2003-04 Budget Update

Presented by John Lenders MP,
Acting Treasurer of the State of Victoria.

Victoria
The Place To Be

The Secretary
Department of Treasury and Finance
1 Treasury Place
MELBOURNE VICTORIA 3002
AUSTRALIA

Telephone: +61 3 9651 5111
Facsimile: +61 3 9651 5298
Website: www.dtf.vic.gov.au

This publication makes reference to the 2003-04 Budget Paper set which includes:
Budget Paper No 1 - Treasurer's Speech
Budget Paper No 2 - Budget Statement
Budget Paper No 3 - Budget Estimates
Budget Overview.

Published by the Department of Treasury and Finance

ISSN 1 440-6969

Published December 2003 by authority

2003-04

Budget Update

Presented by

John Lenders, M.P.

Acting Treasurer of the State of Victoria

For the information of Honourable Members

TABLE OF CONTENTS

BUDGET UPDATE HIGHLIGHTS

- A revised 2003-04 general government operating surplus of $652 million, up from the $245 million 2003-04 Budget estimate primarily as a result of higher than expected taxation revenue, together with lower superannuation expense.
  - This reflects stronger performance in property and equity markets in the first five months of this year than forecast in the May Budget. Since these asset markets are capable of sudden change, the revised annual estimate of $652 million is subject to more than the usual amount of uncertainty.
- In the 2003-04 Budget Papers the Government provided a range of alternative measures of operating performance:
  - the standardised operating surplus, which removes the impact of superannuation fund and other financial asset re-measurements, is now projected to be $387 million in 2003-04, close to the budget-time operating surplus estimate of $245 million; and
  - the GFS net operating balance, which excludes the effects on the operating statement of those superannuation re-measurements and also includes an economic interest cost, is projected to be $484 million in 2003-04.
- Operating surpluses are expected to average $525 million per annum in the following three years.
- Output policy decisions taken since the 2003-04 Budget total $94 million in 2003-04, and an average of $94 million per annum over the following three years.
- General government net financial liabilities (excluding the Growing Victoria infrastructure reserve), as a share of Gross State Product (GSP), are expected to decline from 8.1 per cent at 30 June 2003 to 7.4 per cent at 30 June 2007. This signifies that the projected modest liability growth from $15.5 billion to $17.8 billion over this period can be serviced by the growing Victorian economy.

BUDGET UPDATE HIGHLIGHTS

- A revised 2003-04 general government operating surplus of $652 million, up from the $245 million 2003-04 Budget estimate primarily as a result of higher than expected taxation revenue, together with lower superannuation expense.
  - This reflects stronger performance in property and equity markets in the first five months of this year than forecast in the May Budget. Since these asset markets are capable of sudden change, the revised annual estimate of $652 million is subject to more than the usual amount of uncertainty.
- In the 2003-04 Budget Papers the Government provided a range of alternative measures of operating performance:
  - the standardised operating surplus, which removes the impact of superannuation fund and other financial asset re-measurements, is now projected to be $387 million in 2003-04, close to the budget-time operating surplus estimate of $245 million; and
  - the GFS net operating balance, which excludes the effects on the operating statement of those superannuation re-measurements and also includes an economic interest cost, is projected to be $484 million in 2003-04.
- Operating surpluses are expected to average $525 million per annum in the following three years.
- Output policy decisions taken since the 2003-04 Budget total $94 million in 2003-04, and an average of $94 million per annum over the following three years.
- General government net financial liabilities (excluding the Growing Victoria infrastructure reserve), as a share of Gross State Product (GSP), are expected to decline from 8.1 per cent at 30 June 2003 to 7.4 per cent at 30 June 2007. This signifies that the projected modest liability growth from $15.5 billion to $17.8 billion over this period can be serviced by the growing Victorian economy.

- General government net debt (excluding the Growing Victoria infrastructure reserve) is projected to increase from $2.1 billion at 30 June 2003 to $2.7 billion at 30 June 2007, while remaining at a very low 1 per cent of GSP, well down from 3 per cent of GSP in 1999 and 16 per cent of GSP in 1995.
- Expenditure on fixed assets is expected to average $2.6 billion per annum over the four years to 2006-07.
- The major asset decision taken since the May Budget was the redevelopment of the Royal Women's Hospital.
- Economic growth is forecast to improve from 2.6 per cent in 2002-03 to 3.25 per cent in 2003-04, and 3.5 per cent thereafter.
- After allowing for known future tax policy changes in all States, Victoria's taxes are set to be slightly below the Australian average.

CHAPTER 1: FINANCIAL POLICY OBJECTIVES AND STRATEGIES

- The Government is committed to maintaining an operating surplus of at least $100 million in each year. The budget projections show that this target will be achieved over the budget and forward estimates period.
- The Government is committed to delivering world-class infrastructure to enhance social, economic and environmental outcomes across the State. In line with this goal, the general government capital stock is projected to grow by 11.2 per cent in real terms over the four years to June 2007, more than double the projected population growth of 4.3 per cent.
- The Government will improve quality, access and equity in service delivery to all Victorians through continuing to implement its 2002 election commitments.
- The Government is committed to providing a fair and efficient tax system to Victorian businesses and households that is competitive with other States. After allowing for known future tax policy changes in all States, Victoria's taxes are set to be slightly below the Australian average.
- The Government will maintain state government net financial liabilities and net debt at prudent levels and retain Victoria's triple-A credit rating.

FINANCIAL STRATEGY, OBJECTIVES AND PRIORITIES

This chapter sets out the Government's financial policy objectives and strategies as required by the *Financial Management (Financial Responsibility) Act 2000*. The Act includes a set of sound financial management principles. These are to:

- manage financial risks faced by the State prudently, having regard to economic circumstances;
- pursue spending and taxation policies that are consistent with a reasonable degree of stability and predictability in the level of the tax burden;
- maintain the integrity of the Victorian tax system;

- ensure that government policy decisions have regard to their financial effects on future generations; and
- provide full, accurate and timely disclosure of financial information relating to the activities of the Government and its agencies.

These financial management principles underpin the Government's financial policy objectives and strategies.

With the broad strategic priority remaining to provide a sound and stable financial basis from which growth can be promoted across the whole State, the Government will continue to deliver world-class infrastructure to drive economic growth, and improve quality, access and equity in key services to all Victorians, while maintaining a sound financial position.

The Government's financial responsibility legislation requires a statement of its short and long-term financial objectives in the budget update. It is also a necessary element of the financial management principle of providing full, accurate and timely disclosure of financial information relating to the activities of the Government and its agencies.

Consistent with this, the Government has a number of short and long-term financial objectives, as shown in Table 1.1.

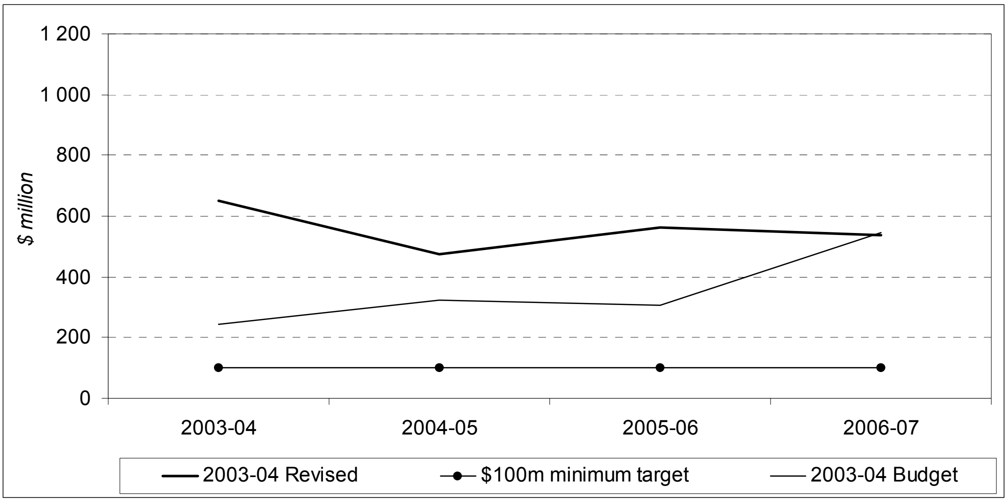
Table 1.1: 2003-04 Financial objectives

Long-term	*Short-term*
Maintain a substantial budget operating surplus	Operating surplus of at least $100 million in each year
Deliver world-class infrastructure to maximise economic, social and environmental benefits	Implement strategic infrastructure projects, including those funded from the Growing Victoria infrastructure reserve
Provide improved service delivery to all Victorians	Implement 2002 election commitments
Provide a fair and efficient tax system that is competitive with other States	Implement reforms to Victoria's business taxation system
Maintain state government net financial liabilities at prudent levels	Maintain a triple-A credit rating

Operating surplus

The Government's long-term objective is to maintain a substantial budget operating surplus. In the short term, its objective is to maintain an operating surplus of at least $100 million in each year. This is the Government's key financial measure. The revised outlook for the budget surplus remains consistent with this objective, as can be seen in Chart 1.1. Following a general government surplus of $236 million in 2002-03, the operating surplus is now forecast to be $652 million in 2003-04 and to average $525 million per annum in the following three years.

Chart 1.1: General government sector operating surplus (a)



Source: Department of Treasury and Finance

Note:
(a) The 'general government sector operating surplus' is equivalent to the 'net result' in the statement of financial performance in Chapter 4, Estimated Financial Statements and Notes.

Given the continued uncertainties in the world and domestic economies (see Chapter 3, *Economic Conditions and Outlook*), the Government is maintaining a moderate buffer above the $100 million minimum operating surplus target.

The operating surplus objective and buffer accord with the financial management principle of pursuing expenditure and taxation policies that allow reasonable stability and predictability in tax burden levels. Victorians can have the confidence that major financial settings will not need to adjust markedly and unexpectedly at some future date to protect the State's financial position.

Alternative measures of operating performance

The Government currently headlines the operating surplus derived from the Australian Accounting Standard (AAS 31).

An alternative measure of operating performance is the *standardised operating surplus*, which has been developed in order to increase understanding of the significant impact the volatility associated with swings in financial asset prices can have on the AAS 31 operating surplus. It is equal to the AAS 31 operating surplus less the difference between the actual rate of return and the expected rate of return on superannuation fund and other financial assets. By removing the impact on the operating surplus associated with volatile swings in asset markets, the standardised operating surplus allows for a more complete analysis of the State's underlying financial performance.

For superannuation fund assets, the actuary calculates a long-term earnings rate assumption in accordance with the requirements of relevant Australian accounting standards. Other financial assets include cash, fixed term deposits and debt securities held in the general government sector.

In years when actual returns are higher than expected, the standardised operating surplus will be lower than the AAS 31 operating surplus. This is the case in 2003-04, where the standardised operating surplus is $265 million lower than the headline 2003-04 operating surplus of $652 million (see Table 1.2).

In contrast, the standardised operating surplus in 2002-03 was $804 million higher than the headline operating surplus of $236 million (reflecting lower actual asset returns compared with expectations in that year). This highlights the substantial volatility inherent in asset markets and hence the benefit of using this measure as an indicator of underlying financial performance.

Removing the effect of actual returns on financial assets relative to expected returns is also broadly consistent with the approach underlying the Government Finance Statistics (GFS) framework used by the Australian Bureau of Statistics (see Appendix E, *Uniform Reporting of Government Finance Statistics*). The GFS *operating balance*, as a measure of financial performance, is similar in concept to the headline AAS 31 operating result, as both match revenue (including taxes and grants) earned in the year, to expenses incurred. However the GFS net operating balance excludes the effects of revaluations (holding gains or losses) arising from changes in market prices. The GFS operating balance, similarly to the headline AAS 31 result, is forecast to be in surplus over the outlook period.

Table 1.2: AAS 31 and GFS budget measures (excluding Growing Victoria)

	2002-03 Actual	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Operating surplus (AAS 31)	236	652	473	564	537
Standardised operating surplus (a)	1 040	387	473	564	537
Net operating balance (GFS)	1 517	484	494	599	547
GFS net lending (b)	1 175	94	- 722	- 914	- 485
GFS cash surplus (b)	613	479	45	- 140	- 122

Source: Department of Treasury and Finance

Notes:

(a) Operating surplus (AAS 31) less the difference between the actual rate of return on superannuation fund and other financial assets and the expected long-term rate of return at the beginning of the financial period.

(b) The table shows GFS net lending (+) / borrowing (-) and GFS cash surplus (+) / deficit (-) excluding the impact of Growing Victoria. Growing Victoria investments are excluded as an offset to gross debt on the grounds that these investments are earmarked for infrastructure projects and are therefore not available to redeem gross debt.

Net lending is equal to the GFS net operating balance less net capital formation. As net lending treats asset expenditure as an immediate expense, rather than over time (through depreciation), it is lower than the GFS net operating balance over the forward estimates due to the size of the Government's infrastructure program.

The GFS *cash surplus* is equal to net cash flows from operating activities less net investment in non-financial assets. Equivalently, the cash surplus is equal to net lending excluding non-cash expenses principally relating to superannuation and employee entitlements. As a result the cash surplus is generally higher than net lending but lower than the GFS net operating balance.

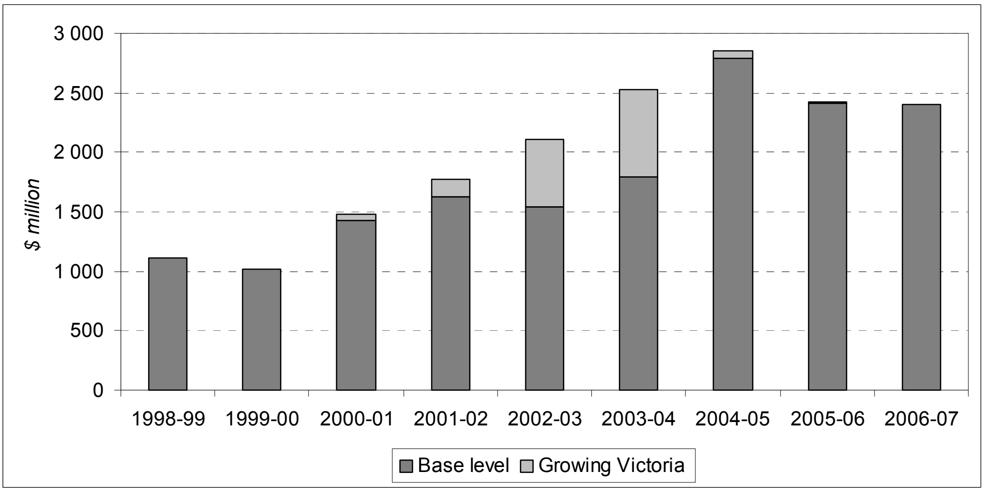
Commencing in 2005-06, Victoria's financial reports, including the budget for that and subsequent years, will be affected by the adoption of International Financial Reporting Standards, and the convergence of GAAP and GFS. These changes in accounting standards will have inter-related effects on the measurement of some assets and liabilities, and on the presentation of the Government's performance and operating results. Consequently, the measures used as benchmarks may change.

Infrastructure

The Government is committed to delivering world-class infrastructure to enhance social, economic and environmental benefits across the State. This commitment is reflected in the significant increase in infrastructure spending since 1998-99 (see Chart 1.2). Over the period 2003-04 to 2006-07, annual expenditure on fixed assets will average $2.6 billion.

This level of expenditure well exceeds estimated depreciation of around $1.1 billion per annum, and results in growth of the real capital stock over the four years to June 2007 of 11.2 per cent compared to projected population growth of 4.3 per cent.

Chart 1.2: General government sector net infrastructure investment [(a)]



Source: Department of Treasury and Finance

Note:

(a) Includes purchases of property, plant and equipment and net contribution to other sectors of government less proceeds from sale of property, plant and equipment.

The significant boost to Victoria's infrastructure over the medium term has been made possible by Victoria's strong financial position. The substantial forecast operating surpluses over the next four years, together with the Growing Victoria infrastructure reserve, have enabled the Government to pursue its program of significantly upgrading and modernising infrastructure.

The 2003-04 Budget provided funding for the commencement of new infrastructure investment projects with a total estimated investment (TEI) of $1.2 billion. Since the Budget, the Government has continued to announce new asset initiatives, including:

- the redevelopment of the Royal Women's Hospital on the same site as the Royal Melbourne Hospital. The new hospital will be completed by the end of 2007 and will include 246 beds and cots, operating theatres and procedure rooms, and delivery and birthing suites. While the new hospital may be built by the private sector under the Partnerships Victoria policy, it will remain a public hospital, with all clinical services continuing to be the responsibility of the Government; and

- $87 million TEI for the construction of new community houses for Kew Residential Services residents across Victoria. This will complete the relocation of all residents from the Kew Residential Services congregate care facility. Associated output funding of $35 million over three years from 2004-05 will provide a greater level of support and community inclusion for residents.

Service delivery

The Government is continuing to improve quality, access and equity in service delivery to all Victorians through the implementation of the Government's 2002 election commitments. Since the 2003-04 Budget, additional funding has been provided for new output policy initiatives of $94 million in 2003-04, and an average of $94 million per annum over the following three years. Specific post-budget initiatives include:

- $209 million over four years for a new model of funding of non-government agencies that provide preschool, disability, community care, housing assistance, palliative care, and drug services. The model will provide greater certainty and flexibility in long-term planning by detailing firm and realistic multi-year funding, while also significantly reducing administrative requirements on agencies. This includes $7 million provided to establish a Community Services Investment Fund to improve the capacity of non-government organisations to deliver programs for Victoria's most vulnerable;
- $18 million over 2003-04 and 2004-05 towards ameliorating the effects of the drought in communities across Victoria through social support services, and providing assistance to drought affected farmers in the form of interest subsidies;
- $15 million over four years under the disabilities program to manage increased demand and complexities for services provided to government school students with special education needs;
- $11 million from 2004-05 to implement a two-year timber salvage harvesting program in the forest management areas of eastern Victoria that were affected by the 2003 bushfires. This program will trial new approaches to manage, price and allocate state forest timber resources;
- $5 million Victorian contribution in 2003-04 to ensure the successful completion of the national red fire ant eradication program. This program involves prevention and response initiatives, which entail baiting of ants and extensive surveillance and monitoring, and has been effective to date, with a 95 per cent kill rate across the treated ant population; and
- as part of the ongoing management of the Office of Housing's financial arrangements, a review has been undertaken of the profile of regular payments made by the Office to the Consolidated Fund, resulting in a reduction in the payments expected in 2003-04.

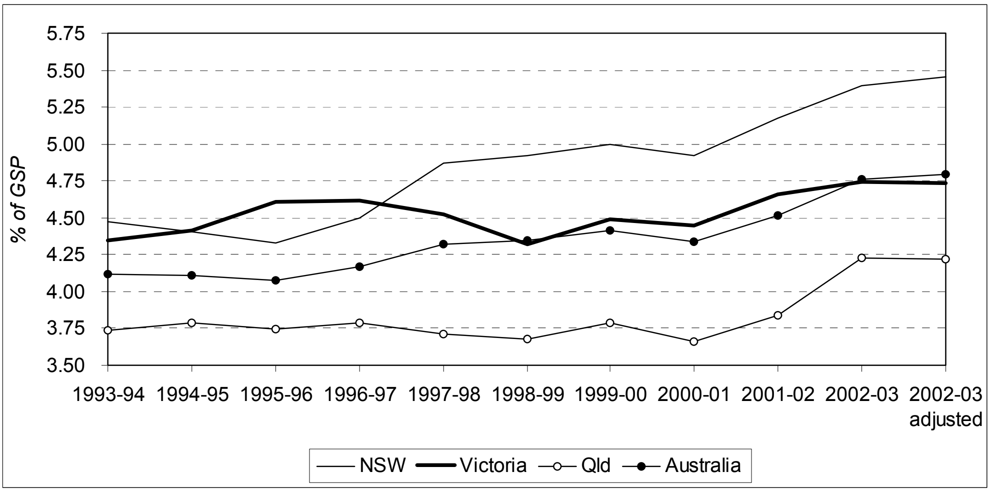
Taxation

The Government's long-term commitment is to ensure a fair and efficient tax system in Victoria that is competitive with other States and which provides the funds needed for meeting our social goals.

The competitiveness of Victoria's tax regime plays an important role in underpinning economic growth and investment. Consistent with the Government's strategic priority of promoting growth across the whole of Victoria, the Government is aiming to ensure that Victoria's taxes remain competitive with the Australian average.

Victoria's preferred measure of tax competitiveness is state taxation expressed as a share of nominal GSP. This measure relates the level of taxation revenue to economic capacity. Chart 1.3 provides a comparison of taxation revenue as a share of nominal GSP for Victoria, New South Wales, Queensland and the Australian average for the years 1993-94 through to 2002-03.

Chart 1.3: Taxation revenue as a share of nominal GSP[(a)]



Sources: Australian Bureau of Statistics, Department of Treasury and Finance, 2002-03 actuals from Annual Financial Reports of all jurisdictions except South Australia and the ACT where 2002-03 revised estimates from 2003-04 Budgets were used.

Note:

(a) Taxation data have been recast to reflect only those taxes that remain after 1 July 2006. 2002-03 data have been further adjusted for all tax changes announced in 2003-04 Budgets.

The increase in taxation as a share of GSP in both 2001-02 and 2002-03 in Victoria, New South Wales, Queensland and Australia on average reflects the buoyant economic activity in 2001-02, particularly in the property market.

Using 2002-03 actual data for all jurisdictions (except South Australia and the ACT where revised estimates were used) and adjusting for all known future tax changes, Victoria's taxation as a share of nominal GSP is set to be slightly below the Australian average (0.07 percentage points of nominal GSP or $127 million), but to remain a substantial 0.7 percentage points of GSP (or $1 390 million) below New South Wales, and 0.5 percentage points ($980 million) above Queensland.

Net financial liabilities

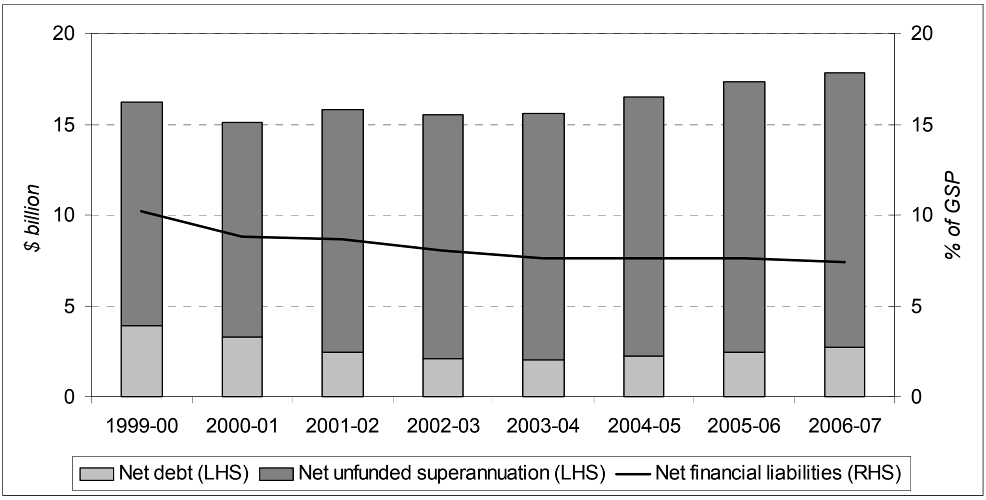
The Government is committed to maintaining the State's net financial liabilities at prudent levels in order to achieve its short-term objective of maintaining Victoria's triple-A credit rating.

Victoria's triple-A long-term local currency debt rating was affirmed by Standard & Poor's on 29 October 2002 and by Moody's on 5 November 2003. Both rating agencies cited Victoria's low debt levels, strong fiscal position and strong financial performance in recent years as key reasons behind their affirmations.

The 2003-04 revised budget outlook reinforces these positive factors as:

- strong operating surpluses are projected for 2003-04 ($652 million) and the remainder of the forward estimates period ($525 million per annum on average);
- general government net financial liabilities (excluding the Growing Victoria infrastructure reserve), as a share of GSP, are expected to decline from 8.1 per cent at 30 June 2003, to 7.4 per cent at 30 June 2007. This signifies that the projected modest liability growth from $15.5 billion to $17.8 billion over this period can be serviced by the growing Victorian economy (see Chart 1.4);
- general government net debt (excluding the Growing Victoria infrastructure reserve) is projected to increase from $2.1 billion at 30 June 2003 to $2.7 billion at 30 June 2007, while remaining at a very low 1 per cent of GSP, well down from 3 per cent of GSP in 1999 and 16 per cent of GSP in 1995; and
- Victoria's net financial liabilities position (incorporating net debt) is expected to remain comparable with other triple-A jurisdictions.

Chart 1.4: General government net financial liabilities excluding Growing Victoria [(a)] [(b)]



Source: Department of Treasury and Finance

Notes:

(a) General government net financial liabilities are calculated as the sum of net debt and net unfunded superannuation liabilities.

(b) Net debt is calculated as gross debt less liquid financial assets. Growing Victoria investments are excluded as an offset to gross debt on the grounds that these investments are earmarked for infrastructure projects and are therefore not available to redeem gross debt.

