2004-05

Budget Update

Presented by

The Honourable John Brumby, M.P.

Treasurer of the State of Victoria

For the information of Honourable Members

This Budget Update refers to the General Government Sector throughout except where specifically stated.

TABLE OF CONTENTS

HIGHLIGHTS

- The Government is committed to maintaining an operating surplus of at least $100 million in each year. The most recent projections show that this target will be achieved over the budget and forward estimates period.
- The revised 2004-05 general government operating surplus is $638 million, which is slightly higher than the $545 million estimated at the time of the 2004-05 Budget.
- Over the remainder of the forward estimates period, the operating surplus is projected to average $536 million each year, compared to the original estimate of an average of $571 million.
- The 2004-05 Budget Papers presented a range of alternative measures of operating performance:
  - the standardised operating surplus is now projected to be $665 million in 2004-05; and
  - the Government Finance Statistics (GFS) net operating balance is now forecast to be $626 million in 2004-05, and average $486 million over the next three years.
- The Government continues to invest in improved service delivery and world class infrastructure for Victorians:
  - the impact of new output initiatives since the 2004-05 Budget is $62 million in 2004-05, averaging $95 million over the following three years; and
  - net infrastructure investment spending is expected to average $2.4 billion a year over the four years to 2007-08.

- The Government's commitment to the prudent management of debt has been a key factor in maintaining Victoria's triple-A credit rating:
  - net financial liabilities (excluding the Growing Victoria infrastructure reserve), as a percentage of gross state product, have fallen from 10.2 per cent at 30 June 2000 to 6.4 per cent at 30 June 2004, and are now projected to decline to 6.3 per cent at 30 June 2008; and
  - net debt is expected to remain low, averaging around 1 per cent of gross state product over the budget and forward estimates period.
- Supportive global and national economic conditions are expected to contribute to another year of solid growth in Victoria:
  - forecast growth in Victoria's gross state product for 2004-05 is unchanged from the budget estimate of 3.25 per cent; and
  - employment growth is predicted to be slightly higher in 2004-05 at 1.75 per cent, with the unemployment rate also increasing marginally reflecting a strong increase in labour force participation.
- The most significant risks to the economic projections relate to higher oil prices and the potential re-emergence of drought conditions:
  - an upward revision to inflation estimates for 2004-05 and 2005-06 largely reflects the impact of rising oil prices.

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 aims to deliver world-class infrastructure to enhance social, economic and environmental outcomes across the State. In line with this goal, general government net infrastructure investment is projected to average $2.4 billion per year over the four years to June 2008.
- The Government will improve quality, access and equity in service delivery to all Victorians through continuing to implement its 2002 election commitments and 2004-05 Budget initiatives.
- 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 Act 1994*. 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*. Consistent with this, the Government's short and long-term financial objectives are shown in Table 1.1.

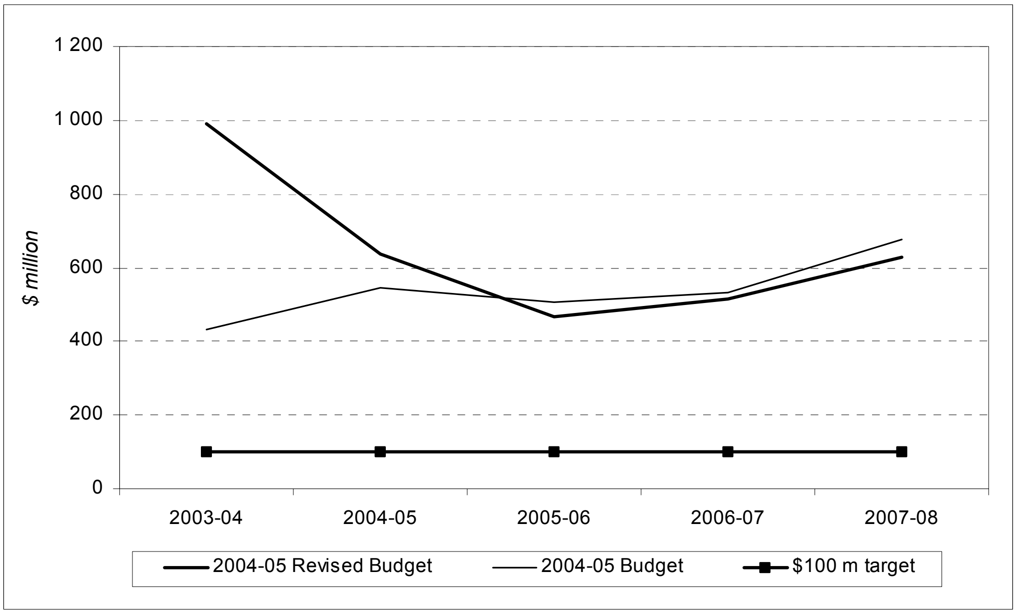
Table 1.1: 2004-05 Financial objectives

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 $990 million in 2003-04, the operating surplus is now forecast to be $638 million in 2004-05 and to average $536 million a year in the following three years.

Chart 1.1: General government sector operating surplus



Source: Department of Treasury and Finance

Given the emerging risks to the world and domestic economies (see Chapter 2, *Economic Conditions and Outlook*), the Government is maintaining a prudent 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 application of Australian Accounting Standards (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 that 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 lower than expected, the standardised operating surplus will be higher than the AAS 31 operating surplus. This is the case in 2004-05, where the standardised operating surplus is forecast to be $27 million higher than the headline 2004-05 operating surplus of $638 million (see Table 1.2).

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 Chapter 6, Accrual *Uniform Presentation 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 include revenue (including taxes and grants) earned in the year and 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

	2003-04 Actual	*2004-05 Revised*	*2005-06 Estimate*	*2006-07 Estimate*	*2007-08 Estimate*
Operating surplus (AAS 31)	990	638	467	515	627
Standardised operating surplus (a)	1 220	665	467	515	627
Net operating balance (GFS)	973	626	440	471	547
GFS net lending	- 116	- 569	- 926	- 307	- 173
GFS cash surplus	219	199	46	8	- 91

Source: Department of Treasury and Finance

Note:

(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. Excludes an adjustment for the one-off item amounting to $1 232 million relating to the discontinuation of the Smelter Reduction Amount in 2003-04.

Net lending is equal to the GFS net operating balance less net capital formation. As net lending expenses asset expenditure immediately, 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.

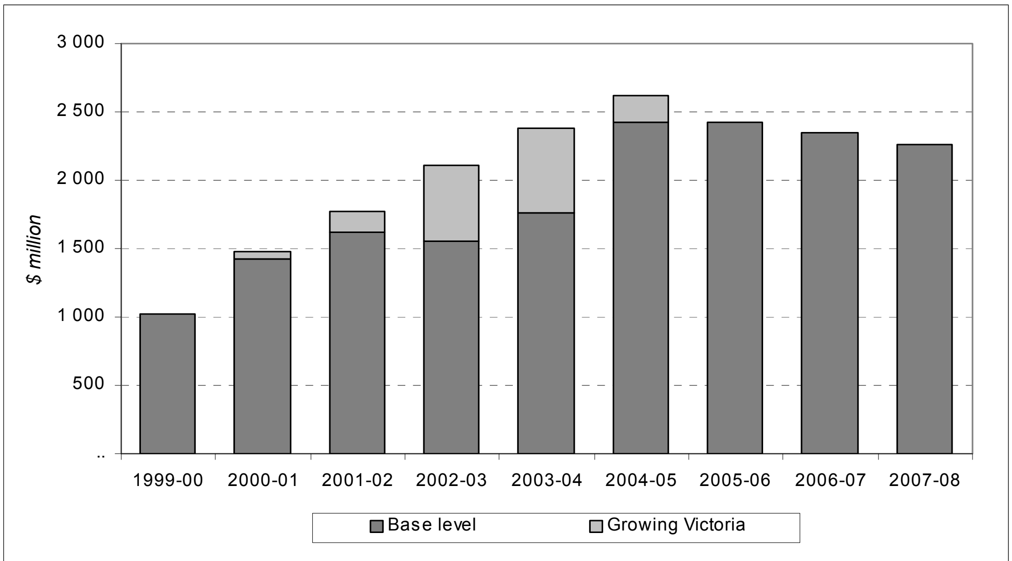
The GFS *cash surplus* is equal to net cash flows from operating activities less net investment in non-financial assets. Equivalently, the cash surplus is equal to net lending excluding non-cash expenses principally relating to superannuation and employee entitlements. As a result, the cash surplus is 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. This change in accounting standards will affect the measurement of some assets and liabilities and 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 1999-2000 (see Chart 1.2). Over the period 2004-05 to 2007-08, annual expenditure on fixed assets will average $2.4 billion per year. This level of expenditure well exceeds estimated average depreciation of around $1.2 billion a year.

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 contributions 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 forecast operating surpluses over the next four years enable the Government to continue its program of significantly upgrading and modernising infrastructure.

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 and its 2004-05 Budget initiatives. The Government has also implemented further initiatives since the 2004-05 Budget. The net budget impact of these new output initiatives is $62 million in 2004-05, averaging $95 million over the following three years.

Taxation

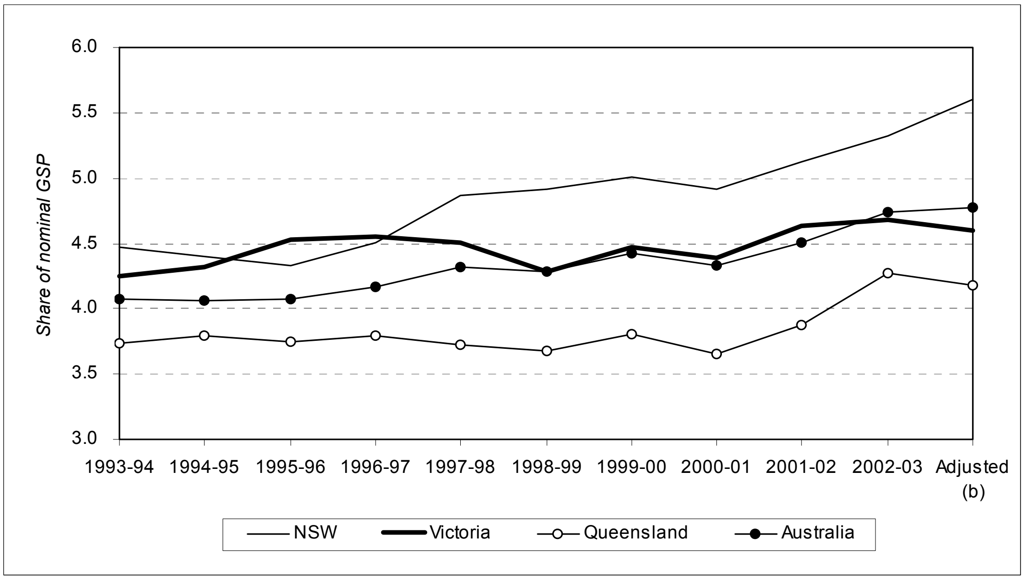
The Government's long-term commitment is to ensure a fair and efficient tax system in Victoria that is competitive with other states and which provides the funds needed for meeting its social goals.

The competitiveness of Victoria's tax regime plays an important role in underpinning the State's 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 gross state product (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 2003-04.

Chart 1.3 shows that Victoria's tax competitive position is set to be 1.0 percentage point (or $1 918 million) below NSW and 0.2 of a percentage point (or $322 million) below the Australian average. The increase in taxation as a share of GSP in 2001-02 and 2002-03 in all four jurisdictions on average reflects the buoyant economic activity in these years, particularly in the property market, which has yielded increases in conveyancing revenue.

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



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

Notes:

(a) Historical taxation data have been recast to exclude those taxes abolished as part of the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations.

(b) 2002-03 data have been further adjusted for tax changes announced in States' 2004-05 Budgets. Includes those taxation changes announced by Western Australia on 28 October 2004.

Net financial liabilities

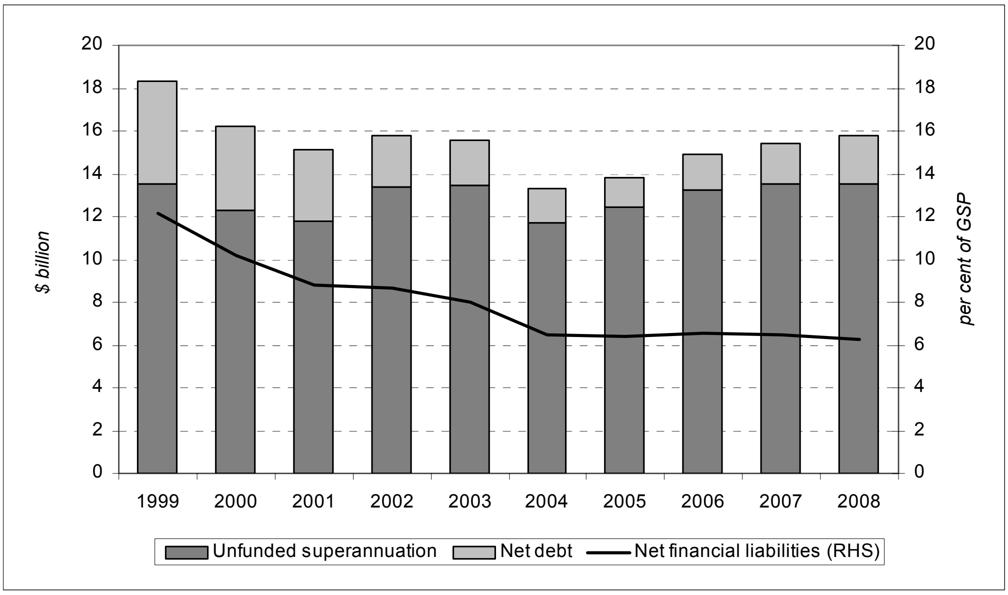
The Government is committed to maintaining the State's net financial liabilities at prudent levels in order to achieve its short-term objective of maintaining Victoria's triple-A credit rating.

