

CHAPTER 2: 2008-09 FINANCIAL OUTCOMES

Key aspects of the Committee's analysis:

- 2.1** The general government sector in Victoria achieved an operating surplus for 2008-09 of \$251 million, marginally higher than the revised estimate of \$243 million and less than the surplus of \$1.6 billion in 2007-08.
- 2.2** The State of Victoria's consolidated operating result for 2008-09 was a deficit of \$63 million compared with a surplus of \$1.6 billion in 2007-08. The government attributes this reduced operating result primarily to the impact of the global financial crisis.
- 2.3** After taking into account major economic flows relating to an increase of \$4.1 billion in the general government sector's superannuation liability due to actuarial losses and a net loss of \$2.7 billion in the Public Financial Corporations sector following the downturn in financial markets, the State's consolidated net result for 2008-09 was a deficit of \$13.1 billion, around \$9.9 billion higher than the deficit net result in 2007-08.
- 2.4** Parliament would benefit if there was greater reporting including quantification in the Annual Financial Report's upfront commentary of factors cited as contributing to major variances between estimated and actual results.
- 2.5** The operating result in the general government sector reflected higher than initially budgeted revenue of \$1.5 billion, offset by increased operating expenses of \$2.1 billion. There were only marginal differences between actual revenue and expenses when compared with revised estimates.
- 2.6** The more significant variances between initially estimated actual and operating revenue involved four items, with Commonwealth grants increasing by \$1.4 billion, sales of goods and services increasing by \$606 million, other revenue increasing by \$413 million, and taxation revenue (principally stamp duty), falling by \$756 million. The variances against revised estimates for these items were marginal.
- 2.7** The higher than initially estimated operating expenses included expenditure of \$638 million of additional Commonwealth funding provided for operating purposes and of \$59 million for bushfire recovery. These variances were, to a large extent, reflected in the relevant revised estimates.
- 2.8** The Committee has recommended enhanced disclosure in the Annual Financial Report of the receipt and expenditure of funding provided to the State under the Commonwealth's new funding framework, the management of bushfire recovery funding and the services component of revenue derived from sales of goods and services.
- 2.9** Net infrastructure spending in the general government sector in 2008-09 amounted to \$4.1 billion, higher, by \$112.8 million, than initially estimated, and \$300 million lower than the revised estimate.

- 2.10** By year-end, net general government sector debt had increased by \$3.1 billion to \$5.3 billion or 2 per cent of GSP. This increase was \$1.7 billion higher than initially forecast, but in line with the revised forecast.
- 2.11** On current estimates, net debt in the general government sector is projected to reach \$16 billion, or 5 per cent of GSP, by 30 June 2013.
- 2.12** Net debt of the non-financial public sector, which combines the general government sector and the public non-financial corporations sector, at 30 June 2009 totalled \$10.7 billion or 4 per cent of GSP, around \$315 million lower than initially forecast but \$6.8 billion higher than as at 30 June 2008.

2.1. Introduction

The Treasurer tabled the Government's Annual Financial Report for 2008-09 in Parliament on 14 October 2009. The report culminates the extensive financial and budget reporting process established by the Government under the *Financial Management Act 1994* for each financial year. This process incorporates reporting quarterly on the State's finances, a mid-year budget update and the year-end report.

The State of Victoria, as a whole-of-government reporting entity, comprises the following three sectors:⁸

- **the General Government sector (GG)** – consisting of all government departments and other public sector agencies that are controlled and largely financed by government. The sector is primarily responsible for the delivery of government policy as set out in the annual Budget;
- **the Public Non-Financial Corporations sector (PNFC)** – comprising a wide range of entities that provide goods and services of a non-financial nature to the public while meeting commercial principles through cost recovery via user charges and fees. The most significant entities in this sector are those providing water, housing, transport and port services; and
- **the Public Financial Corporations sector (PFC)** – encompassing entities that provide financial services in accordance with commercial principles. The seven entities making up this sector are the Transport Accident Commission, Victorian WorkCover Authority, Rural Finance Corporation, State Trustees Limited, Treasury Corporation of Victoria, Victorian Managed Insurance Authority and Victorian Funds Management Corporation.

The year-end report for 2008-09 documents the outcome for the Victorian economy as well as the operating result, net result and financial position of the General Government sector and the State of Victoria.

⁸ Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, pp.17, 31

As in previous years, the 2008-09 Annual Financial Report includes, in addition to a range of data on the State's assets and liabilities, commentary on particular financial and economic results for the year compared with the latest revised expected results published in May 2009 in the 2009-10 Budget Papers.

In addition, the 2008-09 report incorporates, as part of the audited financial statements, a schedule of major variances between budgeted and actual outcomes in the general government sector, a disclosure requirement of the latest professional accounting standard.⁹

The report also includes the State's consolidated financial statements for the year as audited by the Auditor-General. A confirming (unqualified) audit opinion on the financial statements was expressed by the Auditor-General on 29 September 2009.

2.2. Outline of Committee's commentary on key financial outcomes in 2008-09

In this chapter, the Committee provides commentary at a macro level on certain key aspects of the Government's financial outcomes in 2008-09, as presented by the Government in its Annual Financial Report. The chapter examines the main features of the year's financial outcomes from Parliament's perspective, with an emphasis on the quality and transparency of reported material.

The Committee makes four recommendations in the chapter. These recommendations aim to assist the Government to enhance disclosure in the Annual Financial Report. They address:

- the likely benefit to Parliament of greater quantification in the report's upfront commentary of factors cited as contributing to major variances between budgeted and actual results;
- the desirability of expanded presentation on Commonwealth funding and related expenditure under the various categories of the Commonwealth's new funding framework;
- a need for more informative presentation of the Government's annual services revenue which is an increasing component of revenue collected from the sales of goods and services; and
- more detailed reporting on the management of bushfire recovery funding which would complement the informative presentation of budget estimates on bushfire recovery included in the Budget Papers.