CHAPTER 2: BUDGET POSITION AND OUTLOOK

- A revised 2003-04 general government operating surplus of $652 million, up from the $245 million 2003-04 Budget estimate primarily as a result of higher than expected taxation revenue, together with lower superannuation expense.
  - This reflects stronger performance in property and equity markets in the first five months of this year than forecast in the May budget. Since these asset markets are capable of sudden change, the revised annual estimate of $652 million is subject to more than the usual amount of uncertainty.
- The standardised operating surplus, which removes the impact of superannuation fund and other financial asset re-measurements, is now projected to be $387 million in 2003-04.
- Over the remainder of the forward estimates period the operating surplus is projected to average $525 million per annum.
- Net financial liabilities (excluding the Growing Victoria infrastructure reserve) as a share of GSP is projected to decrease from 8.1 per cent at 30 June 2003 to 7.4 per cent at 30 June 2007, signifying that the projected liability growth from $15.5 billion to $17.8 billion over this period can be serviced by the growing Victorian economy.
- Net debt (excluding the Growing Victoria infrastructure reserve) is projected to increase from $2.1 billion as at 30 June 2003 to $2.7 billion as at 30 June 2007, while remaining at a very low 1 per cent of GSP, well down from 3 per cent of GSP in 1999 and 16 per cent of GSP in 1995.

This chapter provides an overview of the projected budget position for the period 2003-04 to 2006-07. The projections, or forward estimates, are based on the economic projections outlined in Chapter 3, *Economic Conditions and Outlook* and reflect the accounting policies and assumptions documented in Chapter 4, *Estimated Financial Statements and Notes*. The estimates take into account the financial impacts of all policy decisions taken by the Government, Commonwealth Government funding revisions and data available regarding other factors affecting the projected general government sector financial statements as at 28 November 2003. Specific policy decisions taken since the 2003-04 Budget that have an effect on the budget position are summarised in Appendix A, *Specific Policy Initiatives Affecting the Budget Position*.

The State's budget forward estimates represent planning projections based on maintaining these policy and other assumptions unchanged through the forecast period. Outcomes will differ from these projections for many reasons, including realisation of the risks described in Chapter 5, *Statement of Risks*.

FORWARD ESTIMATES OUTLOOK 2003-04 TO 2006-07

Table 2.1 sets out the projected aggregate budget outlook over the forward estimates period 2003-04 to 2006-07. A more detailed statement of financial performance for the forward estimates period is provided in Chapter 4, *Estimated Financial Statements and Notes*.

Table 2.1 shows an operating surplus of $652 million is projected for 2003-04. The operating surplus is then projected to decline to $473 million in 2004-05 before increasing to $537 million in 2006-07.

Table 2.1: Summary statement of financial performance 2003-04 to 2006-07

($ million)

	2003-04 Budget	*2003-04 Revised*	*2004-05 Estimate*	*2005-06 Estimate*	*2006-07 Estimate*
Taxation	9 593.2	10 006.9	9 963.3	10 149.7	10 526.3
Investment income	895.9	1 026.8	1 065.3	1 226.5	1 245.5
Grants	12 248.0	12 281.0	12 823.3	13 584.1	13 925.0
Sales of goods and services	2 047.2	2 103.1	2 164.6	2 243.6	2 278.2
Other revenue [(a)]	1 814.1	1 754.6	1 836.6	1 884.9	1 911.9
Total revenue	**26 598.4**	**27 172.4**	**27 853.1**	**29 088.9**	**29 886.9**
% change			2.5	4.4	2.7
Superannuation	1 950.8	1 688.9	1 878.6	1 961.7	2 019.3
Depreciation	1 024.8	1 028.0	1 097.6	1 148.2	1 209.5
Borrowing costs	483.3	485.3	467.9	477.2	475.9
Employee benefits	9 597.7	9 797.6	10 196.6	10 583.8	10 942.9
Supplies and services	8 598.2	8 710.4	8 944.0	9 293.7	9 542.3
Other expenses [(b)]	4 699.1	4 810.2	4 795.5	5 060.1	5 160.3
Total expenses	**26 353.9**	**26 520.4**	**27 380.3**	**28 524.8**	**29 350.2**
% change			3.2	4.2	2.9
Operating surplus	**244.5**	**652.0**	**472.9**	**564.1**	**536.7**
Standardised operating surplus [(c)]	**244.5**	**387.0**	**472.9**	**564.1**	**536.7**

Source: Department of Treasury and Finance

Notes:

(a) Comprises regulatory fees and fines, fair value of assets received free of charge, gains/losses on disposal of physical assets, capital asset charge revenue and other miscellaneous revenue.

(b) Includes grants and transfer payments and amortisation expense.

(c) Standardised operating surplus is equal to the net result less the difference between the actual rate of return and the expected rate of return on superannuation fund and other financial assets.

As shown in the above table, the standardised operating surplus is projected to be $387 million in 2003-04. The standardised operating surplus measure has been developed in order to increase understanding of the significant impact the volatility associated with swings in financial asset prices can have on the net result. It is equal to the net result less the difference between the actual rate of return and the expected rate of return on superannuation fund and other financial assets.

In years when actual returns on superannuation fund and other assets are higher than expected, the standardised operating surplus will be lower than the net result.

Operating revenue

Total revenue is projected to increase by 3.2 per cent per annum on average over the forward estimates period.

In 2004-05 it is expected that taxation revenue will decline by 0.4 per cent. However, it is projected that taxation revenue will grow by 2.8 per cent per annum on average over the remainder of the forward estimates period. The decline in 2004-05 and low subsequent average growth rate reflect the combined impact of a number of factors, including:

- an expected decline in property market activity, resulting in a reduction in property market related duties collected;
- implementation of tax cuts announced by the Government, including abolition of duties on mortgages from 2004-05; and
- the expected abolition of bank accounts debits tax from 2005-06, consistent with the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*.

Investment income is expected to increase by 3.7 per cent in 2004-05, followed by growth of 8.1 per cent per annum on average over the remaining forecast period, due mainly to the expected re-commencement of dividend payments from the Transport Accident Commission.

Grants revenue is projected to increase on average by 4.3 per cent per annum with growth boosted by an expected increase in Commonwealth Budget Balancing Assistance payments following the expected abolition of debits tax from 2005-06.

Operating expenses

Total expenses are projected to increase by an average of 3.4 per cent over the forward estimates period. This is broadly in line with expected wage and price inflation and Victorian population growth.

In line with the Government's significant level of new capital investment in infrastructure, depreciation expense is projected to increase on average by 5.6 per cent per annum. The increase in depreciation expense is partly offset by the decline in borrowing costs. Over the forward estimates period borrowing costs are projected to decline by 0.6 per cent per annum on average. The decline largely reflects the impact of lower average interest rates on the debt portfolio as it matures and is refinanced.

Employee benefits expense is projected to increase by an average of 3.8 per cent over the forward estimates period, reflecting expected wage inflation and the Government's continuing commitment to improve services such as health, education and community safety. Superannuation expense projections incorporate an assumption that returns to state superannuation funds return to long-run actuarial rates.

RECONCILIATION OF FORWARD ESTIMATES TO PREVIOUSLY PUBLISHED ESTIMATES

Table 2.2 compares the revised outlook for the operating surplus for the period 2003-04 to 2006-07 to the estimates published in the 2003-04 Budget.

Table 2.2: Reconciliation of estimates to 2003-04 Budget

($ million)

	2003-04 Revised	*2004-05 Estimate*	*2005-06 Estimate*	*2006-07 Estimate*
Operating surplus – 2003-04 Budget	**245**	**321**	**304**	**547**
Plus: Revenue variations since 2003-04 Budget				
Taxation revenue	404	175	181	157
Investment income	131	144	230	132
Total economic/demographic variations	**535**	**319**	**410**	**289**
Policy decision variations	**- 30**	**0**	**0**	**0**
General purpose grants	118	114	124	130
Specific purpose payments	- 85	- 13	48	- 31
Total Commonwealth funding variations	**33**	**101**	**172**	**99**
Forecast revision - fees & fines	- 119	- 91	- 67	- 59
Increase in own source revenue	134	141	151	170
Other administrative variations	21	3	3	3
Total administrative variations	**36**	**53**	**87**	**114**
Total variation in revenue since 2003-04 Budget	**574**	**473**	**669**	**502**
Less: Variations in operating expenses since 2003-04 Budget				
Policy decision variations [(a)]	**94**	**70**	**95**	**117**
Commonwealth funding variations	**13**	**12**	**99**	**157**

Table 2.2: Reconciliation of estimates to 2003-04 Budget – *continued*

($ million)

	2003-04 Revised	*2004-05 Estimate*	*2005-06 Estimate*	*2006-07 Estimate*
Superannuation variations	**- 265**	**- 19**	**- 20**	**- 21**
Expenses funded from increase in own source revenue	155	157	183	219
Other administrative variations [(a)]	170	101	52	41
Total administrative variations	**324**	**258**	**235**	**260**
Total variation in expenses since 2003-04 Budget	**167**	**321**	**410**	**513**
Revised operating surplus	**652**	**473**	**564**	**537**

Source: Department of Treasury and Finance

Notes:

(a) Output policy decisions reflect the total cost of decisions. The total expenditure for each year may differ to Appendix A, Specific Policy Initiatives Affecting the Budget Position for certain initiatives due to Treasurer's contingency funding being offset against expenditure in 'other' administrative variations and due to departmental reprioritisations being included in Appendix A.

Operating revenue

In 2003-04 total revenue is $574 million higher than the 2003-04 Budget estimates and is projected to be $548 million per annum higher on average over the remainder of the forward estimates period.

As a result of economic/demographic changes, taxation revenue is projected to be $404 million higher in 2003-04 and $171 million per annum higher on average over the forward estimates than in the 2003-04 Budget. Increases in taxation revenue relative to original budget estimates are largely the result of stronger than expected property market sales and prices, resulting in higher revenue from conveyancing, mortgage duties and land tax. Policy decisions detracted $30 million from the overall revenue position in 2003-04, representing a mixture of duty on mortgage-backed debentures and a reduction in revenue payments expected from the Office of Housing.

Offsetting these increases were reductions in gambling tax estimates of $59 million in 2003-04, and an average of $134 million over the remaining forward estimates period, as a result of the continuing impact of smoking restrictions in gaming venues.

Investment income also has a significant impact on 2003-04 total revenue estimates, with increases over the 2003-04 Budget estimates of $131 million in 2003-04 and projected to be $169 million per annum higher on average over the remainder of the forward estimates period. This movement is due mainly to higher distributions from the Transport Accident Commission associated with higher profit forecasts. There have also been increases in interest revenue since the 2003-04 Budget due to investment returns generated on higher than expected general government sector cash surpluses.

Forecasts of Commonwealth funding revenue have increased across the forward estimates period due largely to increased GST grants, which are impacted by higher CPI outcomes released in the Commonwealth Budget in May 2003. Specific purpose payments have also increased for targeted programs in both non-government and government schools. This increase is offset by a reduction in payments from the Commonwealth to Victoria under the Australian Health Care Agreement 2003-2008 and the National Health Development Fund of $63 million per annum on average over the forecast period. In addition, the Commonwealth has tightened eligibility under the Natural Disaster Relief Arrangements and Victoria now expects to receive only $30 million of its $50 million claim for the 2003 bushfires. Commonwealth roads payments have decreased in 2003-04 due to rephasing of projects, and over the remainder of the forward estimates mainly due to cessation of Commonwealth funding for road maintenance pending finalisation of arrangements under the new road funding model AusLink.

Administrative revenue variations are $73 million per annum on average over the forecast period above the 2003-04 Budget. The major component in the variations is higher revenues earned from clients and other third parties by hospitals and community sector, schools and TAFEs. These revenues correspond with increased operating expenses for these bodies (see next section) and are offset by reductions in forecast revenue from fines and regulatory fees, reflecting the delays in the installation of safety cameras as well as changes in driver behaviour.

Operating expenses

As reflected in Table 2.2 operating expenses are projected to be $167 million higher in 2003-04 and $415 million per annum higher on average over the remainder of the forward estimates than the 2003-04 Budget.

The movement in superannuation expense reflects the impact of improved equity market performance on superannuation funds in early 2003-04. Over the remainder of the forward estimates period superannuation expense is projected to be $20 million per annum lower on average than the budget estimates. Equity market performance has a significant impact on the value of financial assets held by state superannuation funds and therefore on the State's unfunded superannuation liability and superannuation expense.

Since the 2003-04 Budget output policy decisions account for additional operating expenses of $94 million in 2003-04 (with the impact on operating expenses in this year offset by contingency funding already provided in the forward estimates) and $94 million per annum on average between 2004-05 and 2006-07. These policy decisions include funding for drought response and contribution to a relief package, introduction of price indexation for three-year service agreements with non-government organisations, establishment and operation of the Southern and Eastern Integrated Transport Authority, and timber salvage harvesting following the bushfires. Specific policy decisions since the 2003-04 Budget are summarised in Appendix A, *Specific Policy Initiatives Affecting the Budget Position*.

Changes to Commonwealth grants funding, in particular specific purpose payments in relation to spending on health, education and roads, also impact on operating expenses.

Other administrative variations to operating expenses comprise increased hospitals and community sector, schools and TAFEs expenses funded by higher third party revenue sources, and increased expenses due to the recognition of additional medical insurance claims incurred but not yet reported.

SUMMARY STATEMENT OF FINANCIAL POSITION

Table 2.3 provides a summary of the general government sector statement of financial position. A more detailed statement of financial position is provided in Chapter 4, *Estimated Financial Statements and Notes*.

Table 2.3: General government summary statement of financial position as at 30 June

($ million)

	2003 Actual	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
Current assets	3 744.5	3 724.6	3 855.1	3 978.8	4 079.7
Non-current assets	44 998.0	46 719.8	48 954.6	51 918.8	54 099.0
Total assets	**48 742.4**	**50 444.4**	**52 809.7**	**55 897.6**	**58 178.7**
Current liabilities	3 649.7	3 322.0	3 610.4	3 822.4	4 016.6
Non-current liabilities	21 484.8	22 108.2	22 768.6	23 862.6	24 118.2
Total liabilities	**25 134.5**	**25 430.2**	**26 379.0**	**27 685.0**	**28 134.8**
Net assets	**23 607.9**	**25 014.2**	**26 430.7**	**28 212.6**	**30 043.9**

Source: Department of Treasury and Finance

General government sector assets were $48.7 billion as at 30 June 2003 and are projected to be $58.1 billion at 30 June 2007, representing a projected growth of 19.4 per cent over the forward estimates period. This trend reflects the significant levels of capital investment expenditure by the Government over the forward estimates period in public infrastructure including roads, health, education and housing.

Table 2.4 shows general government net financial liabilities (excluding the Growing Victoria infrastructure reserve) are projected to increase over the forward estimates period from $15.5 billion as at 30 June 2003 to $17.8 billion as at 30 June 2007. This growth largely reflects the increase in the unfunded superannuation liability. However, as a proportion of GSP, net financial liabilities are projected to decline from 8.1 per cent as at 30 June 2003 to 7.4 per cent of GSP by 30 June 2007.

Table 2.4: General government net financial liabilities as at 30 June

($ million)

	2003 Actual	*2004 Revised*	*2005 Estimate*	*2006 Estimate*	*2007 Estimate*
Financial assets					
Cash and deposits	1 123	1 034	1 104	1 159	1 203
Advances paid	207	187	167	147	125
Investments, loans and placements	3 243	3 405	3 194	3 335	3 108
Growing Victoria	788	171	5	0	0
Total	**5 360**	**4 797**	**4 469**	**4 642**	**4 436**
Financial liabilities					
Deposits held	409	414	419	424	429
Advances received	6	5	5	5	5
Borrowings	6 245	6 254	6 250	6 691	6 700
Total	**6 660**	**6 674**	**6 674**	**7 120**	**7 134**
Net debt	1 300	1 877	2 205	2 479	2 698
Net debt (excl. Growing Victoria) (a)	**2 088**	**2 048**	**2 209**	**2 479**	**2 698**
Unfunded superannuation	**13 437**	**13 520**	**14 262**	**14 874**	**15 136**
Net financial liabilities	14 737	15 396	16 467	17 353	17 835
Net financial liabilities (excl. Growing Victoria) (a)	**15 525**	**15 567**	**16 472**	**17 353**	**17 835**
Net financial liabilities to GSP (excl. Growing Victoria) - % (a)	8.1	7.6	7.6	7.6	7.4
Net debt to GSP (excl. Growing Victoria) - % (a)	1.1	1.0	1.0	1.1	1.1

Source: Department of Treasury and Finance

Note:

(a) The Growing Victoria infrastructure reserve investments are not offset against gross debt on the grounds that these investments are earmarked for infrastructure projects and are therefore not available to redeem gross debt.

Net debt (excluding the Growing Victoria infrastructure reserve) is projected to increase from $2.1 billion as at 30 June 2003 to $2.7 billion as at 30 June 2007, while remaining at a very low 1 per cent of GSP, well down from 3 per cent of GSP in 1999 and 16 per cent of GSP in 1995 (also refer to Table 2.5). The larger increase in net debt projected in 2005-06 reflects the impact on the statement of financial position flowing from the completion and handover to the State of the Partnerships Victoria Spencer Street Station project. The increase in net debt is matched by an increase in the State's non-current assets (Table 2.3).

USE OF CASH RESOURCES

Table 2.5 provides a summary of the application of cash resources for asset investment and the increase/decrease in net debt. Significant surpluses from operating activities, together with drawdown from the Growing Victoria infrastructure reserve, will be predominately applied to fund infrastructure investment.

Table: 2.5 Application of cash resources

($ million)

	2003-04 Budget	*2003-04 Revised*	*2004-05 Estimate*	*2005-06 Estimate*	*2006-07 Estimate*
Operating surplus	**244.5**	**652.0**	**472.9**	**564.1**	**536.7**
Plus: Non-cash expenses (net) [(a)]	1 722.7	1 301.4	2 038.6	1 721.0	1 652.5
Net cash flow from operating activities	**1 967.2**	**1 953.4**	**2 511.5**	**2 285.2**	**2 189.2**
Plus: Net drawdown of Growing Victoria infrastructure reserve	653.3	616.6	166.6	4.5	..
Total cash available for asset investment	**2 620.5**	**2 570.0**	**2 678.1**	**2 289.7**	**2 189.2**
Less:					
Net investment in fixed assets	2 064.0	2 090.5	2 531.1	2 289.2	2 303.6
Net contribution to other sectors of government	525.9	440.2	317.8	130.5	99.3
Other investment activities (net)	6.5	- 0.7	- 9.2	139.1	6.0
Decrease/increase in net debt (excluding Growing Victoria)	**24.1**	**40.0**	**- 161.8**	**- 269.2**	**- 219.7**

Source: Department of Treasury and Finance

Notes:

(a) Includes depreciation and movements in the unfunded superannuation liability and liability for employee benefits.

CHAPTER 3: ECONOMIC CONDITIONS AND OUTLOOK

- The Victorian economy grew by 2.6 per cent in 2002-03, below the average growth rate of recent years, but broadly in line with the 2003-04 Budget estimate and the national growth rate. A significant decline in the State's net exports position was the major reason for the softer growth outcome.
- An improving global economy and emerging recovery from drought should see a rebound in output in 2003-04, with Victorian economic growth forecast to be 3.25 per cent, a downward revision from the 3.75 per cent expected at budget time. Most other 2003-04 Budget forecasts remain unchanged.
- A further modest improvement is expected in the State's labour market, with unemployment set to average 5.5 per cent in 2003-04.
- Possible risks to the economic outlook include the stronger Australian dollar, rising interest rates and a slowing of population growth.

THE ECONOMY SINCE BUDGET

World economic conditions

In the past few months, signs have emerged that the long-awaited global recovery is underway. This is in contrast to budget time six months ago, when the outlook was less certain and forecasts for growth in the major global economies were still generally being lowered. While some uncertainties remain about the durability of the recovery, the outlook appears brighter than for some time.

According to the November 2003 Consensus Economics survey, world growth is expected to increase from 2.4 per cent in 2003 to 3.2 per cent in 2004, up from 2.1 per cent and 3.0 per cent respectively at budget time. This reflects a more optimistic outlook for the United States and Japan, with forecasts for European growth lower than at budget time.

The US economy rebounded strongly in the September quarter 2003, supported by solid growth in consumer spending, housing investment and equipment/software investment. The last of these has risen strongly in the past two quarters, suggesting that business investment (and sentiment) is improving after an extended period of weakness. Leading indicators of the labour market have also shown some signs of recovery. In contrast, economic conditions in the European Union are still subdued, with only modest growth expected in 2003 and 2004.

Forecasts of Japanese growth have been revised higher in recent months, with continued modest improvement in economic conditions, including private investment. Economic growth in 2003 is forecast to be the strongest in three years. Growth in East Asia is expected to accelerate in 2004, with the impact of SARS receding and an improved global climate supporting activity in the region.

Victoria

The Victorian economy grew by 2.6 per cent in 2002-03, similar to the budget estimate of 2.75 per cent and the national growth rate (2.8 per cent).

Growth in 2002-03 was below the average rate of recent years, with a sharp deterioration in the State's net exports position the major factor. The net exports deterioration was due to a combination of strong import growth and weak exports; the former a reflection of solid growth in final demand, and the latter the impact of the drought and subdued global economy. The net exports detraction from growth in 2002-03 (a sizeable 5.5 percentage points) exceeded the national average and was the largest on record for Victoria.

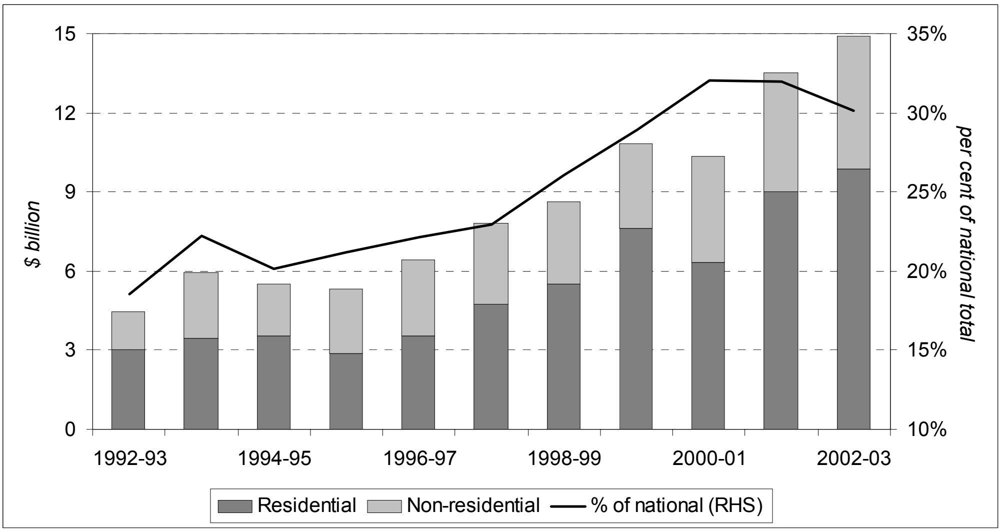
Aggregate demand remained strong in 2002-03, up 5.4 per cent in Victoria, although the rate of growth slowed over the course of the year as housing construction and business investment eased somewhat from recent strong growth rates. More generally, the moderation in final demand may partly reflect a return to more sustainable growth rates (particularly for dwelling investment) after outperforming the national average in each of the previous four years. The slowing in final demand growth was in line with expectations at budget time.

Housing construction remains at high levels despite the recent slowing in activity. Forward indicators suggest activity will remain at relatively high levels in the near-term, with approvals showing some renewed strength since budget. For the year as a whole, however, housing investment is still expected to record a moderate decline, with higher interest rates likely to dampen activity.

Business investment was particularly strong in 2002-03, rising 16.5 per cent, led by growth in non-residential construction and machinery and equipment investment. Victorian business investment per capita has now been above the national average for the past five years, and is the second highest level of the States. The pipeline of non-residential work to be done suggests investment will remain at high levels in 2003-04.

Consumer spending recorded moderate growth in 2002-03, a little below the average of recent years and below the national average. Partial indicators suggest a solid outcome for spending in the September quarter, although growth for the year as a whole is likely to be constrained somewhat by the prospect of higher interest rates and relatively modest employment growth. Recent trends in consumer spending are broadly consistent with expectations at budget time.

Chart 3.1: Value of total building approvals, Victoria [(a)]



Source: Australian Bureau of Statistics

Note:
(a) Annual original data, current prices.

Victorian employment grew by 2.3 per cent in 2002-03, in line with the budget estimate (2.25 per cent). In October 2003, the trend measure of Victorian employment was 1.2 per cent above its year-earlier level. The Victorian unemployment rate remains comfortably below 6 per cent, and has been below the national average for the past three years.

Victorian population growth is strong, supported by continued migration from interstate and overseas. In the year to March 2003, net overseas migration to Victoria exceed 39 000 persons, the highest level since the late 1980’s. However, the net gains over the past year have been below those of previous years, with the State attracting a net 2 500 persons in the year to March 2003. This is below the peak of almost 6 900 persons recorded a year earlier.

ECONOMIC OUTLOOK

Revised projections for the Victorian economy are presented in Table 3.1.

