, ownership and operation of the hospital. In return for the provision of the required health services, the company will be entitled to receive specified fees from the State, mainly based on casemix activity and the payment of other health-related services fees, the value of which is consistent with a financial benchmark determined prior to proceeding with the arrangement for an equivalent public hospital.

## Victorian County Court project

**7.154** The County Court has jurisdiction for civil cases and criminal matters specifically conferred by statute and can hear appeals from the Magistrate's Court and the Family Division of the Children's Court. Currently, the Court operations are conducted over several sites predominantly at a William Street, Melbourne, location.

**7.155** In 1995, the Department of Justice commissioned an external consultant to review the adequacy of existing and future facility requirements of the Court. The consultant concluded that the Court's policy objectives would not be achieved with the existing facilities. The review identified a number of risks and deficiencies with the current facilities impacting on Court operations including: inadequate court facilities to meet demand; presence of asbestos restricting the introduction of information and communication technology; non-compliance with building regulations; and inadequate security, custody and other service facilities. The consultant recommended that the existing Court facilities be consolidated onto a single site by the year 2015.

**7.156** In 1996, the Department proposed direct capital works funding for the construction of the Court. The Department of Treasury and Finance advised the Department to reconsider the project under the financing options that involve the private sector as outlined in the Government's Infrastructure Investment Policy.

**7.157 In June 1997, Cabinet approved the Department's recommendation to provide the new Court facilities and ancillary court services in a single site location utilising the BOO model** and to approach the private sector for Registrations of Capability (RoC). The recommendation was made on the basis that the preferred BOO option provided:

- The lowest net present value of the net capital and recurrent costs over a 20 year life of the options considered;
- An estimated \$18.9 million of government and non government productivity gains; and
- An estimated capital development cost under public sector delivery of \$113.3 million (at 1997 values) including land purchase costs and project management fees. By comparison, the estimated project costs for delivery via the private sector was \$100 million.

### *Bid evaluation and selection process*

**7.158** Following the Government's approval of the project, the Department proceeded to establish a project management team to facilitate the delivery of the new Court. The project management framework included the establishment of the:

- Project Steering Committee - Primarily responsible for providing policy direction and overseeing project delivery;
- Victorian County Court Project Team (the VCCP team) - Responsible for the selection of short-listed proponents, the preparation of the Project Brief, the selection of a preferred bidder and finalisation of contractual relationships with the preferred bidder. The VCCP team is also currently overseeing the construction phase of the project for the Department.

To assist in the evaluation of tenders, the VCCP team engaged external consultants including financial, legal, security, communications, and planning and construction to act as advisors to the project. A probity auditor was appointed to ensure that all bidders are accorded equal and fair treatment and that probity is observed during the selection process; and

- Court Liaison Group - Comprised key stakeholders including several judges of the Court, including the Chief Judge and members of the VCCP team. Its purpose is to ensure that all key stakeholders were provided with timely and accurate information about the Project and to provide an opportunity for stakeholders to provide input into the Project.

**7.159** In early September 1997, the Attorney-General publicly announced plans for the construction of the new County Court by mid-2000. The objectives for the project were:

- for the private sector to deliver a modern County Court facility and ancillary services in a cost-effective manner;
- to transfer those risks best managed by the private sector from the State, in accordance with the Government's Infrastructure Investment Policy;
- to complete construction of a new County Court facility for departmental occupation on or before 1 July 2000;
- to establish a model for private sector participation in the delivery of Court facilities and services; and
- to maximise private sector investment in Victorian infrastructure and encourage private sector innovation in delivery of the project.

**7.160** Interested parties were invited by public advertisement to register their capability for the project by mid-October 1997. The VCCP team received 10 registrations of capacity (RoC). Each submission was assessed against established eligibility and suitability criteria and reviewed by the evaluation panels.

**7.161** The evaluation process resulted in a recommendation for the short-listing of 3 bidders. However, on the recommendation of the Attorney-General and the Department of Treasury and Finance, the fourth ranked bidder was also shortlisted due to the marginal difference in the rating and the bidder proposal which included a different location for the construction of the Court.

**7.162** In June 1998, the Project Brief was issued to the 4 shortlisted parties and by mid-October 1998, 3 submissions were received.

**7.163** In early January 1999, the VCCP team eliminated one bidder as scoring substantially lower on the agreed criteria and with a higher price. Of the 2 remaining bidders, the VCCP team identified that both bidders could be appointed to preferred bidder status on the basis of design and construction and Court services component of the evaluation criteria. **However, neither of the bidders totally met the Government's financial benchmark in net present value (NPV) terms. Both substantially exceeded the Government financial benchmark and, as a result, the VCCP team recommended that the financial benchmark be re-assessed. Nevertheless, the VCCP team made a conditional recommendation to the Committee to appoint one of the bidders as the preferred bidder on the basis that the submission was substantially more attractive than the other bidder and adequately addressed all the financial objectives as stated in the Project Brief.**

**7.164** In mid-January 1999, the Committee considered the VCCP team report and subsequently advised the Attorney-General and the Treasurer that the project financial benchmarks were not met and accepted the recommendation of the VCCP team to review the benchmark. In the following month, the Department of Treasury and Finance engaged an external financial consultant to review the assumptions and methodology of the benchmark used in the evaluation process by the Department of Justice. The consultant's analysis found that the project funding estimates were conservative and did not reflect the full service and facilities specifications of the Project Brief or the associated project risks, with instances identified where the basis for the original assumptions underpinning the original government benchmark was no longer valid. Based on revised assumptions, the consultants calculated a revised NPV of \$279.5 million which was 24 per cent greater than the original NPV of \$225.2 million applied in the initial evaluation of the bids.