In making these recommendations, the Committee recognises the high level nature of the analysis and associated commentary included by the Government in the Annual Financial Report and that more detailed material on financial outcomes is likely to be available in the annual reports of agencies. It nevertheless considers that there is scope to improve the quality of reported data in the identified areas, particularly in instances where responsibility for the management of resources is spread across several agencies or where the data relates to key factors influencing budgetary settings for the period such as in recent times, the Global Financial Crisis, major bushfire recovery commitments and the continuing drought.

9 *ibid.*, p. 43

The Committee is also conscious that the Department of Treasury and Finance is examining the structure and future content of the Annual Financial Report, having regard to contemporary developments in budget management and financial reporting and its ongoing quest to maintain best practice reporting standards.

Because of the chapter's overview nature, the Committee's commentary in some places is cross-referenced to other chapters of this report which contain more detailed information on particular issues.

2.3. Summary of consolidated financial result for 2008-09

A summary of the audited consolidated operating statements for 2008-09 and 2007-08 for the General Government sector and for the State of Victoria as a whole IS outlined in Table 2.1 as presented in the Annual Financial Report.¹⁰

The main measure used by government as an indicator of fiscal performance is the 'Net result from transactions – net operating balance', which equates to an operating result for the General Government sector. It is the first of five financial objectives of the Government.

This result for 2008-09 was a surplus of \$251.2 million, lower than the estimate of \$891.8 million in the 2008-09 Budget and marginally higher than the 2008-09 revised estimate of \$242.5 million.¹¹ The result for the State of Victoria under this indicator was a deficit of \$62.9 million.

Table 2.1 also shows a net result after recognising other economic flows such as disposals of non-financial assets, accounting for financial assets or liabilities at fair value, or actuarial gains and losses for superannuation. The net result for the general government sector was a deficit of \$8,372.8 million and for the State of Victoria \$13,088.8 million.

10 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.45

11 *ibid.*, p. 8

Table 2.1: Consolidated operating statement for the year ended 30 June 2009

	General Government sector		State of Victoria	
	2009	2008	2009	2008
	(\$ million)			
Revenue				
Taxation revenue	12,626.9	12,862.9	12,443.6	12,697.5
Interest	378.2	451.6	1,190.0	1,300.9
Dividends and income tax equivalent and rate equivalent revenue	490.4	759.9	394.3	576.1
Sales of goods and services	4,940.5	4,488.3	10,326.9	9,752.2
Grants	18,970.0	17,210.1	18,722.6	17,108.5
Other current revenue	1,878.9	1,567.5	2,354.5	2,128.4
Total revenue	39,284.8	37,340.3	45,432.0	43,563.4
Expenses				
Employee expenses	14,296.9	13,239.4	15,037.0	13,926.9
Superannuation interest expense	609.7	330.3	610.4	331.4
Other superannuation	1,404.2	1,317.7	1,513.6	1,407.2
Depreciation and amortisation	1,515.8	1,416.2	2,544.0	2,353.7
Interest expense	642.4	438.5	1,410.1	1,151.7
Other operating expenses	13,198.4	11,904.7	19,106.1	17,706.8
Grants and other transfers	7,366.3	7,046.9	5,273.8	5,047.2
Total expenses ^(a)	39,033.7	35,693.8	45,494.9	41,924.9
Net result from transactions – Net operating balance ^(a)	251.2	1,646.6	(62.9)	1,638.6
Other economic flows included in net result				
Net gain/(loss) on disposal of non-financial assets	62.2	16.0	66.5	11.1
Net gain/(loss) on financial assets or liabilities at fair value	(83.8)	(34.8)	(4,022.2)	(1,452.0)
Net actuarial gain/(loss) of superannuation defined benefits plans	(7,510.1)	(3,378.1)	(7,572.5)	(3,398.0)
Share of net profit/(loss) from associates/joint venture entities, excluding dividends	(74.4)	10.6	(13.0)	7.1
Other gains/(losses) from other economic flows	(1,017.9)	(195.0)	(1,484.6)	27.4
Total other economic flows included in net result ^(a)	(8,624.0)	(3,581.4)	(13,025.8)	(4,804.5)
Net result ^(a)	(8,372.8)	(1,934.8)	(13,088.8)	(3,165.9)

Note: (a) A prior period adjustment of \$59 million has changed the previously published result for 2007-08 by an equivalent amount, relating to the reclassification of items previously capitalised to expense. Reclassification of unilaterally decided bad debts expense items from 'transactions expense' to 'other economic flows' has further required re-presentation of the 2007-08 results.

Source: Department of Treasury and Finance, Financial report for the State of Victoria, October 2009, p.45

2.4. Operating result for 2008-09 in the general government sector

2.4.1 Overview of the 2008-09 result

As identified in the Annual Financial Report, the general government sector is primarily responsible for the delivery of government policy as presented in the annual Budget. Each year, the Government sets out its financial objectives, estimated financial statements and policy priorities for the coming year in the Budget Papers.

The primary purpose of entities in the general government sector, which includes all government departments and other bodies who provide services free of charge or at prices significantly below their cost of production, is to provide public services which are mainly non-market in nature for the collective consumption of the community. The operations of these entities are financed mainly through taxes and other compulsory levies.¹²

For 2008-09, the Government's operating result in the general government sector (or net result from transactions) was a surplus of \$251.2 million.

As explained in the 2008-09 Budget Papers, the Government had set for that year a new fiscal target of at least one per cent of revenue to replace its previous long-standing target of a surplus of at least \$100 million. However, just a year later, the emergence of deteriorating fiscal and economic circumstances during 2008-09, as the Global Financial Crisis took its hold, prompted the Government to announce in the 2009-10 Budget Papers that it was reverting to its original target to allow for the delivery of vital services and the provision of key infrastructure. The Government signalled in its announcement that it is committed in the future to returning to a budgeted operating surplus of at least one per cent of revenue.