Table 3.1: Economic forecasts [(a)]

(Projections in 2003-04 Budget, where different, are in parentheses)

	2002-03 Actual	*2003-04 Forecast*	*2004-05 Forecast*
Gross state product	2.6	3.25	3.50
	(2.75)	*(3.75)*	
Employment	2.3	1.00	1.50
	(2.25)		
Unemployment rate [(b)]	5.7	5.50	5.50
	(5.75)	*(5.75)*	
Consumer price index	3.3	2.25	2.25
	(3.00)		
Wage cost index [(c)]	3.6	3.50	3.50
	(3.75)		
Population [(d)]	1.2	1.1	1.1
			(1.0)

Sources: Australian Bureau of Statistics; Department of Treasury and Finance

Notes:

(a) Per cent change on preceding year unless otherwise indicated. All projections, apart from population, are rounded to the nearest 0.25 percentage point.

(b) Year average level, per cent.

(c) Total hourly rate, excluding bonuses.

(d) June quarter, per cent change on previous June quarter.

The Commonwealth, in its May Budget, expected national growth in 2003-04 to be 3.25 per cent, a moderate increase on last year's outcome. The latest Consensus Economics survey of private sector forecasts is similar.

The Australian Bureau of Agricultural and Resource Economics is forecasting a strong rebound in crop production in 2003-04 following generally good rainfalls in recent months. Victoria and New South Wales are forecast to record the strongest recovery in crop production. However, a full rural recovery, especially in livestock industries, is expected to take a little longer. The Bureau of Meteorology continues to indicate a return to 'neutral' weather patterns, although the risk of the return of El Niño has not totally disappeared.

The forecast for Victorian GSP growth in 2003-04 has been revised down to 3.25 per cent, from 3.75 per cent at the time of the 2003-04 Budget. The contribution from state final demand growth is broadly unchanged, with growth in consumer spending, public expenditure and business investment to offset a small decline in housing construction. However, the forecast contribution from net exports has been revised lower, with a full export recovery likely to take longer than originally anticipated at budget time. In large part, this reflects the severity of the drought and the additional time required for a full rural export recovery. The appreciation of the Australian dollar since budget time (from around US$0.63 to US$0.72) is also a contributing factor.

For 2004-05, the Victorian GSP growth forecast is unchanged at 3.50 per cent, with annual growth expected to remain around these levels over the remainder of the forecast horizon. There has been a slight upward revision to the medium-term population growth rates.

The employment growth forecast for 2003-04 is unchanged from the budget estimate of 1.0 per cent. However, the unemployment rate forecast has been lowered slightly to 5.50 per cent, from 5.75 per cent at budget time, consistent with the year-to-date average.

Otherwise, the economic forecasts for 2003-04 and beyond are unchanged since budget time. The consumer price index is on track for an increase of 2.25 per cent in 2003-04, and the wage cost index is forecast to increase by 3.50 per cent.

ECONOMIC RISKS

Major risks to the economic outlook, both upside and downside, include:

- a continuation of the drought, which would further hamper export production and exacerbate downward pressure on farm incomes with indirect effects on the rest of the economy. An alternative scenario is that good rains continue and agricultural production exceeds expectations, placing upward pressure on export growth over the coming year;
- stronger than expected construction activity. Relevant forward indicators are yet to show convincing evidence of a sustained slowdown in this sector;
- further increases in the official cash rate, above current market expectations. In November 2003, the Reserve Bank increased the official cash rate by 25 basis points to 5.0 per cent. Signs of renewed strength in the Australian economy, and improved global conditions, have increased speculation that cash rates will be raised further over coming quarters. A large increase could place some pressure on the growth forecast into 2004-05;
- further strength in the Australian dollar, which has recently been trading at six-year highs. Although a positive for the inflation outlook, continued appreciation of the currency could place some pressure on Australian and Victorian export growth over the coming year;

- continued softness in the global economy, particularly in the United States. If recent signs of improvement are not sustained and the recovery stalls, there could be potentially adverse implications for Australian and Victorian exports. Conversely, if the recovery continues to gather momentum global growth could exceed expectations, creating upside potential for export growth; and
- a slowing of population growth, currently assumed to be at least 1.0 per cent per annum. The gain from net interstate migration over the past year was the lowest for four years. If Victoria's population growth rate moderates, the medium-term economic growth projections could be affected.

These issues are discussed in more detail in Chapter 5, *Statement of Risks*.

CHAPTER 4: ESTIMATED FINANCIAL STATEMENTS AND NOTES

INTRODUCTION

The Estimated Financial Statements in this chapter have been prepared in accordance with the provisions in the *Financial Management Act 1994*. This Act requires the Estimated Financial Statements to be based on generally accepted accounting principles (GAAP) and to be consistent with the Financial Policy Objectives and Strategies Statement (see Chapter 1, Financial Policy Objectives and Strategies).

The purpose of the Estimated Financial Statements is to set out the forecast financial results for the Victorian budget sector, referred to in these statements as the general government sector. Because of the prospective nature of these statements they reflect a number of professional judgements about the most likely operating and financial conditions for the Victorian general government sector. International developments and other risks to the national economy, from which Victoria would not be immune, may cause the general government actual result to differ from the projected result.

The accompanying notes to the Estimated Financial Statements provide details of material economic and other assumptions used and the specific forecast assumptions underlying material items in the financial statements. A number of these assumptions are subject to inherent uncertainties, which are outside the control of the Government. In particular, no adjustment has been made for any consequent effect of the intended adoption in Australia from 1 January 2005 of International Accounting Standards, the outcome of which is uncertain.

ESTIMATED FINANCIAL STATEMENTS FOR THE VICTORIAN GENERAL GOVERNMENT SECTOR

Table 4.1: Estimated statement of financial performance for the year ending 30 June

($ million)

	Note	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Revenue from ordinary activities						
Taxation	2	9 593.2	10 006.9	9 963.3	10 149.7	10 526.3
Fines and regulatory fees		637.2	518.7	572.6	610.2	628.0
Investment revenue	3	895.9	1 026.8	1 065.3	1 226.5	1 245.5
Grants	4	12 248.0	12 281.0	12 823.3	13 584.1	13 925.0
Sale of goods and services		2 047.2	2 103.1	2 164.6	2 243.6	2 278.2
Gain (loss) on the disposal of physical assets		(7.3)	(17.0)	(23.9)	(25.2)	(25.2)
Fair value of assets received free of charge or for nominal consideration		..	..	7.5	..	..
Inter sector capital asset charge		514.0	514.3	514.0	514.0	514.0
Other revenue		670.1	738.6	766.4	785.9	795.2
Total revenue		**26 598.4**	**27 172.4**	**27 853.1**	**29 088.9**	**29 886.9**
Expenses from ordinary activities						
Employee benefits		9 597.7	9 797.6	10 196.6	10 583.8	10 942.9
Superannuation		1 950.8	1 688.9	1 878.6	1 961.7	2 019.3
Depreciation	5	1 024.8	1 028.0	1 097.6	1 148.2	1 209.5
Amortisation	6	67.9	68.5	68.0	69.6	70.1
Borrowing costs	7	483.3	485.3	467.9	477.2	475.9
Grants and transfer payments	8	4 537.2	4 662.7	4 642.0	4 903.0	5 006.8
Supplies and services		8 598.2	8 710.4	8 944.0	9 293.7	9 542.3
Other expenses		94.0	79.1	85.5	87.5	83.5
Total expenses	9	**26 353.9**	**26 520.4**	**27 380.3**	**28 524.8**	**29 350.2**
Net result		**244.5**	**652.0**	**472.9**	**564.1**	**536.7**
Movements in asset revaluation reserve		1 194.5	1 194.5	1 261.5	1 348.3	1 394.0
Total changes in equity other than contributions to other sectors by the State in its capacity as owner		**1 439.0**	**1 846.5**	**1 734.4**	**1 912.4**	**1 930.7**

The accompanying notes form part of these Estimated Financial Statements.

Table 4.2: Estimated statement of financial position as at 30 June

($ million)

	Note	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
Current assets					
Cash assets		1 034.3	1 103.6	1 159.2	1 203.2
Other financial assets		1 202.5	1 224.9	1 244.9	1 259.1
Receivables		1 319.5	1 358.1	1 406.1	1 448.7
Prepayments		51.5	51.7	51.7	51.7
Inventories		116.8	116.9	116.9	117.1
Total current assets		**3 724.6**	**3 855.1**	**3 978.8**	**4 079.7**
Non-current assets					
Other financial assets		2 377.0	1 977.4	2 094.0	1 852.1
Receivables		403.0	417.8	436.6	457.3
Inventories		43.4	43.4	43.4	43.4
Property, plant and equipment	*10*	22 862.4	24 404.5	26 169.0	27 629.1
Road networks	*11*	17 727.4	18 728.5	19 712.9	20 574.5
Other assets	*13*	3 306.7	3 382.9	3 462.9	3 542.5
Total non-current assets		**46 719.8**	**48 954.6**	**51 918.8**	**54 099.0**
Total assets		**50 444.4**	**52 809.7**	**55 897.6**	**58 178.7**
Current liabilities					
Payables		1 556.2	1 559.1	1 569.9	1 581.7
Interest bearing liabilities		114.2	96.0	91.1	90.9
Employee benefits	*14*	999.4	973.6	949.8	926.4
Superannuation	*15*	177.6	523.2	749.2	949.3
Outstanding insurance claims		6.3	5.8	5.3	4.8
Other liabilities		468.3	452.6	457.1	463.5
Total current liabilities		**3 322.0**	**3 610.4**	**3 822.4**	**4 016.6**
Non-current liabilities					
Payables		129.0	129.0	129.0	129.0
Interest bearing liabilities		6 147.2	6 161.0	6 606.9	6 615.8
Employee benefits	*14*	1 989.6	2 212.7	2 439.7	2 581.2
Superannuation	*15*	13 342.2	13 739.0	14 124.8	14 186.9
Outstanding insurance claims		208.5	240.0	283.1	337.9
Other liabilities		291.7	286.9	279.2	267.4
Total non-current liabilities		**22 108.2**	**22 768.6**	**23 862.6**	**24 118.2**
Total liabilities		**25 430.2**	**26 379.0**	**27 685.0**	**28 134.8**
Net assets		**25 014.2**	**26 430.7**	**28 212.6**	**30 043.9**
Equity	*16*				
Retained earnings		12 583.5	12 917.7	13 260.0	13 724.8
Net result for year		652.0	472.9	564.1	536.7
Reserves		11 778.7	13 040.2	14 388.4	15 782.4
Total equity		**25 014.2**	**26 430.7**	**28 212.6**	**30 043.9**

The accompanying notes form part of these Estimated Financial Statements.

Table 4.3: Estimated statement of cash flows for the year ending 30 June

($ million)

	Note	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Cash flows from operating activities						
Receipts						
Taxation		9 546.8	9 960.6	9 926.8	10 110.0	10 483.0
Fines and regulatory fees		510.0	406.5	453.5	490.5	508.3
Grants		12 247.5	12 280.5	12 822.8	13 584.1	13 925.0
Sale of goods and services		2 041.7	2 100.6	2 164.7	2 243.5	2 277.8
Interest received		287.1	347.2	354.3	343.0	356.7
Dividends received		273.1	303.4	331.5	476.5	460.4
Capital assets charge received		514.0	514.3	514.0	514.0	514.0
Other receipts		999.8	1 094.7	1 124.5	1 159.3	1 192.9
Total receipts		**26 420.0**	**27 007.7**	**27 692.1**	**28 920.9**	**29 718.1**
Payments						
Employee benefits		(9 394.3)	(9 606.5)	(9 999.2)	(10 380.7)	(10 824.7)
Superannuation		(1 453.2)	(1 606.3)	(1 136.3)	(1 649.9)	(1 757.1)
Grants and transfer payments		(4 535.5)	(4 661.0)	(4 640.2)	(4 901.2)	(5 005.0)
Supplies and services		(8 581.6)	(8 691.1)	(8 924.5)	(9 225.9)	(9 468.7)
Interest paid		(488.2)	(489.4)	(480.5)	(478.0)	(473.3)
Total payments		**(24 452.8)**	**(25 054.4)**	**(25 180.7)**	**(26 635.7)**	**(27 528.9)**
Net cash flows from operating activities	*17*	**1 967.2**	**1 953.4**	**2 511.5**	**2 285.2**	**2 189.2**
Cash flows from investing activities						
Net customer loans (granted) repaid		20.1	20.1	20.0	20.0	22.4
Net contribution to other sectors of government		(525.9)	(440.2)	(317.8)	(130.5)	(99.3)
Proceeds from sale of property, plant and equipment		66.7	74.3	59.9	53.2	44.2
Purchase of property, plant and equipment		(2 130.7)	(2 164.8)	(2 591.0)	(2 342.4)	(2 347.8)
Net disposal of investments		644.0	454.3	377.0	163.3	227.6
Net cash flows from investing activities		**(1 925.8)**	**(2 056.4)**	**(2 451.9)**	**(2 236.4)**	**(2 152.9)**
Cash flows from financing activities						
Net borrowings		13.7	13.7	10.4	7.9	8.0
Net cash flows from financing activities		**13.7**	**13.7**	**10.4**	**7.9**	**8.0**
Net increase in cash and deposits held		**55.0**	**(89.3)**	**69.9**	**56.7**	**44.3**
Cash at beginning of reporting period		1 723.0	1 107.8	1 018.4	1 088.3	1 145.0
Cash and deposits at end of reporting period	*17*	**1 778.0**	**1 018.4**	**1 088.3**	**1 145.0**	**1 189.2**

The accompanying notes form part of these Estimated Financial Statements.

NOTES TO THE ESTIMATED FINANCIAL STATEMENTS

Due to the possibility that circumstances or events outlined in the Estimated Financial Statements may not occur as expected, actual results may differ from those forecast and the difference may be material. Accordingly, no guarantee is given that the financial results will be achieved. However, the best professional judgement has been applied in preparing the Estimated Financial Statements.

Table of contents

Assumptions

The Estimated Financial Statements have been prepared using the material economic and other assumptions listed below.

Material economic and other assumptions [(a)]

(per cent change)

	2003-04	*2004-05*	*2005-06*	*2006-07*
Gross state product	3.25	3.50	3.50	3.50
Employment	1.00	1.50	1.50	1.50
Consumer price index	2.25	2.25	2.25	2.25
Wage cost index [(b)]	3.50	3.50	3.50	3.50
Population [(c)]	1.10	1.10	1.00	1.00

Source: Australian Bureau of Statistics, Department of Treasury and Finance

Notes:

(a) Year-average per cent change on previous year unless otherwise indicated. All projections apart from population are rounded to the nearest 0.25 percentage point.

(b) Total hourly rate excluding bonuses.

(c) June quarter, per cent change on previous June quarter.

Note 1: Statement of significant accounting policies and forecast assumptions

The following summary presents the significant accounting policies and forecast assumptions which have been adopted in preparing and presenting the Estimated Financial Statements for the forecast period (which includes the budget year and the estimates for the three subsequent years).

A. Compliance framework

These Estimated Financial Statements have been prepared in accordance with sections 23H–23N of the *Financial Management Act 1994* (the FMA), applicable pronouncements issued by the Australian Accounting Standards Board (AASB) and abstracts of the Urgent Issues Group, and are based on Australian generally accepted accounting principles (GAAP). Their presentation is based on New Zealand Financial Reporting Standard Prospective Financial Information (FRS 29) as there are no specific Australian authoritative pronouncements which prescribe the preparation and presentation of prospective financial statements. The information presented in the Estimated Financial Statements takes into account Government decisions and other circumstances that may have a material effect on the statements.

The requirements of FRS 29 have been modified to achieve consistency in the presentation of the Estimated Financial Statements with AASB 1018 Statement of Financial Performance, AAS 36 Statement of Financial Position and AAS 37 Financial Report Presentation and Disclosures.

Future reporting basis

Future Estimated Financial Statements are expected to be prepared on a consistent basis, except for any changes in reporting required by new or revised Australian Accounting Standards. The effect of the intended adoption in Australia of International Accounting Standards from 1 January 2005 is as yet uncertain, and no adjustment has been made for any consequent effect.

B. Basis of accounting and measurement

The accrual basis of accounting has been employed in the preparation of the Estimated Financial Statements whereby assets, liabilities, equity, revenues and expenses are recognised in the reporting period in which they were incurred, regardless of when cash is received or paid.

The opening balances of 1 July 2004 represent the actual audited values as at 30 June 2003, adjusted for the revised estimated movements for 2003-04 and are based on either a cost or fair value basis. Those items measured at valuation include:

- non-current physical assets (excluding plant, equipment and vehicles, and certain infrastructure assets held by water and rail entities which are valued at historical cost) which are reassessed with sufficient regularity to ensure the carrying amount does not differ from their fair value;
- investments and productive trees in commercial native forests which are recognised at their net market value; and
- certain liabilities (e.g. unfunded superannuation) which are calculated with regard to actuarial assessment.

The estimated impact of future revaluations of non-current physical assets is included in the forecasts at the total general government level.

Liabilities other than those actuarially determined do not include the impact of revaluations due to the inherent difficulties in identifying and forecasting these amounts.

C. Basis of consolidation

The Estimated Financial Statements include all reporting entities in the Victorian general government sector, which is a sector of the State of Victoria reporting entity. Details of the entities included in the general government sector are shown in Note 18.

In the process of reporting on the general government sector as a single economic entity, all material transactions and balances within the sector are eliminated. In addition, all capital transactions between the general government sector and the public non-financial corporations and public financial corporations sectors are eliminated in the Estimated Statement of Financial Position.

Future franchising arrangements

Due to the combination of the National Express franchises being in receivership and the commencement of a number of regional rail projects over the next few years, the State plans to move V/Line Passenger into government for the duration of these projects. This will ensure that the impacts of the complex regional rail projects on the operations of V/Line Passenger during this time can be closely managed.

In terms of the other National Express franchises of M>Tram and M>Train, the government is currently reviewing options for future franchising arrangements. Given its intention to re-franchise these operations, no changes have been made to accounting treatments for related items in the estimated financial statements. Any impact of future changes in the franchising arrangements on the general government sector will be determined over the coming year.

Prior to the franchising of V/Line Passenger and other public rail transport operations to the private sector, these were classified in the ABS sectoral classification system as Public Non-Financial Corporations and therefore not included in the general government sector. Any rail operations resumed by government will be classified consistent with previous treatment.

D. Forecast reporting periods

The reporting period for the general government sector and most reporting entities in this sector is the year ending 30 June. However, for those entities with a reporting period other than the year ending 30 June, the latest audited financial statements are used as the basis of the opening balance for 1 July 2003. For example, TAFE institutes have reporting periods ending 31 December.

E. Revenues

Taxation

Accounting policy

General government sector taxation and fee revenue is recognised upon the earlier of either the receipt by the State of a taxpayer's self-assessment or the time the taxpayer's obligation to pay arises, pursuant to the issue of an assessment.

The types of revenue included in the estimates are as follows:

- payroll tax;
- land tax;
- duties levied principally on conveyancing and land transfers, mortgages and rental business;
- debits tax;
- gambling taxes levied mainly on private lotteries, electronic gaming machines, casino operations and racing;
- insurance duty relating to compulsory third party, life and non-life policies;
- insurance company contributions to fire brigades;
- motor vehicle taxes, including registration fees, duty on registrations and transfers, drivers' licence fees; and
- other taxes including landfill levies, concession fees payable by Transurban in respect of Melbourne City Link and minor liquor licence fees.

Forecast assumption

The State's tax revenues are forecast by a process, which involves:

- assessment of economic and other factors influencing the tax bases from which taxes are sourced (e.g. in the case of payroll tax, assessment of employment and wages outlooks; in the case of motor vehicle fees, assessment of the outlook for demand for cars reflecting long-term underlying demand factors and cyclical demand factors);
- analysis of historical information and relationships using econometric and other statistical methods;
- application of the Department of Treasury and Finance's economic forecasts where there is a relationship between taxation revenue and economic variables; and
- consultation with private sector economists, industry associations, and relevant government authorities (e.g. State Revenue Office, Roads Corporation, Office of Gambling Regulation).

Some state taxes are sourced from tax bases, which are particularly volatile, hence, tax revenue from these sources is subject to substantial annual variation. Stamp duty on land transfers and mortgages are examples of such volatility.

Fines and regulatory fees

Accounting policy

Revenue is recognised at the time the fine or regulatory fee is issued.

Forecast assumption

The forecasts of regulatory fees and fines are prepared by those government agencies which collect them. Some of the components may be based on contractual obligations, while the prediction of fines involves assessment of the behaviour of people on the roads and elsewhere. The estimation of the many small, miscellaneous fees is based on an assessment of recent experience in each of the markets.

Investment revenue

Accounting policy

Investment revenue includes interest, dividends, royalties, income tax and rate equivalent revenue and other revenue earned during the financial year from bank term deposits, shares and other investments. Interest revenue is recognised on an accrual basis and dividend income is recognised when dividends are determined. Net realised and unrealised gains/losses on the revaluation of investments form part of investment revenue.

Forecast assumption

As part of the budget process, government business enterprises provide their best available estimates of these future payments for the forecast period.

In determining the forecast dividend payments the following two general benchmarks are used:

- 50 per cent of net profit after tax; or
- dividends and income tax equivalent paid or payable of 65 per cent of pre-tax profit.

Other commercial factors which are considered and will affect the dividend forecasts include the views of the board of directors, the liquidity, operating cash flow and forecast cash requirements of each government business enterprise (including planned capital works), gearing and interest cover of the business, retained earnings and any other specific commercial factors relating to individual businesses.

Dividend and income tax equivalent forecasts can be significantly influenced by a number of factors including the volatility of the financial markets and climatic conditions impacting on the water authorities. The National Tax Equivalent Regime (NTER), administered by the Australian Taxation Office, has effectively replaced the Victorian Income Tax Equivalent Regime. Thirty five government business enterprises are currently subject to the NTER. Revenue raised under the NTER will remain with the State.

Forecast interest revenue is based on projected cash budget surpluses being invested.

Grants

Accounting policy

Grants comprise mainly of funds provided by the Commonwealth to assist the State in meeting general or specific service delivery obligations (primarily for the purpose of aiding in the financing of the operations of the recipient, capital purposes and/or for on-passing). This revenue category also includes grants from other jurisdictions. Revenue is recognised when the State obtains control over these funds.

Forecast assumption

The forecast receipt of financial assistance from the Commonwealth is determined on the latest available advice from the Commonwealth at the time of preparation of the Estimated Financial Statements, taking into account the payment schedules and escalation factors relevant to each type of grant. The payment schedules for some financial assistance from the Commonwealth are on a monthly, quarterly or annual basis, while others are on an irregular basis such as on a project-progress basis.

Sale of goods and services

Accounting policy

Revenue from sale of goods is recognised when control has passed to the buyer and the revenue can be reliably measured.

Revenue for rendering of services is recognised on a stage of completion basis and measured by reference to labour hours or percentage of total services to be performed.

Forecast assumption

Revenues arising from the sale of goods and rendering of services are forecast by taking into account all known factors, such as proposed fee increases in line with the Guidelines for Setting Fees and Charges Imposed by Departments and Budget Sector Agencies issued by the Department of Treasury and Finance, and projected variations in activities. Unless government policy states otherwise, fees will be set to recover the full costs of the goods or services provided.

Gain (loss) from disposal of physical assets

Any gain or loss on disposal of physical assets is recognised at the date of disposal and is determined after deducting from the proceeds, the carrying value of the asset at that time.

Fair value of assets received free of charge or for nominal consideration

Revenues arising from assets received free of charge or for nominal consideration are measured at the fair value of the contribution and are recognised when the State gains control of the contribution or the right to receive the contribution.

F. Expenses

Expenses are recognised when they are incurred.

Employee benefits

Accounting policy

This expense category includes all costs related to employment, other than superannuation, which is accounted for separately. Expenses for employee benefits include wages and salaries, fringe benefits tax, leave entitlements and redundancy payments.

Forecast assumption

Employee benefits are forecast on the basis of staffing profiles and current salaries and conditions. For the forecast period employee benefits are adjusted for approved wage agreements with allowance made for further changes in the future.

Superannuation

Accounting policy

Superannuation expense is determined on the following basis:

- funded schemes: the expense reflects the superannuation contribution paid or accrued by entities within the general government sector; and
- unfunded schemes: the expense includes the net movement in the unfunded superannuation liability during each period after taking account of superannuation contributions paid or accrued in each year.

Forecast assumption

The net movement in the unfunded superannuation liability becomes more sensitive to investment earnings as fund assets increase. The budget assumes a standard fund earning rate across the budget and forward estimates period consistent with long-term actuarial assumptions. However in any year, the actual fund earnings can vary significantly from assumed earnings producing a large variance in the actual result compared to budget.

For the forecast period, superannuation expense for unfunded schemes has been estimated by the Department of Treasury and Finance and is consistent with projections provided by various actuaries of each superannuation fund (refer to Note 15).

Depreciation

Accounting policy

All infrastructure, buildings, plant and equipment and other non-current physical assets (excluding leased items, refer to Note 6) that have a limited useful life are depreciated. Depreciation is generally calculated on a straight-line basis at a rate that allocates the asset's value, less any residual value, over its estimated useful life.

Depreciation rates and methods are reviewed annually.

The following are typical estimated useful lives for the different asset classes used by the general government sector entities:

Asset class	*Useful life*
Dwellings	40 to 50 years
Other buildings	30 to 60 years
Other infrastructure	10 to 32 years
Road pavement	60 years
Bridges	90 years
Plant, equipment and vehicles	3 to 10 years
Cultural assets	100 years

Land and earthworks associated with the declared road network and core cultural assets, which are considered to have an indefinite life, are not depreciated. Depreciation is not recognised in respect of these assets as their service potential will not, in any material sense, be consumed during the reporting period.