**7.165** As a consequence of the consultant's findings, the VCCP team re-assessed the short-listed submissions and determined that:

- the lowest bidder's cost (NPV of \$304.7 million) was 9 per cent greater than the revised government benchmark, with the next lowest bid being 47 per cent above the benchmark; and
- the total facility charge, in the first full year, for the lowest bidder amounted to \$30.2 million. This was \$15 million above the approved budget forward estimates. However, the teams considered that this shortfall could be addressed through negotiation to reduce the annual cost of the bid by at least \$3.3 million from 2001-2002, additional project funding supplementation of \$7.2 million, increasing court fees in civil proceedings – raising an additional \$3 million from 2001-2002 and through other departmental savings.

**7.166** In June 1999, the Attorney-General endorsed the Committee's submission to Cabinet to approve the project proceeding under the Government's Infrastructure and Investment Policy and the proposed project funding supplementation.

**7.167** In late July 1999, following an analysis of the risk and other financial and commercial issues, the Attorney-General and the Treasurer endorsed the Committee's subsequent recommendation that the short-listed bidders be provided with the opportunity to better the public sector benchmark by means of a "Best and Final Offer" process.

**7.168** In late July 1999, short-listed bidders were invited to present a best and final offer by mid-August 1999. However, following an opinion by the probity auditor, this process was conditional and dictated aspects to which the bidder may or may not change their original submission.

**7.169** The evaluation process was completed in early September 1999 by the VCCP Team. All 3 short-listed bidders submitted final offers, however, only The Liberty Group, exceeded the revised NPV benchmark by \$16.4 million. On the basis that the consortium's bid continued to comply with the project brief in service and accommodation quality terms and in their financing regime, and the bid aligned itself to the financial benchmark, the VCCP team conditionally recommended that The Liberty Group be appointed as the preferred bidder. However, ratification of the recommendation by Cabinet was postponed due to the forthcoming October 1999 State election.

**7.170** Following the change in government, the Department was directed to revisit options for delivering the project. Subsequently, in December 1999, Cabinet was presented with 3 options for procurement of the Court, including:

- Public sector delivery involving the traditional procurement approach of seeking tenders from the market for the design and construction of the new facility and public sector operation of the facility;
- Public/Private Partnership Model involving the private sector developing the facility using private sector financing, providing facility management, building maintenance, and security services and an information technology systems. However, core Court services, including Court administration, judicial support and jury supervision functions, prisoner management, and court reporting and recording services to be retained by the public sector; and
- Private Sector Build, Own, Operate where all facilities and specified Court services are provided by the contractor as described in the Project Brief.

**7.171** Based on the Year 1 cost comparison of the 3 alternative procurement options, the Public/Private Partnership Model provided the least total NPV cost over a 20 year term of \$237.3 million. The NPV cost for the private sector build, own, operate approach was marginally higher amounting to \$238 million, while the public sector approach had a NPV cost totalling \$254.7 million. The NPV calculation on all 3 options was adjusted for the cost of the land which was to be provided by the State.

**7.172** Taking into account other commercial elements, in particular the opportunity for broader commercial development options of the recommended bidder, operational risks, and potential productivity gains, the Public/Private Partnership Model was considered the preferred option. Based on this final analysis, Cabinet in December 1999 approved the continuance of the project and recommended the Public/Private Partnership Model approach to project delivery. The Attorney-General subsequently approved the appointment of The Liberty Group as the preferred bidder for the project and authorised the Department to commence contract negotiations with The Liberty Group.



**7.173** The Liberty Group is a consortium consisting of Multiplex Constructions Pty Ltd and ABN AMRO Australia Ltd, and a number of sub-contractors. The Liberty Group is a project-specific company established for the bidding and construction of the County Court and is overseen by Perpetual Trustees Company Ltd who are trustees of the debt and equity contributors.

**7.174** Prior to arriving at the contract price, the Public/Private Partnership Model benchmark was adjusted to take account of the retention of core court services by the Department including persons in custody and in court technology.

**7.175** Following finalisation of contract negotiations with The Liberty Group in early June 2000, the Attorney-General, with the endorsement of Cabinet, entered into a contract for the provision of a new County Court facility pursuant to a private/public sector procurement model for a final negotiated contract price of \$193.26 million in net present value terms, over a 20 year period. The agreed contract price equated to the revised Public/Private Partnership Model benchmark.

**7.176** Throughout the tendering process, the probity auditor appointed by the Department to oversee the tender process, concluded that all bidders received fair and equitable treatment, were evaluated and ranked fairly in accordance with agreed selection criteria and that there was equity associated with the change in the procurement model. As at the date of signing the contract, the probity auditor reported no outstanding probity issues.

**7.177** At the date of preparation of this Report, the Department was considering its options for the existing County Court site including disposal or alternative use of the building by the Department.

**7.178** The new County Court will form part of a 42 000 square metre building currently being constructed diagonally opposite the present County Court in William Street, Melbourne. The new County Court will comprise 46 Courtrooms, new judges' chambers, jury areas and associated facilities.