Table 2.2 shows the progressive dollar impact during 2008-09 of the deteriorating financial environment that prevailed for most of the year on the estimated and actual operating result for the general government sector.

Table 2.2: Operating result for general government sector for 2008-09 – differences between progressive estimates and final result

Operating item	2008-09 Budget (May 2008) (\$ million)	2008-09 Budget Update (December 2008) (\$ million)	2008-09 Revised Estimate (May 2009) (\$million)	2008-09 Actual (June 2009) (\$ million)
Revenue	37,810.0	37,970.3	39,152.1	39,284.8
Expenses	36,918.2	37,588.5	38,909.6	39,033.7
Operating surplus	891.8^(a)	381.8	242.5^(a)	251.2

Note:

- (a) These estimates differ from that of \$827.5 million and \$163 million published in the 2009-10 Budget papers because of the requirements of accounting standard AASB 1049, whole-of-government and general government sector Financial Reporting, under which unilateral bad debts are recognised as other economic flows after calculation of the operating result.

Sources: Budget Paper No.2, 2008-09 Strategy and Outlook, p.39; Budget Update 2008-09, p.27; 2009-10 Statement of Finances, p.270; Annual Financial Statement 2008-09, pp.18 and 124

12 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, pp.17, 52

Table 2.2 identifies a fall of \$640.6 million or 72 per cent in the final operating result for 2008-09 compared with the original budget. The equivalent reported movement for 2007-08 was a rise of \$1.15 billion or 356.8 per cent which illustrates the economic circumstances that prevailed during each period.

As identified in the Committee's report on the 2009-10 Budget Estimates, the Government provided an interim explanation of the reasons for the lower projected operating surplus as at December 2008 in its *2008-09 Budget Update*. That Update explained that the downward revision of the 2008-09 projected surplus at the time reflected:¹³

...a significant reduction in state taxation and GST revenue (due to slowing economic activity). This is offset by increases in Commonwealth specific purpose payment grants and state third party revenue, which also have corresponding increases in expenditure.

The macro commentary in the Annual Financial Report on the general government sector's operating result for 2008-09 describes the result, based on a comparison between the final surplus of \$251.2 million and the latest revised estimate of \$242.5 million as:¹⁴

... in line with expectations and is a particularly good result in the current global financial and economic climate, given the impact of the 2009 Victorian bushfires and the continuing Victorian drought.

The commentary also refers to the value of a positive operating result in the current climate as it enables the Government to fund investment and keep net financial liabilities at prudent levels to maintain a triple-A credit rating.

The Treasurer's public comments, when releasing the Annual Financial Report, included reference to some macro financial impacts of the economic circumstances experienced during 2008-09. The Treasurer stated that:¹⁵

While the Global Financial Crisis has wiped almost \$1 billion worth of GST revenue and over \$900 million worth of stamp duty from our budget, we have adapted relatively well with Victoria now the only state in the country to have a surplus now and into the future...

However, the impact of the Global Financial Crisis, the drought and Victoria's response to the bushfires will continue to put pressure on the Victorian budget well into the future.

It was against the above background of the financial and economic circumstances that were experienced worldwide during 2008-09 that the Committee considered Victoria's operating result in the general government sector for that year and the adequacy, from Parliament's perspective, of the analysis of the result presented in the Annual Financial Report.

13 Department of Treasury and Finance, *2008-09 Budget Update*, December 2008, p.25

14 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.17

15 Mr J Lenders, Treasurer, *Victoria in Surplus despite GFC, Bushfire and Drought*, media release, 14 October 2009

2.4.2 Analysis of the 2008-09 operating surplus in the general government sector

Consistent with the approach followed in previous years, the Government's high-level commentary in the Annual Financial Report on the main factors influencing the 2008-09 operating result is substantially based on a comparison, for key revenue and expense items, of the final result with the latest published revised budget estimates.

The report also includes, in a note to the audited consolidated financial statements (Note 31), explanations of material variances between year-end actuals and the corresponding original Budget Estimates. This latter presentation is a disclosure requirement of the new accounting standard *AASB 1049 Whole of Government and General Government Sector Financial Reporting*.

The Committee considers that there is value in both the comparison of year-end actuals with original budget estimates and with the revised estimates. The latter provides a comparison between the most recent estimates provided in the Budget Papers. This gives a meaningful current comparison, useful in more volatile years including 2008-09. The former provides a comparison against initial estimates provided several months before a financial year begins, i.e. the original starting point. From a longer term analytical perspective, the direct comparison is with the previous years actuals – hence with 2007-08. The Financial Report provides such a comparison in major tables.¹⁶

In terms of economic and financial reporting, however, it is important that key fiscal reports presented to Parliament provide sufficient information and analysis of changes over the whole of a financial year as well as a comprehensive statement at the end of a year. In Victoria, this is done via quarterly reporting and the budget, as well as in the Financial Report for the State of Victoria which incorporates Quarterly Financial Report No. 4.

The Committee considers that the availability of information and analytical material extending across 2008-09 provides users with an appropriate insight into the budgetary and financial management ramifications of the exceptional economic circumstances that characterised the reporting period.

Table 2.3 shows the comparison between outcomes for 2007-08 and 2008-09 as well as the variances between initial Budget Estimates and final outcomes in 2008-09 for the main revenue and expense items, as presented in the Government's Annual Financial Report.