Forecast assumption

Depreciation is forecast on the basis of known asset profiles, asset sales programs and approved new asset investment programs. The expense is based on the assumption that there will be no change in depreciation rates over the forecast period. The estimated impact of future revaluation of assets on depreciation is also included in the expense.

Borrowing costs

Accounting policy

Borrowing costs, other than those capitalised in relation to qualifying assets, are recognised as expenses in the period in which they are forecast to be incurred.

Borrowing costs include:

- interest on outstanding borrowings;
- amortisation of discounts or premiums relating to borrowings;
- amortisation of ancillary costs incurred in connection with the arrangement of borrowings;
- indexation of principal outstanding for capital indexed securities and indexed annuities in line with movements in the Consumer Price Index (CPI);
- capital gains/losses incurred on debt retirement or debt portfolio restructuring; and
- finance lease charges.

Borrowing costs directly attributable to assets under construction are capitalised as part of the cost of those assets.

Forecast assumption

Estimates for borrowing costs are based on the forecast level of outstanding general government sector debt. This is expected to mainly comprise a fixed rate facility, indexed-linked securities from the Treasury Corporation of Victoria and a motor vehicle finance lease facility. All maturities in the forecast period are assumed to be refinanced at forward interest rates. The indexed securities are adjusted in line with movements in the CPI and any movements in the principal outstanding is recognised as a finance cost.

Grants and transfer payments

Accounting policy

Grants and transfer payments to third parties are recognised as an expense during the financial year in which they are paid or payable. These payments include transactions such as grants, subsidies and other transfer payments made to local government, non-government schools, community groups, public non-financial corporations and public financial corporations.

Forecast assumption

Grants and transfer payments are forecast on the basis of known activity and adjusted by the appropriate economic parameters. Where payments are tied to third party revenue, such as Commonwealth grants for on-passing, forecasts are in line with estimated receipts.

Supplies and services (including maintenance)

Accounting policy

Supplies and services generally represent the day-to-day running costs, including maintenance costs, incurred in the normal operation of general government sector entities. These items are recognised as an expense in the financial period in which they are incurred.

Forecast assumption

Supplies and services are forecast on the basis of known activity changes including the application of government policy such as savings strategies, changes in the method of service delivery and the application of the appropriate economic parameters.

An allowance is made for emerging demand that may arise over the forecast period.

G. Assets

The 1 July 2004 opening balance of assets represents the audited value as at 30 June 2003, revised for estimated movements for 2003-04.

Cash assets

Accounting policy

Cash assets comprise cash on hand, cash at bank, deposits at call and highly liquid investments with short periods to maturity, which are readily convertible to cash on hand and are subject to an insignificant risk of changes in value.

Forecast assumption

Cash assets are assumed to be held at levels sufficient to cover operating requirements over the forecast period.

Prepayments

Accounting policy

Prepayments represent payments in advance of receipt of goods or services or an expenditure made in one accounting period covering a term extending into the next accounting period.

Forecast assumption

Unless otherwise stated prepayments for expenditure extending into the next accounting period are assumed to apply only to minor contractual obligations for goods and services.

Other financial assets

Accounting policy

Other financial assets comprise marketable securities (less provision for diminution) and deposits that are valued at net market value, except for long-term investments. Long-term investments, such as international bonds, are investments that are expected to be held for greater than 12 months. Long-term investments are recognised using the cost method of valuation, being the cost at the date of acquisition. Any discount or premium is amortised over the life of the investments and gains or losses arising from the investments prior to maturity are recognised in the estimated statement of financial performance.

Forecast assumption

All surplus cash resources for the period 2003-04 to 2006-07 are assumed to be held as financial assets (investments) to preserve budget decision-making flexibility.

Receivables

Accounting policy

Receivables include debtors in relation to goods and services, taxes and fines, accrued investment income and the GST input tax credits recoverable. Receivables are recognised at the nominal amounts due, less any provision for bad and doubtful debts.

Forecast assumption

Receivables are forecast on the basis of revenue activity levels.

Inventories

Accounting policy

Inventories include goods, other property and services, held for sale in the ordinary course of business. It includes land held for resale and excludes depreciable assets.

The opening balance of inventories is valued at the lower of cost and net realisable value. The methods used to assign costs to inventories, other than land held for resale, are based on either purchase cost, weighted average cost, or cost on a ‘first-in first-out’ basis.

Land held for resale is valued at the lower of cost and net realisable value.

Forecast assumption

Inventories forecast to be purchased are valued at the forecast cost.

Non-current physical assets

Accounting policy

Non-current physical assets include land and buildings, infrastructure assets, national parks, state forests and other Crown land, cultural assets and plant, equipment and vehicles.

In general, all non-current physical assets with a value over $1 000 are capitalised.

Non-current physical assets, other than plant, equipment and vehicles, are measured at fair value. Fair value is determined on the following basis:

- Land and buildings are measured at the amounts for which the assets could be exchanged between knowledgeable willing parties in an arm's length transaction.
- Infrastructure assets, including road pavements and bridges and earthworks, and are measured by reference to the assets' written down replacement cost.
- National parks, state forests and other Crown land are determined by reference to the estimated current market-buying price of adjacent land assuming existing purpose, discounted to adjust for the restricted nature of current use. This valuation methodology does not take into account the intrinsic value of these assets to the community. Other Crown land in rural areas has been recognised at values determined by applying an average valuation for broad area rural improved land (cropping and grazing) and unimproved land (bushland) for all parishes and townships in the State.
- Cultural assets and collections, including heritage assets, are those assets that the State intends to preserve because of their unique historical, cultural or environmental attributes. These assets include items such as the Royal Botanical Gardens, Herbarium, State Library, Government House, Parliament House, historic houses, monuments, certain museum exhibits, art collections, archival collections and other items of cultural significance. Heritage assets and collections that generate substantial revenues are valued at the greater of current market buying price and net present value. Natural heritage assets and collections are valued at estimated realisable value or net present value, whichever is the higher. All other heritage assets and collections are valued at estimated written-down replacement cost.

Plant, equipment and vehicles comprise of furniture and fittings, office equipment, general library collections, information technology systems and computer equipment, machinery, motor vehicles, musical equipment, and sporting equipment and are measured at cost.

Revaluations are made with sufficient regularity to ensure that the carrying amount of each asset does not differ materially from its value by independent assessments. As a general expectation this will occur at least every three to five years.

Revaluation increments are credited directly to the asset revaluation reserve, except that, to the extent that an increment reverses a revaluation decrement in respect of that class of asset previously recognised as an expense in net result, the increment is recognised immediately as revenue in determining the net result.

Revaluation decrements are recognised immediately as expenses in the net result, except that, to the extent that a credit balance exists in the asset revaluation reserve in respect of the same class of assets, they are debited directly to the asset revaluation reserve.

Revaluation increments and decrements are offset against one another within a class of non-current assets.

Restrictive nature of cultural and heritage assets, Crown land and infrastructure

Agencies in the Victorian general government sector hold cultural assets, heritage assets, Crown land and infrastructure. Such assets are deemed worthy of preservation because of the social rather than financial benefits they provide to the community. The nature of these assets means that there are certain limitations and restrictions imposed on their use and/or disposal.

Forecast assumption

The value of non-current physical assets will change during the forecast period to account for acquisitions, disposals and the impact of depreciation and revaluation.

New investments in assets are valued at the forecast purchase price or, where appropriate, recognised progressively over the estimated construction period.

The forward estimates include the estimated impact of revaluations of non-current physical assets. These estimates have been derived based on examination and extrapolation of historical trends in asset revaluations by major asset class. These estimates have been included in the forward estimates at a total general government level.

Other non-current physical assets

Land under roads

Accounting policy

Land under roads and road reserves have not been recognised.

Natural resources

The majority of natural resource assets comprise of commercial native forests.

Accounting policy

The opening value of commercial native forests is measured at their net market value. The net market value is determined as the difference between the net present value of cash flows expected to be generated by the commercial native forests (discounted at a risk adjusted interest rate) less the net market value of the land on which the commercial native forests are growing.

The net market value of the land has been determined in accordance with an independent valuation.

Forecast assumption

The value of natural resources will change during the forecast period to account for acquisitions, disposals and the impact of revaluations.

Partnerships Victoria projects

Budget funded infrastructure projects approved in-principle by the Government for possible delivery under the Partnerships Victoria model are initially reflected in the estimated financial statements as non-current physical assets (with associated financing and depreciation costs).

A final decision on whether to proceed with a Partnerships Victoria delivery approach will be made following evaluation of bids arising from the tender process for the project and will be based on a value for money assessment. If, at the conclusion of the tender process, a decision is made to proceed with a Partnerships Victoria delivery approach and in those cases where it is an operating arrangement, the financial statements will be adjusted as required, to convert the budgeted asset investment, depreciation and financing flows to an appropriate stream of service payments to the private sector.

In relation to the Mitcham-Frankston freeway project, the State government has committed $100 million over 2 years for initial works and this amount has been included in the estimated financial statements. The government has announced that a toll will be applied to motorists to fund this project. Once the project financing arrangements are finalised, the future estimated financial statements will be adjusted as required to take account of those arrangements.

Leases

Accounting policy

A distinction is made between finance leases, which effectively transfer from the lessor to the lessee substantially all the risks and benefits incident to ownership of the leased assets, and operating leases, under which the lessor effectively retains substantially all such risks and benefits.

Leases are classified at their inception as either operating or finance leases based on the economic substance of the agreement so as to reflect the risks and benefits incidental to ownership.

Finance leases are recognised as assets and liabilities at the present value of the minimum lease payments. The lease asset is amortised over the shorter of the estimated useful life of the asset or the term of the lease. Minimum lease payments are allocated between the principal component of the lease liability and the interest expense calculated using the interest rate implicit in the lease and charged directly to the estimated statement of financial performance.

Operating lease payments are recognised as an expense on a straight-line basis in the estimated statement of financial performance in the periods in which they are incurred.

Any lease incentive liability in relation to a non-cancellable operating lease is reduced on an imputed interest basis over the lease term at the rate implicit in the lease.

Contingent rentals are recognised as an expense in the financial year in which they are incurred.

The cost of leasehold improvements is capitalised as an asset and amortised over the remaining term of the lease or the estimated useful life of the improvements, whichever is the shorter.

Forecast assumption

Unless otherwise stated existing leases are assumed to be replaced by leases with similar terms and conditions.

H. Liabilities

The 1 July 2004 opening balance of liabilities represents the audited value as at 30 June 2003, revised for estimated movements for 2003-04.

Payables

Accounting policy

Payables consist predominantly of creditors and other sundry liabilities and are recognised at the nominal amounts to be paid in the future for goods and services received, whether or not billed as at the end of each reporting period to the economic entity.

Forecast assumption

For the forecast period payables are based on known movements in contractual arrangements and other outstanding payables.

Interest-bearing liabilities

Accounting policy

The interest bearing liabilities of the State represent funds raised from the following sources:

- public borrowings mainly through the Treasury Corporation of Victoria;
- the residual amount outstanding for loans raised in previous years by the Commonwealth government on behalf of the State; and
- finance leases.

Debt is recognised at book value, which represents historical cost adjusted for amortisation of discount and premium.

Forecast assumption

For forecasting, budget sector debt is valued at its historical cost including unamortised premiums/discounts.

Employee benefits

Accounting policy

An estimate of the provision is made in the Estimated Financial Statements for benefits not taken at the end of each forecast reporting date in respect of wages and salaries, annual leave and long service leave. The provisions are measured at their nominal amounts except for long service leave, which is estimated at the present value of the estimated future cash outflows to be made in respect of services provided by employees up to each reporting date.

Forecast assumption

Employee benefits are forecast on the basis of staffing profiles and current salaries and conditions. For the forecast period, employee benefits are adjusted for approved wage agreements with allowance made for future movements.

Superannuation

Accounting policy

The opening balance of the State's superannuation obligations is based on the latest actuarial assessment of the members' benefits, net of scheme assets, and represents the audited value as at 30 June 2003, revised for estimated movements in 2003-04, in respect of the contributory service of current and past government employees. The valuation is determined by discounting to present value the gross benefit payments at a current, actuarially determined, risk-adjusted discount rate appropriate to the respective plans.

Forecast assumption

For the forecast period the superannuation liability has been estimated by the Department of Treasury and Finance and is consistent with projections provided by the various fund actuaries (refer to Note 15).

Outstanding insurance claims

Accounting policy

The outstanding insurance claims mostly comprise the claims liability, which is independently assessed by actuaries, cover claims reported but not yet paid, claims incurred but not reported and the anticipated direct and indirect costs of settling those claims. The actuaries take into account projected inflation and other factors to arrive at expected future payments. These are then discounted at the reporting date using a market determined, risk adjusted discount rate.

Forecast assumption

The level of outstanding insurance claims liability at the end of each forecast year is based on historical trends and existing actuarial valuations and projections adjusted for forecast activity levels.

Other liabilities

Accounting policy

Other liabilities consist of income tax equivalent, dividends payable, deferred tax liability, unearned/prepaid income, GST and FBT payables, and are recognised at the estimated amounts payable in each reporting period.

I. Right to receive assets

Accounting policy

An independent private sector entity, has leased land and Stateworks from the State and has constructed the city link network on which it charges tolls to motorists during the concession period.

The concession period has a nominal term (33.5 years) and at the end of the period, the Stateworks together with the constructed facilities will be returned to the State.

The recognition of the right of the State to receive the network asset (the asset) is currently being considered by the Accounting Profession and a cross jurisdictional government working party but the accounting treatment has been deferred until authoritative guidance is available.

Accordingly the asset is not disclosed, pending authoritative guidance or the development of relevant accounting standards on the appropriate treatment in the statement of financial position and statement of financial performance.

J. Accounting for the goods and services tax (GST)

Accounting policy

Revenues, expenses and assets are recognised net of GST except where the amount of GST incurred is not recoverable, in which case it is recognised as part of the cost of acquisition of an asset or part of an item of expense. GST receivable from and payable to the Australian Taxation Office is included in the statement of financial position.

K. Estimated statement of cash flows

Cash

Accounting policy

For the purposes of the estimated statement of cash flows, cash comprises cash on hand, cash at bank, bank overdrafts and deposits at call, and highly liquid investments with short periods to maturity, which are readily convertible to cash on hand and are subject to an insignificant risk of changes in value.

L. Rounding

Accounting policy

All amounts in the Estimated Financial Statements have been rounded to the nearest hundred thousand dollars unless otherwise stated.

Figures in the estimated financial statements may not add due to rounding.

Note 2: Taxation

($ million)	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Payroll tax	2 730.0	2 701.4	2 865.1	3 005.8	3 153.9
Taxes on immovable property	876.1	877.8	976.2	1 074.3	1 059.1
Financial and capital transactions [(a)]	2 348.2	2 844.6	2 351.8	2 100.1	2 153.4
Gambling	1 420.1	1 361.3	1 433.4	1 510.0	1 591.8
Insurance	950.6	951.5	1 012.5	1 078.4	1 147.8
Motor vehicles	1 204.1	1 205.9	1 252.9	1 302.0	1 336.6
Other licences and levies	64.1	64.5	71.3	79.1	83.7
Total taxation	**9 593.2**	**10 006.9**	**9 963.3**	**10 149.7**	**10 526.3**

Note:

(a) *Financial and capital transactions include duty on land transfers, debits tax and other property stamp duty.*

Note 3: Investment revenue

($ million)	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Dividends	273.1	303.4	331.5	476.5	460.4
Income tax and rate equivalent revenue	148.7	180.6	187.4	210.6	231.6
Interest	287.7	347.8	355.0	343.7	357.2
Royalties	44.9	48.0	43.3	46.3	45.5
Rents	15.3	15.3	15.6	15.6	15.6
Other	126.1	131.7	132.4	133.9	135.2
Total investment revenue	**895.9**	**1 026.8**	**1 065.3**	**1 226.5**	**1 245.5**

Note 4: Grants revenue

($ million)	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Operating grants					
General purpose grants	6 957.2	7 046.6	7 270.3	7 792.9	8 056.7
Specific purpose grants for on-passing	1 387.5	1 396.8	1 478.1	1 560.7	1 643.8
Other specific purpose grants	3 443.6	3 423.2	3 539.8	3 722.9	3 855.8
Total operating grants	**11 788.2**	**11 866.5**	**12 288.2**	**13 076.5**	**13 556.3**
Capital grants					
Specific purpose grants for on-passing	121.6	124.3	128.6	133.7	138.9
Other specific purpose grants	338.2	290.2	406.5	373.9	229.8
Total capital grants	**459.8**	**414.5**	**535.1**	**507.5**	**368.7**
Total grants	**12 248.0**	**12 281.0**	**12 823.3**	**13 584.1**	**13 925.0**

Note 5: Depreciation

($ million)	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Plant and equipment and infrastructure other than roads	473.6	489.2	518.0	527.7	537.8
Buildings [(a)]	279.2	266.8	291.3	324.5	368.5
Road network	258.0	258.0	273.3	286.9	296.0
Other assets	14.0	14.0	15.0	9.1	7.2
Total depreciation	**1 024.8**	**1 028.0**	**1 097.6**	**1 148.2**	**1 209.5**

Note:
(a) Includes estimated depreciation on amounts not yet allocated to projects in 2004-05 to 2006-07.

Note 6: Amortisation

($ million)	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Leased plant and equipment	44.7	44.7	46.4	48.0	49.6
Leasehold buildings	11.0	11.7	11.9	11.9	11.9
Intangible assets	12.1	12.1	9.8	9.8	8.6
Total amortisation	**67.9**	**68.5**	**68.0**	**69.6**	**70.1**

Note 7: Borrowing costs

($ million)	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Interest on long-term interest bearing liabilities	424.7	411.9	417.1	411.7	405.6
Interest in short-term interest bearing liabilities	11.8	23.8	12.4	12.7	12.7
Finance charges on finance leases	11.7	13.0	11.7	27.1	32.5
Other borrowing costs	35.1	36.6	26.7	25.6	25.2
Total borrowing costs	**483.3**	**485.3**	**467.9**	**477.2**	**475.9**

Note 8: Grants and transfer payments

($ million)

	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Commonwealth	1.5	33.8	35.4	35.9	35.4
Local government	509.4	521.4	495.0	456.9	471.9
Private sector	3 133.5	3 193.5	3 180.6	3 386.1	3 608.4
Grants within Victorian Government	892.3	908.3	930.5	1 023.6	890.6
Other	0.5	5.7	0.5	0.5	0.5
Total grants and transfer payments	**4 537.2**	**4 662.7**	**4 642.0**	**4 903.0**	**5 006.8**

Note 9: Total expenses from ordinary activities by department

($ million)

	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Expenses from ordinary activities (a)					
Education and Training	7 752.4	7 842.2	7 973.9	8 082.3	8 145.2
Human Services	9 502.5	9 659.6	9 909.3	10 066.7	10 201.9
Infrastructure	2 612.2	2 838.6	2 606.3	2 655.7	2 698.0
Innovation, Industry and Regional Development	379.8	417.7	282.3	247.4	266.0
Justice	2 353.3	2 343.4	2 419.1	2 500.9	2 570.8
Parliament	116.0	118.0	114.2	98.6	99.5
Premier and Cabinet	387.6	408.9	409.3	405.0	404.1
Primary Industries	297.5	313.4	279.5	271.8	270.2
Sustainability and Environment	924.0	959.7	819.1	798.2	791.8
Treasury and Finance	2 144.6	1 892.7	2 061.0	2 144.6	2 173.1
Victorian Communities	847.7	884.7	799.3	889.1	724.2
Contingencies not allocated to departments (b)	488.1	425.3	1 122.5	1 730.4	2 366.4
Regulatory bodies and other part budget funded agencies (c)	922.6	901.9	940.6	980.2	1 008.6
Total	**28 728.2**	**29 006.3**	**29 736.4**	**30 870.8**	**31 719.8**
Less eliminations (d)	(2 374.3)	(2 485.8)	(2 356.1)	(2 346.0)	(2 369.6)
Total expenses from ordinary expenses	**26 353.9**	**26 520.4**	**27 380.3**	**28 524.8**	**29 350.2**

Notes:

(a) *This note has been prepared on a departmental allocation basis consistent with the recently announced changes to the machinery of government.*

(b) *Departmental expenses will be supplemented for certain costs that are provided for in contingencies.*

(c) *Other general government sector agencies, which receive less than 50 per cent of their revenue from appropriations and therefore are not allocated to departments.*

(d) *Comprised of payroll tax, capital assets charge and inter-departmental transfers.*

Note 10: Property, plant and equipment and infrastructure systems other than roads

($ million)

	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
Land, national parks and other land only holdings	**9 057.7**	**9 364.1**	**9 691.9**	**10 025.2**
Buildings [(a)]	12 370.9	13 824.6	15 157.7	16 731.7
Less: Accumulated depreciation	(767.4)	(1 017.6)	(1 316.0)	(1 678.9)
Buildings (written down value)	**11 603.6**	**12 807.0**	**13 841.7**	**15 052.8**
Infrastructure systems other than roads	1 843.5	2 000.7	2 541.8	2 617.3
Less: Accumulated depreciation	(1 444.4)	(1 465.4)	(1 485.5)	(1 505.8)
Infrastructure systems other than roads (written down value)	**399.0**	**535.3**	**1 056.3**	**1 111.4**
Plant, equipment and vehicles	3 828.0	4 131.9	4 438.7	4 736.8
Less: Accumulated depreciation	(2 249.1)	(2 658.5)	(3 084.2)	(3 520.2)
Plant, equipment and vehicles (written down value)	**1 579.0**	**1 473.4**	**1 354.5**	**1 216.6**
Leased plant, equipment and vehicles	285.1	295.1	305.1	315.1
Less: Accumulated depreciation	(62.0)	(70.4)	(80.4)	(92.0)
Leased plant, equipment and vehicles (written down value)	**223.1**	**224.7**	**224.7**	**223.1**
Total property, plant and equipment	**22 862.4**	**24 404.5**	**26 169.0**	**27 629.1**

Note:

(a) Includes amounts not yet allocated to projects in 2004-05 to 2006-07.

Note 11: Road networks

($ million)

	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
Road Infrastructure	5 115.9	5 115.9	5 115.9	5 115.9
Less: Accumulated depreciation on road infrastructure	(1 406.4)	(1 406.4)	(1 406.4)	(1 406.4)
Roads and earthworks	18 835.1	20 109.2	21 379.8	22 536.4
Less: Accumulated depreciation on roads	(4 817.3)	(5 090.2)	(5 376.4)	(5 671.4)
Total road networks	**17 727.4**	**18 728.5**	**19 712.9**	**20 574.5**

Note 12: Reconciliation of movements in fixed assets [(a)]

($ million)

	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
Carrying amount at the start of the year	38 500.7	40 589.8	43 133.0	45 881.9
Additions [(b)]	2 127.2	2 572.3	2 765.0	2 339.4
Disposals at written down value	(91.3)	(83.8)	(78.4)	(69.4)
Revaluations increments	1 123.5	1 188.1	1 272.4	1 315.5
Assets transferred	..	7.5	(11.0)	..
Depreciation/amortisation expense	(1 070.3)	(1 140.9)	(1 199.0)	(1 263.8)
Carrying amount at the end of the year	**40 589.8**	**43 133.0**	**45 881.9**	**48 203.6**

Notes:

(a) Fixed assets comprise land and buildings, infrastructure systems, plant, equipment, vehicles, roads and earthworks. Excludes movements in other non-current assets in Note 13 below.

(b) Includes assets acquired under finance lease arrangements.

Note 13: Other assets

($ million)

	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
Non-current				
Natural resources reserves at valuation	266.6	275.0	283.4	291.8
Other assets - including works of art, museum collection, rare book collections and intangibles	3 158.4	3 246.8	3 335.4	3 426.6
Less: Accumulated depreciation/amortisation	(118.2)	(138.9)	(155.9)	(175.8)
Total other assets	**3 306.7**	**3 382.9**	**3 462.9**	**3 542.5**

Note 14: Employee benefits

($ million)

	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
Current				
Accrued salaries and wages, and other employee benefits [(a)]	784.9	806.3	827.6	850.1
Long service leave	214.5	167.4	122.2	76.3
Total current employee benefits	**999.4**	**973.6**	**949.8**	**926.4**
Non-current				
Accrued salaries and wages, and other employee benefits [(a)]	4.5	4.5	4.5	4.5
Long service leave	1 985.1	2 208.2	2 435.2	2 576.7
Total non-current employee benefits	**1 989.6**	**2 212.7**	**2 439.7**	**2 581.2**
Total employee benefits	**2 988.9**	**3 186.3**	**3 389.5**	**3 507.6**

Note:

(a) Includes accrued annual leave, payroll tax and other similar on-costs.

Note 15: Superannuation

The liability for employee superannuation benefits is the responsibility of the State's public sector superannuation funds. These funds are not consolidated in the Estimated Financial Statements as they are not controlled by the State. However, the major proportion of unfunded superannuation liabilities are the responsibility of the State and are recognised accordingly.

The long-term assumptions adopted by the actuary can differ from other economic assumptions that are listed at the start of the Notes to the Financial Statements.

For 2003-04 to 2006-07, the weighted average discount rate used by the actuary is 7 per cent per annum and the assumed weighted average rate of salary increases is 4 per cent per annum (excluding promotions). For 2003-04, the CPI is assumed to increase by 2.25 per cent, and for 2004-05 and beyond, a long-term inflation rate of 3 per cent per annum is assumed.