Victoria's triple-A long-term local currency and foreign currency debt rating was affirmed by Standard & Poor's in July 2004 and by Moody's Investors Service in October 2004. 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 2004-05 revised budget outlook reinforces these positive factors as:

- strong operating surpluses are projected for 2004-05 ($638 million) and the remainder of the forward estimates period ($536 million a year on average);
- general government net financial liabilities (excluding the Growing Victoria infrastructure reserve) as a share of GSP are expected to decrease from 6.4 per cent at 30 June 2004 to 6.3 per cent at 30 June 2008 (see Chart 1.4);
- general government net debt (excluding the Growing Victoria infrastructure reserve) is projected to increase from $1.6 billion at 30 June 2004 to $2.2 billion at 30 June 2008, and is expected to average less than 1 per cent of GSP from 30 June 2004 to 30 June 2008. This is well down from 3 per cent of GSP in 1999 and 16 per cent of GSP in 1995; and
- Victoria's net financial liabilities are expected to remain comparable with other triple-A jurisdictions.

Chart 1.4: General government net financial liabilities excluding Growing Victoria as at 30 June



Source: Department of Treasury and Finance

CHAPTER 2: ECONOMIC CONDITIONS AND OUTLOOK

- A supportive global and national economic backdrop should underpin another year of solid growth in the Victorian economy, forecast at 3.25 per cent in 2004-05. This is unchanged from the budget estimate, although the expected drivers of growth have changed somewhat, with housing construction stronger than previously forecast and net exports somewhat weaker.
- The Victorian economy grew by 3.7 per cent in 2003-04. This was above the budget-time estimate of 3.25 per cent and a little below the national growth rate of 4.0 per cent.
- The Victorian labour market remains sound, and the 2004-05 employment growth forecast has been revised higher. Labour market participation has also been stronger than expected.
- The major change to forecasts has been to the inflation outlook, with rising oil prices the major contributor to an upward revision to the CPI estimates for 2004-05 and 2005-06.

THE ECONOMY SINCE BUDGET

World economic conditions

Over the past six months, the global economy has continued to expand at a reasonably strong pace. The forecast for aggregate growth is a little higher than at the time of the 2004-05 Budget, due primarily to stronger activity in Asia, including Japan. Although analysts remain positive about the outlook, global growth is expected to ease back in 2005.

According to the latest Consensus Economics survey (November 2004), world growth is forecast at 4.1 per cent in 2004, up from the estimate at budget time of 3.7 per cent. However, more moderate growth of 3.1 per cent is expected for 2005, partly due to the impact of higher interest rates and oil prices.

The US economy has performed largely as expected this year, with the Consensus Economic panel anticipating growth of 4.4 per cent in 2004, an estimate that has changed little over the course of the year. The US recovery has been most evident in private investment, particularly housing construction and business investment in equipment and software. The labour market has shown moderate gains, with the unemployment rate edging lower since the beginning of the year. After a strong 2004, the Consensus Economic panel expects softer (but still solid) economic growth of 3.4 per cent in 2005.

The outlook for Europe has improved slightly since budget time, although growth of only 2.3 per cent is forecast for 2004. In contrast, activity in Japan and East Asia has generally exceeded expectations, with the growth forecasts for 2004 and 2005 revised higher; export growth has been a key driver of regional performance over the past year.

Interest rates have risen in many major economies this year, including the United States and the United Kingdom. Higher rates are one of the factors behind the lower Consensus global growth forecast for 2005. However, most analysts see higher oil prices, if sustained, as the key risk to global prospects.

Victoria

The improved global environment, and steady recovery from drought, have supported a rebound in Victorian exports, an area of the economy that has under performed in recent times. Although the volume of exports was flat in 2003-04 as a whole, exports grew strongly in the second half of the year, suggesting an export recovery is under way. Despite this, continued solid domestic demand produced a further large rise in imports, resulting in net exports again detracting from growth.

Overall, the Victorian economy grew by 3.7 per cent in 2003-04, above the budget estimate of 3.25 per cent and an improvement on the previous year's (drought-affected) 3.3 per cent.

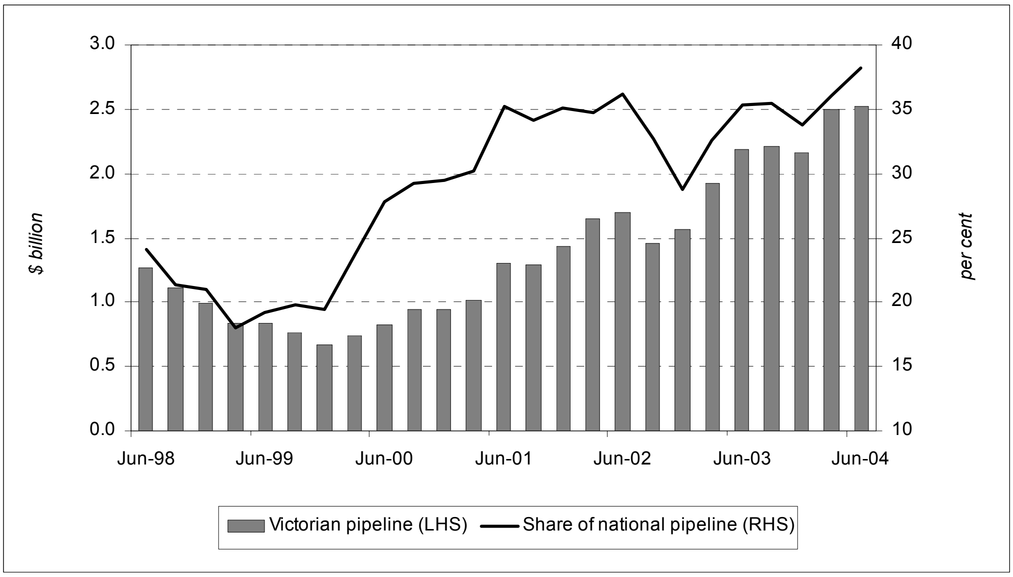
Aggregate demand increased by 4.0 per cent, somewhat below the average of recent years, as the rate of growth eased in housing construction and business investment. The growth in final demand was in line with expectations at budget time, and the more moderate increase sees the rate of expansion return to more sustainable levels after several strong years.

Consumer spending continued to grow strongly, with the increase of 4.7 per cent in 2003-04 the strongest in five years. Areas of strength were household furnishings, hotels/cafes/restaurants, communications and clothing/footwear. More recently, partial indicators suggest that the rate of increase in spending may have slowed. Weaker house prices, rising oil prices and the possibility of higher interest rates suggest the growth in consumer spending will be more subdued in the coming year. Nevertheless, fundamentals such as income and employment growth remain supportive, and should underpin a solid increase in spending.

Housing construction, and housing-related retail spending, surprised on the upside in 2003-04. Dwelling investment in Victoria rose a further 7.5 per cent, although most of this increase was in alterations and additions rather than the construction of new dwellings. Leading indicators have declined from their peaks, but appear to have levelled out in recent months. Solid population growth and relatively low interest rates should underpin a reasonable level of demand for new dwellings. Overall, housing construction is expected to decline over the coming year, although to a lesser extent than anticipated at budget time.

Non-residential construction has also been a strong area for Victoria, contributing to a further rise in business investment last year. Business investment rose 2.7 per cent in 2003-04, the sixth consecutive annual increase. Victorian per capita investment has been above the national average for the past five years. All components of business investment rose last year, although non-residential and livestock investment were particularly strong. The pipeline of non-residential work to be done in Victoria is at a record high (see Chart 2.1), suggesting investment will remain an important contributor to growth over the coming year.

Chart 2.1: Value of non-residential investment pipeline, Victoria[(a)]



Source: Australian Bureau of Statistics

Note:
(a) Value of non-residential work yet to be done. Quarterly original data, current prices.

Victorian employment grew by 1.3 per cent in 2003-04, in line with the budget estimate (1.25 per cent). By industry, the largest gains were in wholesale trade, accommodation/cafes/restaurants, communication services and education, partly offset by a fall in manufacturing employment. The strength in employment over the past year has meant that more people have been encouraged to enter the workforce; this increase in labour force participation has contributed to a small rise in Victoria's unemployment rate since mid-2004.

ECONOMIC OUTLOOK

Revised projections for the Victorian economy are presented in Table 2.1.

Table 2.1: Economic projections[(a)]

(Projections in 2004-05 Budget, where different, are in parentheses)

	2003-04 Actual	*2004-05 Forecast*	*2005-06 Forecast*
Gross state product	3.7	3.25	3.25
	(3.25)		*(3.50)*
Employment	1.3	1.75	1.25
		(1.50)	*(1.50)*
Unemployment rate [(b)]	5.6	5.75	5.50
		(5.50)	
Consumer price index	2.2	2.50	2.50
		(2.00)	*(2.25)*
Wage cost index [(c)]	3.2	3.50	3.50
	(3.50)		
Population [(d)]	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. 2003-04 is an estimate.

Global conditions remain supportive of continued solid economic growth in Victoria and Australia over the coming year, with the Consensus Economic panel expecting continued growth in our major trading partners. Nationally, the Commonwealth, in its *Pre-Election Economic and Fiscal Outlook*, is forecasting growth of 3.5 per cent in 2004-05, below last year's outcome (4.0 per cent).

The forecast for Victorian gross state product (GSP) growth in 2004-05 is unchanged from the budget estimate of 3.25 per cent. The rebalancing of growth, from domestic sources to exports, is expected to continue, although it is likely to be less pronounced than anticipated at budget time. Relative to budget estimates, the growth in housing construction is forecast to be stronger (albeit still negative), while export volumes could be somewhat weaker.

The employment growth forecast for 2004-05 has been revised higher, from 1.5 per cent to 1.75 per cent, reflecting the strong growth already recorded in the first few months of the financial year. However, the unemployment rate estimate has been raised to 5.75 per cent (from 5.5 per cent), the result of a strong increase in labour force participation.

For 2005-06, the Victorian GSP growth forecast has been lowered slightly from the 3.5 per cent expected at budget time to 3.25 per cent. Essentially, this reflects the delayed downturn in the construction housing cycle, and weaker growth in consumer spending. The employment growth forecast has also been revised, from 1.5 per cent to 1.25 per cent.

The other major change to the budget forecasts has been to inflation. Since the budget oil prices have generally been higher than forecast and the Australian dollar lower. Although oil prices have unwound somewhat and the Australian dollar recovered, the flow through effect of recent months are expected to add to price pressures. The estimate for consumer price index (CPI) inflation has been revised up to 2.5 per cent in both 2004-05 and 2005-06, from 2.0 per cent and 2.25 per cent respectively at budget time. The Commonwealth, in its *Pre-Election Economic and Fiscal Outlook*, is estimating national inflation at the same rate (2.5 per cent a year).

Despite the emerging pressure on inflation, and the relatively tight labour market, economy-wide wage pressures to date have been minimal. The forecast for wages growth is unchanged from budget estimates, at 3.5 per cent in both 2004-05 and 2005-06.

ECONOMIC RISKS

The economic projections are sensitive to a number of upside and downside risks. The major risks to the Victorian economic projections include high oil prices, the re-emergence of drought conditions, the possibility of higher interest rates and, on the positive side, continued strength in housing activity. These issues are discussed in Chapter 4, *Statement of Risks*.

CHAPTER 3: BUDGET POSITION AND OUTLOOK

- The revised 2004-05 general government operating surplus is $638 million, slightly higher than the $545 million 2004-05 Budget estimate, and over the forward estimates period, operating surpluses are now projected to average $536 million a year.
- The standardised operating surplus, which removes the impact of superannuation fund and other financial asset re-measurements, is now projected to be $665 million in 2004-05.
- On a Government Finance Statistics (GFS) basis, the net operating balance, which excludes economic flows such as superannuation revaluations and other remeasurements, is forecast to be $626 million in 2004-05, and to average $486 million a year over the next three years.
- Net infrastructure investment spending is expected to average $2.4 billion a year over the four years to 2007-08.
- Net financial liabilities (excluding the Growing Victoria infrastructure reserve) as a share of GSP are projected to decrease from 6.4 per cent at 30 June 2004 to 6.3 per cent at 30 June 2008, signifying that the projected liability growth from $13.3 billion to $15.7 billion over this period can be comfortably serviced by the growing Victorian economy.
- Net debt (excluding the Growing Victoria infrastructure reserve) is projected to increase from $1.6 billion as at 30 June 2004 to $2.2 billion as at 30 June 2008, but nevertheless remains around 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 2004-05 to 2007-08 for the general government sector, and a reconciliation of movements in revenues and expenses since those published in May 2004 in the 2004-05 Budget (referred to as ‘original budget’).