¹⁶ Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, Table 2.1, p. 18

Table 2.3: 2008-09 Operating revenue and expenses – comparisons with 2007-08 and with estimates

Operating item	Column 1	Column 2	Column 3	Column 4	Column 5	Column 6	Column 7	Column 8
	2007-08 Actual	2008-09 Actual	2008-09 Revised estimate	Revised estimate variance (Column 2-3)	Revised estimate variance (%)	2008-09 Budget estimate	Budget variance (Column 2-6)	Budget variance (Column 2-6)
		(\$ million)	(\$ million)	(\$ million)	(%)	(\$ million)	(\$ million)	(%)
Revenue								
Taxation	12,862.9	12,626.9	12,720.0	-93.1	-0.7	13,382.9	-756.0	-5.6
Interest	451.6	378.2	408.2	-30.0	-7.3	402.2	-24.0	-6.0
Dividends, Income tax and rate equivalent revenue	759.9	490.4	474.2	16.2	3.4	669.9	-179.5	-27.0
Sales of goods and services	4,488.3	4,940.5	5,076.6	-136.1	-2.7	4,334.5	606.1	14.0
Grants	17,210.1	18,970.0	18,789.4	180.6	1.0	17,555.0	1,414.9	8.0
Other revenue	1,567.5	1,878.9	1,683.8	195.1	11.6	1,465.6	413.4	28.0
Total revenue	37,340.3	39,284.8	39,152.1	132.7	0.3	37,810.0	1,474.9	4.0
Expenses								
Employee expenses	13,239.4	14,296.9	14,366.6	-69.7	-0.5	14,225.6	71.3	1.0
Superannuation	1,648.0	2,013.9	2,004.3	9.6	0.5	1,858.2	155.7	23.0
Depreciation and amortisation	1,416.2	1,515.8	1,557.4	-41.6	-2.7	1,609.4	-93.6	-6.0
Interest expense	438.5	642.4	566.7	75.7	13.4	499.4	143.0	29.0
Other operating expenses	11,904.7	13,198.4	13,171.5	26.9	0.2	12,286.2	912.2	7.0
Grants and other transfers	7,046.9	7,366.3	7,243.0	123.3	1.7	6,439.4	926.9	14.0
Total expenses	35,693.8	39,033.7	38,909.6	124.1	0.3	36,918.2	2,115.5	6.0
Operating surplus	1,646.6	251.2	242.5	8.7	3.6	891.8	-640.6	-72.0

Source: Department of Treasury and Finance, Financial Report for the State of Victoria, 2008-09, October 2009, pp. 18, 124

Major variances in revenue items

The following paragraphs provide commentary on the principal variances between estimates and final revenue outcomes for 2008-09, as well as the actual revenue outcomes for 2007-08 as reported by the Government in its Annual Financial Report. The commentary covers the four revenue items with the more significant variances, namely grants (which essentially relate to Commonwealth funding), taxation, sales of goods and services, and other operating revenue.

More detailed information on the 2008-09 revenue outcomes is presented in Chapter 4 of this report.

Grants

Revenue from grants, which mainly involve Commonwealth grants, is the highest source of operating revenue to the Government in the general government sector. The figures shown in Table 2.3 for this item cover all Commonwealth grants including GST grants.

The significant increase of \$1.4 billion in grants revenue in 2008-09 relates, compared with budget, predominately to the new funding framework introduced by the Commonwealth during 2008-09 associated with Economic Stimulus funding, new National Agreements and New National Partnerships. The Committee's detailed analysis of the new Commonwealth funding developments, which included a tabular presentation of expected aggregate funding in 2008-09 and beyond under the various funding categories, was included in its October 2009 report to Parliament on the 2009-10 Budget Estimates.¹⁷

The Annual Financial Report identifies that the higher than budgeted grants revenue for 2008-09 comprised principally of increased Commonwealth (other than GST) grants of \$2.1 billion offset by lower than budgeted GST grants of \$962 million. In explaining this variance, the Annual Financial Report presents a listing of numerous additional Commonwealth funding (other than GST grants) amounting to around \$1.8 billion.

While the description in each case is informative, the identified additional funding is not grouped and subtotalled according to the key funding categories disclosed in the 2009-10 Budget Papers.¹⁸ The Committee has therefore restated in Table 2.4 under relevant funding categories the data presented in the Annual Financial Report.

Table 2.4 relates only to data for 2008-09 as the Commonwealth's new funding framework, incorporating National Agreements and National Partnerships as well as the Economic Stimulus Plan became effective during that year.

17 Public Accounts and Estimates Committee, *Report on the 2009-10 Budget Estimates – Part Two*, October 2009, pp.41–50

18 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.127

Table 2.4: Major variances between 2008-09 budgeted and actual Commonwealth grants (other than GST grants) – comparison with revised 2008-09 estimates

Funding category	Variations between revised budget and actual funding 2008-09	Totals
	(\$ million)	(\$ million)
Economic stimulus plan		
Building the education revolution – government and non-government school infrastructure	261.0	
Social housing dwellings	64.4	325.4
National Agreements		
Healthcare – public hospitals	136.0	
National Disability	47.6	183.6
National Partnerships		
Hospitals and health workforce reform	316.0	
Digital Education revolution – computers in government and non-government schools	242.0	
Social housing	49.6	
Indigenous housing	2.8	610.4
First Home Owners Boost	209.0	209.0
Australian Immunisation Agreement	44.0	44.0
Regional Rail Link project	150.0	150.0
Funding brought forward from 2009-10		
Financial assistance to local government	92.2	
Road and rail projects (excluding local roads)	121.1	
Local roads	33.9	247.2
Living Murray Initiative	33.5	33.5
Port Melbourne rail Access Improvement Project	10.0	10.0
Aggregate variance		1,813.1

Source: Data included in the Department of Treasury and Finance Financial Report for the State of Victoria 2008-09, October 2009, p.127

Given the Commonwealth's accountability requirements that have accompanied the introduction of the new funding framework, the Committee considers that the Government should expand its future year-end reporting in this area beyond a listing of explanations of major variances with budget to show the estimated and actual Commonwealth funding under relevant categories alongside the actual expenditure of such funding for each category. Such expanded disclosure, ideally in the form of a special purpose statement, would facilitate Parliament's assessment of the nature and level of Commonwealth funding and the extent to which such funding has been expended in line with planned timelines. It would also obviate Parliament's perusal of many departmental annual reports in the search for similar material, which would be a demanding exercise.