**7.179** Construction of the County Court facilities commenced in June 2000. The contractor is required to substantially complete the judicial building structure up to level 4 by May 2001, followed by completion of construction and commissioning, after which the Department will issue an acceptance certificate by May 2002.



*Artist's impression of the new County Court facility.  
(Drawing courtesy of the Department of Justice.)*

### *Contractual framework*

**7.180** Contractual agreements between the State, The Liberty Group (the contractor), ABN AMRO Australia Ltd (the project financier), Multiplex Construction Pty Ltd (the project builder) and the service providers were executed in early June 2000. These included the following:

#### *Court Services Agreement*

**7.181** The Agreement provides for the development of a County Court facility, provision of Court accommodation (for a 20 year period), as well as building management and security services (for an initial period of 5 years). The Minister has the option for 5 extensions of 3 years each for Court services. Alternatively, the Minister may tender out the delivery of Court services at the end of the initial or subsequent terms. The Minister has no obligation to renew the Agreement. The contractor has the ability to re-lease or sell the facility to another party, or to convert the facility for alternative use at the end of the 20 year term of the provision of Court accommodation.

#### *Ground lease*

**7.182** The contractor is required to construct the new County Court on land controlled by the Department and leased to the contractor (the lessee) for a 99-year period. The total site was valued at \$14.9 million by the Valuer-General, with the portion of the land to be used by the contractor for commercial development purposes subsequently sold to the contractor for \$3.5 million, as valued by the Valuer-General.

**7.183** Under the lease agreement, a nominal rental of \$1 per annum is payable for the duration of the Court Services Agreement (20 years), and the remainder of the ground lease term, provided the lease has not been terminated.

**7.184** The ground lease can only be terminated, prior to completion of the Court facility, where a construction default occurs. Such a default can arise from either the contractor's failure to achieve construction milestones by prescribed target dates or failure to perform all their relevant contractual obligations. **Where the ground lease is terminated prior to the completion of construction of the facility, the Department is required to pay the contractor for completed works, up to an amount, not exceeding the total project cost.**

**7.185** In the event that the Court Services Agreement is terminated following construction of the facility, the contractor retains its rights to the leased land, however, **the State is to be paid rent based on market rates (commencing 3 years from the date of termination).** The State's only remedy for any breach of the lease agreement is the right to sue for damages or specific performance. At the end of the lease, where requested by the State, the contractor must remove all property from the land and remedy any contamination or pollution. Any property remaining on the land becomes the property of the State.

#### *Multiparty agreement*

**7.186** A Multiparty Agreement has been entered into between the State, the contractor and Perpetual Trustee Company Ltd (the Trustee). This Agreement details the remedy options of any defaults by the contractor under the Court Services Agreement, the State's step-in rights and arrangements for the Trustee right to cure contractor's non-compliance to avoid termination.

**7.187** The Agreement provides for the assignment to the Trustee of a security interest over the contractor's rights, title and interest in the Court Services Agreement, the lease and the facility. The State and Trustee agree that the fixed and floating charge with the financiers at all times rank first in priority to the State's security.

#### *Concluding comments*

**7.188** **The Liberty Group Consortium Pty Ltd was selected as the preferred tenderer 3 years from the date of the public announcement by the Minister to seek private involvement in the construction of the Victorian County Court facility.** Under the Court Services Agreement, The Liberty Group will construct the Court and related facilities on Crown land. The Crown land is leased to the Liberty Group on nominal terms over a 99-year period (the notional rental is offset against the fees over the 20-year contract term).

**7.189** **As at 30 June 2000, the net present value of the obligations of the Department to pay accommodation and Court services to The Liberty Group is estimated to be \$193.26 million, which has been disclosed in note 28 in the Government's Annual Financial Statement.**

**7.190** The Liberty Group is to provide accommodation services to the State (located on 7 of the 9 floors of the main Court building) for a period of 20 years and defined Court services to the State for an initial period of 5 years with renewal options. Accommodation services initially include 46 Courtrooms, plus related jury, witness, administration and registry accommodation, and custody facilities. Court services includes the provision of building management, security services and information technology. **The Department is obliged to pay the contractor fixed use payments, court reservation fees, Court usage fees and Court service fee. In addition, the State is required to make an upfront payment of \$3 million for Court services to assist the contractor in meeting costs associated with consultants, building design, staff training and sub-contractor upfront payments.**

**7.191** In my opinion, despite the retention of certain defined obligations, The Liberty Group bears substantial risks associated with the construction, financing and operation of the Court facility. The risks retained by the Department include the utilisation of the minimum reserved capacity over the 20 year period. In addition, the State retains the risk associated with the costs of pre-existing contamination, native title claims, modification works requested by the State, delay costs caused by government acts of prevention, movements in the CPI impacting on the Court service fee, additional contractor costs arising from changes in law (adversely affecting delivery of service) and changes in government policy.

**7.192** In the event of a termination event at pre-completion stage, the contractor is entitled to claim the value of the works completed, up to an amount, not exceeding the total cost of the project. In the event of a termination event post-completion, such as an irretrievable accommodation service failure, the site is retained by the contractor, with the State entitled to the market value rental over the remaining agreed period.