The projections, or budget and forward estimates years, are based on the economic projections outlined in Chapter 2, *Economic Conditions and Outlook* and reflect the accounting policies and assumptions documented in Chapter 5, *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 other factors as at 17 November 2004 affecting the projected general government sector financial statements. Specific policy decisions taken since the 2004-05 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 (2004-05) and forward estimates years (2005-06 to 2007-08) represent planning projections based on unchanged policy and other assumptions. Outcomes will differ from these projections for many reasons, including realisation of the risks described in Chapter 4, *Statement of Risks*.

The estimates are formulated on the Australian Generally Accepted Accounting Principles (GAAP) that were in existence at the time of the original budget. Subsequent to the release of the 2004-05 Budget in May 2004, the Australian Accounting Standards Board (AASB) approved the Australian Equivalents to the International Financial Reporting Standards (AEIFRS), which are applicable for reporting periods commencing on or after 1 January 2005.

To ensure consistency and comparability, the estimates contained in this publication still apply the GAAP standards that were applicable for the 2004-05 Budget in May 2004. The 2005-06 Budget scheduled for release in May 2005 will adopt the new AEIFRS framework.

2004-05 TO 2007-08 OUTLOOK

Table 3.1 sets out the projected aggregate outlook over the budget and forward estimates period. A more detailed statement of financial performance is provided in Chapter 5, *Estimated Financial Statements and Notes*.

Table 3.1 shows that the Government is forecast to achieve its short-term financial objective of delivering at least a $100 million operating surplus in every year. Following the 2003-04 operating surplus of $990 million, an operating surplus of $638 million is projected for 2004-05, before averaging $536 million over the following three years.

These strong forecast surpluses demonstrate the Government's solid performance in continuing to responsibly manage the State's finances. Operating surpluses are an important funding source for the Government's substantial capital investment program, while maintaining net debt at modest levels (see *Cash Flows* below).

Table 3.1: Summary statement of financial performance 2004-05 to 2007-08

($ million)

	2004-05 Budget	*2004-05 Revised*	*2005-06 Estimate*	*2006-07 Estimate*	*2007-08 Estimate*
Taxation	10 384.2	10 407.0	10 481.1	10 786.3	11 061.7
Investment income	1 225.4	1 247.6	1 272.1	1 255.6	1 273.3
Grants	13 080.5	13 384.2	14 059.7	14 468.8	15 199.2
Sales of goods and services	2 231.3	2 304.0	2 346.0	2 378.9	2 404.3
Other revenue [(a)]	2 063.4	1 856.8	1 959.1	2 061.1	2 041.3
Total revenue	**28 984.9**	**29 199.6**	**30 118.0**	**30 950.6**	**31 979.8**
% change			3.1%	2.8%	3.3%
Employee benefits	10 480.5	10 564.1	10 922.4	11 270.8	11 500.9
Superannuation	1 789.2	1 828.8	1 846.9	1 895.1	1 896.0
Depreciation	1 142.7	1 148.3	1 204.0	1 265.2	1 345.2
Borrowing costs	476.2	487.1	491.5	486.8	479.2
Supplies and services	9 311.0	9 300.3	9 944.0	10 273.3	10 821.0
Other expenses [(b)]	5 240.1	5 233.4	5 242.2	5 244.0	5 310.6
Total expenses	**28 439.9**	**28 562.0**	**29 650.9**	**30 435.2**	**31 352.9**
% change			3.8%	2.6%	3.0%
Operating surplus	**545.0**	**637.6**	**467.1**	**515.5**	**626.8**
Standardised operating surplus [(c)]	**545.0**	**664.7**	**467.1**	**515.5**	**626.8**

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 set out in Table 3.1, the operating surplus is now expected to be $638 million in 2004-05, an increase of approximately $93 million from the original budget estimate. The operating surplus is then expected to decline to $467 million in 2005-06 before rising to $627 million in 2007-08.

As shown above, the standardised operating surplus in 2004-05 is expected to be only marginally higher than the operating surplus, largely as a result of slightly lower than expected actual returns on superannuation fund assets in early 2004-05.

Operating revenue

Total revenue is projected to increase by 3.1 per cent a year on average over the forward estimates period.

Over this period, it is projected that taxation revenue will grow by 2.1 per cent a year on average, reflecting the positive impact of continuing strength in wages, employment and overall economic growth, as well as the flow through of property value growth, partly offset by a combination of factors including:

- an expected continuing moderation in property market activity, and therefore land transfer revenue, in 2005-06;
- impact of land tax rate and threshold adjustments announced in the 2004-05 Budget;
- abolition of debits tax from 2005-06, consistent with the *Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations*; and
- the introduction of a complete smoking ban within all enclosed licensed premises (with some exceptions) from 1 July 2007, which will impact gambling taxation revenue from 2007-08.

Investment income is expected to increase by around 0.7 per cent a year on average over the forward estimates period. This low growth is largely due to dividend and income tax equivalent revenues from public authorities returning to normal levels following the impact on 2004-05 of stronger than expected 2003-04 profits.

Commonwealth grants are expected to grow at an average rate of 4.3 per cent a year over the forward estimates. This reflects several factors including continuing growth in GST collections, partly offset from 2006-07 by the Commonwealth's decision to cease national competition policy payments. Grants are also expected to grow from increases in specific purpose payments, in particular funding being provided for non-government schools.

Operating expenses

Total expenses are projected to increase by an average of 3.2 per cent a year over the forward estimates period. This is broadly in line with expected price inflation and Victorian population growth.

Reflecting expected inflation and the Government's continuing commitment to improve services such as health, education and community safety, employee benefits are expected to grow by 2.9 per cent a year over the forward estimates period, with purchases of supplies and services, grants and 'other' expenses expected to rise by 3.6 per cent a year on average.

Depreciation expense is expected to increase by 5.4 per cent a year on average, reflecting growth in the capital stock as a result of the Government's continuing substantial infrastructure investment program and revaluations of physical assets. Slightly offsetting this, borrowing costs are projected to decline by 0.5 per cent a year on average over the forward estimates, largely due to the impact of lower average interest rates on the debt portfolio as it matures and is refinanced.

Modest growth in superannuation expense (averaging 1.2 per cent a year) reflects the assumption that asset returns on state superannuation funds return to long-run actuarial rates (as published in Note 26 of the *2003-04 Financial Report for the State of Victoria*).

RECONCILIATION OF FORWARD ESTIMATES TO PREVIOUSLY PUBLISHED ESTIMATES

Table 3.2 compares the revised outlook for the operating surplus for the period 2004-05 to 2007-08 to the estimates published in the 2004-05 Budget.

The revised projected 2004-05 operating surplus is $638 million, an increase of approximately $93 million from the result estimated at the time of the 2004-05 Budget. Over the forward estimates period, operating surpluses are expected to be slightly lower on average relative to original budget estimates.

Table 3.2: Reconciliation of estimates to 2004-05 Budget[(a)]

($ million)

	2004-05 Revised	*2005-06 Estimate*	*2006-07 Estimate*	*2007-08 Estimate*
Operating surplus - 2004-05 Budget	**545.0**	**505.4**	**530.5**	**675.7**
Plus: Revenue variations since 2004-05 Budget				
Economic/demographic variations				
Taxation revenue	-18.8	38.0	19.1	-94.3
Investment income	107.8	37.0	72.7	48.5
Total economic/demographic variations	**89.0**	**75.0**	**91.8**	**-45.8**
Policy decision variations	**41.7**	**57.4**	**57.4**	**58.6**
Commonwealth grant variations				
General purpose grants	320.9	304.7	142.4	199.8
Specific purpose payment grants	-17.2	38.7	118.8	147.0
Total Commonwealth grant variations	**303.7**	**343.4**	**261.2**	**346.8**
Administrative variations				
Forecast revision - fees and fines	-102.5	-48.2	1.1	1.1
Increase in own source revenue	15.3	-16.7	-30.5	-26.8
Other administrative variations	-132.4	-47.8	-25.8	-78.8
Total administrative variations	**-219.7**	**-112.8**	**-55.3**	**-104.5**
Total variation in revenue since 2004-05 Budget	**214.7**	**363.0**	**355.1**	**255.1**
Less: Variations in operating expenses since 2004-05 Budget				
Policy decision variations [(b)]	**61.5**	**90.1**	**94.8**	**100.4**
Commonwealth variations	**-52.6**	**60.8**	**8.1**	**6.5**
Superannuation variations	**27.0**	**2.0**	**5.9**	**13.6**
Administrative variations				
Variations due to changes in own source revenue	34.5	12.0	-29.3	-21.0
Other administrative variations	51.7	236.4	290.5	204.4
Total administrative variations	**86.2**	**248.3**	**261.2**	**183.4**
Total variation in expenses since 2004-05 Budget	**122.1**	**401.3**	**370.1**	**304.0**
Revised operating surplus	**637.6**	**467.1**	**515.5**	**626.8**

Source: Department of Treasury and Finance

Note:

(a) Totals may not add due to rounding.

(b) 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.

Variations to total operating revenue

Operating revenue in 2004-05 is expected to be $215 million higher than the 2004-05 Budget estimate and is projected to be $324 million a year higher on average over the forward estimates period.

Variations to taxation revenue projections, caused by economic and demographic factors, are minor for the period 2004-05 to 2006-07, with a downward revision of $94 million in 2007-08. This revision is largely the result of lower forecast gambling taxation revenue associated with the impact of the introduction of a smoking ban within enclosed licensed premises (with some exceptions) from 1 July 2007.

Factors increasing forecast taxation revenue over the budget and forward estimates period include higher than expected increases in land values, resulting in higher land tax revenue estimates, and higher than forecast gambling taxes, reflecting higher than anticipated household disposable income. Projected increases in taxation revenue from these sources are offset by:

- a reduction in 2004-05 property taxation, as a result of lower than anticipated revenue in 2004-05 after the abolition of mortgage duty from 1 July 2004; and
- reduced insurance tax collections over the forward estimates, in line with a flattening of growth in premium rates for personal insurance classes.

Investment income has also varied from original budget due to changes in underlying economic or demographic conditions. In 2004-05 investment income is expected to be boosted by an additional $108 million in increased dividends and tax equivalent payments, largely from the public financial corporations sector. This is primarily due to higher than expected profit performance in 2003-04. As discussed below, this increase in investment income will be partly offset by lower interest revenue.

Policy decisions have increased the overall tax revenue forecasts by $42 million in 2004-05, and by $58 million a year on average over the forward estimates. This is largely due to the introduction from 2004-05 onwards of an annual environmental contribution by water authorities to ensure that prices better reflect the scarcity of water and costs related to the environmental impacts associated with the provision of water-related services. As announced in the June 2004 *White Paper (Our Water Our Future)*, the proceeds of the environmental contribution will be used to fund a package of initiatives to enhance the sustainability of the State's water resources.

This increase in tax revenue was slightly offset by the Government's decision to exempt caravan parks from land tax, applying from the 2005 land tax year (impacting from the 2004-05 financial year). Special land tax will apply when the use of exempt land changes.

Grants revenue forecasts are, on average, $314 million a year higher over the budget and forward estimates period than at the time of the 2004-05 Budget. The change in general purpose grants mainly reflects an upward revision to GST grants of $346 million a year on average, due largely to stronger expected GST collections as announced in the Commonwealth's *Pre-election Economic and Fiscal Outlook 2004*. From 2006-07, this is partially offset by the Commonwealth's decision to cease national competition policy payments. Changes to Commonwealth specific purpose payments include:

- the rephasing into 2005-06 of Commonwealth contributions towards the Melbourne 2006 Commonwealth Games;
- the impact of the Commonwealth's new road funding model *AusLink* (which reduced estimated road funding in 2004-05 and 2005-06 while forecast to increase funding over the remainder of the forward estimates period); and
- increased funding to the health and community services sectors from 2004-05 for a range of programs, including Highly Specialised Drugs and Home and Community Care.

Administrative variations have reduced the revenue estimates by $123 million a year on average over the budget and forward estimates period since the 2004-05 Budget. This variation reflects a number of factors, including:

- a reduction in interest revenue of around $50 million a year on average due to utilising the financial assets generated through previous years' strong surpluses to retire $765 million in general government sector debt as part of a strategy to reduce the Government's credit and financial management risk;
- lower forecast revenue from fines and regulatory fees of $103 million in 2004-05 and $48 million in 2005-06. This revision reflects a general improvement in driver behaviour and the identification of issues associated with the fixed digital safety camera system, which has resulted in the delays in the implementation of a number of safety initiatives; and
- a reduction of $15 million a year on average in own source revenue, reflecting lower revenues earned from clients and other third parties, partly offset by higher fees received from the Commonwealth associated with the provision of hospital services to veterans.

Variations to total operating expenses

Operating expenses in 2004-05 are expected to be $122 million higher than the 2004-05 Budget estimates and are projected to be $359 million a year higher on average over the forward estimates period.