Recommendation 1: **The Department of Treasury and Finance incorporate within the Annual Financial Report for the coming financial years a special purpose statement disclosing estimated and actual Commonwealth funding under relevant categories and the actual spending for each category, together with explanations of major variances.**

Taxation

Taxation revenue is the second highest source of operating revenue to the Government in the general government sector.

Unlike 2007-08, when the difference between the initial budget and actual taxation revenue was an increase of \$1.3 billion (11 per cent), the taxation revenue in 2008-09 was \$756 million (6 per cent) lower than the original budget, but only \$93.1 million lower than the revised estimate. As a percentage of aggregate operating revenue, taxation revenue in 2008-09 fell from an initially-estimated 35.4 per cent to an actual year-end of 32.1 per cent.

The Government has reported that the lower than initially budgeted taxation revenue in 2008-09 was primarily attributable to:¹⁹

- reduced revenue of \$935.8 million from land transfer duty (stamp duty) reflecting the impact of the Global Financial Crisis on the property market; partially offset by
- an increase of \$187.8 million in land tax following revaluations of site values as at 1 January 2008 in line with legislative valuation cycles.

On a year to year basis, revenue from stamp duty was \$904.6 million lower in 2008-09 when compared with the final result for 2007-08.

From a future perspective, the Treasurer, when releasing the Annual Financial Report in October 2009, commented that:²⁰

...payroll tax, worth 10 per cent of the budget, was expected to grow by only 1.5 per cent [in 2009-10] and stamp duty, worth 8 per cent of the budget, was not expected to recover to 2007-08 levels until at least 2012-13.

Sale of goods and services

Proceeds from sale of goods and services represent the third highest source of operating revenue to the Government in the general government sector.

Revenue from sale of goods and services totalled \$4.9 billion in 2008-09 which was \$136 million below the year's revised estimate. The Government has identified that this reduction reflected the effects of the Global Financial Crisis.

19 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.126

20 Mr J Lenders, Treasurer, *Victoria in Surplus despite GFC, Bushfire and Drought*, media release, 14 October 2009

Revenue from this source was \$606 million in excess of the initial budget in 2008-09, which the Government attributes to:²¹

- a \$266 million reimbursement from the Commonwealth Government for costs associated with the 2009 Victorian bushfires under the National Disaster Relief and Recovery Arrangements. In the 2009-10 Budget, the State Government identified that the Commonwealth Government has shared the cost of many bushfire relief and recovery initiatives on a dollar for dollar basis;
- higher third party revenue of \$90.8 million in the health sector and \$28 million from the operations of VicRoads;
- increased revenue of \$86.4 million in the TAFE sector from on-shore and off-shore international student fees;
- additional public transport revenue of \$19.6 million reflecting patronage growth of nine per cent; and
- contributions of \$67.3 million from water retailers towards the cost of the Foodbowl Modernisation project and the Shepparton Irrigation Area Modernisation project.

Each year, the budgeted and actual revenue derived from the services element of this source, such as third party revenue, represents a significant component of aggregate services revenue. For example, in 2008-09, services revenue totalled \$3.1 billion or 63 per cent of aggregate revenue from sales of goods and services for the year.

The Government's 2009-10 Budget Update indicates that services revenue for that year is expected to total \$3.3 billion or 66 per cent of aggregate estimated revenue from sales of goods and services.

The Government's Annual Financial Report refers to this revenue as '*Provision of services*' but there is no breakdown of this item except for commentary on any major variances from the initial and revised budgets in particular areas.

The Committee considers there would be merit in the Government dissecting this item in future Annual Financial Reports into its major components for both budgeted and actual revenue. Such disclosure would complement the current reporting of variances. It would also provide more transparent data to the Parliament on the levels of expected and actual revenue arising from service provision in the State's various sectors and facilitate the identification of trends in both budgeted and actual services revenue across financial periods.

Recommendation 2: The Department of Treasury and Finance include in future Annual Financial Reports a dissection of estimated and actual revenue for the major components of the revenue item 'Provision of services' to facilitate Parliament's consideration of relevant revenue trends.

21 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.126

Other operating revenue

This revenue category is the fourth highest source of revenue in the general government sector. It includes fines, donations and gifts, royalties, fair value of assets received free of charge and other miscellaneous income.

Revenue from this source in 2008-09 totalled \$1.9 billion, \$195 million higher than the revised budget estimate.

The Government has identified in its Annual Financial Report that other operating revenue was higher than initially budgeted by \$413.4 million in 2008-09 which was attributable to four primary factors, namely:²²

- greater than budgeted assets received free of charge from the Murray Darling Basin Authority of \$78 million under the Living Murray Initiative following a change in the Authority's classification from an investment in a joint venture to Victoria's share of jointly owned assets;
- higher donations, bequests, fund raising income, research grants and private sector clinical trial income in health services totalling \$67 million;
- unclaimed monies in excess of budget of \$61 million following a reduction under legislation of the period in which businesses are required to hold such monies prior to deposit with the State Revenue Office – this change brought about a one-off recognition by that Office in 2008-09 of two years' worth of unclaimed monies; and
- additional non-operating revenue generated by Major Projects Victoria of \$56.1 million, mainly relating to the redevelopment of the former Kew Cottages site into a new integrated residential neighbourhood.

The Government's 2009-10 Budget Update forecasts that other operating revenue in that year is expected to total \$1.7 billion, slightly higher than the year's initial estimate but around \$137 million lower than the actual revenue for 2008-09.