### Infrastructure projects - Regional water authorities

**7.193** In 1997, the Government announced a \$410 million regional reform package as a major water service and infrastructure initiative for rural Victoria. The primary objectives of the reform package were that:

- all reticulated drinking water in the State met the health-related parameters of the 1984 World Health Organization Guidelines by 1999;
- all sewerage treatment plants in the State discharge effluent to standards consistent with the State's Environment Protection Policy by 2001;
- all towns in the State with a population of more than 500 people and with reticulated water be supplied by sewer facilities by 2001, unless exempted by the Environment Protection Agency; and
- water supply authorities with significant dams to carry out any necessary dam improvement works by 2003.

**7.194** In addition, the Government required all water authorities to reduce tariffs by an average of 18 per cent from 1 January 1998.

**7.195** With regard to the efficient delivery of capital projects, the Government's objectives included:

- co-operation between non-metropolitan urban water businesses to ensure the most effective utilisation of the capital to be invested in all capital projects; and
- the maximum amount of private sector involvement in design, construction, ownership and operation of infrastructure, consistent with lowest cost to customers.

**7.196** In December 1997, Memorandums of Understanding were entered into between the 15 non-metropolitan urban water authorities and the Minister for Agriculture and Resources which outlined the principal conditions associated with State funding provided by the State and included submissions from each non-metropolitan urban water authority detailing proposed projects that would achieve the State's reform package objectives. These Memorandums of Understanding also incorporated agreed drinking water quality and sewerage treatment standards, authorised application of funds and the extent of funding to be provided by the State.

**7.197** In respect of proposed capital works the Authorities were required to undertake project evaluations in accordance with the Government guidelines. **If accepted by the Treasurer, the projects proposed are required to undergo a competitive tendering process and be delivered using the private sector through a build, own and operate (BOO) or build, own, operate and transfer (BOOT) model, or variations thereof.**

**7.198** The following paragraphs provide an analysis of the tendering and contractual arrangements entered into by Central Highlands, Coliban and the Grampians Regional Water Authorities for the construction of water related infrastructure and the provision of associated services.

#### *Grampians Region Water Authority*

**7.199** The Grampians Region Water Authority serves approximately 52 000 people, provides water to 74 towns and manages the sewage systems of 21 towns. The Authority geographically services the largest area of any water authority in the State, extending 200 kilometres, east to west from Charlton to the South Australian border and 300 kilometres, south to north from Lake Bolac to Ouyen covering nearly the entire Wimmera Mallee region.

**7.200** The Memorandum of Understanding entered into between the Authority and the Minister for Agriculture and Resources in December 1997 incorporated a number of water projects including the Grampians Growth Corridor Project, comprising the construction of water treatment plants at Ararat, Stawell, Pomonal/Lake Fyans, Great Western and Halls Gap.

**7.201** The estimated cost of construction of the water treatment plants and additional infrastructure amounted to \$18 million and was scheduled for completion by December 1999.

#### *Bid evaluation and selection process*

**7.202** As a result of the Government's preference to involve the private sector, the Authority investigated the appropriateness of the BOOT/BOO model. In May 1998, an externally appointed project manager reported to the Authority that the identified projects "lent" themselves to a BOOT model. Based on the project manager's assessment, the Authority subsequently resolved to seek expressions of interest from the private sector.

**7.203** In June 1998, the Authority established a Project Steering Committee comprising the Chairman of the Board, 2 other Board members, the Chief Executive Officer, Chief Finance Officer, a Technical Officer of the Authority, a Project Manager and a representative from the Department of Treasury and Finance. The Project Steering Committee was responsible for recommending to the Board the successful contractor to undertake the proposed BOOT projects. The Steering Committee was assisted by a sub-committee and external legal, financial and technical advisors.

**7.204** Following the Treasurer's approval in June 1998, the Authority formally advertised for expressions of interest for the Grampians Water Growth Corridor project and the design and construction of water infrastructure pipe works in Ararat, Stawell, and Halls Gap to be undertaken concurrently under a BOOT project model. In July 1998, 7 parties registered their tender bids with the Authority. The sub-committee assessed each bid against certain criteria.

**7.205** In July 1998, following the endorsement of the sub-committee recommendation, the Project Steering Committee subsequently recommended to the Board that 4 parties be short-listed for the project.

**7.206** The Request for Proposal was released to the short-listed proponents following its approval by the Treasurer and the Board in August 1998. The project was expected to be delivered under a BOOT model, provided that the bids were acceptable to the Authority and exceeded the internal benchmarks established by the Authority which incorporated financial, commercial, technical and operational benchmarks.

**7.207** The Authority received responses from all of the short-listed parties in early November 1998, which were evaluated by the sub-committee. The Project Steering Committee in November 1998 reported to the Board that the short-listed bidders' proposals contained a number of departures from the Authority's specified requirements. In addition, other elements of the proposals varied from the Authority's position, in particular in relation to the treatment and acceptance of risk transfer.

**7.208** On the approval of the Board, the Authority requested the short-listed parties to re-submit the proposals taking into account revised proposed legal documentation and additional information made available to the short-listed parties relating to the project.

**7.209** The sub-committee reassessed the revised offers in December 1998 and recommended to the Steering Committee and subsequently to the Board that negotiations proceed with Aqua Tower Pty Ltd, which was identified as the preferred bidder on the basis of price, risk transfer and other commercial and technical criteria.

**7.210** In December 1998, the Board endorsed the Steering Committees recommendation on the condition of finalising outstanding commercial, legal and technical issues by the end of that month.