Superannuation expense in 2004-05 is slightly higher than forecast, largely reflecting slightly lower than expected equity market performance on superannuation funds in early 2004-05.

Since the 2004-05 Budget, policy decisions account for additional operating expenses of $62 million in 2004-05 (with the impact on operating expenses offset by contingency funding) and $95 million a year on average over the forward estimates period. While specific policy decisions since the 2004-05 Budget are summarised in Appendix A, *Specific Policy Initiatives Affecting the Budget Position*, key items include:

- enhancing the sustainability of the State's water resources through a package of initiatives under the *Our Water Our Future* policy;
- developing wind energy manufacturing in Victoria;
- reducing the pressure on the criminal justice and corrections systems;
- delivering additional works required to improve the overall operational safety and efficiency of the regional fast rail services for the long-term; and
- improving the capacity of the Ombudsman to handle more high-profile inquiries.

Changes to Commonwealth funding have had only a minor impact on expenses, on average, over the budget and forward estimates period compared with the original budget. These changes mainly relate to:

- additional funding for hospital services for veterans, the Highly Specialised Drugs and Home and Community Care programs;
- the impact of changed timing of Commonwealth grants funding to be received for the Commonwealth Games from 2004-05 to 2005-06; and
- the flow on impact of reduced NCP payments from 2006-07 on grants to local government.

Administrative variations are expected to increase operating expenses above original budget by $195 million a year on average over the forward estimates period. This variation reflects a number of factors, including:

- a reduction in borrowing costs of around $50 million a year on average associated with the retirement of debt;
- an increase in expenses of $80 million a year on average due to a reclassification of roads funding from asset investment to operating expense. This follows the VicRoads and Department of Infrastructure review and adjustment of the treatment of committed road projects and road related expenditure to more appropriately reflect the nature of the project expenditure;
- a discount interest expense of $57 million a year on average related to the restatement of the long term payable to SECV to cover the long term electricity supply agreements with Portland and Point Henry Aluminium Smelters in accordance with accounting standards; and
- an upward revision to expenditure from individual agencies' own source revenue in 2004-05, before a decline over the forward estimates period.

CASH FLOWS

The operating surplus is an important funding source for the Government's substantial capital investment program. Table 3.3 provides a summary of cash generated through the operations of Victorian government departments and other general government sector agencies and how that cash is applied to infrastructure investment and the general government net debt position over the budget and forward estimates period.

Table 3.3: Application of cash resources

($ million)

	2004-05 Budget	*2004-05 Revised*	*2005-06 Estimate*	*2006-07 Estimate*	*2007-08 Estimate*
Operating surplus	**545.0**	**637.6**	**467.1**	**515.5**	**626.8**
Add back: Non-cash revenue and expenses (net) [(a)]	1 995.6	1 953.5	2 173.1	1 564.9	1 379.4
Net cash flow from operating activities	**2 540.6**	**2 591.1**	**2 640.2**	**2 080.4**	**2 006.3**
Plus: Net drawdown of Growing Victoria infrastructure reserve	185.6	196.5	..	..	..
Total cash available for asset investment	**2 726.2**	**2 787.5**	**2 640.2**	**2 080.4**	**2 006.3**
Less:					
Net investment in fixed assets					
Purchase of property, plant and equipment	2 470.9	2 478.8	2 219.4	2 105.9	2 190.5
Proceeds from sale of property, plant and equipment	(80.9)	(88.5)	(61.5)	(39.9)	(101.3)
Net contribution to other sectors of government	481.6	228.5	261.2	280.8	173.6
Total net investment in fixed assets	**2 871.6**	**2 618.7**	**2 419.1**	**2 346.8**	**2 262.7**
Other investment activities (net)	(2.0)	2.2	436.2	6.5	8.3
Decrease/(increase) in net debt (excluding Growing Victoria)	**(143.4)**	**166.6**	**(215.1)**	**(272.9)**	**(264.7)**

Source: Department of Treasury and Finance

Note:

(a) Includes depreciation and non-cash movements in liabilities such as unfunded superannuation and employee benefits.

Table 3.3 shows an expected budget operating surplus for 2004-05 of $638 million. Adjusting for a number of expense and revenue items that do not require or provide cash resources during the year (including depreciation, growth in unfunded superannuation liabilities and employee benefit liabilities) yields a projected net cash inflow from operating activities for 2004-05 of $2 591 million.

As shown in Table 3.3, this cash surplus from operating activities is the main source of financing for the 2004-05 net infrastructure investment program, along with the $197 million draw down from the Growing Victoria infrastructure reserve. In fact, with net infrastructure investment (including net contributions to other sectors of government) absorbing $2 619 million, some cash can be applied to reduce net debt (excluding the Growing Victoria infrastructure reserve) by $167 million in 2004-05.

Compared with the original budget estimates, net debt projected at 30 June 2005 is $310 million lower than originally anticipated, primarily due to higher than expected cash flows from operations, and net infrastructure investment in 2004-05 being below the original budget estimates. The variance in net investment in fixed assets largely reflects the Government's decision to deliver new prisons as a *Partnerships Victoria* project. It should also be noted that the reduction in net contributions to other government sectors is due to a change in the treatment of asset funding between the Department of Infrastructure and the public non-financial corporations sector, which results in an offsetting increase in purchases of property plant and equipment.

Infrastructure investment of $2 412 million a year on average over the budget and forward estimates period is largely financed by cash flow from operating activities averaging $2 330 million a year over this period. The balance of $82 million is financed by an average increase in net debt of $33 million together with the final expected drawdown in 2004-05 from the Growing Victorian infrastructure reserve. The remaining increase in net debt is largely due to the additional increase in other investment activities in 2005-06 of $436 million, which mainly reflects the completion and handover to the State of the *Partnerships Victoria* Spencer Street Station redevelopment project.

FINANCIAL POSITION

Table 3.4 provides a summary of the general government sector statement of financial position. A more detailed statement of financial position is provided in Chapter 5, *Estimated Financial Statements and Notes*.

Table 3.4: General government summary statement of financial position as at 30 June

($ million)

	2004 Actual	2005 Revised	2006 Estimate	2007 Estimate	2008 Estimate
Assets					
Capital stock [a]	44 481.7	47 201.6	50 284.0	52 847.1	55 465.5
Financial assets [b]	4 347.6	4 550.1	4 800.0	4 555.6	4 303.5
Other assets	2 253.6	2 308.2	2 376.3	2 478.7	2 576.4
Total assets	**51 083.0**	**54 059.9**	**57 460.3**	**59 881.3**	**62 345.5**
Liabilities					
Superannuation	11 710.6	12 405.1	13 227.1	13 502.1	13 563.6
Borrowings	5 507.4	5 714.7	6 153.6	6 154.0	6 140.3
Other liabilities	7 586.2	7 783.6	8 005.2	8 089.0	8 129.1
Total liabilities	**24 804.3**	**25 903.4**	**27 385.9**	**27 745.1**	**27 833.0**
Net assets	**26 278.7**	**28 156.5**	**30 074.4**	**32 136.2**	**34 512.5**

Source: Department of Treasury and Finance

Notes:

(a) Capital stock includes land and buildings, plant and equipment, roads and earthworks, cultural and other assets.

(b) Financial assets include cash assets, investments, loans and placements.

General government sector net assets are expected to increase from $26.3 billion as at 30 June 2004 to $34.5 billion at 30 June 2008. This growth is largely due to an expected increase in the value of the capital stock, primarily driven by the significant levels of capital expenditure by the Government over the budget and forward estimates period on public infrastructure (particularly in roads, health, and education), together with anticipated upwards revaluations of assets. This increase is partly offset by growth in the value of the unfunded superannuation liability over the forward estimates, which is in line with the profile as set by the fund actuary to enable the Government to achieve its target of full funding by 2035.

With net assets rising, the balance sheet is supporting the Government's commitment to sound financial management by providing a strong, stable and flexible financial position for the State.

NET DEBT AND NET FINANCIAL LIABILITIES

In comparison to the preceding analysis which is on an Australian accounting standards basis, the analysis of net financial liabilities and net debt are based on the Government Finance Statistics (GFS) economic framework (see Chapter 6, *Accrual Uniform Presentation of Government Finance Statistics*).

The Government's commitment to sound financial management includes maintaining the State's net financial position at prudent levels in order to achieve its short-term objective of maintaining Victoria's triple-A credit rating. The key measures of financial position are the GFS measures of *net debt* and *net financial liabilities.* The international credit rating agencies focus on both net debt and net financial liabilities of the general government sector and the non-financial public sector as measures of overall indebtedness. Table 3.5 highlights these key measures for the general government sector, and estimates for the non-financial public sector are provided in Chapter 6.

Victoria's triple-A long-term local currency and foreign currency debt ratings were affirmed by Standard & Poor's in July 2004 and Moody's Investors Service in October 2004. Both rating agencies cited low debt levels and a strong fiscal position and performance in recent years as key reasons behind their affirmations. As presented in Table 3.5, the levels of general government net debt and net financial liabilities from 2004-05 reinforce these positive trends.

Table 3.5: General government net financial liabilities as at 30 June

	2004 Actual	*2005 Revised*	*2006 Estimate*	*2007 Estimate*	*2008 Estimate*
Financial assets					
Cash and deposits	1 301	1 379	1 424	1 472	1 512
Advances paid	205	185	165	143	120
Investments, loans and placements	3 043	3 167	3 372	3 080	2 788
Total financial assets	**4 549**	**4 731**	**4 961**	**4 694**	**4 420**
Financial liabilities					
Deposits held	446	451	457	463	467
Advances received and borrowings	5 506	5 714	6 152	6 153	6 139
Total financial liabilities	**5 952**	**6 164**	**6 609**	**6 615**	**6 606**
Net debt	**1 403**	**1 433**	**1 648**	**1 921**	**2 186**
Net debt (excl. Growing Victoria) [(a)]	**1 600**	**1 433**	**1 648**	**1 921**	**2 186**
Superannuation liability	11 711	12 405	13 227	13 502	13 564
Net financial liabilities (excl. Growing Victoria)	**13 310**	**13 838**	**14 875**	**15 423**	**15 750**

Source: Department of Treasury and Finance

Note:

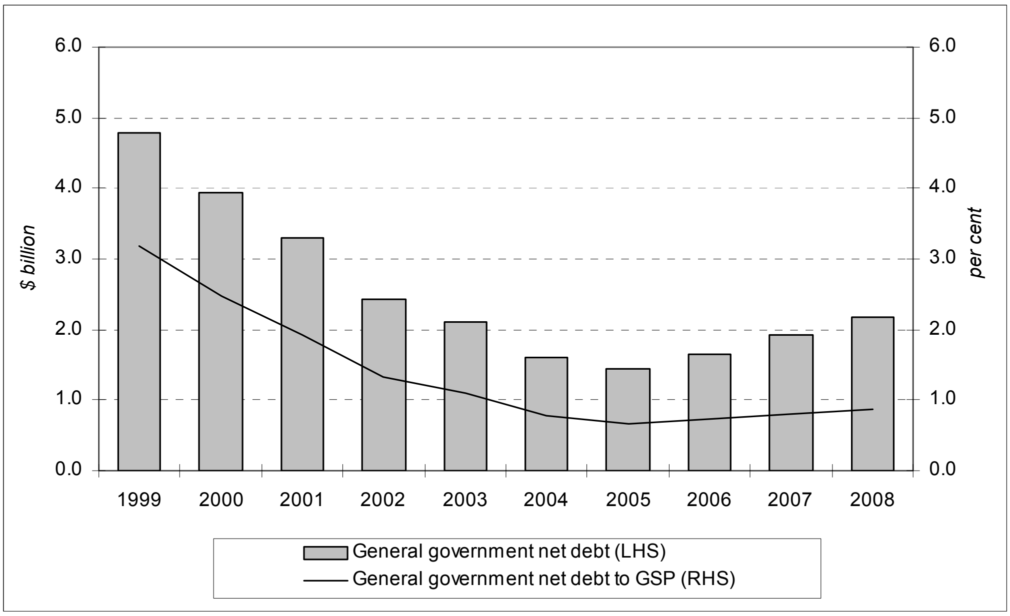
(a) The Growing Victoria infrastructure reserve investments are not offset against gross debt on the grounds that these investments are earmarked for infrastructure projects and are therefore not available to redeem gross debt.

Net debt (excluding Growing Victoria infrastructure reserve), which is the standard measure used to assess general government indebtedness, is determined by deducting liquid financial assets from gross debt. The rationale for deducting liquid financial assets is that, in a period of financial difficulty, liquid assets would be available to redeem debt.

Table 3.5 shows net debt (excluding the Growing Victoria infrastructure reserve) is projected to increase slightly from $1.6 billion as at 30 June 2004 to $2.2 billion as at 30 June 2008.

As shown in Chart 3.1, despite this small rise in the value of net debt over the forward estimates period, as a percentage of GSP, general government net debt is expected to remain around 1 per cent over the period, which is well down from 3 per cent in 1999 and 16 per cent in 1995.