The general government's share of the unfunded superannuation liability based on Department of Treasury and Finance estimates is as follows:

Superannuation liability

($ million)

	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
State Superannuation Fund	13 187.6	14 143.3	14 766.7	15 050.8
Other funds [(a)]	332.2	118.8	107.3	85.4
Total superannuation liability	**13 519.8**	**14 262.1**	**14 874.0**	**15 136.2**
Current liability	177.6	523.2	749.2	949.3
Non current liability	13 342.2	13 739.0	14 124.8	14 186.9
Total superannuation liability	**13 519.8**	**14 262.1**	**14 874.0**	**15 136.2**

Note:
(a) Other consists of Emergency Services Superannuation Fund, Constitutionally Protected Schemes, Parliamentary Contributory Superannuation Scheme, Local Authorities and HealthSuper Funds.

Note 16: Reconciliation of changes in equity

($ million)

	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
Balance at the beginning of the year	23 607.9	25 014.2	26 430.7	28 212.6
Net result for year	652.0	472.9	564.1	536.7
Movements in revaluation reserves	1 194.5	1 261.5	1 348.3	1 394.0
Contributions by the State to other sectors in its capacity as owner	(444.4)	(319.8)	(132.9)	(101.3)
Other adjustments in equity	4.2	2.0	2.4	1.9
Total equity at end of the year	**25 014.2**	**26 430.7**	**28 212.6**	**30 043.9**

Note 17: Reconciliation of net cash flows from operating activities

($ million)	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Cash	320.0	349.3	383.4	411.5	435.7
Deposits at call	1 459.8	685.1	720.2	747.8	767.6
Bank overdraft	(1.8)	(15.9)	(15.3)	(14.2)	(14.0)
Cash held as at 30 June	**1 778.0**	**1 018.4**	**1 088.3**	**1 145.0**	**1 189.2**
Reconciliation of the net result to net cash flows from operating activities					
Net result	**244.5**	**652.0**	**472.9**	**564.1**	**536.7**
Non cash movements					
Depreciation	1 024.8	1 028.0	1 097.6	1 148.2	1 209.5
Amortisation	67.9	68.5	68.0	69.6	70.1
Revaluation of investments	0.1	0.1	0.1	0.1	0.1
Assets received /given free of charge	..	..	(7.5)	11.0	..
Revaluation of assets	(8.4)	(8.4)	(8.4)	(8.4)	(8.4)
Discount /premium on investment/interest bearing liabilities	11.7	12.5	4.1	3.0	2.6
Write down of liabilities	(1.6)	(1.6)	(1.6)	(1.7)	(1.7)
Movements included in investing and financing activities					
Net revenue from sale of property, plant and equipment	7.3	17.0	23.9	25.2	25.2
Movements in assets and liabilities					
Increase in provision of doubtful debts	93.6	78.6	84.9	86.9	82.9
increase (decrease) in payables	(6.8)	(6.8)	(14.2)	6.4	11.6
Increase in employee benefits	207.9	195.6	201.8	207.6	122.6
Increase in superannuation	497.6	82.6	742.3	311.8	262.2
Increase in insurance claims liabilities	10.7	20.7	31.0	42.6	54.3
Decrease in other liabilities	(14.5)	(21.9)	(24.9)	(7.7)	(9.9)
Decrease in receivables	(167.8)	(163.9)	(158.5)	(173.8)	(168.6)
Increase (decrease) in other current assets	0.3	0.3	(0.2)	..	(0.1)
Net cash flows from operating activities	**1 967.2**	**1 953.4**	**2 511.5**	**2 285.2**	**2 189.2**

Note 18: General government sector entities

The following is a list of entities, which have been consolidated for the purposes of the Estimated Financial Statements. For further details on consolidation policy see Note 1 C, Basis of Consolidation.

Public non-financial and public financial corporations do not form part of the general government sector and are therefore not included in this list of controlled entities. For a complete listing of all government entities, please refer to the 2002-03 Financial Report for the State of Victoria.

General government sector entities
Department of Education and Training
Adult, Community and Further Education Board
Adult Multicultural Education Services
Centre for Adult Education
TAFEs including:
Bendigo Regional Institute of TAFE
Box Hill Institute of TAFE
Central Gippsland Institute of TAFE
Chisholm Institute of TAFE
Driver Education Centre of Australia Ltd
East Gippsland Institute of TAFE
Gordon Institute of TAFE
Goulburn Ovens Institute of TAFE
Holmesglen Institute of TAFE
Institute of Land and Food Resources (TAFE Division)
International Fibre Centre Limited
Kangan Batman Institute of TAFE
Northern Melbourne Institute of TAFE
Royal Melbourne Institute of Technology (TAFE Division)
South West Institute of TAFE
Sunraysia Institute of TAFE
Swinburne University of Technology (TAFE Division)
University of Ballarat (TAFE Division)
Victoria University of Technology (TAFE Division)
William Angliss Institute of TAFE
Wodonga Institute of TAFE
Victorian Curriculum and Assessment Authority
Victorian Institute of Teaching
Victorian Learning and Employment Skills Commission
Victorian Qualifications Authority
Department of Human Services
Hospitals, Health Services and Ambulance Services including:
Alexandra and District Ambulance Service
Alexandra District Hospital
Alpine Health
Ambulance Service Victoria Metropolitan Region
Austin and Repatriation Medical Centre

General government sector entities (continued)

Bairnsdale Regional Health Service
Ballarat Health Services
Barwon Health
Bayside Health
Beaufort and Skipton Health Service
Beechworth Health Service
Benalla and District Memorial Hospital
Bendigo Health Care Group
Boort District Hospital
Casterton Memorial Hospital
Central Gippsland Health Service
Cobram District Hospital
Cohuna District Hospital
Colac Community Health Services
Coleraine and District Health Services
Dental Health Services Victoria
Djerriwarrh Health Services
Dunmunkle Health Services
East Grampians Health Service
East Wimmera Health Service
Eastern Health
Echuca Regional Health
Edenhope and District Memorial Hospital
Gippsland Southern Health Service
Goulburn Valley Health
Health Purchasing Victoria
Hepburn Health Service
Hesse Rural Health Service
Heywood Rural Health (formerly Heywood and District Memorial Hospital)
Infertility Treatment Authority
Inglewood and District Health Service
Kerang and District Hospital
Kilmore and District Hospital, The
Kooweerup Regional Health Service
Kyabram and District Health Services
Kyneton District Health Service
Latrobe Regional Hospital
Lorne Community Hospital
Maldon Hospital
Mallee Track Health and Community Services
Manangatang and District Hospital
Mansfield District Hospital
Maryborough District Health Service
McIvor Health and Community Services
Melbourne Health
Mildura Base Hospital
Moyne Health Services
Mt Alexander Hospital

General government sector entities (continued)

Nathalia District Hospital
Northern Health
Numurkah District Health Service
Omeo District Hospital
Orbost Regional Health
Otway Health and Community Services, The
Peninsula Health
Peter MacCallum Cancer Institute
Portland and District Hospital
Queen Elizabeth Centre, The
Robinvale District Health Services
Rochester and Elmore District Health Service
Royal Victorian Eye and Ear Hospital
Rural Ambulance Victoria
Rural Northwest Health
Seymour District Memorial Hospital
South Gippsland Hospital
South West Healthcare
Southern Health
Stawell Regional Health
Swan Hill District Hospital
Tallangatta Health Service
Terang and Mortlake Health Service
Timboon and District Health Care Service
Tweddle Child and Family Health Service
Upper Murray Health and Community Services
Wangaratta District Base Hospital
West Gippsland Health Care Group
Victorian Institute of Forensic Mental Health
West Wimmera Health Service
Western District Health Service
Western Health
Wimmera Health Care Group
Wodonga Regional Health Service
Women's and Children's Health
Wonthaggi and District Hospital
Yarram and District Health Service
Yarrawonga District Health Service
Yea and District Memorial Hospital

Other DHS Boards including:

Chinese Medicine Registration Board of Victoria
Chiropractors Registration Board of Victoria
Dental Practice Board of Victoria
Medical Practitioners Board of Victoria
Mental Health Review Board
Nurses Board of Victoria
Optometrists Registration Board of Victoria
Osteopaths Registration Board of Victoria
Pharmacy Board of Victoria
Physiotherapists Registration Board of Victoria

General government sector entities (continued)

Podiatrists Registration Board of Victoria
Psychologists Registration Board of Victoria
Psychosurgery Review Board
Victorian Health Promotion Foundation
Victorian Relief Committee

Department of Infrastructure

Office of Gas Safety
Office of the Chief Electrical Inspector
Roads Corporation
Spencer Street Station Authority

Department of Innovation, Industry and Regional Development

Liquor Licensing Panel
Prince Henry's Institute of Medical Research
Regional Development Victoria
Tourism Victoria

Department of Justice

Country Fire Authority
Domestic Building (HIH) Indemnity Fund
Emergency Communications Victoria
Equal Opportunity Commission
Gambling Research Panel
Legal Practice Board
Metropolitan Fire and Emergency Services Board
Office of the Privacy Commissioner
Office of Public Prosecutions
Office of the Legal Ombudsman
Office of the Public Advocate
Victoria Legal Aid
Victoria Police (Office of the Chief Commissioner of Police)
Victorian Casino and Gaming Authority
Victorian Electoral Commission
Victorian Institute of Forensic Medicine
Victorian Law Reform Commission

Department of Premier and Cabinet

Australian Centre for the Moving Image
Film Victoria
Library Board of Victoria
Museums Board of Victoria
National Gallery of Victoria, Council of Trustees
Office of Public Employment
Office of the Ombudsman

Department of Primary Industries

Veterinary Practitioners Registration Board of Victoria

General government sector entities (continued)

Department of Sustainability and Environment

Architects Registration Board of Victoria
Building Commission
Catchment Management Authorities including:
- Corangamite Catchment Management Authority
- East Gippsland Catchment Management Authority
- Glenelg-Hopkins Catchment Management Authority
- Goulburn-Broken Catchment Management Authority
- Mallee Catchment Management Authority
- North Central Catchment Management Authority
- North East Catchment Management Authority
- West Gippsland Catchment Management Authority
- Wimmera Catchment Management Authority

EcoRecycle Victoria
Environment Protection Authority
Heritage Council
Parks Victoria
Plumbing Industry Commission
Royal Botanic Gardens Board
Shrine of Remembrance Trustees
Surveyors Board
Trust for Nature (Victoria)

Department of Treasury and Finance

Essential Services Commission

Department of Victorian Communities

Victorian Institute of Sport Ltd Victoria
Victorian Institute of Sport Trust Victoria

Parliament of Victoria

Victorian Auditor-General's Office

CHAPTER 5: STATEMENT OF RISKS

- The major risks to the Victorian economic outlook include strength of the world and national economies, the stronger Australian dollar, rising interest rates and a slowing of population growth.
- The general government operating surplus is sensitive to a range of economic and financial developments. These factors include economic activity (GSP and employment), inflation, wages growth, equity, property and bond markets.
- A number of contingent assets and liabilities have been identified.

ECONOMIC RISKS

The main risks to the Victorian economic projections stem from overseas and national developments from which Victoria would not be immune. There is also the possibility that Victorian population growth may vary due to unexpected changes in net interstate migration patterns, which could have some impact on medium-term economic growth.

In the past few months, signs have emerged that the long-awaited global recovery is underway. Reflecting this, forecasts of global growth have recently been revised a little higher, particularly for the United States and Japan. However, there are still some concerns about the sustainability of the recovery. If the global recovery stalls, there is a risk that Victorian (and national) export growth could be weaker than forecast, producing a somewhat slower GSP growth rate for 2003-04 and 2004-05. Conversely, if the recovery gathers pace more strongly than expected, supported by the substantial fiscal and monetary stimulus in the United States, there could be upside potential for export (and economic) growth.

The Australian Bureau of Agricultural and Resource Economics is forecasting a strong rebound in crop production in 2003-04, although a full rural recovery from drought is expected to take a little longer. The Bureau of Meteorology continues to indicate a return to 'neutral' weather patterns, although the risk of the return of El Niño has not totally disappeared. If El Niño returns and drought conditions re-emerge, this would further hamper export production and exacerbate downward pressure on farm incomes and economic growth. An alternative scenario is that recent good rains to many areas continue and agricultural production exceeds expectations, placing upward pressure on export and economic growth over the coming year.

The Australian dollar has strengthened further in recent months, to be trading around six-year highs against the US currency. Although a positive for the inflation outlook, continued appreciation of the currency could dampen Victorian (and national) export growth over the coming year.

In November 2003, the Reserve Bank increased the official cash rate by 25 basis points to 5.0 per cent. Signs of renewed strength in the Australian economy, and improved global conditions, have increased speculation that cash rates will be raised further over coming quarters. An increase beyond current market expectations could place some downward pressure on the growth forecast into 2004-05.

Victoria has been gaining population from interstate for the past five years, and this has contributed to the State's solid population growth. The forward population projections currently assume annual population growth of at least 1.0 per cent per annum. If Victoria's population growth rate moderates beyond current estimates, the medium-term economic growth projections could be affected.

On the positive side, the construction industry has been an important driver of economic growth over the past couple of years, with strength in both residential and non-residential activity. There is a risk that construction activity could still surprise on the upside in the near term, with relevant forward indicators yet to show convincing evidence of a sustained slowdown in this sector.

SENSITIVITY OF THE BUDGET TO ECONOMIC CONDITIONS

The importance of these economic risks can be gauged by estimating the sensitivity of the general government-operating surplus to changes in key economic and financial indicators. This section updates the sensitivity estimates from the 2003-04 budget papers.

Table 5.1 shows the impact on revenue, expenses and the operating surplus over a four-year period (beginning in 2003-04) of an increase in selected economic and financial indicators, and, in so doing, indicates the risk associated with the forecasts or projections of each variable. The major variables that affect Victoria's operating surplus are economic growth, employment, prices, wages, interest rates and volatility within asset markets.

To assess sensitivity to change, the level of the economic indicator, in each case, is permanently increased by 1 percentage point in the first year above the forecast growth rate (detailed in Chapter 3, *Economic Conditions and Outlook*) and is then reverted back to the forecast growth rate. It is assumed during the analysis of each indicator that all others follow their forecast growth rates. It should also be noted that an equivalent one percentage point decrease in each indicator would have an opposite impact to that shown in the table.

The results suggest that:

- the general government operating surplus is sensitive over the forward estimates period to changes in the levels of GSP, employment and wages;
- movements in equity prices also impact significantly on the operating result but primarily in the year in which the movement occurs; and
- interest rates and property prices are more volatile than other parameters, but tend to have a smaller ongoing effect on the operating position than changes of a similar size in the levels of economic activity, inflation or wages.

In interpreting the results in Table 5.1, it is worth noting that some of the economic indicators are more volatile than others, such as share and property markets, and so pose more of a risk to the outlook. In other words, for the parameters considered, a 1 percentage point variation does not have a uniform likelihood of occurring.

The sensitivities in table 5.1 are similar to those detailed and explained in the 2003-04 Budget Papers. The exception is recalculated price sensitivity, whereby a 1 per cent rise in the CPI is estimated to reduce the operating result by $15 million in 2003-04 (compared to an estimated $23 million reduction at budget time). This reflects a revised assessment of the sensitivity of public authority revenue to movements in the CPI.

Table 5.1: Impact on the general government operating surplus of a 1-percentage point increase in selected economic indicators in 2003-04 [(a)]

($ million)

	2003-04	*2004-05*	*2005-06*	*2006-07*
GSP				
Taxes, regulatory fees and fines	28	29	29	30
Other revenue [(b)]	20	24	25	27
Superannuation expenses	..	..	..	..
Other expenses	..	..	1	2
Operating surplus	**48**	**52**	**53**	**55**
Employment				
Taxes, regulatory fees and fines	27	29	30	32
Other revenue [(b)]	1	2	4	6
Superannuation expenses	..	..	..	..
Other expenses	..	..	..	..
Operating surplus	**28**	**31**	**34**	**37**
Consumer prices				
Taxes, regulatory fees and fines	33	35	35	36
Other revenue [(b)]	131	142	153	160
Superannuation expenses	120	..	..	..
Other expenses	60	61	62	65
Operating surplus	**-15**	**116**	**125**	**131**
Average weekly earnings [(c)]				
Taxes, regulatory fees and fines	27	29	30	32
Other revenue [(b)]	-17	-22	-13	-18
Superannuation expenses	110	9	10	10
Other expenses	98	102	106	109
Operating surplus	**-197**	**-105**	**-99**	**-106**
Domestic share prices				
Taxes, regulatory fees and fines	..	..	..	..
Other revenue [(b)]	5	5	..	..
Superannuation expenses	-36	-3	-3	-3
Other expenses	..	..	..	..
Operating surplus	**40**	**7**	**3**	**3**
Overseas share prices				
Taxes, regulatory fees and fines	..	..	..	..
Other revenue [(b)]	4	4	..	..
Superannuation expenses	-24	-2	-2	-2
Other expenses	..	..	..	..
Operating surplus	**27**	**5**	**2**	**2**

Table 5.1: Impact on the general government operating surplus of a 1-percentage point increase in selected economic indicators in 2003-04 [(a)] – *continued*

($ million)

	2003-04	*2004-05*	*2005-06*	*2006-07*
Property prices				
Taxes, regulatory fees and fines	35	28	47	48
Other revenue [(b)]	2	4	5	8
Superannuation expenses	-10	-1	-1	-1
Other expenses	..	..	..	..
Operating surplus	**46**	**33**	**53**	**56**
Property volumes				
Taxes, regulatory fees and fines	25	20	20	21
Other revenue [(b)]	2	3	3	4
Superannuation expenses	..	..	..	..
Other expenses	..	..	..	..
Operating surplus	**27**	**24**	**23**	**25**
Interest rates [(d)]				
Taxes, regulatory fees and fines	..	..	..	..
Other revenue [(b)]	77	80	41	42
Superannuation expenses	61	4	4	4
Other expenses	3	7	12	17
Operating surplus	**13**	**68**	**24**	**20**

Source: Department of Treasury and Finance

Notes:

(a) A positive number for taxes, regulatory fees and fines, and other revenue denotes an increase in revenue. A positive number for superannuation expenses and other expenses denotes an increase in expenses (and hence a reduction in the operating surplus). A positive number for the operating surplus denotes an improvement in the operating surplus. Numbers may not balance due to rounding.

(b) Other revenue includes changes in dividends and income tax equivalent payments from public authorities. These revenues are based on an estimated dividend payout ratio. However, dividends paid by government business enterprises are determined by the Treasurer having regard to relevant commercial considerations including reported profit/loss, operating cash flow, gearing and interest cover, capital requirements and the views of the Board and the portfolio Minister. Therefore, the actual impact on this revenue source is dependent on the current circumstances of the relevant public authority.

(c) Assumes wages of Victorian Government employees also increase by 1 percentage point above what was expected.

(d) Assumes a 1 percentage point increase in interest rates over the entire period.

FISCAL RISKS

Expenditure risks

There are several general risks, such as unforeseen changes in the size and structure of the Victorian population, which can impact on the expenditure and revenue outlook. These risks can be classified into those that affect all government departments and those that are department specific.

Examples of a government-wide factor that would have potential to increase general expenditures above those allowed for in the forward estimates are unplanned increases in award wage costs.

The main risks to specific departmental expenditures relate to growth in demand for key services, the modernisation of assets and government responses to unforeseen events. Examples of these types of impacts could include pressures related to the maintenance of assets such as government schools and TAFE institutes and funding required in relation to natural disaster relief.

The 2003-04 Budget and forward estimates include a contingency provision to allow for the likelihood that some of these department-specific and government-wide expenditure risks will be realised during the budget year or over the course of the outlook period. The contingency provision includes a general allowance for:

- the impact of planned award wage increases, consistent with government policy, on departmental operating costs;
- growth in Victoria's population and, from it, derived demand for government services; and
- other expenditure risks which are unforeseen or not able to be quantified at the time of construction of the budget estimates.

The inclusion of an operating contingency provision in the budget estimates mitigates the potential impact of expenditure risks on the overall budget position. Realised expenditure risks will only impact on total expenditure and the annual budget position to the extent that they cannot be accommodated within the contingency provision built into the budget estimates.

In addition to the operating contingency, the budget estimates include an unallocated capital provision to provide capacity for future asset investment funding requirements. With a capital program the size of that funded by the Government there are always likely to be variations in actual costs for individual asset investment projects against budget. However, the forward estimates assume that capital cost pressures are managed within the existing forward estimates with no budget impact. Management of capital cost pressures may occur in one of three ways:

- the reallocation of resourcing within departments' global capital budgets (reflecting the likelihood that cost over-runs will be offset by cost under-runs on other projects);
- re-scoping a project to fit within funding parameters (subject to government approval); and
- funding from the unallocated capital funding set aside in the forward estimates (subject to government approval).

Significant events that could represent a call on the operating contingency or unallocated capital funding and/or impact on the total budget expenditure forecasts are detailed below.

Public transport franchise arrangements

The Government is currently in the midst of negotiations with Yarra Trams and Connex in relation to the ongoing operation of consolidated tram and train franchises. The outcome of this process is expected to be known in the next few months with the new franchises to commence in the first half of next year. While a significant contingency has been set aside in the forward estimates, the ultimate cost and structure of the new franchise and transition arrangements still pose a moderate expenditure risk.

Roads

Roads of National Importance are funded on a 50:50 basis between State and Commonwealth governments. Depending on the size and timing of announcements made by the Commonwealth, the Victorian Government may be required to provide matching funding for road construction and operating expenditure.

The Federal Government has announced its intention to introduce, from July 2004, a new funding model for Australia's land infrastructure, called AusLink. The Commonwealth is proposing to fund rail, in addition to road, projects on a declared national network. The Commonwealth has announced a preference to introduce reciprocal funding arrangements with State and Territory Governments, including for the currently declared National Highway System, which is presently funded 100 per cent by the Commonwealth for maintenance as well as construction.

Insurance exposures

Over the past year, governments in Australia have been subject to sustained pressure to compensate for the absence of private sector insurance in areas as diverse as medical indemnity, professional indemnity cover for medical research, and public liability for religious institutions, adventure tourism, historic railways and public transport operations. To date, last resort insurance arrangements in Victoria have been entered into under strict conditions with known, limited potential exposure.

In response to certain instances of sharp rises in insurance premiums, the Government has also taken on risk that was previously held by the private sector. An example is the absorption of the medical indemnity exposures of bush nursing hospitals into the insurance programs of the Department of Human Services.

Furthermore, pressures on private medical indemnity premiums may result in the State assuming larger numbers of high risk medical procedures. Any such movement, together with the impact of claims that arise from the current levels of public medical services, means that there is a continuing need to monitor closely the State's medical indemnity liabilities and expenses.

Revenue risks

Muir Electrical Co v Commissioner of State Revenue [2002] VSC 224

Payroll tax is the most significant tax levied by the Victorian Government, worth approximately $2.7 billion in 2002-03. The *Pay-roll Tax Act 1971* (the Act) includes provisions to prevent the avoidance or minimisation of payroll tax liability by the splitting up of businesses. In calculating the total taxable wages subject to payroll tax, businesses may be 'grouped' where they share common employees and/or the same person(s) have a controlling interest in two or more of the businesses. These provisions have been in place since 1987 and in recent times have come under the scrutiny of the Supreme Court of Victoria.

Muir Electrical Co (MEC) and 18 retailers were 'grouped' for the purposes of calculating the total level of taxable wages. In a challenge to this decision, the Court of Appeal found that during the assessable period, the retailers could not be grouped under one of the common employee tests outlined in the grouping provisions. The matter was referred back to the Victorian Civil and Administrative Tribunal where it was found that another test applied to group MEC and the retailers. This finding was subsequently overturned in the Supreme Court and was the subject of a further appeal.

In August 2003, the Court of Appeal found that the retailers could not be grouped on other common employee tests and again reserved for subsequent consideration by the Victorian Civil and Administrative Tribunal the grouping of MEC and six retailers on the grounds that MEC had a controlling interest in these retailers.

Legislation has since been enacted during the Autumn 2003 session of Parliament to rectify problems identified in this case.

Royal & Sun Alliance Insurance Australia Limited v Commissioner of State revenue

Taxes are levied on a range of transactions, including transactions involving insurance products, under the *Duties Act 2000* (previously the *Stamps Act 1958*). The Duties Act 2000 imposes duty on the premium paid for general insurance policies at the rate of 10 per cent. Following the introduction of the GST on 1 July 2000, stamp duty has been payable on total insurance premiums inclusive of the GST. This is consistent with the pre-GST situation where the duty was payable on the total value of transactions, including Commonwealth indirect taxes.

In August 2002, following litigation brought by Royal & Sun Alliance Insurance Australia Limited against the Commissioner of State Revenue, the Supreme Court held that the GST component of the amount payable by the insured was not part of the insurer's gross premiums and therefore was not dutiable where this was separately identified in insurance policies.

In order to limit possible risks to revenue in the event of an unfavourable appeal outcome to the State, the Government announced on 3 September 2002 that it would immediately draft legislation to confirm and clarify existing arrangements to ensure that the entire premium remains subject to duty. This legislation was introduced into Parliament in Autumn 2003 and took effect from the date the *Duties Act 2000* came into force (1 July 2001).