**7.211** Subsequent to the Board's approval to execute the deed with Aqua Tower Pty Ltd in February 1999, the Authority became aware during final negotiations that a guarantor to Aqua Tower Pty Ltd, was experiencing certain financial difficulties. Aqua Tower Pty Ltd advised the Authority that one of the companies, in the guarantor group, had been placed in receivership and subsequently advised that all of the companies within the group had been placed into voluntary administration.

**7.212** In late March 1999, the Authority requested the Aqua Tower Pty Ltd to demonstrate to the satisfaction of the Authority that it had the financial, technical and operational capacity to perform and observe all of its respective obligations under the proposed contractual arrangements.

**7.213** In late May 1999, Aqua Tower Pty Ltd confirmed that a new company JJB Group Holding Pty Ltd had been formed, which is a wholly-owned subsidiary of Abigroup Contractors Pty Ltd. The company further confirmed that its bid remained unchanged. In reassessing the Aqua Towers offer, the Authority sought financial and commercial advice from their financial advisors in relation to ability of Abigroup Contractor Pty Ltd to provide equity, to support its obligations as guarantor, acceptance of external financial arrangements, and the acceptance of the risk profile previously negotiated with Aqua Tower Pty Ltd. The Authority's financial advisors advised that Abigroup Contractor Pty Ltd appeared to satisfy the aforementioned requirements.

**7.214** The Steering Committee, satisfied that the concerns raised were adequately addressed, proceeded with negotiations with the Aqua Tower consortium. The agreement was formally executed on 31 August 1999 subject to certain conditions precedent.

**7.215** In September 1999, the probity auditor appointed by the Authority to oversee the tender process advised that no probity requirements had been contravened throughout the tender process and no issues remained outstanding.

#### *Water Treatment Services Agreement*

**7.216** The Water Treatment Services Agreement executed between the Authority and Aqua Tower Pty Ltd provided for the design, construction, finance, operation, maintenance and repair of new water treatment facilities to be built at specified sites so that each facility is capable of providing services to the Authority in accordance with the terms and conditions of the Agreement. The Contractor has agreed to build, own, operate and transfer back to the Authority, after 25 years, 4 water treatment plants located in Ararat, Stawell, Pomonal near Halls Gap and Great Western for a nominal amount. In addition, the contractor has also agreed to design and construct water infrastructure pipe works in Ararat, Stawell and Halls Gap.

**7.217** Works commenced on the Stawell Water Treatment project in December 1999 and by May 2000, works had commenced on all remaining water treatment plants and infrastructure works. These works were due to be completed between October to December 2000.

**7.218** As at 30 June 2000, the net present value of the obligations of the Authority to pay fixed and variable service charges to Aqua Tower Pty Ltd was estimated at \$22.9 million.

**7.219** In addition to the construction of the 4 water treatment plants, the **Authority engaged the contractor to design and construct a specific infrastructure upgrade, for a fixed price of \$3.6 million payable upon completion of the approved works.**



*Commencement of the construction of the water treatment facility at Halls Gap.  
(Photo courtesy of the Grampians Region Water Authority.)*

#### *Concluding comments*

**7.220** Under the terms of the arrangement, the contractor shall design, construct, finance, maintain and operate the facility. At the end of the 25 year period, the contractor is to transfer all the assets to the Authority for a nominal amount. In return for the provision of these services, the contractor will be entitled to receive fixed and variable service charges estimated at \$22.9 million. This excludes the additional contract works for a fixed contract payment of \$3.6 million, payable upon completion of the approved works, in respect of the design and construction of a specific infrastructure upgrade. The Authority is able to reduce the charges in the event of the promoter not meeting minimal performance standards.

**7.221** In my opinion, despite the retention of certain defined obligations, the contractor bears substantial risks associated with the construction, operation and financing of the 4 treatment plants. These include the risks associated with construction, commissioning, financing and operation. The Authority has retained certain defined risks including the costs associated with addressing specific issues relating to public health, changes in law and movements in the consumer price index. In default circumstances which result in the termination of the deed prior to expiry of the 25-year term, the site lease is to be terminated and the facilities are to revert to the Authority.



*Central Highlands Region Water Authority*

**7.222** Central Highlands Region Water Authority serves a population of 112 000 covering 60 communities within the Central Highlands region. The service area covers the Ballarat and Maryborough districts, and includes the townships of Daylesford, Beaufort, Avoca and Navarre. Central Highlands is responsible for 28 reservoirs, 3 weirs, 3 water treatment plants and 10 disinfection plants.

**7.223** In October 1995, the Authority engaged a consultant to review the location and capacity of water treatment facilities for the Ballarat water supply. Existing water supplies for Ballarat are sourced from 2 reservoirs, namely, the White Swan Reservoir to the north of Ballarat and Lal Lal Reservoir to the south-east of Ballarat. The review forecast a population growth from 1993 to 2015 of around 38 per cent and an increase in average annual demand for water of 44 per cent over the same period. The report identified that the projected ultimate annual demand beyond 2015 (31 400 Mega Litres) is approximately equal to the combined water capacity of the existing facilities from the White Swan and Lal Lal Reservoirs. The report analysed a number of options and recommended that based on estimated capital and operating costs, the preferred strategy would be to construct water treatment sites at White Swan and Lal Lal Reservoirs.