Chart 3.1: General government net debt as at 30 June excluding Growing Victoria[(a)]



Source: Department of Treasury and Finance

Note:

(a) 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. The Growing Victoria Infrastructure reserve was established in 2000.

Net financial liabilities are the sum of unfunded superannuation liabilities and general government net debt. Table 3.5 shows general government net financial liabilities (excluding the Growing Victoria infrastructure reserve) are projected to increase from $13.3 billion as at 30 June 2004 to $15.7 billion as at 30 June 2008. This growth largely reflects the increase in the unfunded superannuation liability.

As a share of GSP (excluding the Growing Victoria infrastructure reserve), general government net financial liabilities have fallen from 12 per cent in 1999 and are projected to fall from 6.4 per cent at June 2004 to 6.3 per cent at June 2008. This illustrates the projected growth in net financial liabilities over this period can be serviced by the growing Victorian economy, and reinforces the Government's commitment to maintaining financial liabilities at prudent and manageable levels.

CHAPTER 4: STATEMENT OF RISKS

- The budget projections are sensitive to a number of upside and downside risks (both economic and fiscal) and contingent assets and liabilities.
- The major risks to the Victorian economic projections include high oil prices, the re-emergence of drought conditions and on the positive side, continued strength in housing activity.
- Contingency provisions within the budget provide general protection against fiscal risks, including increased demand for government services.
- A number of contingent assets and liabilities have been identified, in particular relating to the public transport rail agreements.

This chapter provides a discussion of the risks to Victoria's budget position. These risks include economic risks, incorporating an analysis of the sensitivity of the budget operating surplus to macroeconomic shocks, and fiscal risks.

ECONOMIC RISKS

The main risks to the Victorian economic projections relate to oil prices, and the re-emergence of drought conditions. There is also the possibility that Victorian population growth may vary due to unexpected changes in net migration patterns, and that the housing sector will remain relatively buoyant.

On the international front, the price of oil has been highly volatile in recent months. Sustained increases could affect both growth and inflation projections.

Domestically, the economy has experienced a partial recovery from the severe drought conditions of 2002-03. Victorian crop production, livestock investment and agricultural employment all rose over the past year. The Bureau of Meteorology's outlook through to February 2005 is for mostly average rainfall across the State. If this fails to materialise, a re-emergence of drought conditions would hamper export growth, exacerbating pressure on farm incomes with indirect effects on the rest of the economy.

Housing construction has been an important contributor to growth in Victoria and Australia over the past few years. A modest downturn in housing investment has been expected for some time, but housing starts have remained at relatively high levels. Although leading indicators of housing activity are now off their highs, there is little hard evidence that a housing downturn is imminent. If dwelling investment holds around current high levels over 2004-05, this could place upward pressure on the growth forecasts.

Victoria has recently experienced a small net interstate migration loss, after several years of net positive inflows. High levels of net overseas migration has meant that total population growth remains strong in Victoria. However, if there is a sustained decline in interstate or overseas migration trends, this could place some pressure on the population and medium-term economic growth projections.

In terms of financial conditions, the official cash rate in Australia has been steady at 5.25 per cent since December 2003. Financial markets anticipate interest rates to remain on hold in the near term. An increase could place some pressure on the growth forecast into 2005-06.

The Australian dollar has traded in a reasonably wide range over 2004, from a low of US$0.68 to a high of US$0.80. In the past couple of months, the currency has been on a renewed upward trend. Although a positive for the inflation outlook, continued strength in the Australian dollar could place some pressure on forecasts for net exports. Conversely, renewed weakness could further underpin export growth at a time of strong global activity.

Sensitivity analysis

The sensitivity analysis indicates the risk associated with forecasts or projections of selected economic and financial variables by estimating the impact on revenue, expenses and the operating surplus. The major variables that affect Victoria's operating surplus are economic growth, employment, prices, wages, interest rates and volatility in asset markets.

To assess sensitivity to change, the level of the economic indicator, in each case, is permanently increased by one percentage point in the first year above the forecast growth rate and then allowed to grow at the forecast rate. It is assumed during the analysis of each indicator that all other indicators follow their forecast growth rates.

Table 4.1: Impact on the general government operating surplus of a one percentage point increase in selected economic indicators in 2004-05[(a)(b)]

($ million)

	2004-05 Estimate	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
GSP				
Taxes, regulatory fees and fines	34	34	36	37
Other revenue [(c)]	92	104	114	125
Superannuation expenses	..	..	..	..
Other expenses	..	..	1	2
Operating surplus	**127**	**137**	**149**	**160**
Employment				
Taxes, regulatory fees and fines	29	30	32	33
Other revenue [(c)]	1	3	4	6
Superannuation expenses	..	..	..	..
Other expenses	..	..	..	..
Operating surplus	**30**	**33**	**36**	**39**
Consumer prices				
Taxes, regulatory fees and fines	42	43	45	46
Other revenue [(c)]	153	164	167	173
Superannuation expenses	120	..	..	..
Other expenses [(d)]	40	178	183	191
Operating surplus	**35**	**29**	**30**	**29**
Average weekly earnings [(e)]				
Taxes, regulatory fees and fines	29	30	32	33
Other revenue [(c)]	-14	-13	1	3
Superannuation expenses	109	9	9	9
Other expenses [(d)]	..	..	..	..
Operating surplus	**-94**	**8**	**24**	**27**
Domestic share prices				
Taxes, regulatory fees and fines	..	..	..	..
Other revenue [(c)]	5	5	..	..
Superannuation expenses	-45	-3	-3	-3
Other expenses	..	..	-1	-1
Operating surplus	**49**	**8**	**4**	**4**
Overseas share prices				
Taxes, regulatory fees and fines	..	..	..	..
Other revenue [(c)]	4	4	0	0
Superannuation expenses	-31	-2	-2	-2
Other expenses	..	..	-1	-1
Operating surplus	**35**	**6**	**3**	**3**
Property prices				
Taxes, regulatory fees and fines	31	29	50	50
Other revenue [(c)]	2	4	5	8
Superannuation expenses	-12	-1	-1	-1
Other expenses	..	..	..	..
Operating surplus	**45**	**34**	**56**	**58**

Table 4.1: Impact on the general government operating surplus of a one percentage point increase in selected economic indicators in 2004-05 (cont)

	2004-05 Estimate	*2005-06 Estimate*	*2006-07 Estimate*	*2007-08 Estimate*
Property volumes				
Taxes, regulatory fees and fines	22	21	21	22
Other revenue [(c)]	2	3	3	4
Superannuation expenses	..	..	..	..
Other expenses	..	..	..	..
Operating surplus	**24**	**24**	**24**	**26**
Interest rates [(f)]				
Taxes, regulatory fees and fines	..	..	..	..
Other revenue [(c)]	77	80	41	43
Superannuation expenses	121	9	9	9
Other expenses	1	5	9	13
Operating surplus	**-44**	**67**	**24**	**21**

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) An equivalent one percentage point decrease in each indicator would have an opposite impact to that shown.

(c) Other revenue includes general and specific purpose grants, including grants for on-passing, as well as changes in dividends and income tax equivalent payments from public authorities. Dividends and income tax equivalent payments 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.

(d) Following the implementation of the departmental funding model, employee entitlements, included as part of other expenses, are now sensitive to changes in prices, whereas in previous years these impacts would have been identified under average weekly earnings.

(e) Assumes wages of Victorian Government employees also increase by one per cent above government wages policy without productivity offsets or additional departmental funding.

(f) Assumes a one percentage point increase in interest rates over the entire period.

The operating surplus is most sensitive to economic growth, prices, wages, domestic and overseas share prices, property prices and interest rates. It is worth noting that some economic variables, particularly property and share prices are likely to be more volatile than others and as such may pose a greater threat to the operating result.

Compared to the 2004-05 budget estimates, a revised assessment of superannuation fund sensitivities has increased the estimated impact of interest rate variations on the operating surplus.

Sensitivity to economic growth

A 1 per cent increase in gross state product (GSP) is expected to have a positive impact on the operating surplus of $127 million in 2004-05, rising to $160 million in 2007-08. This primarily reflects higher GST grant revenue, which is driven by national economic growth, as well as additional gambling and motor vehicle taxation revenue.

Sensitivity to prices

A 1 per cent increase in the consumer price index is expected to increase the operating surplus by $35 million in 2004-05, and by an average of $29 million in the forward years. The improvement in the operating surplus is driven by higher GST and other Commonwealth grant revenue, combined with higher gambling, motor vehicle and insurance taxation revenue, which is offset primarily by higher superannuation expenses in 2004-05 and increased employee entitlements from 2005-06 and ongoing.

Sensitivity to wages

A 1 per cent increase in economy-wide wages would reduce the operating surplus by $94 million in 2004-05. This reflects the one off impact of assumed higher than anticipated public service wages on unfunded superannuation liabilities. This is partially offset by additional payroll tax revenue, which over the forward years results in an improvement in the operating surplus rising to $27 million in 2007-08.

Sensitivity to domestic and overseas share prices

An increase in domestic share prices of 1 per cent will increase the operating surplus by $49 million in 2004-05, with a corresponding rise in overseas share prices raising the operating surplus by $35 million in the same year. Movements in equity prices have a significant current year impact on superannuation expenses, but a more moderate impact on the forward years.

Sensitivity to property prices

A 1 per cent increase in property prices will result in a $45 million increase in the operating surplus in 2004-05, primarily reflecting a one off fall in superannuation expenses, and additional conveyancing duty on land transfers. A lag in the valuation determinations of property for land tax assessments results in delayed land tax receipts, which boost the surplus by $56 million in 2006-07 and $58 million in 2007-08.

Sensitivity to interest rates

An assumed 1 per cent increase in the forecast interest rate would have a negative impact on the operating surplus of $44 million in 2004-05, then positive from 2005-06 onwards. This reflects the one-off impact of unrealised losses on bonds held by the State Superannuation Fund, which is partially offset by additional interest income and public authority income. This result compares to a $24 million reduction in 2004-05 estimated in the 2004-05 Budget, with the variation reflecting a revision to assumed tax rates on superannuation fund returns.

FISCAL RISKS

Expenditure risks

Following the introduction of the departmental funding model from 2004-05, departments now need to plan for, and manage, all costs associated with delivering services. This includes wage increases within government wages policy, which was a risk previously held and managed centrally through a contingency provision. Total departmental funding provided by government is now subject to an approved indexation factor, which maintains alignment with movements in the rate of inflation. This, combined with productivity improvements, provides sufficient allowance in the current departmental estimates to meet award wage increases consistent with government policy.

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

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 2004-05 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 forward years. The contingency provision includes a general allowance for:

- 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.

In addition, the budget estimates include a contingency from 2007-08 that acknowledges that a number of initiatives with only four-year funding will conclude in 2006-07. A provision is provided on the basis that the Government may endorse a number of these initiatives to continue or be replaced to meet service delivery priorities.

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 on some projects will be offset by cost under-runs in other areas);
- 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.

Insurance exposures

In recent years, 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.

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, mean that there is a continuing need to monitor closely the State's medical indemnity liabilities and expenses.

As set out in the contingent liabilities section, as the insurer for the Victorian general government sector, the Victorian Managed Insurance Authority (VMIA) insures any additional risks assumed by the general government sector, either explicitly through indemnities provided to non-government bodies, or implicitly through transfer of activities from private sector to general government sector service providers. However, the State continues to bear directly the risks of losses arising from events for which VMIA does not provide insurance, such as terrorist attacks.

Wimmera-Mallee Pipeline

In the 2002-03 Budget, the Government committed funding of $77 million nominal total estimated investment (TEI) for Victoria's contribution to the Wimmera-Mallee water pipeline project, over the next decade. Victoria's share was based on the $301 million preliminary business case for the project. This initiative will replace the existing 17 500 kilometres of open channels with a new pipelines system in the Wimmera-Mallee region. This funding was subject to Commonwealth matching funding and confirmation of feasibility.

In November 2003, an interim business case revised the total from $301 million to $501 million TEI. The Government has recently reviewed the interim business case, and has increased the Victorian contribution to $125 million, subject to matching Commonwealth funds.

Commonwealth deliberations were delayed as a result of the recent election. However, during the election campaign, the Commonwealth committed to a $167 million contribution using funding previously allocated to National Competition Payments to the States and Territories. Discussions between Victoria and the Commonwealth on this matter are continuing.

Revenue risks

Commonwealth Grants

Commonwealth grants are a major source of revenue for the Victorian Government, worth approximately $12.6 billion in 2003-04. Commonwealth grants include General Purpose Grants (GST grants and National Competition Policy payments) and Specific Purpose Payments (SPPs).

The level of SPPs is determined by the policies of the Commonwealth Government, and is published on an annual basis in the Commonwealth Budget Papers. The level of General Purpose Grants, and in particular GST grants, is affected by the general level of activity in the Australian economy and the GST revenue sharing relativities calculated by the Commonwealth Grants Commission (CGC).

The Commonwealth has indicated that it will release its 2004-05 Mid-year Economic and Fiscal Outlook by the end of January 2005. This will outline the Commonwealth Government’s expectations on Australia-wide economic activity, and will include any revisions to the expected level of GST grants throughout the forward estimates period. The CGC provides annual updates of its GST revenue sharing relativities in February, which are approved by the Commonwealth Treasurer at the Ministerial Council for Commonwealth-State Financial Relations in March.