Major variances in expense items

The earlier Table 2.3 shows that, as presented in the Government's Annual Financial Report, the three main factors contributing to higher than initially budgeted operating expenses of \$2.1 billion in 2008-09 were budget variances of \$926.9 million for grants and other transfers, \$912.2 million for other operating expenses and \$143.0 million for interest expense. Commentary on these variances and the variances against the year's revised estimates for these items, as reported by the Government, is provided in the following paragraphs.

22 *ibid.*, p.128

Grants and other transfers

Grants and other transfers expense in 2008-09 was \$7.4 billion, \$123.3 million higher than the revised estimate. The Government has reported that this difference was mainly due to the on-passing of additional Commonwealth grants to non-government schools.

Most of the factors identified by the Government under this expense heading as contributing to the increase in revenue of \$926.9 million, when compared with the initial budget, initially involved operating expenditure corresponding to additional Commonwealth funding identified in the earlier analysis of higher than budgeted grants revenue. These factors included:²³

- the on-passing of additional Commonwealth funding totalling \$638 million and incorporating the First Home Owners Boost (\$209 million); the non-government schools components of the Building Education Revolution initiative (\$100.2 million), the Digital Education Revolution initiative (\$92.2 million) and the National Schools special purpose payment and Investing in Our Schools program (\$19.5 million); the additional Commonwealth funding for Local Government and local roads projects (\$126.1 million); and the additional funding for housing initiatives (\$91.0 million); and
- payment of higher than budgeted grants by the state to non-government schools for the planning, upgrading or replacement of educational facilities (\$40.7 million) and to other state governments under the Living Murray Initiative (\$33.4 million).

Other operating expenses, including expenditure on bushfire recovery

Other operating expenditure in 2008-09 totalled \$13.2 billion, just \$27 million above the year's revised estimate

The Government's Annual Financial Report discloses that expenditure in excess of the initial 2008-09 budget was \$912.2 million and '*primarily reflects the impact of significant new policy measures, including the delivery of additional outputs funded since the 2008-09 Budget, such as 2009 Victorian Bushfire Response and Recovery initiatives*'.²⁴

In addition to the above reference to the 2009 Bushfires, the Annual Financial Report identifies, as part of its overview commentary, that:²⁵

The Victorian Government has committed significant resources in the recovery of bushfire affected towns and regions in response to the 2009 Victorian bushfires, one of the worst natural disasters in Australia's history. The Government, with support from the Commonwealth Government, spent nearly \$1 billion in 2008-09 towards support, recovery and prevention measures including fire response and suppression activities, support for affected individuals and families through emergency assistance grants, temporary housing and the provision of case managers, support for affected businesses through grants, subsidised low interest loans and a tourism package to encourage visitors back to the regions; an improved emergency services communications system; and upgraded fire fighting equipment.

23 ibid., p.129

24 ibid.,

25 ibid., p.4

Also, as mentioned in the above paragraphs analysing the higher than budgeted revenue for sales of goods and services in 2008-09, the Annual Financial Report indicates that Victoria received \$266 million from the Commonwealth for reimbursement of costs associated with the 2009 bushfires as part of natural disaster relief and recovery arrangements.

The above references in the Annual Financial Report to the 2009 bushfires were complemented by the following comment made by the Treasurer at the time of the public release of the Annual Financial Report:²⁶

...the government provided almost \$1 billion of funding for fire fighting efforts and Victoria's recovery from the bushfires including \$595.9 million in the 2008-09 financial year.

In the 2009-10 Budget Papers, the Government provided a detailed description of output bushfire recovery funding totalling \$908 million earmarked to occur over five years to 2012-13. Of this estimate, around \$593 million had been earmarked for 2008-09 which is consistent with the actual figure of \$595.9 million cited by the Treasurer when releasing the Annual Financial Report.

The 2009-10 Budget Papers disclosed the various categories of budgeted expenditure on bushfire recovery including fire suppression, supporting businesses and individuals, improving emergency services, and the operations of the Royal Commission and the Victorian Bushfire Reconstruction and Recovery Authority.²⁷

In its report on the 2009-10 Budget Estimates, the Committee recognised the breadth of information included in the Budget Papers on intended bushfire expenditure. It expressed the view that it looked forward to comprehensive and transparent reporting to Parliament on the management of bushfire funding and on the level of effectiveness in achieving recovery outcomes.²⁸

The Committee advocates that the Government's future reporting on bushfire recovery in the Annual Financial Report be expanded to take the form of a consolidated special purpose statement identifying:

- initially budgeted funding from the Commonwealth and the State for the year corresponding to material shown in the Budget Papers;
- a comparison of budgeted and actual expenditure for each of the main categories of expenditure cited in the Budget Papers, including explanations of any material variances; and
- guidance to Parliament and other readers on further information sources such as particular departmental annual reports likely to present more extensive coverage of bushfire recovery outlays and their effectiveness in achieving planned outcomes.

The importance of the latter reference to relevant departmental annual reports is reinforced by the fact that the extraction of detailed data from departmental annual reports could be a demanding exercise as the 2009-10 Budget Papers identified that all then ten departments had been allocated bushfire funding. On this point, Chapter 9 of this report includes a detailed analysis of

26 Mr J Lenders, Treasurer, media release, *Victoria in Surplus despite GFC, Bushfire and Drought*, 14 October 2009

27 Budget Paper No 3, *2009-10 Service Delivery*, pp.10-13

28 Public Accounts and Estimates Committee, *Report on the 2009-10 Budget Estimates – Part Two*. October 2009, p.26

departmental bushfire recovery expenditure based on material obtained from departments during the Committee's 2008-09 outcomes inquiry.

Recommendation 3: The Department of Treasury and Finance provide an extended report on bushfire recovery expenditure in the 2009-10 Annual Financial Report to correlate with the presentation format for forecast expenditure set out in the 2009-10 Budget Papers.