The Commissioner's appeal against the Supreme Court's decision was heard between 24 and 26 February 2003. On 14 November 2003, the Court of Appeal ruled in favour of the Commissioner by concluding that the GST component falls part of the insurance premium dutiable under the Act. Royal & Sun Alliance Insurance Australia Limited has 28 days to seek special leave to appeal the decision.

CONTINGENT ASSETS AND LIABILITIES

Contingent assets

Contingent assets are either:

- possible assets that arise from past events where the probability of existence of an asset is considered higher than remote but which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- assets that fail either or both of the criteria for recognition as assets. These are:
  - (i) assets for which it is not probable that the future economic benefits embodied in them will eventuate; and/or
  - (ii) assets that do not possess a cost or other value that can be measured reliably.

Table 5.2: Quantifiable contingent assets as at 30 June 2003

($ million)

	2002	2003
Guarantees, indemnities	0.2	0.8
Potential early termination of contractual arrangements [(a)]	235.0	80.0
Legal proceedings and disputes	..	1.2
Other [(b)]	60.0	70.7
Total contingent assets	**295.2**	**152.7**

Notes:

(a) *In respect to any additional costs arising to the Director of Public Transport on early termination of the franchise, the franchisee must, to the extent of the performance bonds, indemnify the Director for any losses, damages or costs incurred by him as a result of early termination. If the franchisee does not do so, the Director has the right to draw on the franchisee's performance bonds for the amount of losses, damages or costs. These bonds total $80.0 million ($235.0 million for 2002).*

(b) *Concession Fees: A dispute exists between Transurban and the Australian Tax Office (ATO) on the treatment of deductibility of concession fees for tax purposes. In the event that Transurban is successful in its challenge, the concession fee values would be enhanced. Therefore the amount of the concession fee to be taken up as a contingent asset is $65.1 million.*

Table 5.2 lists $153 million of contingent assets able to be quantified. The reduction since 2002 reflected the drawdown on National Express performance bonds when they terminated their public transport franchise. In addition, the following non-quantifiable contingent assets may be available to the Government.

Public transport rail franchise agreements

During 1999-2000 the Director of Public Transport, on behalf of the Crown, entered into contractual arrangements with franchisees to operate passenger rail transport services in the State. The following summarises the major contingent assets arising from those arrangements.

Contingent assets arising from Interim Operator Agreements (IOA)

IOA offsets: The Director will be entitled to payments from the franchisees if the funding requirements and insurance costs are lower than expected and where revenue is greater than expected.

Contingent asset arising on early termination or expiry of franchise agreements (also refer to non quantifiable contingent liabilities)

Performance bonds: The Director will be entitled to call upon performance bonds if the franchisee does not indemnify the Director for any losses, damages or costs incurred by him as a result of early termination.

Payments on termination: If on termination of the franchise agreements by expiry or otherwise there is a net liability, the franchisee will have a liability to pay the Director.

Melbourne City Link

Concession fees: A dispute exists between Transurban and the Australian Tax Office (ATO) on the treatment of deductibility of concession fees for tax purposes. In the event that Transurban is successful in its challenge, the concession fee values would be enhanced. If the concession fee is taken up as a contingent asset the possible amount is $65.1 million.

Contingent liabilities

Contingent liabilities are either:

- possible liabilities that arise from past events where the probability of existence of a liability is considered higher than remote but which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- provisions that fail either or both of the criteria for recognition as liabilities. These are:
  - (i) provisions for which it is not probable that the future sacrifice of economic benefits will be required; and/or
  - (ii) provisions the amount of which cannot be measured reliably.

Table 5.3: Quantifiable contingent liabilities as at 30 June 2003

($ million)

	2002	*2003*
Guarantees, indemnities	167.3	189.8
Potential early termination of contractual arrangements [a]	787.3	712.5
Legal proceedings and disputes	289.8	271.3
Other [b]	6.5	60.1
Non general government debt	2 650.0	3 160.2
Total contingent liabilities	**3 900.9**	**4 393.9**

Notes:

(a) A contractual agreement of $599.0 million ($648.0 million for 2002) relates to the cost of correctional services beyond the current contract period. The State has the option to re-tender for the provision of correctional services every three years, after the initial five-year period for each contract. The commercial arrangement for the provision of prison facilities for the remaining 9 to 14 years and correctional services for the current three year term, which expires 9 September 2005, are included as commitments above.
In respect of early termination or expiry of the public transport rail franchise agreements, there would be an estimated liability of $115.3 million ($139.3 million for 2002).

(b) Melbourne Water Corporation included a new contingent liability of $44.4 million for possible environment compliance and decommissioning costs in respect of surplus sites.

A number of potential obligations, which are non-quantifiable at this time, have been recognised by the Government arising from:

- indemnities provided in relation to transactions, including financial arrangements and consultancy services, as well as for directors and administrators;
- performance guarantees, warranties, letters of comfort, and the like;
- deeds in respect of certain obligations; and
- unclaimed moneys which may be subject to future claims by the general public against the State.

Asset sales

There are potential exposures associated with the sale of a number of assets and services where the purchaser was provided with various indemnities and warranties.

Melbourne Cricket Ground Redevelopment

On 15 August 2002 (in addition to a commitment to provide grants of $77 million towards the capital cost of the redevelopment and a guarantee of up to $360 million in respect of a TCV Loan Facility to the Melbourne Cricket Club (MCC)), the State entered into agreements to support the redevelopment of the Melbourne Cricket Ground (MCG) for the 2006 Commonwealth Games. These agreements include:

- indemnities to the MCG Trust and the MCC in the event that there will be insufficient trading surpluses to meet scheduled debt servicing and repayments, or if the total project construction cost exceeds $450 million;
- agreement for compensation to the Australian Football League as a result of the holding of the Commonwealth Games in 2006. The amount of compensation will be finalised following the completion of the 2006 AFL draw. All compensation claims will be calculated in accordance with an agreed compensation formula;
- agreement has been reached with the AFL for compensation for lost seating capacity for Grand Finals in 2003, 2004 and 2005. All compensation claims will be calculated in accordance with an agreed compensation formula. The base compensation has been agreed at $5.7 million and will be paid in equal instalments on 30 November 2003 and 2004. If capacity targets are unable to be met, agreement has been reached to provide additional compensation as a pro-rata amount in accordance with the compensation formula; and
- the State has previously provided indemnities to the MCC and MCG Trust in the context of the 1990 Great Southern Stand development, which have been re-incorporated into the contractual arrangements of the Northern Stand redevelopment, under greater accountability and responsibility of the MCC to the MCG Trust.

Public Transport Corporation lease arrangements

Under various transport lease arrangements made by the Public Transport Corporation, the State of Victoria indemnified the lessors against adverse tax rulings and third-party personal injury claims, where the third party is injured by the operation of the equipment during the period of the lease. The last of these lease arrangements was terminated by June 1999. The normal statute of limitations is five years for tax claims and six years for personal injury claims.

Public transport rail franchise agreements

During 1999-2000 the Director of Public Transport, on behalf of the Crown, entered into contractual arrangements with franchisees to operate passenger rail transport services in the State. The following summarises the major contingent liabilities arising from those arrangements.

Contingent liabilities on early termination or expiry of franchise agreements

New rolling stock lease direct agreements: As part of the franchising arrangements, the franchisee of each passenger rail business has undertaken to provide new rolling stock. Each franchisee is expected to enter into a lease with a third party lessor with respect to this rolling stock. In addition, the Director is expected to enter into rolling stock direct agreements with the respective lessors to protect the State's interest in the rolling stock. In the event of expiry or on early termination of the franchises, the Director can either exercise a right to acquire the new rolling stock at predetermined values or the lease payment obligations are transferred to the Director or a successor franchisee. At 30 June 2003, all five rolling stock direct agreements have been entered into. The contingent liability of the Director to take over the lease payments only commences upon delivery of the units of new rolling stock.

In respect to V/Line Passenger the State has taken over as the lessor of 38 new rolling stock units through the establishment of the State owned company Rolling Stock Holdings (Victoria) Pty Ltd. These lease commitments are disclosed in Table 5.2.

The Government has appointed receivers and managers to the National Express train and tram franchises, in order to protect Government interests and to ensure continuation of services.

The Director intends to terminate the franchise agreements with National Express upon appointment of successor operators for the businesses concerned. Until the franchise is terminated the rolling stock leases remain the responsibility of the National Express franchises under receivership. However, after balance date, on 1 October 2003, the V/Line Passenger franchise was terminated and placed into Government ownership until 29 October 2006.

Other direct agreements: The Director is also party to a number of other direct agreements with the providers of key services to franchisees in respect of carrying out their operations. The intention of these agreements is that in the event of a 'Step-in Event' occurring or on early termination or expiry of a franchise that the key services will be (at the option of the Director), continued by the providers for the Director or his nominee under the same terms and conditions as the original contract.

Payments on termination: On termination of the franchise agreements by expiry or otherwise the Director will have a liability:

- to pay for certain assets and liabilities on the basis set out in the agreements; and
- for termination value payments in respect of designated rolling stock improvements and capital projects. (Estimated contingent liability at 30 June 2003 - $113.5 million (2002 - $139.3 million)).

Contingent liability arising on early termination of franchise agreements (performance bonds)

With respect to any additional costs arising to the Director on the early termination of a franchise, the franchisee must indemnify the Director for any losses, damages or costs incurred by him as a result of the early termination. If the franchisee does not do so, the Director has the right to draw on the franchisee's performance bond for the amount of those losses, damages or costs. To the extent that the performance bonds may be insufficient to meet these outgoings, the Director will be required to cover any additional costs. The Director has utilised this provision to obtain funding of $135 million from the National Express Group as a result of its withdrawal from its train and tram franchises.

Connex and Yarra trams signed Interim Operator Agreements (IOAs) in December 2002. The bonds provided by Yarra Trams ($30 million) and Connex ($50 million) under Settlement Agreements dated March 2002 have been extended to the earlier of 31 December 2003 and termination of their IOA. After the earlier of 31 December 2003 and termination of the IOAs, these bonds will reduce to $15 million for Yarra Trams and $25 million for Connex.

If on re-franchise a new franchisee becomes the successor operator, the outgoing franchisee must comply with its obligations to ensure transition to the successor. Where there is default, the Director will have access to the performance bonds of Yarra Trams and Connex until re-franchise.

The Director also has a fixed and floating charge over franchisee assets as security for amounts payable by franchisees.

Contingent liabilities arising from Interim Operator Agreements

There are a number of contingent liabilities arising from the Interim Operator Agreements between the Director of Public Transport and Connex and Yarra which were signed in December 2002. These possible liabilities refer to payments to be made by the Director of Public Transport to Connex and Yarra under certain scenarios. These include:

Funding requirements: Under the IOAs the Director has agreed to pay specified monthly amounts to the franchisees to assist them in meeting their funding requirements. These specified amounts are based on the forecast funding requirements of the franchisees. If the forecast funding requirements differ to the actual funding requirements then an adjustment is made between the parties to reflect the actual funding requirements of the franchisee.

Insurance: If the actual insurance premiums for a quarter are greater than the forecast insurance premiums for that quarter, then the Director must reimburse the franchisee an amount as calculated per the formula in the IOA. The IOAs make provision for the reimbursement to the franchisees with respect to insurance claims where there is a difference between the deductible payable under the original insurance policy and the current insurance policy. The Director will pay 50 per cent of the difference between the new deductible and the original deductible.

Revenue risk sharing: The Director must pay to the franchisee an amount calculated by a formula in the IOA representing lower then expected revenue.

Capital investment: On the termination of the franchise agreement as a result of a termination event the Director must pay or procure the payment to the franchisee the early termination values in accordance with the capital projects listed in the IOA.

Other contingent liabilities arising from National Express withdrawal from train and tram franchises

The National Express franchisees each granted to the Director charges over the company's property. The Director appointed receivers to the National Express franchisees and by the Receivership Deed of Indemnity, the Treasurer has agreed to indemnify the receivers for debts properly incurred by them in the course of the receivership.

The Treasurer has also agreed to remunerate the receivers in accordance with the rates set out in the deed.

Contingent liabilities arising from potential changes to existing conditions

Change in Victorian law: Franchisees may make a claim against the Director for any net losses incurred as a result of a change in Victorian law which directly relates to the franchise business.

Latent defects: If a latent defect is identified in any part of the infrastructure, which has been leased to the franchisees, and the cost of rectifying the defect is in excess of a threshold amount, then the Director will indemnify the franchisee for the amount by which the cost of the works to rectify the defect exceeds the threshold amount.

Pre-existing contamination: The Director has indemnified franchisees from and against all losses, damages, liabilities, actions, suits, claims, demands, costs and expenses of every kind arising from a failure by the Director to clean up the land as defined in the infrastructure leases entered into with franchisees.

Native title: The Director is liable for payments of any valid compensation claim to native title holders made under the *Native Title Act 1993* or other laws relating to native and aboriginal title in respect of the land as defined in the infrastructure leases entered into with franchisees.

Net loss provisions: On the occurrence of certain events specified in the franchise agreements, including the undertaking of infrastructure works by the State, the franchisees may make a claim against the Director if the franchisee incurs a net loss as a result of those events.

Contingent liabilities relating to the Department of Infrastructure as bus industry representative

The Secretary of the Department of Infrastructure is a shareholder in the Revenue Clearing House Pty Ltd (RCH) and VicTrip Pty Ltd as the appointed representative of route bus operators with whom the Department has a bus service contract.

The RCH Shareholders Agreement and the VicTrip Shareholders Agreement contain several clauses that mean that the State (along with the franchisees) will become liable for additional capital requirements for the RCH and VicTrip to remain solvent and any losses suffered by the RCH and VicTrip.

The MetCard Management Agreement with the RCH contains several clauses in the agreement which means that the State (along with the franchisees) will become liable for any shortfalls suffered by the RCH in specific circumstances.

Melbourne City Link

The key arrangements for Melbourne City Link are set out in the Concession Deed, which has effect from 20 October 1995.

Under the arrangements as set out in the Concession Deed and the legislation, the State is responsible for acquiring and paying for the land necessary for the project to proceed, paying for certain state works and general project costs. It is also subject to certain compensation claims in the event that it can be shown that Transurban's revenue has been adversely affected by State actions.

While all land has been acquired, the final compensation payable is subject to resolution in some instances.

There is currently an outstanding claim from Transurban relating to an alleged 'Appendix Event' and leading to a Material Adverse Effect claim from Transurban in relation to the construction of Wurundjeri Way and widening of the Westgate Freeway. This claim is currently being handled by the documented dispute resolution processes and the Department of Infrastructure is managing the claim for the State. In the first phase of this process, an independent expert has found in favour of the State. However, Transurban has invoked the appeal process leading to the documented arbitration procedures. At the date of this report, the outcome is still outstanding.

As regards to compensation for land acquisitions, several matters remain in the negotiation/determination phase in an effort to agree the ultimate level of compensation for the acquisitions.

Native title

A number of claims have been filed with the Federal Court under the *Native Title Act 1993* that affect Victoria. While many such claims are being processed through the legal system, the Government has committed itself to resolving claims through mediation, where possible. It is not feasible at this time to quantify any future liability.

Gas supply incident

The State, and a number of its instrumentalities, have been named as parties in a class action before the Supreme Court arising from the explosion and fire in September 1998 at Esso's gas processing plant at Longford. The State and its instrumentalities have denied liability and are vigorously defending their rights.

Transmission of business under Section 149 of the Workplace Relations Act 1996

Contractors now performing functions previously performed by government have sometimes engaged staff on lesser rates and conditions than those that previously applied under awards or agreements for public sector employees. Following an appeal by the State of Victoria and the Hospital Network to the High Court a settlement was subsequently made and the appeals withdrawn. The broader financial implications remain unclear.

Court decisions have indicated that previous rates and conditions may apply to the contractor's employees with outsourcing. The application of this principle requires transfer of the whole or part of the business (of the Government) and a test that is generally applied is whether there is a 'substantial identity' between the activities before and after the outsourcing. If applicable, the principle would generally cause increases in employment costs for the contractor if the prior existing rates and conditions are more beneficial to the employees. The principle may also apply to circumstances where a ‘business’ is taken back by the State from a contractor. Accordingly, in some circumstances, the State may have a liability in respect of the terms and conditions of employment applying to the staff employed by the contractor.

HIH Insurance

The State’s quantifiable direct exposures arising from the collapse of the HIH Insurance Group are included in the liabilities shown in the financial statements of the agencies directly responsible for them (such as the Victorian WorkCover Authority and VMIA), and are consolidated in the financial statements of the State.

The State’s obligations in respect of its builders’ warranty insurance rescue package are direct liabilities of the State itself. They do not form part of the liabilities of Housing Guarantee Fund Limited, which manages claims on behalf of the State.

The State also retains some unquantifiable contingent exposures arising from the collapse. These contingent exposures arise primarily through the possibility that the State may be involved in litigation in which it would be entitled to recover damages from third parties. If these third parties were insured by HIH, recovery in full may not be possible.

Smelter Levy

The State Electricity Commission of Victoria (SECV) is the first defendant in a matter before the High Court of Australia, commenced by summons dated 5 June 2003, in which Australian Steel Company (Operations) Pty Ltd is the plaintiff. The plaintiff has claimed that Schedule 9A2 of the National Electricity Code, among other legislation imposing a charge known as the Smelter Reduction Amount, is invalid. The plaintiff seeks reimbursement of Smelter Reduction Amounts previously paid, together with interests and costs. The claim will be vigorously defended and the timing and outcome of any conclusion are uncertain. It is not practicable to quantify the liability in the event of a successful claim by the plaintiff.

Under an agreement between the SECV and the State of Victoria in relation to this matter, the interests of the SECV are being managed by the State, and the SECV has been granted a full indemnity by the State for all legal costs and any other monies payable by the SECV in the matter.

2006 Commonwealth Games

In winning the bid to host the 2006 Commonwealth Games in Melbourne, the State entered into two contracts:

- the Endorsement Contract with the Australian Commonwealth Games Association; and
- the Host City Contract with the Commonwealth Games Federation.

Subsequent to winning the rights to host the Games, the Government established the Melbourne 2006 Commonwealth Games Pty Ltd (M2006) as the Organising Committee for the Games, with the Premier as the sole shareholder. An agreement between the State and the company provides the basis for funding the company from 2001 to 2007. On 7 October 2003, Melbourne 2006 Commonwealth Games Corporation, as a statutory corporation, took over the operations of Melbourne 2006 Commonwealth Games Pty Ltd.

Under the Endorsement Contract, the State is obliged to underwrite any shortfall between revenue and expenditure of M2006 for the organisation of the Games. Also under this contract, any remaining surplus resulting from the Games, after the Organising Committee has discharged all financial commitments and other obligations, is to be transferred to the Association. This surplus is, in turn, required to be paid to the State to be used for the benefit of sport in Victoria.

The Host City Contract specifies the rights and obligations of the Organising Committee in relation to organising the Games. The contract includes the commitment the State gave in its bid document to offer travel grants to competitors and team officials attending the Games.

The Government has established a comprehensive range of Governance arrangements to control expenditure in relation to these agreements. These include a thorough scoping of services required and implementation of clear financial parameters for the Games.

M2006 has an agreement with the Nine Network Australia Pty Ltd in relation to broadcast rights to the Games for Australia and Papua New Guinea. The agreement includes certain force majeure and major change provisions, which may be invoked in certain circumstances. M2006 has obtained insurance against the risk of these circumstances arising and resulting in payments becoming refundable to the Nine Network.

During November 2002, the State entered into a binding Heads of Agreement ('HOA') with Village Park Consortium, comprising Citta Property Group Pty Ltd and Australand Holdings Limited, for the development of the Commonwealth Games

Village. The HOA includes among other things, the commercial terms of the development. The HOA includes a number of conditions precedent, including a process for public consultation, which must be satisfied for the development to continue. It is expected that these conditions will be satisfied in due course.

Land remediation — environmental concerns

A number of properties have been identified as potentially contaminated sites. The State does not admit any liability in respect of these sites. However, remedial expenditure may be incurred to restore the sites to an acceptable environmental standard in the event of future developments taking place.

Victorian Managed Insurance Authority (VMIA)

VMIA was established in 1996 as a captive insurer for departments and participating bodies (predominantly general government sector). VMIA provides its client bodies with a range of insurance cover, including for property, public and products liability, professional indemnity and contract works. VMIA re-insures in the private market for losses above $50 million arising out of any one event, up to a maximum for each type of cover (e.g. $1 250 million for property and $750 million for public liability). The risk of losses above these re-insured levels is borne by the State.

Gambling/gaming licences

In 1994, the State sold TABCORP Holdings Limited (TABCORP) a wagering and gambling licence for $597 million. The *Gaming and Betting Act 1994* requires the State to provide in 2012 a refund to TABCORP of an amount equal to the licence value of the former licences or the premium payment paid by the new licensee, whichever is the lesser. While this creates an obligation on the State to refund the licence value to TABCORP, it will be offset by the premium payment from the issue of any new licences. In 1992, a gaming operator's licence was issued to the Trustees of the Will and Estate of the late George Adams (the licensee). The *Gaming Machine Control Act 1991* entitles the licensee to be paid, at the end of its current licence period in 2012, an amount equal to the value of its current licence or the premium payment paid by the new licensee, whichever is the lesser. This entitlement is contingent on the licensee not being granted a new licence.

Builders' warranty

The builders' warranty insurance market, like other insurance markets, has been affected by the 11 September 2001 terrorist attacks in the United States and adverse claims experience. In mid-April 2002, the State agreed to provide temporary (to 30 June 2002) re-insurance support to builders' warranty insurance provider Dexta

Corporation following the withdrawal of some of its commercial re-insurance support. This support was subsequently extended to 30 September 2002. The Government determined that there would be no further extension.

The State receives re-insurance premiums for this participation and will be required to contribute to payment of re-insured claims, as well as paying management fees. The precise timing and value of these receipts and payments is uncertain, as claims may be made by home owners for up to 6½ years after the arrangement ceases.

Receipts and payments will be contingent on the volume of insurance underwritten and re-insured by 30 September 2002. Based on Dexta's previous levels of activity, the central estimate of the State's gross exposure (i.e. before premium receipts) is not more than $6 million. While the State expects, like the commercial re-insurers who are party to the agreement, to at least break even on these arrangements, the State retains an unquantifiable contingent liability that claims may exceed the central estimate.

On 13 March 2002, Victoria and NSW jointly announced a series of reforms to builders' warranty insurance arrangements. This announcement included a commitment to provide a catastrophe fund capable of supporting claims above $10 million. Since builders' warranty insurance commenced there have been no losses by an insurer to any one builder exceeding this amount. To meet this commitment, the two States offered reinsurance arrangements to all builders' warranty insurers covering claims in respect of any one builder exceeding $10 million, with each of the two States reinsuring claims relating to properties in that State. A reinsurance agreement giving effect to these arrangements was concluded in December 2002 (effective from 1 January 2003) with one insurer. This agreement requires the insurer to pay the two States reinsurance premiums that are estimated to be sufficient for the States to at least break even on these arrangements. However, the State retains an unquantifiable contingent liability for additional claims.

APPENDIX A: SPECIFIC POLICY INITIATIVES AFFECTING THE BUDGET POSITION

Appendix A outlines output, asset investment and revenue initiatives since the May 2003 Budget.

OUTPUT AND ASSET INITIATIVES

Government-wide initiatives

The following tables provide details of the total cost of government-wide output and asset initiatives.

Table A1: Output initiatives – Government–wide

($ million)

	2003-04	*2004-05*	*2005-06*	*2006-07*
Drought Response Package 2003-04	6.8	..	..	..
Total output initiatives	**6.8**	**..**	**..**	**..**

Source: Department of Treasury and Finance

Drought Response Package 2003-04

Funding of $6.8 million has been provided to ameliorate the effects of the drought in communities across Victoria that are not receiving a full range of support services under the Commonwealth-State Exceptional Circumstances assistance program. The programs funded across various government departments under this initiative are aimed at supporting the empowerment of drought affected communities. The programs include the Social Recovery Strategy, additional Rural Finance Counsellors and the Business Capacity Rebuilding program.

Departmental initiatives

The following tables provide details of output and asset investment initiatives since the May 2003 Budget, for each applicable department. Except where specified, figures indicate the total cost of initiatives. Funding from reprioritisation and existing fund sources has not been deducted from the total cost of the initiative.

Education and Training

Output initiatives

Table A2: Output initiatives – Department of Education and Training

($ million)

	2003-04	2004-05	2005-06	2006-07
Services to Students with Disabilities	4.0	5.0	3.5	2.5
Apprentice-trainee completion bonus	3.4	1.4	3.4	5.7
Total output initiatives	**7.4**	**6.4**	**6.9**	**8.2**

Source: Department of Treasury and Finance

Services to Students with Disabilities

Additional funding is provided, over the next four years, to manage increased demand and complexities for services provided to government school students with special education needs under the Disabilities Program.

Apprentice-trainee completion bonus

Additional funding is provided, over the next four years, for a completion bonus paid to employers when apprentices and trainees complete their qualification.

Human Services

Output initiatives

Table A3: Output initiatives – Department of Human Services

($ million)

	2003-04	2004-05	2005-06	2006-07
Price index for the non-government sector	26.7	40.5	61.9	80.3
Kew Residential Services redevelopment	..	0.9	16.2	18.3
Total output initiatives	**26.7**	**41.4**	**78.1**	**98.6**

Source: Department of Treasury and Finance

Price index for the non-government sector

A price index was introduced as part of new service agreements with non-government organisations, which provides funding certainty and will significantly reduce administrative requirements. This will enable organisations to focus on improving services to better meet community needs.