CONTINGENT ASSETS AND LIABILITIES

Contingent assets

Contingent assets are either:

- possible assets that arise from past events where the probability of existence of a possible 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:
  - assets for which it is not probable that the future economic benefits embodied in them will eventuate; and/or
  - assets that do not possess a cost or other value that can be measured reliably.

These can be classified into either quantifiable, where the potential economic benefit is known, or non-quantifiable.

Quantifiable contingent assets

Table 4.2: Quantifiable contingent assets

($ million)

	As at June 2003	*As at June 2004 [(a)]*
Guarantees, indemnities	0.8	0.5
Potential early termination of contractual arrangements	80.0	100.0
Legal proceedings and disputes	1.2	0.1
Other	70.7	65.1
Total contingent assets	**152.7**	**165.7**

Source: Department of Treasury and Finance

Note:

(a) The only material change to quantifiable contingent assets since 30 June 2004 has been a $102 million increase in 'Other' in relation to the Mitcham-Frankston Project as explained in the text below.

Included in Table 4.2 under 'potential early termination of contractual arrangements' are any additional costs arising to the Director of Public Transport on early termination of the public transport partnership agreements. The operator 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 operator does not do so, the Director has the right to draw on the operator's performance bonds for the amount of losses, damages or costs. The expected value of these bonds is $100 million ($80 million for 2003).

A dispute existed between Transurban City Link Limited and the Australian Tax Office in respect of the deductibility for taxation purposes of concession fees payable by Transurban to the Victorian Government. The Federal Court had previously found against Transurban in this matter, however a recent appeal by Transurban to the full bench of the Federal Court was determined in its favour in October 2004. The value of concession fee notes presently held by the Victorian Government is estimated to be $65.1 million as a result of this decision, and are included in Table 4.2 under 'Other'. However, the Australian Tax Office has recently announced that it is seeking leave to appeal.

On 14 October 2004, the State entered into a concession deed with ConnectEast to construct the Mitcham-Frankston Project. Various performance bonds provided under the concession deed are able to be drawn by the State in circumstances where the concessionaire (ConnectEast) or one of its contractors fails to meet its obligations. These bonds, totalling $102 million, include a process bond ($10 million), construction bond ($87 million) and operation phase bond ($5 million), and are reflected in the footnote to Table 4.2 above.

Non-quantifiable contingent assets

Public transport partnership agreements

On 19 February 2004, the Director of Public Transport, on behalf of the Crown, entered into contractual arrangements with Connex and Yarra Trams to operate rail transport services in the State. The following paragraphs summarise the major contingent assets arising from those arrangements.

Profit sharing: The Director is entitled to receive payment from operators should operator profits exceed defined thresholds.

Operational Performance Regime (OPR): The OPR entitles the Director to receive penalty payments from operators failing to meet set punctuality and reliability performance targets.

Special event payments: The Director is entitled to receive payments at a set rate for special event kilometres short of a defined contractual limit.

Newport depot: The annual amount payable to Connex is to be reduced by the value of the Newport lease rental at the expiry or early surrender of the lease.

OneLink service contract: The Director will be paid all compensation payments under the OneLink service contract for failure to meet all required performance standards.

Employee entitlements: Operators are required to manage employee entitlements to agreed forecast amounts.

The Director is entitled to receive payments where the provision for employee entitlements (excluding long service leave) is greater than an agreed forecast amount, and actual long service leave payments are less than an agreed forecast amount.

Adjustment event: The Director is obliged to decrease the fixed monthly amount payable as a result of a defined adjustment event occurring which has a fundamental impact.

Mitcham-Frankston Project

On 14 October 2004, the State entered into a concession deed with ConnectEast to construct the Mitcham-Frankston Project. The following paragraphs summarise the major non-quantifiable contingent assets arising from the concession deed.

Additional lease rental

The concession deed sets out circumstances where the State is entitled to receive by way of increased lease rentals, a share of revenue that the concessionaire receives over an agreed base sum. The concessionaire's ability to make these payments also depends on other cash flow criteria at the time.

Compensable enhancements

The concession deed sets out circumstances where the State may receive compensation for providing a measurable benefit to the concessionaire by the taking of certain actions. Primarily these are enhancements to the road network that generate incremental traffic for the concessionaire over and above those road network enhancements which have already been identified in the concession deed and which have been factored in to the current tolling structure. Any compensation receivable would be net of any negative impacts caused by the State by the taking of certain actions, e.g. negative impact on traffic levels.

Refinance benefits

In the event that the concessionaire is able to achieve future incremental refinancing benefits over the course of the concession, the State may share in any gain subject to certain conditions.

Rectangular stadium (Melbourne and Olympic Park)

Bids by Melbourne and Perth have been short listed to host the remaining Australian team in the expanded Super 14s international rugby union competition from 2006. To support Victoria’s bid the Government has made a commitment to help fund a new rectangular stadium at Olympic Park. However, this commitment is subject to Melbourne being named the successful bidder for the remaining Super 14 team. In addition to hosting of Super 14 rugby matches, a rectangular stadium could be used for both soccer and rugby league matches. The Australian Rugby Union is expected to announce the successful bidder in December. If Melbourne is the successful bidder, the value of the Government’s contribution would not be quantifiable for some time after the announcement.

Contingent liabilities

Contingent liabilities are either:

- possible liabilities that arise from past events where the probability of existence of a possible 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:
  - provisions for which it is not probable that the future sacrifice of economic benefits will be required; and/or
  - provisions the amount of which cannot be measured reliably.

As with contingent assets, contingent liabilities are also classified as either quantifiable or non-quantifiable.

Quantifiable contingent liabilities

Table 4.3: Quantifiable contingent liabilities

($ million)

	As at June 2003	*As at June 2004* [(a)]
Guarantees, indemnities	189.8	272.5
Potential early termination of contractual arrangements	712.5	622.4
Legal proceedings and disputes	271.3	212.2
Other	60.1	12.5
Non general government debt	3 160.2	2 881.4
Total contingent liabilities	**4 393.9**	**4 001.1**

Source: Department of Treasury and Finance

Note:
(a) *There have been no material changes to quantifiable contingent liabilities since last reported in the 2003-04 Financial Report for the State of Victoria.*

Included in Table 4.3 under 'potential early termination of contractual arrangements' is a contractual agreement of $622 million ($713 million for 2003) relating 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.

Non-quantifiable contingent liabilities

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, the State entered into agreements to support the redevelopment of the Melbourne Cricket Ground (MCG) for the Melbourne 2006 Commonwealth Games. This is 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 Treasury Corporation of Victoria Loan Facility to the Melbourne Cricket Club (MCC).

These agreements include:

- indemnities to the MCG Trust and the MCC in the event that there should 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 (AFL) as a result of the holding of the Melbourne 2006 Commonwealth Games. 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; and
- previously provided indemnities to the MCC and MCG Trust in the context of the 1990 Great Southern Stand development, which have been reincorporated into the contractual arrangements of the Northern Stand redevelopment, under greater accountability and responsibility of the MCC to the MCG Trust.

Former Public Transport Corporation lease arrangements

Under various transport lease arrangements made by the former 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 six years for personal injury claims.

Public transport rail partnership agreements

The Director of Public Transport, on behalf of the Crown, entered into new partnership contractual arrangements with Connex and Yarra Trams to operate rail and tram transport services in the State operative from 18 April 2004. The following paragraphs summarise the major contingent liabilities arising from those arrangements.

Contingent liabilities arising during the agreement period

There are a number of contingent liabilities arising from the new partnership agreements between the Director of Public Transport and Connex and Yarra Trams which were signed on 19 February 2004.

These possible liabilities refer to payments to be made by the Director of Public Transport to Connex and Yarra Trams should certain events occur:

Operational Performance Regime (OPR): The OPR obliges the Director to make incentive payments for operators exceeding set punctuality and reliability performance targets.

Special event payments: The Director is obliged to make payments at a set rate for special event kilometres operated above a defined contractual limit.

Farebox risk sharing: The Director is obliged to make payments should farebox receipts fall below defined thresholds.

Service growth incentive: The Director is obliged to make payment for additional services introduced to meet service standards.

Commonwealth Games revenue guarantee payments: The Director is obliged to make a top-up payment should, as a result of the Commonwealth Games, farebox receipts fall below a projected amount based on the prior period's farebox and patronage growth.

Commonwealth Games kilometre payment: The Director is obliged to make payment for additional service kilometres operated above the master timetable requirements in respect of the Commonwealth Games.

New ticketing revenue guarantee payment: Operators have an option to elect to permanently move to a revenue guarantee payment regime should the implementation or new ticket fare structures associated with the introduction of the new ticketing system cause a real reduction in the farebox.

The revenue guarantee payment will be based on the prior period's farebox including an estimate for patronage growth and inflation. Under the above arrangement, the Director is liable for the difference between actual farebox received and the guaranteed revenue amount.

New ticketing system start-up: The State is obliged to pay any additional labour costs associated with training and deployment of staff in relation to the establishment of the new ticketing system.

Employee entitlements: Operators are required to manage employee entitlements to agreed forecast amounts.

The Director is obliged to make payments where the provision for employee entitlements (excluding long service leave) is less than an agreed forecast amount, and actual long service leave payments are greater than an agreed forecast amount.

Access charge adjustment: Should the access charge regime for train rail access be reset, then the Director is obliged to make payment to the operator in respect of any increased cost as a result of the reset.

The Director is also required to reimburse the operator's reasonable costs incurred in renegotiating the access charges.

Regional Fast Rail: The Director is required to meet the incremental costs incurred by Connex associated with the introduction of Regional Fast Rail.

VicTrack and Spencer Street Station Authority indemnity: The Director indemnifies VicTrack and the Spencer Street Station Authority from any claim brought by the operators under the Infrastructure Lease.

Adjustment event: The Director is obliged to increase the fixed monthly amount payable as a result of a defined adjustment event occurring which has a fundamental impact.

Contingent liabilities on early termination or expiry

Franchise assets: To maintain continuity of services, the Director at early termination or expiry of the arrangements will:

- for new rolling stock – either acquire the new rolling stock at predetermined values or have the lease payment obligations transferred to the Director or a successor operator; and
- for operator assets – either purchase the assets or have the assets transferred to the successor.

Unfunded superannuation: At the early termination or expiry of the contract, the Director will assume any unfunded superannuation amounts (apart from contributions the operator is required to pay over the contract term) to the extent that the State becomes the successor operator.

Contingent liabilities arising from potential changes to existing conditions

Change in Victorian law: Rail operators may make a claim against the Director for any net losses incurred as a result of a change in Victorian law that directly relates to the operator's business.

Latent defects: The Director is responsible for leased infrastructure defects above a threshold amount.

Pre-existing contamination: The Director is responsible for all costs associated with pre-existing contamination clean-up. The Director also indemnifies the operator from and against all losses, damages, actions suits, claims, demands, costs and expenses associated with pre-existing contamination.

Native Title: The Director is liable for payments of any valid compensation claim to native title holders made under any Native Title law in respect of the land defined in the infrastructure leases entered into with operators.

Contingent liabilities arising from National Express receivership

In December 2002, the Government appointed receivers and managers to the National Express train and tram businesses, in order to protect government interest, ensure continuation of services up to the commencement of new partnership agreements and deal with any subsequent termination issues.

The Treasurer, under the Receivership Deed of Indemnity, has agreed to indemnify the receivers for debts properly incurred by them in the course of receivership. The Treasurer has also agreed to remunerate the receivers in accordance with the rates set out in the deed.

Melbourne City Link

An outstanding claim exists from Transurban City Link Limited pursuant to the concession deed of the Agreement to the *Melbourne City Link Act 1995*, relating to an alleged adverse effect claim in respect of the construction of Wurundjeri Way and widening of the West Gate Freeway. Expert determination found in favour of the State; however, the claim has now been appealed to arbitration which is yet to proceed. VicRoads is defending this claim and is unable to assess the likelihood of success at this time.

Mitcham-Frankston Project

On 14 October 2004, the State entered into a concession deed with ConnectEast to construct the Mitcham-Frankston Project. The major non-quantifiable contingent liability arising from the concession deed relates to the State providing Project Land to ConnectEast according to the agreement, and the Key Risk Management Regime. The Regime relates to the occurrence of certain circumstances that may have a detrimental impact on the concessionaire's ability to achieve its forecast returns. It identifies the areas that enable the concessionaire to claim redress from the State. These may include act of prevention, failure to support a principal road interface, discriminatory changes in State law, Native Title and the Environmental Effects Statement.

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.

Transmission of business under Section 149 (awards) and 170 MB (certified agreements) 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. 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 the Victorian Managed Insurance Authority), 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 of the HIH Insurance Group. 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 Reduction Amount

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 the Australian Steel Company (Operations) Pty Ltd is the plaintiff. The plaintiff has claimed that Schedule 9A2 of the National Electricity Code, amongst 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 interest and costs.

The Government discontinued the collection of the Smelter Reduction Amount from 30 June 2004.