Interest expense

The Government's Annual Financial Report identifies interest expenses in 2008-09 were \$642 million, \$76 million higher than the revised estimate. It attributes this difference to

- higher discount interest expense relating to the liability to the State Electricity Commission of Victoria following the fall in the aluminium price (\$20 million);
- an increase in finance lease interest expense incurred by the Royal Women's Hospital (\$17 million); and
- higher borrowings by the Treasury Corporation of Victoria (not quantified) to fund the State's capital interest program.

The Annual Financial Report also identifies that the greater than initially budgeted interest expense of \$143 million in 2008-09 reflected higher borrowings by the Treasury Corporation of Victoria.

2.5. State of Victoria Outcome for 2008-09

The Financial Report for the State of Victoria also provides an overview and analysis of the outcomes for the State of Victoria as a whole by including the Public Non Financial Corporations (PNFC) Sector and the Public Financial Corporations (PFC) Sector along with the General Government sector.²⁹ As there are no estimates for the whole of State outcome, any analysis is largely focussed on comparisons with the preceding year (2007-08)

As shown in Table 2.1, the consolidated 2008-09 operating result for the State was a deficit of \$63 million compared with a surplus of \$1.6 billion in 2007-08. The overall commentary in the Annual Financial Report on this adverse movement points out that all three sectors of government experienced declines in their operating results.³⁰

The factors contributing to the result in the general government sector are explained in some detail in the Annual Financial Report as detailed in section 2.4 above. The Annual Financial Report attributes a reduced operating result in the PNFC sector to the challenging financial and economic conditions experienced during the year and in the PFC sector to, in part, the impact of the economic downturn on financial markets.³¹

29 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.5 and Chapter 3

30 *ibid.*, p.32

31 *ibid.*

The analysis of consolidated 2008-09 revenue and expenses compared with the previous years³² shows that revenue increased by \$1.9 billion due mainly to increased grants income from the Commonwealth. It also shows that expenses rose by \$3.6 billion with the two highest increases occurring in employee expenses (\$1.1 billion or an 8 per cent whole of State increase) and other operating expenses (\$1.4 billion).³³

The report describes the higher employee expenses as reflecting additional service delivery initiatives and wage outcomes. It attributes the increase in other operating expenses to several factors including, in the PNFC sector, a rise in network charges incurred by the Victorian Energy Networks Corporation and paid to the transmission network provider for the use of the network.

The earlier Table 2.1 also shows that, after taking into account other relevant economic flows, the consolidated 2008-09 net result was a deficit of \$13.1 billion compared with a deficit of \$3.2 billion in 2007-08. Net losses from the impact of other economic flows contributed around \$8.2 billion to this adverse turnaround in the net result. The Annual Financial Report identifies that these net losses included:³⁴

- an increase in the general government sector's net superannuation liability of \$4.1 billion (to \$7.5 billion) with the aggregate figure due principally to actuarial losses relating to:
 - a reduction in the discount rate used to value the superannuation liability leading to an increase of \$3.8 billion in the reported liability; and
 - lower than expected investment returns – the Annual Financial Report describes this factor as the other major component of the year's actuarial loss but does not provide a specific quantification.
- a net loss of \$2.7 billion in the PFC sector reflecting the impact of the downturn in financial markets and including:
 - an increase in insurance liabilities due to a reduction in discount rates;
 - an increase in the market value of borrowings of the Treasury Corporation of Victoria in an environment of lower interest rates; and
 - a reduction in the value of investment assets held by the State's insurance agencies, largely made up of realised and unrealised losses on financial markets.

The Annual Financial Report does not quantify the individual factors contributing to the increase in the net loss incurred in the PFC sector. The Committee believes that the Department of Treasury and Finance could incorporate further analysis within its high level commentary on financial outcomes in the Annual Financial Report, including quantifications of the major factors contributing to significant movements in individual items.

32 *ibid.*, p.22

33 *ibid.*, pp.32–4

34 *ibid.*, pp.23, 34

Recommendation 4: **The Department of Treasury and Finance provide further detail in its upfront high level analysis of financial outcomes in the Annual Financial Report on all major factors contributing to significant movements in individual items, including where possible quantification of such factors.**

2.6. Capital expenditure and debt movements in 2008-09 in the general government sector

In the 2008-09 Budget Papers, the Government's net infrastructure spending for the year in the general government sector was projected to total \$3.9 billion.³⁵ Such spending includes total purchases of property, plant and equipment, capital contributions to other sectors of government and net proceeds from sale of assets. Based on the figures shown in the Budget Papers for 2008-09, around 68 per cent of this projected spending was expected to be funded from cash operating surpluses with the remainder financed by borrowings.

The 2009-10 Budget Papers reported a revised estimate for net capital spending of \$4.4 billion, \$500 million higher than the initial estimate.

The 2008-09 Annual Financial Report identifies that actual net infrastructure spending for the general government sector in 2008-09 was \$4.1 billion, \$112.8 million in excess of the initial budget and \$300 million lower than the revised budget. The report indicates that Victoria's growing population necessitates greater investment in infrastructure. It also mentions that the onset of the Global Financial Crisis emphasised the importance of investing in infrastructure in 2008-09 to secure and support employment for Victorians. The report further explains that, by accelerating investment in public infrastructure and working in partnership with the Commonwealth, initiatives taken under an expanded infrastructure program have '*helped cushion the Victorian economy from the global financial crisis, as well as prepare the State to take advantage of the economic upturn by reducing infrastructure bottlenecks*'.³⁶

Table 2.5 compares the actual and estimated infrastructure spending for 2008-09 and the related funding sources.