The new funding arrangements apply to non-government agencies providing preschool, disability, community care, housing assistance, palliative care and drug services.

Funding of $7 million has also been provided to establish a Community Services Investment Fund. This fund will be used to improve the capacity of non-government organisations to deliver programs for Victoria's most vulnerable.

Kew Residential Services redevelopment

The Government has committed $87 million TEI for the construction of new community houses for Kew Residential Services residents across Victoria. This will complete the relocation of all residents from the Kew Residential Services congregate care facility. Associated output funding of $35 million over three years from 2004-05 will provide a greater level of support and community inclusion for residents.

Asset initiatives

Table A4: Asset initiatives – Department of Human Services

($ million)

	2003-04	*2004-05*	*2005-06*	*2006-07*	*TEI*
Royal Women's Hospital [(a)]	n.a.	n.a.	n.a.	n.a.	250.0
Latrobe Regional Hospital accommodation	2.5	..	..	..	2.5
Kew Residential Services redevelopment [(b)]	0.0	51.2	27.3	8.0	86.5
Total asset investment initiatives	**2.5**	**51.2**	**27.3**	**8.0**	**339.0**

Source: Department of Treasury and Finance

Note:
(a) Project costing information will be finalised after completion of the Partnerships Victoria tender process.
(b) Refer to output initiatives for the description of this initiative.

Royal Women's Hospital

A new Royal Women's Hospital will be built on the Royal Melbourne Hospital site. The new hospital will be completed by the end of 2007 and will include 246 beds and cots, operating theatres and procedure rooms, and delivery and birthing suites. While the new hospital may be built by the private sector under the Partnerships Victoria policy, it will remain a public hospital, with all clinical services continuing to be the responsibility of the Government.

Latrobe Regional Hospital accommodation

Funding is provided to assist with the purchase of consulting suites adjacent to the Latrobe Regional Hospital as part of funding arrangements with the finalisation of the wind-up of the former privatised hospital.

Infrastructure

Output initiatives

Table A5: Output initiatives – Department of Infrastructure

($ million)	*2003-04*	*2004-05*	*2005-06*	*2006-07*
Renegotiation of Train and Tram Franchise Contracts	21.0	..	..	..
Southern and Eastern Integrated Transport Authority	16.1	11.7	10.2	9.8
Total output initiatives	**37.1**	**11.7**	**10.2**	**9.8**

Source: Department of Treasury and Finance

Renegotiation of Train and Tram Franchise Contracts

Funding for financial, engineering, legal and commercial expertise has been provided to support the renegotiation of the current train and tram franchising contracts.

Southern and Eastern Integrated Transport Authority

Funding has been provided for the operation of the Southern and Eastern Integrated Transport Authority, which was established to facilitate the delivery of the Mitcham-Frankston Freeway project.

Asset initiatives

Table A6: Asset initiatives – Department of Infrastructure

($ million)	*2003-04*	*2004-05*	*2005-06*	*2006-07*	*TEI*
Regional Fast Rail [(a)]	3.4	20.0	..	..	23.4
Total asset investment initiatives	**3.4**	**20.0**	**..**	**..**	**23.4**

Source: Department of Treasury and Finance

Note:

(a) Project TEI is $616.8 million as a result of the above additional $23.4 million, increased project insurance costs of $11.3 million (see 2002-03 Annual Financial Report p109) and the loss of offsetting savings of $25.2 million.

Regional Fast Rail

Funding has been provided to cover the cost of building passing loops on the Bendigo line north of Kyneton, improve track at stations along the Bendigo and Latrobe Valley lines, shorten the construction shutdown period on the Bendigo line, improve the power supply along the Latrobe Valley line, as well as cover some higher land acquisition costs on the Ballarat line.

Premier and Cabinet

Output initiatives

Table A7: Output initiatives – Department of Premier and Cabinet

($ million)

	2003-04	2004-05	2005-06	2006-07
Implementing New Career Structure	2.5	..	..	..
Total output initiatives	**2.5**	**..**	**..**	**..**

Source: Department of Treasury and Finance

Implementing New Career Structure

Funding has been provided for departmental training and development programs for managers to assist with the implementation of the new public service career structure.

Primary Industries

Output initiatives

Table A8: Output initiatives – Department of Primary Industries

($ million)

	2003-04	2004-05	2005-06	2006-07
Drought – Exceptional Circumstances Victorian matching contribution	5.5	5.3	..	..
Imported red fire ants eradication	5.2	..	..	..
Total output initiatives	**10.7**	**5.3**	**..**	**..**

Source: Department of Treasury and Finance

Drought – Exceptional Circumstances Victorian matching contribution

These initiatives provide assistance for farmers experiencing drought through interest subsidies. The funding represents the State's contribution to an Exceptional Circumstances Drought Relief Package, which is jointly funded by the Commonwealth. Farmers only receive the grant if they demonstrate that they have undertaken appropriate drought management practices. Assistance packages have been offered to farmers in the Northern, Eastern Mallee, and the Northeast and Central areas of Victoria. Grant approval is dependent on certain criteria such as additional expenses and losses incurred due to the dry conditions.

Imported red fire ants eradication

The Government has committed funds under a national campaign to eradicate fire ants. The eradication program involves prevention and response initiatives, which entail baiting of ants and extensive surveillance and monitoring. The program has been successful to date resulting in a 95 per cent kill rate across the treated ant population. The additional funding provided during 2003-04 represents Victoria's matching contribution to the national red fire ant eradication program and was provided to ensure that the program could be successfully completed. Any lapse in the eradication program will increase the likelihood that the surviving ant population will re-establish the red ant population in Australia.

Sustainability and Environment

Output initiatives

Table A9: Output initiatives – Department of Sustainability and Environment

($ million)

	2003-04	*2004-05*	*2005-06*	*2006-07*
Timber Salvage Harvesting	6.9	4.0	..	..
Geospatial Emergency Information Network	0.3	..	..	..
Total output initiatives	**7.2**	**4.0**	..	..

Source: Department of Treasury and Finance

Timber Salvage Harvesting

The Government has committed $11 million from 2003-04 to implement a two-year timber salvage harvesting program in the forest management areas of eastern Victoria that were affected by the 2003 bushfires. This program will trial new approaches to manage, price and allocate state forest timber resources.

Geospatial Emergency Information Network

Funding of $0.3 million was provided for initial planning of the Geospatial Emergency Information Network, as part of the Government's Counter-Terrorism Program. This network will facilitate a rapid and strategic response in the event of an emergency by coordinating emergency information across agencies and across the State.

Asset initiatives

Table A10: Asset initiatives – Department of Sustainability and Environment

($ million)

	2003-04	*2004-05*	*2005-06*	*2006-07*	*TEI*
Lake Mountain Visitor Centre	1.0	..	..	..	1.0
Delatite River Bridge and Mt Stirling approaches	0.9	..	..	..	0.9
Total asset investment initiatives	**1.9**	..	..	..	**1.9**

Source: Department of Treasury and Finance

Lake Mountain Visitor Centre

Funding of $1.0 million was provided to complete the construction of the Lake Mountain visitor centre and associated infrastructure prior to winter 2004. The modern facilities will improve visitor experiences, promote year round use and help secure the resort's ongoing operations.

Delatite River Bridge and Mt Stirling approaches

Funding of $0.9 million was provided to construct the replacement Delatite River Bridge and Mt Stirling approaches prior to winter 2004. This will ensure year round access for all visitors.

REVENUE INITIATIVES

Table A11: Revenue initiatives

($ million)

	2003-04	*2004-05*	*2005-06*	*2006-07*
Duty on mortgage-backed debentures	10.0	..	..	..
Housing revenue	-40.0	..	..	..
Total revenue initiatives	**-30.0**	..	..	..

Source: Department of Treasury and Finance

Duty on mortgage-backed debentures

The Duties Act 2000 has been amended to remove mortgage duty concessions for mortgage-backed debentures. This amendment helps the Government protect the revenue base and ensure proper compliance by removing the loophole, which encouraged the use of contrived schemes involving the issue of mortgage-backed debentures, especially to financial institutions outside Victoria over properties in Victoria.

The removal of the concession applies from 15 August 2003, which is the date of the Treasurer's press release announcing the removal of this mortgage duty concession.

Housing revenue

As part of the ongoing management of the Office of Housing's financial arrangements, a review has been undertaken of the profile of regular payments due to be made by the Office to the Consolidated Fund. This has resulted in a reduction in the revenue payments expected in 2003-04.

APPENDIX B: GENERAL GOVERNMENT SECTOR YEAR-TO-DATE ACTUALS

The Victorian general government sector net result for the first four months of 2003-04 was a surplus of $738 million, compared with a revised estimated surplus for the whole of 2003-04 of $652 million.

The general government sector result for the four-month period to October is a poor indicator of the expected result for the year as a whole, due to a range of seasonal factors and volatility inherent in the year-to-date data, including financial markets, particularly in relation to superannuation expense.

Previous experience shows a pattern of revenue that tends to be spread relatively evenly throughout the year, whereas expenses tend to be more seasonal and biased toward the latter part of the financial year. In addition, improved equity market performance, by reducing the expense recorded for unfunded superannuation liability, has tended to mask the underlying result.

In the 2003-04 Budget Papers the Government published a standardised operating surplus as an alternative measure of operating performance. This standardised operating surplus of $606 million for the four months to the end of October excludes the effects of revaluations of superannuation fund investments. Because of the improvement in financial markets during the period, superannuation and other asset valuations improved, with a subsequent impact on the general government result by $132 million.

A more detailed discussion and analysis of the revised budget outlook for the 2003-04 financial year as a whole is provided in Chapter 2, *Budget Position and Outlook*. The revised outlook takes into account the result to the end of October and the revised expectations for the remainder of the financial year.

REVENUE

Aggregate revenue for the four months to the end of October 2003 of $9 058 million was largely in line with the revised estimate for 2003-04 as a whole, representing 33.3 per cent of the revised estimate.

Taxation revenue at the end of October 2003 was $3 231 million, or 32.3 per cent of the 2003-04 revised estimate, which is broadly in line with the pro-rata comparison. Individual variations principally reflect the influence of seasonal factors, particularly for land tax where the majority of assessments will be issued in early 2004 for the 2003-04 financial year.

Fines and regulatory fees revenue for the first four months of 2003-04 was $154 million, or 29.6 per cent of the 2003-04 revised estimate. The lower than pro-rata revenue largely reflects the combined effect of delays in the installation of safety cameras as well as changes in driver behaviour.

Investment revenue, which is not earned evenly throughout the year, for the four-month period to the end of October 2003, was $292 million, or 28.5 per cent of the 2003-04 revised estimate. The lower than pro-rata investment income revenue is largely a reflection of the strong seasonal nature of the recognition of property related investment revenue.

Revenue from grants to the end of October 2003 amounted to $4 272 million, or 34.8 per cent of the 2003-04 revised estimate.

- General purpose grants (comprising GST grants, GST transitional grants and national competition policy payments) amounted to $2 606 million, representing 37.0 per cent of the 2003-04 revised estimate. The higher than pro-rata revenue is a reflection of the seasonal pattern (administrative arrangements) of general purpose grant payments to the jurisdictions by the Commonwealth.
- Specific purpose and other grants revenue amounted to $1 666 million, representing 31.8 per cent of the 2003-04 revised estimate. The lower than pro-rata revenue reflects the timing of grant payments by the Commonwealth, particularly in relation to education, health and roads grants.

Combined revenue from sale of goods and services ($724 million) and other revenue ($385 million) for the first four months of 2003-04 was $1 109 million, or 33.2 per cent of the 2003-04 revised estimate. This is in line with the historical pattern of revenue collections over previous years.

EXPENSES

Victorian general government sector aggregate expenses were $8 319 million for the first four months to October, representing 31.4 per cent of the revised full-year estimate of $26 520 million.

Expenses for the period included relatively low superannuation expense, which reflected the strong equity market performance during the period. Equity market performance has a significant impact on the value of financial assets held by state superannuation funds and therefore on the State's unfunded superannuation liability and superannuation expense. The reduced level of superannuation expense, due to improving financial markets, has no impact on the State's cash position for the year.

The overall pattern of other departmental spending, mainly on purchases of goods and services and grants payments, is influenced by seasonal factors and the timing of certain contractual obligations and on-passing of grant payments, and is biased towards higher spending levels in the final quarter of the financial year.

The implementation of the Government's 2003-04 output initiatives announced in 2003-04 Budget is also expected to boost the level of expenditure during the latter part of the financial year.

Table B1: Statement of financial performance

($ million)

	2003-04		
	4 months to October	*Budget*	*Revised*
Revenues from ordinary activities			
Taxation	3 231.0	9 593.2	10 006.9
Fines and regulatory fees	153.6	637.2	518.7
Investment revenue	292.1	895.9	1 026.8
Grants revenue	4 272.0	12 248.0	12 281.0
Sales of goods and services	724.1	2 047.2	2 103.1
Gain (loss) from disposal of physical assets	(1.9)	(7.3)	(17.0)
Fair value of assets received free of charge or for nominal consideration	(0.0)	..	..
Inter-sector capital asset charge	171.3	514.0	514.3
Other revenue	215.3	670.1	738.6
Total revenue	**9 057.5**	**26 598.4**	**27 172.4**
Expenses from ordinary activities			
Employee benefits	3 228.4	9 597.7	9 797.6
Superannuation	516.6	1 950.8	1 688.9
Depreciation	326.6	1 024.8	1 028.0
Amortisation	25.8	67.9	68.5
Borrowing costs	166.0	483.3	485.3
Grants and transfer payments	1 409.2	4 537.2	4 662.7
Supplies and services	2 616.0	8 598.2	8 710.4
Other expenses	30.8	94.0	79.1
Total expenses	**8 319.3**	**26 353.9**	**26 520.4**
Net result	**738.2**	**244.5**	**652.0**
Movement in asset revaluation reserve	53.8	1 194.5	1 194.5
Total changes in equity other than contributions to other sectors by the State in its capacity as owner	**792.0**	**1 439.0**	**1 846.5**
Standardised operating surplus	**605.8**	**244.5**	**387.0**

Source: Department of Treasury and Finance

Table B2: Statement of financial position

($ million)

	Opening Balances 1 July 2003	Closing Balances 31 October 2003	2003-04 Revised budget
Current assets			
Cash assets	1 123.1	1 493.1	1 034.3
Other financial assets	1 187.3	1 237.9	1 202.5
Receivables	1 265.5	1 121.4	1 319.5
Prepayments	51.8	392.0	51.5
Inventories	116.7	119.5	116.8
Total current assets	**3 744.5**	**4 364.0**	**3 724.6**
Non-current assets			
Other financial assets	2 846.5	2 534.4	2 377.0
Receivables	391.6	353.0	403.0
Inventories	43.4	42.3	43.4
Land and buildings	19 649.5	19 853.4	20 661.3
Plant, equipment and infrastructure systems other than roads	2 156.2	2 138.1	2 201.1
Road network	16 695.0	16 694.5	17 727.4
Other assets	3 215.7	3 239.9	3 306.7
Total non-current assets	**44 998.0**	**44 855.6**	**46 719.8**
Total assets	**48 742.4**	**49 219.6**	**50 444.4**
Current liabilities			
Payables	1 546.0	1 350.0	1 556.2
Interest bearing liabilities	131.2	142.5	114.2
Employee benefits	946.6	921.2	999.4
Superannuation	534.9	345.3	177.6
Outstanding insurance claims	7.1	6.9	6.3
Other liabilities	483.8	522.8	468.3
Total current liabilities	**3 649.7**	**3 288.6**	**3 322.0**
Non-current liabilities			
Payables	129.1	129.7	129.0
Interest bearing liabilities	6 121.6	6 116.9	6 147.2
Employee benefits	1 851.3	1 848.9	1 989.6
Superannuation	12 902.3	13 046.9	13 342.2
Outstanding insurance claims	187.0	185.4	208.5
Other liabilities	293.5	297.2	291.7
Total non-current liabilities	**21 484.8**	**21 625.1**	**22 108.2**
Total liabilities	**25 134.5**	**24 913.6**	**25 430.2**
Net assets	**23 607.9**	**24 305.9**	**25 014.2**
Equity			
Retained earnings	13 023.7	12 923.5	12 583.5
Reserves	10 584.2	10 644.3	11 778.7
Net result for the period	..	738.2	652.0
Total equity	**23 607.9**	**24 305.9**	**25 014.2**

Source: Department of Treasury and Finance

Table B3: Statement of cash flows

($ million)

	2003-04 4 months to October	2003-04 Budget	Revised
Cash flows from operating activities			
Receipts			
Taxation	3 317.0	9 546.8	9 960.6
Fines and regulatory fees	125.3	510.0	406.5
Grants	4 399.3	12 247.5	12 280.5
Sale of goods and services	744.1	2 041.7	2 100.6
Interest received	120.6	287.1	347.2
Dividends received	121.6	273.1	303.4
Capital asset charge received	171.3	514.0	514.3
Other receipts	282.9	999.8	1 094.7
Total receipts	**9 282.1**	**26 420.0**	**27 007.7**
Payments			
Employee benefits	(3 256.2)	(9 394.3)	(9 606.5)
Superannuation	(561.7)	(1 453.2)	(1 606.3)
Grants and transfer payments	(1 693.4)	(4 535.5)	(4 661.0)
Supplies and services	(2 885.5)	(8 581.6)	(8 691.1)
Interest paid	(124.3)	(488.2)	(489.4)
Total payments	**(8 521.0)**	**(24 452.8)**	**(25 054.4)**
Net cash flows from operating activities	**761.1**	**1 967.2**	**1 953.4**
Cash flows from investing activities			
Net customer loans (granted) repaid	(11.2)	20.1	20.1
Net disposal (purchase) investments	229.1	644.0	454.3
Net contributions to other sectors of government	(93.9)	(525.9)	(440.2)
Proceeds from sale of property, plant and equipment	26.0	66.7	74.3
Purchases of property, plant and equipment	(542.2)	(2 130.7)	(2 164.8)
Net cash flows from investing activities	**(392.3)**	**(1 925.8)**	**(2 056.4)**
Cash flows from financing activities			
Net repayment of borrowings	(14.6)	13.7	13.7
Net cash flows from financing activities	**(14.6)**	**13.7**	**13.7**
Net increase (decrease) in cash and deposits held	**354.2**	**55.1**	**(89.3)**
Cash and deposits held at beginning of period	1 107.8	1 107.8	1 107.8
Cash and deposits held at end of reporting period	**1 462.0**	**1 162.8**	**1 018.4**

Source: Department of Treasury and Finance

APPENDIX C: ACCRUAL UNIFORM PRESENTATION OF GOVERNMENT FINANCE STATISTICS

THE ACCRUAL GFS PRESENTATION

The Government Finance Statistics (GFS) system employed by the Australian Bureau of Statistics (ABS) is designed to provide statistics relating to all Australian public sector entities. The statistics show consolidated transactions of the various institutional sectors of government from an economic viewpoint, providing details of the revenue, expenses, payments, receipts, assets and liabilities. It includes only those transactions over which a government exercises control under its legislative or policy framework. This means that, unlike the accounting viewpoint, the GFS excludes from the calculation of net operating balance both revaluations (holding gains or losses) arising from a change in market prices, and other changes in the volume of assets that result from discoveries, depletion and destruction of assets. This means that differences arise between the GFS and accounting frameworks, particularly within the operating statement.

Operating statement

The operating statement, also referred to as a statement of financial performance, is designed to capture the composition of GFS revenues and GFS expenses and the net cost of a government's activities within a financial year. It shows the full cost of resources consumed by government in achieving its objectives, and how these costs are met from various revenue sources.

Unlike a standard accounting operating statement, the GFS operating statement reports two major fiscal measures – the GFS net operating balance and GFS net lending. The GFS net operating balance is calculated as GFS revenue minus GFS expenses. In contrast, GFS net lending, or fiscal balance, includes net capital expenditure but excludes depreciation, thereby giving a measure of a jurisdiction's call on financial markets.

Balance sheet

The balance sheet records a government's stocks of financial and non-financial assets and liabilities. This statement, also referred to as a statement of financial position, discloses the resources over which a government maintains control.

The GFS balance sheet differs from the standard accounting presentation in that it provides information on financial and non-financial assets, and does not distinguish between current and non-current assets and liabilities.

Cash flow statement

The cash flow statement records a government's cash receipts and payments and shows how a government obtains and expends cash.

The GFS cash flow statement reports two major fiscal measures – the net increase in cash held and the cash surplus. Net increase in cash held is the sum of net cash flows from all operating, investing and financing activities. The cash surplus comprises only net cash received from operating activities, and from sales and purchases of non-financial assets, minus distributions paid (in the case of public financial corporations and public non-financial corporations), minus finance leases and similar arrangements.

The GFS cash surplus measure is broadly comparable with the old cash-GFS surplus measure, allowing for comparisons between the two frameworks.

INSTITUTIONAL SECTORS

General government sector

The general government sector comprises all government departments, offices and other bodies engaged in providing services free of charge or at prices significantly below their cost of production. General government services include those which are mainly non-market in nature, those which are largely for collective consumption by the community, and those which involve the transfer or redistribution of income. These services are financed mainly through taxes, other compulsory levies and user charges.

Public non-financial corporations sector

The public non-financial corporations sector was formerly known as the public trading enterprises sector. It comprises bodies mainly engaged in the production of goods and services (of a non-financial nature) for sale in the market place at prices that aim to recover most of the costs involved (e.g. water and port authorities). In general, public non-financial corporations are legally distinguishable from the governments which own them.

Non-financial public sector

The non-financial public sector represents the consolidated transactions and assets and liabilities of the general government and public non-financial corporations sectors. In compiling statistics for the non-financial public sector, transactions and debtor-creditor relationships between sub-sectors are eliminated to avoid double counting.

Table C.1: General government sector operating statement

($ million)

	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
GFS revenue					
Taxation revenue	9 480	9 895	9 850	10 033	10 433
Current grants and subsidies	11 788	11 867	12 288	13 077	13 556
Capital grants	460	414	535	508	369
Sales of goods and services	3 008	3 059	3 140	3 240	3 260
Interest income	288	348	355	344	357
Other	1 574	1 598	1 700	1 905	1 929
Total revenue	**26 597**	**27 181**	**27 869**	**29 106**	**29 904**
GFS expenses					
Employee Expenses	10 759	10 961	11 419	11 839	12 241
Depreciation	1 025	1 084	1 156	1 208	1 271
Other Operating expenses	8 424	8 538	8 750	9 088	9 328
Nominal superannuation interest expense	955	975	946	998	1 041
Other interest expense	460	461	445	455	453
Other property expenses	..	..	..	..	..
Current transfers	4 178	4 295	4 229	4 458	4 492
Capital transfers	374	383	428	461	530
Total expenses	**26 174**	**26 697**	**27 374**	**28 507**	**29 356**
GFS net operating balance	**423**	**484**	**494**	**599**	**547**
Less: Net acquisition of non-financial assets					
Purchases of non-financial assets	2 131	2 165	2 591	2 342	2 348
Sales of non-financial assets	- 67	- 74	- 60	- 53	- 44
Less: Depreciation	1 025	1 084	1 156	1 208	1 271
Plus: Change in inventories	..	..	..	..	..
Plus: Other movements in non-financial assets	..	..	7	437	..
Total net acquisition of non-financial assets	**1 039**	**1 006**	**1 383**	**1 518**	**1 033**
GFS net lending (+) / borrowing (-) [(a)]	**- 616**	**- 522**	**- 888**	**- 919**	**- 485**

Source: Department of Treasury and Finance

Note:

(a) GFS net lending also equals net transactions in financial assets less net transactions in liabilities. If the boost to infrastructure investment funded by the Growing Victoria infrastructure reserve is excluded the GFS net lending / borrowing aggregates are:

GFS net lending (+) / borrowing (-) (excluding Growing Victoria)	*37*	*94*	*- 722*	*- 914*	*- 485*

Table C.2: Public non-financial corporations sector operating statement

($ million)

	2003-04 Budget	2003-04 Revised	2004-05 Estimate
GFS revenue			
Sales of goods and services	2 989	2 754	2 821
Current grants and subsidies	740	748	767
Capital grants	5	5	5
Interest income	43	43	56
Other	333	333	240
Total revenue	**4 109**	**3 882**	**3 888**
GFS expenses			
Employee expenses	429	429	435
Depreciation	514	514	519
Other operating expenses	2 349	2 114	2 162
Property expenses	497	496	505
Current transfers	67	67	69
Capital transfers	20	20	3
Total expenses	**3 876**	**3 641**	**3 693**
		..	..
GFS net operating balance	**233**	**241**	**195**
Less: Net acquisition of non-financial assets			
Purchases of non-financial assets	958	958	958
Sales of non-financial assets	- 86	- 86	- 88
Less: Depreciation	514	514	519
Plus: Change in inventories	26	26	26
Plus: Other movements in non-financial assets	141	141	45
Total net acquisition of non-financial assets	**524**	**524**	**421**
GFS net lending (+) / borrowing (-) [(a)]	**- 291**	**- 283**	**- 227**

Source: Department of Treasury and Finance

Note:
(a) GFS net lending also equals net transactions in financial assets less net transactions in liabilities.