The State of Victoria has entered into an agreement with SECV, whereby the State has fully indemnified the SECV in respect of all legal costs and any other moneys payable by the SECV in the matter. The interests of the SECV are being managed by the State of Victoria.

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.

The Organising Committee for the Commonwealth Games is the Melbourne 2006 Commonwealth Games Corporation (M2006), a statutory corporation.

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 M2006 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 M2006 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.

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 – property and public liability

The Victorian Managed Insurance Authority (VMIA) was established in 1996 as a captive insurer for departments and participating bodies (predominantly in the 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 a wagering and gambling licence to TABCORP Holdings Limited (TABCORP) for $597 million. The *Gambling Regulation Act 2003* 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 *Gambling Regulation Act 2003* 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, was 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 received re-insurance premiums for this participation and is required to contribute to payment of re-insured claims, as well as paying management fees. The precise timing and value of claims-related payments is uncertain, as claims may be made by home owners for up to six and a half years after the arrangement ceased.

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, along with 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 New South Wales 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 exceeding this amount by an insurer to any one builder. 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.

CHAPTER 5: ESTIMATED FINANCIAL STATEMENTS AND NOTES

The Estimated Financial Statements have been prepared in accordance with the provisions of the *Financial Management Act 1994*. This Act requires the Estimated Financial Statements to be consistent with the Financial Policy Objectives and Strategies Statement (see Chapter 1, *Financial Policy Objectives and Strategy*), and to be prepared in a manner and form determined by the Minister. Consistent with the form of the Estimated Financial Statements presented in the 2004-05 Budget Papers, these updated statements are based on generally accepted accounting principles (GAAP).

The purpose of the Estimated Financial Statements is to provide updated information on the forecast financial results for 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 projections.

The accompanying notes to the statements provide details of the 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 Financial Reporting Standards.

Compared with the balance sheet estimates published in the 2004-05 Budget Papers, the opening balances as at 30 June 2004 and consequent forecast closing balances have been adjusted to reflect actual audited balances as at 30 June 2004. The original estimates were based on audited values at 30 June 2003 adjusted for estimated movements during 2003-04.

Estimated Financial Statements for the Victorian General Government Sector

Table 5.1: Estimated statement of financial performance for the financial year ending 30 June

($ million)

.. ..	Notes	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Revenue from ordinary activities		..				
Taxation	2	10 384.2	10 407.0	10 481.1	10 786.3	11 061.7
Fines and regulatory fees	..	617.0	514.5	608.2	678.7	682.2
Investment revenue	3	1 225.4	1 247.6	1 272.1	1 255.6	1 273.3
Grants	4	13 080.5	13 384.2	14 059.7	14 468.8	15 199.2
Sale of goods and services	..	2 231.3	2 304.0	2 346.0	2 378.9	2 404.3
Gain (loss) on the disposal of physical assets	..	11.9	27.2	15.7	(1.9)	(5.8)
Fair value of assets received free of charge or for nominal consideration	..	..	0.2	..	..	..
Inter sector capital asset charge		587.5	599.4	619.1	631.9	646.0
Other revenue		847.1	715.5	716.2	752.4	718.9
Total revenue	..	**28 984.9**	**29 199.6**	**30 118.0**	**30 950.6**	**31 979.8**
Expenses from ordinary activities		..				
Employee benefits	..	10 480.5	10 564.1	10 922.4	11 270.8	11 500.9
Superannuation		1 789.2	1 828.8	1 846.9	1 895.1	1 896.0
Depreciation	5	1 142.7	1 148.3	1 204.0	1 265.2	1 345.2
Amortisation	6	67.0	54.8	45.6	42.0	33.9
Borrowing costs	7	476.2	487.1	491.5	486.8	479.2
Grants and transfer payments	8	5 087.7	5 100.1	5 120.1	5 118.5	5 193.3
Supplies and services		9 311.0	9 300.3	9 944.0	10 273.3	10 821.0
Other expenses		85.4	78.4	76.4	83.4	83.4
Total expenses	9	**28 439.9**	**28 562.0**	**29 650.9**	**30 435.2**	**31 352.9**
Net result		**545.0**	**637.6**	**467.1**	**515.5**	**626.8**
Movements in asset revaluation reserve	..	1 283.6	1 771.6	1 876.6	1 903.0	1 923.0
Total changes in equity other than contributions to other sectors by the State in its capacity as owner	..	**1 828.6**	**2 409.2**	**2 343.7**	**2 418.5**	**2 549.8**

The accompanying notes form part of these Estimated Financial Statements.

Table 5.2: Estimated statement of financial position as at 30 June

($ million)					
	Notes	*2005 Revised*	*2006 Estimate*	*2007 Estimate*	*2008 Estimate*
Current assets					
Cash assets		1 379.0	1 424.5	1 471.9	1 512.0
Other financial assets		2 491.2	2 500.9	2 520.4	2 531.3
Receivables		1 647.0	1 708.2	1 802.6	1 882.8
Prepayments		87.2	87.3	87.4	87.5
Inventories		132.1	133.0	132.9	132.7
Total current assets		**5 736.4**	**5 853.8**	**6 015.1**	**6 146.2**
Non-current assets					
Other financial assets		680.0	874.6	563.3	260.2
Receivables		408.7	413.5	420.5	437.2
Inventories		33.3	34.3	35.4	36.4
Property, plant and equipment	*10,12*	26 238.1	27 881.3	29 017.8	30 327.2
Road networks	*11,12*	17 679.4	19 039.9	20 413.1	21 657.2
Other assets	*13*	3 284.1	3 362.9	3 416.2	3 481.1
Total non-current assets		**48 323.6**	**51 606.5**	**53 866.2**	**56 199.3**
Total assets		**54 059.9**	**57 460.3**	**59 881.3**	**62 345.5**
Current liabilities					
Payables		1 996.4	2 061.5	2 124.4	2 182.4
Interest bearing liabilities		183.3	172.0	177.9	180.9
Employee benefits	*14*	1 037.6	1 082.7	1 130.4	1 178.0
Superannuation	*15*	54.9	731.0	997.1	1 198.4
Outstanding insurance claims		63.1	62.6	62.1	61.6
Other liabilities		491.6	490.9	497.2	504.2
Total current liabilities		**3 826.8**	**4 600.7**	**4 989.1**	**5 305.4**
Non-current liabilities					
Payables		1 230.1	1 149.0	1 040.9	933.2
Interest bearing liabilities		5 531.4	5 981.6	5 976.2	5 959.4
Employee benefits	*14*	2 171.1	2 373.9	2 492.9	2 568.7
Superannuation	*15*	12 350.2	12 496.1	12 505.0	12 365.2
Outstanding insurance claims		335.1	330.5	297.6	268.3
Other liabilities		458.7	454.0	443.4	432.8
Total non-current liabilities		**22 076.6**	**22 785.2**	**22 756.0**	**22 527.6**
Total liabilities		**25 903.4**	**27 385.9**	**27 745.1**	**27 833.0**
Net assets		**28 156.5**	**30 074.4**	**32 136.2**	**34 512.5**

The accompanying notes form part of these Estimated Financial Statements.

Table 5.3: Estimated statement of cash flows for the financial year ending 30 June

($ million)

..	Notes	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Cash flows from operating activities	..	..	..	..	..	..
Receipts	..					
Taxation	..	10 361.7	10 384.6	10 455.3	10 756.7	11 022.5
Fines and regulatory fees	..	497.9	405.7	499.8	559.0	562.5
Grants	..	13 080.0	13 383.4	14 059.7	14 468.8	15 199.2
Sale of goods and services	..	2 230.2	2 278.9	2 343.8	2 381.0	2 403.8
Interest received	..	434.8	349.1	372.9	393.8	397.0
Dividends received	..	478.1	516.6	565.1	483.1	498.8
Capital assets charge received	..	587.5	599.4	619.1	631.9	646.0
Other receipts	..	1 119.7	1 080.7	1 009.3	1 050.4	1 032.4
Total receipts	..	**28 789.9**	**28 998.4**	**29 924.9**	**30 724.6**	**31 762.1**
Payments	..	..	..	..	..	..
Employee benefits	..	(10 283.1)	(10 332.6)	(10 674.6)	(11 104.1)	(11 377.4)
Superannuation	..	(1 121.8)	(1 134.4)	(1 024.9)	(1 620.1)	(1 834.5)
Grants and transfer payments	..	(5 030.6)	(5 160.4)	(5 186.9)	(5 191.3)	(5 279.4)
Supplies and services	..	(9 330.3)	(9 351.9)	(9 959.1)	(10 297.7)	(10 841.6)
Interest paid	..	(483.5)	(428.1)	(439.2)	(431.0)	(423.0)
Total payments	..	**(26 249.3)**	**(26 407.4)**	**(27 284.8)**	**(28 644.2)**	**(29 755.9)**
Net cash flows from operating activities	***16***	**2 540.6**	**2 591.1**	**2 640.2**	**2 080.4**	**2 006.3**
Cash flows from investing activities	..	..	..	..	..	..
Net customer loans repaid	..	20.0	20.0	20.0	22.4	22.4
Net contribution to other sectors of government	..	(481.6)	(228.5)	(261.2)	(280.8)	(173.6)
Proceeds from sale of property, plant and equipment	..	80.9	88.5	61.5	39.9	101.3
Purchase of property, plant and equipment	..	(2 470.9)	(2 478.8)	(2 219.4)	(2 105.9)	(2 190.5)
Net disposal of investments	..	173.6	(124.6)	(204.4)	291.7	292.1
Net cash flows from investing activities	..	**(2 677.9)**	**(2 723.3)**	**(2 603.5)**	**(2 032.7)**	**(1 948.2)**
Cash flows from financing activities	..	..	..	..	..	..
Net borrowings	..	213.6	212.6	8.9	(0.3)	(17.9)
Net cash flows from financing activities	..	**213.6**	**212.6**	**8.9**	**(0.3)**	**(17.9)**
Net increase in cash and deposits held	..	**76.2**	**80.4**	**45.6**	**47.4**	**40.1**
Cash at beginning of reporting period	..	1 295.2	1 295.2	1 375.6	1 421.1	1 468.5
Cash and deposits at end of reporting period	***17***	**1 371.4**	**1 375.6**	**1 421.1**	**1 468.5**	**1 508.6**

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)				
	2004-05	*2005-06*	*2006-07*	*2007-08*
Gross state product	3.25	3.25	3.50	3.50
Employment	1.75	1.25	1.50	1.50
Consumer price index	2.50	2.50	2.50	2.50
Wage cost index [(b)]	3.50	3.50	3.50	3.50
Population [(c)]	1.10	1.00	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 points. Projections of population are rounded to the nearest 0.1 percentage points.
(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 sets out the significant accounting policies and forecast assumptions that 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* (FMA), applicable pronouncements issued by the Australian Accounting Standards Board (AASB), Urgent Issues Group consensus views and other authoritative pronouncements, 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.

Impacts of adopting IASB standards

Australia is currently making changes to accounting standards designed to enhance comparability across jurisdictions. The public sector will be affected by changes to *ex-post* reporting requirements affecting reporting periods from 2005-06 onwards, involving the harmonisation of Australian and international financial reporting standards, together with a second proposed harmonisation of the new accounting standards to a revised framework of Government Finance Statistics (GFS). There is currently no firm deadline for this second element of changes affecting the public sector.

The Victorian Government is actively monitoring the proposed changes to the accounting framework, and the project for harmonisation of accounting frameworks with GFS. Both sets of possible changes are likely to affect the presentation of financial information across government, at the aggregate level as well as at entity level.

No adjustments have been made in these Estimated Financial Statements for any consequent effect of the intended adoption from 2005-06 onwards of international financial reporting standards as their impacts are still uncertain.

(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 to which they relate, regardless of when cash is received or paid.

The opening balances of 1 July 2004 are based on the audited financial report as at that date and have been prepared in accordance with the historical cost convention, except for those items measured at valuation, which include:

- non-current physical assets (other than plant, equipment and vehicles 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, most notably unfunded superannuation, which are calculated with regard to actuarial assessments.

(C) Reporting entity

The Victorian general government sector includes all government departments, agencies and other bodies engaged in providing services free of charge or at prices significantly below their cost of production. The general government sector is not a separate entity but represents a sector within the State of Victoria reporting entity.

The primary function of entities within the general government sector is to provide public services (outputs) which are mainly non-market in nature, for the collective consumption of the community, and involve the transfer or redistribution of income and are financed mainly through taxes and other compulsory levies.

(D) Basis of consolidation

The Estimated Financial Statements incorporate assets and liabilities of all reporting entities within 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 to the financial statements.

Where control of an entity is obtained during a financial year, its results are included in the consolidated Statement of Financial Performance from the date on which control commenced. Where control ceases during a financial period, the entity's results are included for that part of the period in which control existed. Where dissimilar accounting policies are adopted by entities and their effect is considered material, adjustments are made to ensure consistent policies are adopted in these Estimated Financial Statements.

In the process of reporting the general government sector as a separate segment of the Government, all material transactions and balances between agencies within the general government sector are eliminated.