**7.224** In 1997, the Authority evaluated possible options to deliver the Ballarat Water Treatment Supply Strategy. The Authority confirmed the recommendations of the consultant provided in October 1995. This preferred option was included in the Memorandum of Understanding entered into with the Minister of Agriculture and Resources in December 1997.

**7.225** The design, construction and operation of the 2 water treatment plants was estimated to cost \$31 million and was anticipated to be completed by December 1999.

*Bid evaluation and selection process*

**7.226** In December 1997, the Authority established a Project Steering Committee comprising the Chief Executive Officer and other senior staff members of the Authority, a representative from the Department of Treasury and Finance and a project manager to oversee the evaluation and tender process. The Project Steering Committee was responsible for recommending to the Authority's Board the preferred provider.

**7.227** The Authority also established a sub-committee consisting of members of the Project Steering Committee and engaged the assistance of external financial, commercial, legal and technical advisors. A probity auditor was also appointed by the Authority to oversee the tender process.

**7.228** Following approval by the Treasurer in March 1998 of the proposed Ballarat Water Treatment Project, the Authority sought registrations of capability to undertake the project. By late April 1998, 11 registrations of capability were received and were evaluated by the sub-committee.

**7.229** Based on the recommendations of the Project Steering Committee, the Authority's Board resolved in May 1998 to provide a project brief to 4 short-listed proponents.

**7.230** In June 1998, following the approval of the Treasurer, the Project Brief was released to the 4 short-listed proponents on the basis that the tender process would be split into 2 components, being:

- technical and project scope issues - to be lodged early September 1998; and
- legal and commercial issues - to be lodged late September 1998 (this date was subsequently extended to mid-October 1998).

**7.231** To facilitate the evaluation of proposals, the Authority developed project benchmarks against which private sector submissions would be assessed to determine whether it was feasible to allow private sector participation in the project on the basis of a BOOT arrangement.

**7.232** A report prepared in December 1998 by the sub-committee concluded that the short-listed bidders did not exceed the Authority's risk and financial benchmark components. Accordingly, the Board resolved that the 2 highest ranking proponents would be invited to resubmit their bids.

**7.233** In mid-February 1999, the Project Steering Committee recommended to the Board that Thames Water (Holdings) Pty Ltd be selected for the project. The recommended proponent was selected on the basis that the bid bettered the Authority's cost benchmark, outranked the competing bids in terms of price and contract delivery, and the proponent's offer represented good value for money in that it offered high quality treated water at an affordable price, a commercial risk profile for the project, and full project support of an experienced and capable international water company.

**7.234** Prior to Board approval, a probity auditor appointed in February 1998 submitted a report which confirmed that the proponents were evaluated and ranked fairly against agreed selection criteria and had been accorded fair and equitable treatment and that there were no outstanding issues that had impacted on the tendering process.

#### *Water Treatment Services Deed*

**7.235** The Water Treatment Services Deed was executed between the Authority and Thames Water Ballarat Pty Ltd (the promoter) in mid-April 1999. The Deed provides for the design, construction, commissioning, operation, maintenance and financing of water treatment facilities. The promoter is to operate and maintain the water treatment facilities and ensure that treated water is delivered to the Ballarat region and neighbouring communities over a period of 25 years. The promoter will transfer the facility to the Authority at the end of the term for a nominal amount. The land of which the facilities are to be constructed remains the property of the Authority.

**7.236** Thames Water Ballarat Pty Ltd was established for the specific purpose of bidding for the Ballarat water treatment project. Thames Water Ballarat Pty Ltd is a wholly-owned subsidiary of Thames Water Holding (Australia) Pty Ltd, which in turn is wholly-owned by Thames Water Plc, a UK-based company and having global interests in the water and wastewater industry.

**7.237** Thames Water Ballarat Pty Ltd is required to build, own and operate the treatment facilities, on lands owned by the Authority located at White Swan Reservoir and the Lal Lal Reservoir. **Existing assets on this land including buildings, items of plant and equipment at a written-down value of \$1.5 million were transferred to the promoter on 1 July 1999 at a nominal amount.**

**7.238** Construction of the water treatment plant commenced in June 1999 with commercial acceptance of the new treatment facilities achieved in October 2000. However, this was extended to late August 2000 with technical completion rescheduled to November 2000.

**7.239** As at 30 June 2000, the net present value of the obligations of the Authority to pay fixed and variable service charges to Thames Ballarat Pty Ltd is estimated to be \$54.39 million over the 25 year term.

*Concluding comments*

**7.240** In my opinion, despite the retention of certain defined obligations, the contractor bears substantial risks associated with the construction, operation and financing of the 2 treatment plants on lands owned by the Authority located at White Swan Reservoir and Lal Lal Reservoir. These include the risks associated with construction, commissioning, financing and operation. The Authority has retained certain defined risks including the costs associated with construction modifications requested by the Authority, augmentation works, addressing specific issues relating to public health, changes in law and movements in the consumer price index. In default circumstances which result in the termination of the deed prior to expiry of the 25-year term, the site lease is to be terminated and the facilities are to revert to the Authority.

**7.241** The financial commitments associated with these arrangements are disclosed in note 28 to the Government's Annual Financial Statement.