Table C.3: Non-financial public sector operating statement

($ million)

	2003-04 Budget	2003-04 Revised	2004-05 Estimate
GFS revenue			
Taxation revenue	9 426	9 856	9 808
Current grants and subsidies	11 788	12 614	13 055
Capital grants	462	419	540
Sales of goods and services	5 079	4 995	5 138
Interest income	331	391	411
Other	1 481	1 454	1 471
Total revenue	**28 567**	**29 729**	**30 423**
GFS expenses			
Employee expenses	11 086	11 390	11 855
Depreciation	1 539	1 599	1 675
Other operating expenses	9 605	10 470	10 831
Nominal superannuation interest expense	955	975	946
Other interest expense	619	620	607
Other property expenses	..	- 0	- 0
Current transfers	3 195	3 443	3 355
Capital transfers	504	423	409
Total expenses	**27 503**	**28 920**	**29 678**
GFS net operating balance [(a)]	**1 065**	**809**	**744**
Less: Net acquisition of non-financial assets			
Purchases of non-financial assets	3 089	3 123	3 549
Sales of non-financial assets	- 153	- 161	- 148
Less: Depreciation	1 539	1 599	1 675
Plus: Change in inventories	26	26	26
Plus: Other movements in non-financial assets		141	52
Total net acquisition of non-financial assets	**1 423**	**1 530**	**1 804**
GFS net lending (+) / borrowing (-) [(b)]	**- 358**	**- 722**	**-1 060**

Source: Department of Treasury and Finance

Note:

(a) Subsequent to the 2003-04 Budget, a consolidation error has been identified and this explains the majority of the reduction in the revised estimates. The 2003-04 Budget figure should have been $740 million.

(b) GFS net lending also equals net transactions in financial assets less net transactions in liabilities. If the boost to infrastructure investment funded by the Growing Victoria infrastructure reserve is excluded the GFS net lending / borrowing aggregates are:

GFS net lending (+) / borrowing (-) (excluding Growing Victoria)	*295*	*- 105*	*- 893*

Table C.4: General government sector balance sheet

($ million)

as at 30 June	2003 Opening	2004 Budget	2004 Revised	2005 Estimate	2006 Estimate	2007 Estimate
Assets						
Financial assets						
Cash and deposits	1 123	1 179	1 034	1 104	1 159	1 203
Advances paid	207	187	187	167	147	125
Investments, loans and placements	4 030	3 386	3 576	3 199	3 335	3 108
Other non-equity assets	1 454	1 528	1 539	1 612	1 699	1 785
Equity	28 564	29 095	29 013	29 357	29 484	29 585
Total financial assets	**35 379**	**35 374**	**35 350**	**35 438**	**35 825**	**35 806**
Non-financial assets						
Land and fixed assets	40 898	43 052	43 064	45 678	48 506	50 911
Other non-financial assets	1 464	1 477	1 478	1 483	1 484	1 480
Total non-financial assets	**42 362**	**44 529**	**44 541**	**47 161**	**49 990**	**52 392**
Total assets	**77 740**	**79 903**	**79 891**	**82 600**	**85 815**	**88 197**
Liabilities						
Deposits held	409	414	414	419	424	429
Advances received	6	5	5	5	5	5
Borrowing	6 245	6 253	6 254	6 250	6 691	6 700
Superannuation liability	13 437	13 935	13 520	14 262	14 874	15 136
Other employee entitlements and provisions	3 178	3 385	3 375	3 587	3 834	4 011
Other non-equity liabilities	1 859	1 862	1 862	1 855	1 857	1 853
Total liabilities	**25 134**	**25 854**	**25 430**	**26 379**	**27 685**	**28 135**
Net worth	**52 606**	**54 049**	**54 461**	**56 221**	**58 130**	**60 063**
Net financial worth [(a)]	**10 244**	**9 520**	**9 919**	**9 060**	**8 140**	**7 671**
Net debt [(b)]	**1 300**	**1 921**	**1 877**	**2 205**	**2 479**	**2 698**

Source: Department of Treasury and Finance

Notes:

(a) Net financial worth equals total financial assets minus total liabilities

(b) Net debt equals the sum of deposits held, advances received and borrowings, minus the sum of cash and deposits, advances paid, and investments, loans and placements. If Growing Victoria investments are not included as an offset to debt, on the grounds that these investments are earmarked for infrastructure projects and are therefore not available to redeem debt, the net debt figures are:

Net debt (excluding Growing Victoria)	*2 088*	*2 056*	*2 048*	*2 209*	*2 479*	*2 698*

Table C.5: Public non-financial corporations sector balance sheet

($ million)				
as at 30 June	*2003 Opening*	*2004 Budget*	*2004 Revised*	*2005 Estimate*
Assets				
Financial assets				
Cash and deposits	392	389	360	359
Advances paid	237	244	197	166
Investments, loans and placements	1 040	1 118	915	915
Other non-equity assets	1 847	1 748	1 847	1 847
Equity	..	..	..	..
Total financial assets	**3 516**	**3 500**	**3 318**	**3 286**
Non-financial assets				
Land and fixed assets	31 312	32 316	33 083	34 484
Other non-financial assets	139	147	145	151
Total non-financial assets	**31 451**	**32 463**	**33 228**	**34 635**
Total assets	**34 967**	**35 963**	**36 546**	**37 921**
Liabilities				
Deposits held	80	82	81	82
Advances received	31	33	32	33
Borrowing	3 077	3 218	2 941	2 781
Superannuation liability	52	52	52	52
Other employee entitlements and provisions	2 424	2 448	2 454	2 516
Other non-equity liabilities	612	612	609	605
Total liabilities	**6 277**	**6 444**	**6 168**	**6 069**
Shares and other contributed capital	**28 690**	**29 519**	**30 378**	**31 852**
Net worth	**..**	**..**	**..**	**..**
Net financial worth [(a)]	**-2 761**	**-3 773**	**-2 850**	**-2 783**
Net debt [(b)]	**1 520**	**1 580**	**1 582**	**1 457**

Source: Department of Treasury and Finance

Notes:

(a) *Net financial worth equals total financial assets minus total liabilities*

(b) *Net debt equals the sum of deposits held, advances received and borrowings, minus the sum of cash and deposits, advances paid, and investments, loans and placements.*

Table C.6: Non-financial public sector balance sheet

($ million)

as at 30 June	*2003 Opening*	*2004 Budget*	*2004 Revised*	*2005 Estimate*
Assets				
Financial assets				
Cash and deposits	1 515	1 568	1 394	1 462
Advances paid	286	293	245	214
Investments, loans and placements	5 069	4 504	4 490	4 063
Other non-equity assets	3 305	3 281	3 321	3 343
Equity	- 126	305	- 126	- 126
Total financial assets	**10 049**	**9 950**	**9 325**	**8 957**
Non-financial assets				
Land and fixed assets	71 776	74 934	75 714	79 729
Other non-financial assets	1 565	1 586	1 584	1 596
Total non-financial assets	**73 341**	**76 520**	**77 298**	**81 325**
Total assets	**83 391**	**86 470**	**86 623**	**90 282**
Liabilities				
Deposits held	489	495	494	500
Advances received	18	19	17	19
Borrowing	9 183	9 331	9 076	8 891
Superannuation liability	13 489	13 987	13 572	14 314
Other employee entitlements and provisions	4 742	4 974	4 969	5 243
Other non-equity liabilities	2 458	2 461	2 457	2 448
Total liabilities	**30 379**	**31 266**	**30 586**	**31 415**
Net worth	**53 012**	**55 203**	**56 037**	**58 866**
Net financial worth (a)	**-20 330**	**-21 317**	**-21 260**	**-22 459**
Net debt (b)	**2 819**	**3 481**	**3 458**	**3 671**

Source: Department of Treasury and Finance

Notes:

(a) Net financial worth equals total financial assets minus total liabilities

(b) Net debt equals the sum of deposits held, advances received and borrowings, minus the sum of cash and deposits, advances paid, and investments, loans and placements. If Growing Victoria investments are not included as an offset to debt, on the grounds that these investments are earmarked for infrastructure projects and are therefore not available to redeem debt, the net debt figures are:

Net debt (excluding Growing Victoria)	*3 615*	*3 624*	*3 629*	*3 675*

Table C.7: General government sector cash flow statement

($ million)

	2003-04 Budget	2003-04 Revised	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate
Cash receipts from operating activities					
Taxes received	9 434	9 849	9 813	9 993	10 389
Receipts from sales of goods and services	2 906	2 976	3 052	3 148	3 166
Grants/subsidies received	12 248	12 281	12 823	13 584	13 925
Other receipts	1 838	1 907	2 009	2 200	2 242
Total receipts	**26 425**	**27 012**	**27 697**	**28 926**	**29 723**
Cash payments from operating activities					
Payment for goods and services	-19 428	-19 905	-20 069	-20 995	-22 105
Grants and subsidies paid	-4 067	-4 192	-4 121	-4 348	-4 415
Interest paid	- 460	- 461	- 445	- 455	- 453
Other payments	- 502	- 502	- 543	- 547	- 569
Total payments	**-24 457**	**-25 060**	**-25 178**	**-26 345**	**-27 541**
Net cash flows from operating activities	**1 967**	**1 953**	**2 519**	**2 581**	**2 182**
Net cash flows from investing in non-financial assets					
Sales of non-financial assets	67	74	60	53	44
Purchases of non-financial assets	-2 131	-2 165	-2 591	-2 342	-2 348
Total cash flows - non-financial assets	**-2 064**	**-2 090**	**-2 531**	**-2 289**	**-2 304**
Net cash flows from investments in financial assets for policy purposes	**- 510**	**- 429**	**- 323**	**- 107**	**- 79**
Net cash flows from investments in financial assets for liquidity	**644**	**454**	**377**	**- 137**	**228**
Net cash flows from financing activities					
Advances received (net)	- 1	- 1	..	..	..
Borrowings (net)	10	11	- 3	6	10
Deposits received (net)	5	5	5	5	5
Other financing (net)	4	4	2	2	2
Net cash flows from financing activities	**18**	**19**	**4**	**13**	**17**
Net increase in cash held	**56**	**- 93**	**46**	**61**	**44**
Net cash from operating activities & investments in non-financial assets	- 97	- 138	- 12	292	- 122
Acquisitions under finance leases	..	..	..	437	..
Surplus (+) /deficit (-)	**- 97**	**- 138**	**- 12**	**- 145**	**- 122**

Source: Department of Treasury and Finance

Note:
(a) Table below shows GFS surplus (+)/deficit(-) excluding impact of Growing Victoria.

Surplus (+) /deficit (-) (excluding Growing Victoria)	*557*	*479*	*45*	*- 140*	*- 122*

Table C.8: Public non-financial corporations sector cash flow statement

($ million)

	2003-04 *Budget*	2003-04 *Revised*	2004-05 *Estimate*
Cash receipts from operating activities			
Receipts from sales of goods and services	2 980	2 737	2 830
Grants/subsidies received	745	753	772
Other receipts	311	311	285
Total receipts	**4 036**	**3 801**	**3 886**
Cash payments from operating activities			
Payment for goods and services	-2 259	-2 025	-1 666
Grants and subsidies paid	- 35	- 35	- 18
Interest paid	- 148	- 148	- 150
Other payments	- 748	- 748	- 696
Total payments	**-3 190**	**-2 956**	**-2 531**
Net cash flows from operating activities	**846**	**845**	**1 355**
Net cash flows from investing in non-financial assets			
Sales of non-financial assets	86	86	88
Purchases of non-financial assets	- 958	- 958	- 958
Total cash flows from investing in non-financial assets	**- 872**	**- 872**	**- 870**
Net cash flows from investments in financial assets for policy purposes	**39**	**39**	**48**
Net cash flows from investments in financial assets for liquidity purposes	**125**	**125**	**50**
Net cash flows from financing activities			
Advances received (net)	- 1	- 1	- 2
Borrowings (net)	136	136	160
Deposits received (net)	- 1	- 1	- 1
Distributions paid	- 307	- 326	- 357
Other Financing (net)	22	22	..
Total net cash flows from financing activities	**- 150**	**- 169**	**- 200**
Net increase in cash held	**- 12**	**- 32**	**383**
Net cash from operating activities, dividends paid, and investments in non-financial assets	- 333	- 353	128
Acquisition of assets under finance leases and similar arrangements	..	..	..
Surplus (+) /deficit (-)	**- 333**	**- 353**	**128**

Source: Department of Treasury and Finance

Table C.9: Non-financial public sector cash flow statement

($ million)

	2003-04 Budget	*2003-04 Revised*	*2004-05 Estimate*
Cash receipts from operating activities			
Taxes received	9 380	9 809	9 772
Receipts from sales of goods and services	4 970	4 895	5 058
Grants/subsidies received	12 250	13 033	13 594
Other receipts	1 785	1 711	1 824
Total receipts	**28 385**	**29 448**	**30 249**
Cash payments from operating activities			
Payment for goods and services	-21 346	-21 774	-21 712
Grants and subsidies paid	-3 210	-3 324	-3 170
Interest paid	- 608	- 609	- 596
Other payments	- 656	-1 223	-1 184
Total payments	**-25 820**	**-26 931**	**-26 662**
Net cash flows from operating activities	**2 565**	**2 518**	**3 587**
Net cash flows from investing in non-financial assets			
Sales of non-financial assets	153	161	148
Purchases of non-financial assets	-2 901	-3 123	-3 549
Total cash flows from investing in non-financial assets	**-2 748**	**-2 962**	**-3 401**
Net cash flows from investments in financial assets for policy purposes	**- 391**	**39**	**48**
Net cash flows from investments in financial assets for liquidity purposes	**769**	**579**	**427**
Net cash flows from financing activities			
Advances received (net)	- 1	- 3	- 2
Borrowings (net)	146	167	177
Deposits received (net)	4	4	4
Other financing (net)	74	67	11
Total net cash flows from financing activities	**223**	**236**	**191**
Net increase in cash held	**419**	**174**	**661**
Net cash from operating activities and investments in non-financial assets	- 183	- 445	186
Acquisition of assets under finance leases and similar arrangements	..	..	..
Surplus (+) /deficit (-) [(a)]	**- 183**	**- 445**	**186**

Source: Department of Treasury and Finance

Note:

(a) *Table below shows GFS surplus (+)/deficit(-) excluding impact of Growing Victoria.*

Surplus (+) /deficit (-) (excluding Growing Victoria)	*471*	*172*	*243*

Table C.10: General government AAS31 net result reconciled to GFS measures

($ million)

	2003-04 Budget	*2003-04 Revised*	*2004-05 Estimate*	*2005-06 Estimate*	*2006-07 Estimate*
General government net result	**245**	**652**	**473**	**564**	**537**
Plus:					
Operating revaluations & gains on sale of physical assets	- 1	9	16	17	17
Expense for doubtful debts	94	79	85	87	83
Amortisation not included as GFS expenses	68	12	10	10	9
Change to provision for employees superannuation (difference between nominal interest and expense)	18	- 268	- 89	- 79	- 98
Unrealised gains on sales of investments	0	0	0	0	0
General government net operating balance (GFS)	**423**	**484**	**494**	**599**	**547**
Less: Gross fixed capital formation	2 064	2 090	2 531	2 289	2 304
Add: Depreciation	1 025	1 084	1 156	1 208	1 271
Less: Movements in other non-financial assets	- 0	- 0	7	437	- 0
Change in inventories	0	0	0	0	0
GFS net lending(+)/borrowing(-) [(a)]	**- 616**	**- 522**	**- 888**	**- 919**	**- 485**
Plus:					
Superannuation expense (difference between operating statement and cash flow statement)	- 475	- 625	- 115	- 308	- 681
Other non-cash expenses	995	1 010	991	1 082	1 044
GFS cash surplus(+)/deficit(-)	**- 97**	**- 138**	**- 12**	**- 145**	**- 122**
Plus: Growing Victoria net cash flow	653	617	167	5	..
GFS cash surplus (+) /deficit (-) (exluding Growing Victoria)	**557**	**479**	**45**	**- 140**	**- 122**
Plus: Net contributions to other sectors of government and other	524	439	207	129	98
Decrease in general government net debt (excluding Growing Victoria)	**32**	**40**	**- 162**	**- 269**	**- 220**

Source: Department of Treasury and Finance

Note:
(a) The table below shows GFS net lending (+) / borrowing (-) and GFS cash surplus (+)/ deficit (-) excluding the impact of Growing Victoria.

GFS net lending (+) / borrowing (-) (excluding Growing Victoria)	*37*	*94*	*- 722*	*- 914*	*- 485*

Victoria's 2003-04 Loan Council Allocation

As required under the Uniform Presentation Framework, Table C.11 compares Victoria's 2003-04 Loan Council Allocation (LCA) as approved by Loan Council in March 2003 with the revised LCA based on *2003-04 Budget Update* estimates.

Table C.11: Loan Council Allocation 2003-04

($ million)

	2003-04 Nomination	*2003-04 Revised*
General government sector cash (+) deficit / (-) surplus	348	138
Public non-financial corporation sector cash (+) deficit / (-) surplus	399	353
Non-financial public sector cash (+) deficit / (-) surplus [(a)]	670	445
Less: Net cash flows from investments in financial assets for policy purposes [(b)]	- 16	- 391
Plus: Memorandum items [(c)]	204	252
Loan Council Allocation	**890**	**1 087**
Tolerance limit (2% of non-financial public sector cash receipts from operating activities) [(d)]	575	575

Source: Department of Treasury and Finance

Notes:

(a) The sum of the surplus / deficit of the general government and public non-financial corporation sector does not directly equal the non-financial public sector surplus due to intersectoral transfers, which are netted out in the calculation of the non-financial public sector figure.

(b) The non-financial public sector surplus / deficit relating to 2003-04 includes net cash flows from investments in financial assets for policy purposes.

(c) Memorandum items are used to adjust the ABS deficit to include in LCAs certain transactions, such as operating leases, that have many of the characteristics of public sector borrowings but do not constitute formal borrowings. They are also used, where appropriate, to deduct from the ABS deficit certain transactions that Loan Council has agreed should not be included in LCAs (e.g. the over/under funding of employers' emerging costs under public sector superannuation schemes, or borrowings by entities such as statutory marketing authorities).

(d) A tolerance limit equal to 2 per cent of 'total non-financial public sector cash receipts from operating activities' applies to jurisdictions' LCA. The tolerance limit applying to Victoria in 2003-04 is $575 million (2 per cent of $28 733 million - sourced from 2002-03 Budget Update).

Listed below are details of Victoria's infrastructure projects with private sector involvement for which it is expected that contracts will be signed in the 2003-04 financial year.

In line with the current Loan Council guidelines for the treatment of such projects, the termination liabilities as measured by the Government's contingent exposure, are to be included as a footnote to the LCA.

As the following projects are still in development stages, full details about the extent and nature of actual payments, forward commitments and contingent liabilities associated with the projects cannot be provided at this stage, but will be included in the 2003-04 LCA outcome.

Central Highlands Water – North Ballarat Wastewater Plant and Reuse Project

The project is being driven by the need to comply with stricter EPA wastewater discharge standards and involves upgrading the Ballarat North Treatment Plant to a tertiary treatment level to cater for full reuse of effluent. Central Highlands Water and their consultants are focusing on Partnerships Victoria opportunities.

The likely outcome will be a Design, Built, Finance and Operate arrangement where a private proponent would upgrade the Ballarat North and Creswick Wastewater Treatment Plants and take full responsibility for a wastewater reuse system, including the construction, ownership and operation of the assets as well as the responsibility of developing the reuse market in the Central Highlands area.

The term of the contract is 25 years.

Mitcham-Frankston Freeway Project

The project will be built by the private sector and funded by a toll. The freeway will join the Eastern Freeway at Mitcham to the Frankston Freeway at Seaford.

The freeway is 34 kilometres and includes tunnels of 1.5 kilometres. This will be the first Partnerships Victoria road project.

The term of the contract is 34 years, four years construction and 30 years operation.

Delays have been experienced in the early stages of the process, and as a result the project may be contracted in 2004-05 rather than 2003-04 as earlier projected.

Metropolitan Mobile Radio

The Metropolitan Mobile Radio (MMR) project proposes a complete replacement of metropolitan radio systems for Victoria Police, Metropolitan Fire and Emergency Services Board and the Metropolitan Ambulance Service with digital trunked radios. The MMR project is part of the Statewide Integrated Public Safety Communications Strategy (SIPSaCS).

The project is being delivered under the Partnerships Victoria policy framework. The term of the contract is seven years, with the option to extend for a further two years.

Correctional Facilities

The development of new correctional facilities is a key part of the Government's Corrections Long Term Management Strategy. Part of the strategy includes two new correctional facilities for males – a 300-bed Correctional Programs Centre and a 600-bed Remand Centre.

The project involves the design, construction, finance and maintenance of the centres for a period of 25 years. In line with Partnerships Victoria, the public sector – Corrections Victoria – will operate both facilities.

In addition, there are a range of infrastructure services (e.g. power, gas, communications, water, drainage) to each facility that are to be provided by the successful tenderer on a design and construct basis which will be paid for by the State as a separate lump sum amount.

Emergency Alerting Systems (EAS)

The Emergency Alerting Systems (EAS) project is a multi-agency initiative to equip career and volunteer emergency services personnel throughout Victoria with alerting devices. EAS will enable the Country Fire Authority, the Victorian Statewide Emergency Services and Rural Ambulance Victoria to contact their career and volunteer staff to alert them to emergency situations.

The project is being delivered under the Partnerships Victoria policy framework. The term of the contract is five years, with the option to extend for a further two years.

APPENDIX D: TAX EXPENDITURES

Part of the higher level of disclosure required under the *Financial Management (Financial Responsibility) Act 2000* is an overview of tax expenditures.

The Victorian tax system, in common with those of other state jurisdictions and the Commonwealth, contains a variety of concessions or exemptions as a means of providing assistance, encouragement or relief to particular taxpayers or particular activities. This assistance can take the form of tax exemptions, deductions, rebates, credits, concessionary rates or deferrals of payment or tax.

Table D.1 shows updated aggregate tax expenditure estimates by the main categories of tax for the period 2002-03 to 2006-07. The 2003-04 Budget estimate for total estimated tax expenditures for 2003-04 was $1 910 million, $139.3 million lower than the current estimate of $2 049.3 million. The variations from the estimates published in 2003-04 Budget are linked to changes in revenue estimates for the forecast period, revisions to tax expenditure estimates for 2002-03 in view of updated information, and improved methodology. The main revision is to land tax expenditures to reflect updated estimates of land tax revenue associated with increased projected site valuations.

Table D.1: Aggregate tax expenditures (excluding thresholds) by type of tax

($ million)

Description	*2002-03 Estimate*	*2003-04 Estimate*	*2004-05 Estimate*	*2005-06 Estimate*	*2006-07 Estimate*
Land tax	998.4	1172.3	1314.3	1459.6	1432.0
Payroll tax	537.3	553.9	587.5	616.3	646.7
Gambling taxes	65.1	66.8	70.3	74.1	78.1
Vehicle taxation	109.8	119.6	124.3	129.2	132.6
Other stamp duties	128.8	136.6	144.4	152.2	160.0
Total estimated tax expenditures	**1839.5**	**2049.3**	**2240.8**	**2431.4**	**2449.4**

Source: Department of Treasury and Finance

APPENDIX E: REQUIREMENTS OF THE *FINANCIAL MANAGEMENT ACT 1994*

This appendix describes the provisions of the amendments to the *Financial Management Act 1994*, as amended by the *Financial Management (Financial Responsibility) Act 2000*, passed by Parliament in April 2000.

The provisions of the *Financial Management (Financial Responsibility) Act 2000* have been complied with in the *2003-04 Budget Update*. Table E1 details the statements required to be included in this document under the provisions of the Act.

Table E1: Statements required by the *Financial Management Act 1994* and their location in the *2003-04 Budget Update*

Relevant section of the amended Acts and corresponding requirement	*Location*
(Sections 23 E-G of the *Financial Management Act 1994*) Statement of financial policy objectives and strategies for the year.	Chapter 1, *Financial Policy Objectives and Strategies*
(Sections 23 L-N of the *Financial Management Act 1994*)	
Estimated financial statements for the year comprising: – an estimated statement of financial performance over the year; – an estimated statement of financial position at the end of the year; – an estimated statement of cash flows for the year; and – a statement of the accounting policies on which these statements are based and explanatory notes.	Chapter 4, *Estimated Financial Statements and Notes*

Table E1: Statements required by the *Financial Management Act 1994* and their location in *2003-04 Budget Update* (cont.)

Relevant section of the amended Acts and corresponding requirement	*Location*
Budget sector financial statements to 31 October 2002 (Section 23 K of the *Financial Management Act 1994*)	Appendix B, *General Government Sector Year-to-Date Actuals*
Accompanying statement to estimated financial statements which: – outlines the material economic assumptions used in preparation of the estimated financial statements;	Chapter 3*, Economic Conditions and Outlook* and Chapter 4, *Estimated Financial Statements and Notes*
– discusses the sensitivity of the estimated financial statements to changes in these assumptions;	Chapter 5, *Statement of Risks*
– provides an overview of estimated tax expenditures in the budget;	Appendix D, *Tax Expenditures*
– provides a statement of the risks that may have a material effect on the estimated financial statements.	Chapter 5, *Statement of Risks*



2003-04 Budget Update

www.dtf.vic.gov.au



State Government Victoria

Department of Treasury and Finance