³⁵ Budget Paper No 2, *2008-09 Strategy and Outlook*, May 2008, p.49

³⁶ Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.3

Table 2.5: Funding of 2008-09 capital and infrastructure program in general government sector – comparison of actuals with estimates

Expense and funding items	2008-09 Actual (a) (\$ million)	2008-09 Budget (b) (\$ million)	2008-09 Revised estimate (c) (\$ million)	Budget variance (a)-(b) (\$ million)	Revised estimate variance (a)-(c) (\$ million)
Operating surplus	251.2	827.5	242.5	-576.3	8.7
Add back: non-cash revenues and expenses (net) ^(a)	1,729.5	1,866.7	1,690.3	-137.2	39.2
Net cash flow from operating activities	1,980.7	2,694.2	1,932.8	-713.5	47.9
Less:					
Net investment in fixed assets					
Expenditure on approved projects	4,319.4	4,092.2	4,543.1	227.2	-223.7
Proceeds from asset sales	-268.2	-153.8	-190.5	-114.4	77.7
Total net investment in fixed assets	4,051.2	3,938.4	4352.6	112.8	-301.4
Finance leases	453.4	231.4		222.0	453.4
Other investment activities (net)	617.7	-7.9	664.6	625.6	46.9
Increase in net debt	3,141.7	1,467.6	3,084.4	1673.9	57.3
Net debt at year-end	5,291.7	3,738.6	5,234.5	1,553.1	57.2
	per cent	per cent	per cent		
Net debt to GSP at year-end	2.0	1.3	1.9		

Note:

(a) includes depreciation and non cash movements in liabilities such as superannuation and employee benefits

Sources: Budget Paper No.2, 2008-09 Strategy and Outlook, p.49, 56; Department of Treasury and Finance, Financial Report for the State of Victoria 2008-09, October 2009, p.27, 29

2.6.1 Movements in net debt – general government sector

It can be seen from Table 2.5 that the increase in net debt of \$3.1 billion in 2008-09 in the general government sector to \$5.3 billion at year-end, or 2 per cent of GSP, was \$1.7 billion higher than the initial estimate increase for the year, but in line with the revised estimate. A more extended treatment of debt is found in Chapter 8, including comparisons with performance in other jurisdictions.

The information in the table also shows that this higher than initially estimated level of debt came about as a result of a reduction of \$713.5 million in the year's expected cashflow from operations and additional infrastructure investments of \$960.4 million either in direct spending, recognition of finance leases or other investment activities. The significant non-budgeted movement in the latter item of \$625.6 million is not explained in the Annual Financial Report, however the 2009-10 Budget Papers identified that the then revised 2008-09 estimate for this item included 'movement of Murray Darling Basin Commission assets from investments using the equity method to buildings, plant and equipment'.³⁷ An add-back adjustment for this item arises from the fact that general government sector investments using the equity method are deducted from computations of net debt.

The impact of the economic circumstances experienced during the year meant that just 49 per cent of the infrastructure program in the general government sector was financed by cash operating resources compared to the initially estimated 68 per cent.

As pointed out in the Government's 2009-10 Budget Update, the projected level of funding available from operating cash resources for capital purposes in the general government sector is expected to remain at relatively low levels in 2009-10 and 2010-11 before climbing to as high as around 97 per cent by 2012-13. The Budget Update identifies that general government sector net debt is expected to rise from \$5.3 billion at 30 June 2009 to \$16.0 billion or 4.9 per cent of GSP by 30 June 2013.³⁸

The Committee has previously reported to Parliament on the importance of the Government ensuring that its budgetary position over the current forward estimates period is closely monitored and that debt levels do not adversely impact its operating results and overall financial position.³⁹

2.6.2 Movements in net debt – non-financial public sector

The non-financial public sector (NFPS) comprises the general government sector and the PNFC sector. It excludes the PFC sector. The Annual Financial Report states that, under the Uniform Presentation Framework adopted by all Australian jurisdictions, the NFPS is the broadest sector classification for which data is currently required to be presented.⁴⁰

Each year, a chapter in the Budget Papers addresses the NFPS and includes budget estimates on the sector's operating performance, financial position, infrastructure investment, net debt and financial sustainability.⁴¹

The 2008-09 Budget Papers include a budgeted cashflow statement for the NFPS. However, unlike its commentary on similar data relating to the general government sector, the Annual Financial Report does not include a tabular comparison of actual and budgeted cashflows for the NFPS, incorporating the year's infrastructure investment and the movement in net debt needed to fund that investment.

37 Department of Treasury and Finance, Budget Paper No.4, *2009-10 Statement of Finances*, May 2009, p.323

38 Department of Treasury and Finance, *Budget Update 2009-10*, November 2009, pp.35, 37

39 Public Accounts and Estimates Committee, *Report on the 2009-10 Budget Estimates – Part Two*, October 2009, p.29

40 Department of Treasury and Finance, *Financial Report for the State of Victoria 2008-09*, October 2009, p.37

41 For example, see Budget Paper No 2, *2008-09 Strategy and Outlook*, Chapter 4, p.59

In the above circumstances, the information presented in Table 2.6 covers only the movements in net debt in dollar terms and as a percentage of GSP in the NFPS for 2008-09 as this was the only actual data that could be readily extracted from the Annual Financial Report.

Table 2.6: Movements in NFPS net debt in 2008-09

Item	2007-08 Actual	2008-09 Actual (a)	2008-09 Revised estimate (c)	2008-09 Budget (b)	Budget variance (a) – (b)	Revised estimate variance (a) – (c)
	(\$ million)	(\$ million)	(\$ million)	(\$ million)	(\$ million)	
Net debt at year-end	3,858.3	10,696.4	11,220.1	11,011.0	-314.6	-523.7
	(%)	(%)	(%)	(%)	(%)	(%)
Net debt to GSP at year-end	1.4	4.0	4.2	3.9	–	–

Source: Department of Treasury and Finance, Budget Paper No 2, 2008-09 Strategy and Outlook, p.70; Budget Paper No. 2 2009-10 Strategy and Outlook, p.68, Department of Treasury and Finance, Financial Report for the State of Victoria 2008-09, October 2009, p38