*Coliban Region Water Authority*

**7.242** Coliban Region Water Authority provides water and wastewater services to 130 000 retail urban and rural water customers across 16 500 square kilometres of central and northern Victoria. The Authority serves some 55 towns or service systems, including Bendigo, Castlemaine, Kyneton and Echuca. The Authority provided over 44 500 wastewater services and supplied water to 57 200 residential and non-residential customers.

**7.243** In December 1997, the Authority and the Minister for Agriculture and Resources entered into a Memorandum of Understanding incorporating a number of potential BOO/BOOT projects including the Castlemaine Wastewater Treatment Project and the Aqua 2000 Project.

*Castlemaine Wastewater Project (and other works)*

**7.244** In 1995, the Authority recognised that the Castlemaine sewerage system was in need of improvement in order to comply with Environmental Protection Authority requirements and to provide a reliable and cost-effective system to cater for future growth. Following several studies, the Authority identified several options and concluded that the preferred option for meeting the Castlemaine sewerage disposal requirements was to construct a new wastewater treatment plant at the existing site. The new facility was to incorporate parts of the existing facility.

**7.245** The proposed Castlemaine Wastewater Treatment Plant at Castlemaine and associated facilities were intended to service an equivalent population of 13 000 including a major meat processing business located within the Castlemaine area. The construction was estimated to cost \$9.7 million.

*Bid evaluation and selection process*

**7.246** Following the Authority's Board endorsement to progress the Castlemaine Water Treatment Project via a BOO arrangements in January 1997, the Authority established a Project Steering Committee. This Committee comprised the Chief Executive and other senior members of the Authority, a representative from the Department of Treasury and Finance and an externally appointed project manager. The Steering Committee was to oversee the management of the project, endorse the scope of the expression of interest and the request for proposal, endorse the evaluation criteria and process, assess the submissions and evaluations, and recommend the preferred proponent to the Authority's Board. The Project Steering Committee was supported by sub-committees and external probity, legal, financial and technical advisers.

**7.247** In March 1997, the Treasurer endorsed the project and the Authority sought expressions of interest in April 1997. Prior to the formal release of the expression of interest brief, the Authority recognised that an improved commercial result may be achieved by allowing flexibility in the scope of the project in order to encourage interest from a diverse range of companies. The Authority subsequently expanded the scope of the project and resolved that the development of the project and associated facilities would be completed using either a BOO or BOOT approach, subject to the final negotiated development proposal commercially meeting or exceeding the Authority's developed benchmark.

**7.248** The final scope of the project comprised the following works:

- the Castlemaine Wastewater Treatment Plant, pre-treatment for Castle Bacon Pty Ltd, and upgrade of a trunk sewer and pump stations;
- the Maldon sewerage reticulation scheme, including connection to the Castlemaine Wastewater Treatment Plant; and
- sludge processing and disposal at the Epsom Wastewater Plant (Bendigo).

**7.249** The estimated capital cost for the expanded works was \$20.6 million. The key selection criteria applied by the Authority evaluated the ability of tenderers to satisfy the technical requirements of the project, provide a sustained quality solution, innovation of approach, financial viability and management skills of the bidder.

**7.250** Following the advertisement seeking expressions of interest, the Authority received 10 registrations for expression of interest in May 1997. The Authority's Board approved the recommendation from the Project Steering Committee that 3 preferred bidders proceed to the "Request for Proposal" stage.

**7.251** Following the approval of the Treasurer, in September 1997, the Request for Proposal was released to the 3 prospective bidders, with final proposals received in late October 1997.

**7.252** A sub-committee undertook a detailed evaluation of the final proposals in early December 1997, evaluating each bid against both qualitative and quantitative criteria. Qualitative criteria assessed included the achievement of the Authority's objectives, financial capacity, structure, commitment and certainty, design suitability and flexibility, innovation and surety of guarantees and securities. Quantitative criteria not only included results of modelling applied to each proposal and the benchmark to check sensitivity of demand, but also the commercial elements of the bids, differences in risk approach, departures from the specifications, tolling methodologies, performance measures, commercial principals, consequential impacts on the Authority, value added offers, gain sharing approaches, asset transfer proposals, financial parameters and any other variables.

**7.253** Following the completion of the evaluation process in mid-December 1997, the sub-committee recommended to the Project Steering Committee and subsequently to the Authority's Board that Henry Walker Environmental Pty Ltd (HWE) be selected as the preferred promoter. The proposal of HWE exceeded both quantitative and qualitative aspects of the Authority's benchmark. HWE is a wholly-owned subsidiary of the an Australian company, Henry Walker Group Ltd. Castlemaine Wastewater Treatment Pty Ltd, was established as a subsidiary of the Henry Walker Environmental Pty Ltd for the specific purpose of the project.

**7.254** In July 1998, the probity auditor appointed by the Authority to oversee the tender process concluded that the process was fair and equitable and that there were no issues of probity outstanding.

#### *Project Deed*

**7.255** A Project Deed for the provision of wastewater treatment services at Castlemaine, reticulated sewerage at Maldon and enhanced treatment of sludges at the Bendigo wastewater treatment plant was signed in July 1998 with Castlemaine Wastewater Treatment Pty Ltd. The contract was enacted on 17 February 1999 (commencement date) with commercial acceptance of the project Deed granted in June 2000.

**7.256** Castlemaine Wastewater Treatment Pty Ltd is to design, build, operate and ultimately transfer to the Authority at the end of the contract period the facility at a nominal value. **The Authority transferred ownership of designated existing assets with a book value of \$6.7 million to Castlemaine Wastewater Treatment Pty Ltd for nil consideration.** The facilities are to be constructed on land owned by the Authority.

**7.257** As at 30 June 2000, the Authority estimated that the present value of the obligations to pay service charges to Castlemaine Wastewater Treatment Pty Ltd comprising fixed and variable charges to be \$46.7 million.

*Aqua 2000 project*

**7.258** The Aqua 2000 project was one of the projects identified in the Memorandum of Understanding agreed to by the Authority and the Treasurer. The service outcome of this project was the provision of fully treated water to its customers in the major provincial centres of Bendigo, Castlemaine and Kyneton. The Authority proposed that by the end of the 2000 year, 97 per cent of its customers, including those in Bendigo, Castlemaine and Kyneton, will receive water quality which meets or betters health-related and aesthetic parameters of the 1984 World Health Organization Guidelines and 1996 Australian Drinking Water Guidelines.

**7.259** The project includes the construction of water treatment plants, storage tanks, pipelines and associated infrastructure. The improved quality of water would benefit some 110 000 people in the Bendigo, Castlemaine and Kyneton areas.

**7.260** In August 1997, the Authority resolved that the preferred approach for the Bendigo, Castlemaine and Kyneton water quality improvement project would be a BOOT approach, subject to the final negotiated development proposal commercially meeting or exceeding the Authority's developed benchmark.

**7.261** The Aqua 2000 project was estimated by the Authority to cost approximately \$73.2 million to construct.

*Bid evaluation and selection process*

**7.262** As with the Castlemaine BOOT project, management of the project was overseen by a Project Steering Committee assisted by sub-committees and a team of external probity, legal, financial and technical advisers.

**7.263** Following the approval of the Treasurer in December 1997, the Authority called for registrations of expression of interest from the private sector. By the closing date in late February 1998, the Authority received 7 registrations for expressions of interest relating to the project.

**7.264** Following the evaluation of the expression of interests against the key selection criteria the first 4 ranked consortia were requested to submit proposals.

**7.265** Following the receipt of the final bids from the 4 short-listed proponents in late July 1998, a sub-committee evaluated the bids against an established benchmark and in August 1998, recommended to the Project Steering Committee that 2 of the 4 remaining proposals be accorded preferred proponent status. The Board subsequently approved the Steering Committee's recommendation to short-list 2 preferred proponents for the Aqua 2000 project and that a further analysis be undertaken to identify a single preferred bidder.

**7.266** In February 1999, after further analysis, the sub-committee recommended to the Project Steering Committee that the qualitative and quantitative assessments favoured US Filter (Aus) Pty Ltd, which was nominated as the preferred proponent. This nomination was endorsed by the Authority's Board in mid-February 1999 which authorised its Chief Executive Officer to negotiate and finalise the contract.

**7.267** Negotiations with US Filter (Aus) Pty Ltd were concluded with the signing of the contract in May 1999 with escrow conditions satisfied in November 1999.

**7.268** The probity auditor appointed by the Authority to oversee the project concluded that it was satisfied with the tender process and no issues of probity remained outstanding.

*Project Deed*

**7.269** In May 1999, Coliban Region Water Authority signed a Project Deed with USF Bendigo Water Services Pty Ltd (the promoter) which is wholly-owned by US Filter (Aus) Pty Ltd to provide water treatment facilities, water storage facilities, distribution of water and associated infrastructure in the Bendigo, Castlemaine, Kyneton, Taradale and Elphinstone areas. The scheme requires the promoter to develop, finance, build, own, and operate a facility for a period of 25 years.

**7.270** At the expiration of this 25 year period, the facility will be transferred to the Authority for a nominal amount. **The Authority will transfer ownership of designated existing assets with a book value of \$30.8 million to USF Bendigo Water Services Pty Ltd for no consideration.** The new facilities are to be constructed on land owned by the Authority.

**7.271** The contract commencement date was mid-February 2000, with commercial acceptance to be achieved within 18 months.

**7.272** As at 30 June 2000, the Authority estimated that the present value of the obligations to pay service charges to the promoter comprising fixed and variable charges at \$84.3 million.

*Concluding comments on the Castlemaine Wastewater and Aqua  
2000 projects*

**7.273** Under the arrangements, the promoters shall design, construct, finance, maintain and operate the facilities. At the end of the 25 year period, the contractor is to transfer all the assets to the Authority for a nominal amount. In return for the provision of services, the contractor will be entitled to receive specified fees.

**7.274** As at 30 June 2000, the net present value of the 2 obligations of the Authority to pay fixed and variable service charges is estimated to be \$131 million over the 25 year term. The payment of these charges is dependent upon meeting service requirements and defined performance standards.

**7.275** In my opinion, despite the retention of certain defined obligations, the promoters bear substantial risks associated with the construction, operation and financing of these 2 projects. These include the risks associated with construction, commissioning, financing and operation. The Authority has retained certain defined risks including the costs associated with construction modifications requested by the Authority, delay costs as a result of an extension of time granted as a result of an act of prevention caused by the Authority, augmentation works, specific changes in law and movements in the consumer price index. In default circumstances which result in the termination of the deed prior to expiry of the 25-year term, the site lease is to be terminated and the facilities are to revert to the Authority.

**7.276** The financial commitments associated with these arrangements are disclosed in note 28 to the Government's Annual Financial Statement.