(E) Forecast reporting periods

The reporting period for most reporting entities is the year ended 30 June. However, for those entities with a reporting period other than 30 June, the most recently audited financial year results are used as a basis for the opening balance beginning 1 July 2004. For example, schools and TAFE institutes have a reporting period ending on 31 December. Consequently, the results of these entities for the year ended 31 December 2003 and the balances existing as at 31 December 2003 have been used in the preparation of these financial statements.

(F) Revenues

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured.

Taxation

State 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 taxation revenue raised by the State include:

- payroll tax;
- land tax;
- duties levied principally on conveyancing and land transfers and rental business;
- bank account 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 and insurance company contributions to fire brigades;
- motor vehicle taxes, including registration fees, duty on registrations and transfers, drivers' licences fees;
- other taxes, including landfill levies, concession fees payable by Transurban in respect of Melbourne City Link and licence fees; and
- levies on statutory corporations (including the environmental levy).

Forecast assumption

The State's tax revenues are forecast by a process that 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 revenues from these sources are subject to substantial annual variation. Stamp duty on land transfers is an example of a volatile tax base.

Fines and regulatory fees

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 Government announced, as part of the 2003-04 Budget, that a policy of automatic indexation of fees and fines payable to the Public Account would be applied. The key implementation mechanism is the provisions included in the *Monetary Units Act 2004*.

Fees and fines payable to the Public Account are annually indexed by the Treasurer's annual rate, which is based on the expected Consumer Price Index (CPI) for Victoria calculated at the time of the *Budget Update*. An indexation factor of 2.25 per cent has been applied to fines and regulatory fees for 2004-05.

Investment revenue

Investment revenue includes interest, dividends, royalties and other revenue from bank term deposits, shares and other investments, including dividends from other government sectors and income tax and rate equivalent revenue. 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 considered which will affect the dividend forecasts include the views of each agency's 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. Currently, 35 government business enterprises are subject to the NTER. Revenue raised under the NTER remains with the State.

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

Grants

Grants mainly comprise 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. Grants also include 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 progress basis.

Sale of goods and services

Revenue from sale of goods is recognised when control of goods 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 is measured by reference to the labour hours or as a 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 imposed by departments and budget sector agencies in line with the *Guidelines for Setting Fees and Charges* (issued by the Department of Treasury and Finance) and/or indexation as provided for under the *Monetary Units Act 2004*. 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 entity within the general government sector gains control of the contribution or the right to receive the contribution.

(G) Expenses

Expenses are recognised when they are incurred, and reported in the financial year to which they relate.

Employee benefits

These expenses include all costs related to employment (other than superannuation which is accounted for separately) including 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 given the Government's wage policy. Under this policy costs associated with Enterprise Bargaining Agreement outcomes beyond the maintenance of real wages (based on the normal indexation factor used to escalate departmental output revenue) are funded from real and sustainable productivity improvements, cost savings and improved service delivery.

Superannuation

Superannuation expense is determined on the following basis:

- *Defined contribution superannuation plans*

  The amount recognised as an expense reflects the State's contribution, paid or accrued, in respect of the reporting period.

- *Defined benefit superannuation plans*

  The amount recognised as an expense reflects the net movement in the unfunded superannuation liability during the reporting period based on an actuarial assessment, after taking account of superannuation contributions, paid or accrued in the period.

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 as detailed in Note 15. 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.

Depreciation

All infrastructure, buildings, plant and equipment and other non-current physical assets (excluding leased items) that have a limited useful life are depreciated. Depreciation is generally calculated on a straight-line basis, at rates that allocate 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 for both current and prior years:

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 has not, in any material sense, been 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

Borrowing costs, other than those capitalised in relation to qualifying assets, are recognised as expenses in the period in which they are 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;
- finance lease charges;
- certain exchange differences arising from foreign currency borrowings;
- indexation of principal outstanding for capital indexed securities and indexed annuities, in line with movements in the CPI; and
- capital gains/losses incurred on debt retirement or debt portfolio restructuring.

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, and index-linked securities from the Treasury Corporation of Victoria. 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

Grants and transfer payments to third parties are recognised as an expense during the reporting period in which they are paid or payable. They 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

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

(H) Assets

The 1 July 2004 opening balance of assets represents the audited value as at that date.

Cash assets

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

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

Other financial assets comprise marketable securities (less provision for diminution) and deposits that are valued at 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 twelve 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 2004-05 to 2007-08 are assumed to be held as financial assets (investments) to preserve budget decision-making flexibility.

Receivables

Receivables consist predominantly of debtors in relation to goods and services, taxes and fines, accrued investment income, and 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

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

Inventories including land held for resale are measured 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 either on purchase cost on a weighted average cost, or cost on a 'first-in, first-out' basis, whichever is appropriate.

Forecast assumption

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

Non-current physical assets

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, 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; and
- 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 revenue 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 higher. All other heritage assets and collections are valued at estimated written-down replacement cost.

Plant, equipment and vehicles comprise 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 fair value by independent assessments. As a general expectation, this will occur at least every three years.

Revaluation increments are credited directly to the asset revaluation reserve, except where the increment reverses a revaluation decrement in respect of that class of asset previously recognised as an expense in the net result, in which case 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 the same class of non-current assets.

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

Certain 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

Land under roads and road reserves have not been recognised, consistent with current accounting standards.

Natural resources

The majority of natural resource assets comprise commercial native forests.

Commercial native forests are 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

Infrastructure projects approved in-principle by the Government for possible delivery under the *Partnerships Victoria* model are initially included in the Estimated Financial Statements as non-current physical assets (with associated financing and depreciation costs). An exception to this is the Mitcham-Frankston Project, which is expected to be predominantly funded by user pay tolls.

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 an assessment of value for money and satisfaction of the public interest. If, at the conclusion of the tender process, a decision is made to proceed with a *Partnerships Victoria* delivery approach, the budget treatment 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.

Leases

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

(l) Liabilities

The 1 July 2004 opening balance of liabilities represents the audited value as at that date.

Payables

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

The State's interest-bearing liabilities mainly represent funds raised from the following sources:

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

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

Forecast assumption

General government sector debt is assumed to be refinanced at forward interest rates.

Employee benefits

An estimate of the provision is made in the Estimated Financial Statements mainly 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 the amounts expected to be paid, 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

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 2004. The valuation is determined by discounting to present value future benefit payments arising from past service 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.

Outstanding insurance claims

The outstanding claims liability is independently assessed by actuaries. It covers claims reported but not yet paid, claims incurred but not yet 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, existing actuarial valuations and projections adjusted for forecast activity levels.

Other liabilities

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.

(J) Right to receive assets

An independent private sector entity has leased land and state works 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 state works, together with the constructed facilities, will be returned to the State.

The recognition of the right to receive infrastructure assets 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 Estimated Statement of Financial Position and Estimated Statement of Financial Performance.

(K) Accounting for the goods and services tax (GST)

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 has been included in the Estimated Statement of Financial Position.

(L) Estimated statement of cash flows

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.

(M) Rounding

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)	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Payroll tax	2 875.5	2 893.5	3 035.2	3 179.1	3 331.0
Taxes on immovable property	1 036.9	1 046.7	1 181.1	1 132.4	1 088.6
Financial and capital transactions [(a)]	2 610.6	2 572.0	2 169.1	2 186.3	2 247.7
Gambling	1 371.7	1 390.8	1 460.4	1 542.7	1 523.1
Insurance	1 060.7	1 026.1	1 064.5	1 118.2	1 176.1
Motor vehicles	1 355.2	1 359.3	1 430.8	1 482.9	1 549.5
Levies on statutory corporations	..	44.7	60.4	60.4	61.6
Other licences and levies	73.5	73.9	79.6	84.2	84.1
Total taxation	**10 384.2**	**10 407.0**	**10 481.1**	**10 786.3**	**11 061.7**

Note:

(a) Financial and capital transactions mainly include duty on land transfers, debits tax and other property stamp duty. Duty on mortgages was abolished from 1 July 2004. Bank accounts debits tax will be abolished from 1 July 2005.

Note 3: Investment revenue

($ million)	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Dividends	478.1	516.6	565.1	483.1	498.8
Income tax and rate equivalent revenue	186.5	255.9	204.5	246.8	245.6
Interest	435.5	349.7	373.5	394.5	397.5
Royalties	43.3	43.3	46.3	45.5	45.5
Rents	15.6	15.6	15.7	15.7	15.7
Other	66.3	66.3	67.1	69.9	70.2
Total investment revenue	**1 225.4**	**1 247.6**	**1 272.1**	**1 255.6**	**1 273.3**

Note 4: Grants

($ million)	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Operating grants					
General purpose grants	7 281.7	7 602.6	7 976.8	8 239.5	8 721.6
Specific purpose grants for on-passing	1 561.5	1 556.5	1 663.4	1 772.2	1 878.0
Other specific purpose grants	3 653.9	3 597.3	3 836.8	3 917.6	4 094.9
Total operating grants	**12 497.2**	**12 756.4**	**13 477.0**	**13 929.3**	**14 694.5**
Capital grants					
Specific purpose grants for on-passing	127.9	126.6	132.2	136.6	137.3
Other specific purpose grants	455.4	501.1	450.4	402.9	367.3
Total capital grants	**583.4**	**627.8**	**582.6**	**539.5**	**504.7**
Total grants	**13 080.5**	**13 384.2**	**14 059.7**	**14 468.8**	**15 199.2**

Note 5: Depreciation

($ million)	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Plant and equipment	496.1	498.9	523.5	553.9	573.1
Infrastructure	34.4	34.4	36.1	30.3	30.3
Buildings [(a)]	311.6	307.7	335.0	365.2	416.9
Road networks	286.8	293.5	302.3	311.4	320.7
Other assets	13.9	13.9	7.1	4.4	4.4
Total depreciation	**1 142.7**	**1 148.3**	**1 204.0**	**1 265.2**	**1 345.2**

Note:
(a) *Includes estimated depreciation on amounts not yet allocated to projects in 2005-06 to 2007-08.*

Note 6: Amortisation

($ million)	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Leased plant and equipment	40.5	28.3	9.7	6.4	7.1
Leasehold buildings	16.9	16.9	17.5	17.5	17.7
Intangible assets	9.6	9.6	18.3	18.1	9.1
Total amortisation	**67.0**	**54.8**	**45.6**	**42.0**	**33.9**

Note 7: Borrowing costs

($ million)	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Interest on long-term interest bearing liabilities	414.0	423.8	414.4	402.7	393.8
Interest on short-term interest bearing liabilities	20.8	21.4	28.6	31.7	32.2
Finance charges on finance leases	16.9	13.1	20.3	23.1	23.5
Other borrowing costs	24.5	28.8	28.1	29.4	29.7
Total borrowing costs	**476.2**	**487.1**	**491.5**	**486.8**	**479.2**

Note 8: Grants and transfer payments

($ million)

	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Commonwealth	52.9	52.4	53.6	54.8	56.0
Local government	492.7	493.4	470.8	514.3	511.3
Private sector	3 291.4	3 178.7	3 152.8	3 198.6	3 220.3
Grants within Victorian Government	1 246.2	1 371.1	1 439.3	1 349.1	1 405.2
Grants to other State Governments	4.5	4.5	3.7	1.8	0.5
Total grants and transfer payments	**5 087.7**	**5 100.1**	**5 120.1**	**5 118.5**	**5 193.3**

Note 9: Total expenses from ordinary activities by department

($ million)

	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Expenses from ordinary activities					
Education and Training	8 389.5	8 556.4	8 825.5	9 099.3	9 075.9
Human Services	10 530.5	10 660.6	10 994.0	11 344.0	11 570.3
Infrastructure	3 063.0	3 202.9	3 321.5	3 393.4	3 496.9
Innovation, Industry and Regional Development	349.1	376.5	270.3	308.3	274.1
Justice	2 596.9	2 560.2	2 719.2	2 833.7	2 910.1
Parliament	121.5	121.2	105.0	107.8	109.2
Premier and Cabinet	440.9	444.2	459.4	465.2	472.3
Primary Industries	342.9	362.9	315.9	319.6	300.7
Sustainability and Environment	890.3	934.5	912.1	926.8	920.9
Treasury and Finance	2 115.9	2 107.1	2 040.9	2 076.1	2 121.1
Victorian Communities	943.6	881.2	981.5	744.0	682.4
Contingencies not allocated to departments (a)	268.1	(14.9)	302.0	433.2	1 088.4
Regulatory bodies and other part budget funded agencies (b)	954.2	954.2	1 014.7	1 046.0	1 079.4
Total	**31 006.5**	**31 147.0**	**32 261.9**	**33 097.2**	**34 101.6**
Less eliminations (c)	(2 566.6)	(2 585.0)	(2 610.9)	(2 662.1)	(2 748.6)
Total expenses from ordinary expenses	**28 439.9**	**28 562.0**	**29 650.9**	**30 435.2**	**31 352.9**

Notes:

(a) This contingency includes a provision for programs lapsing in 2007-08, future demand growth and an allowance for departmental underspending in 2004-05 which may be subject to carryover into 2005-06. Under the departmental funding model, from 1 July 2004 departments are required to manage all costs within their departmental budgets.

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

(c) Comprising payroll tax, capital assets charge and inter-departmental transfers.

Note 10: Property, plant and equipment and infrastructure systems

($ million)

	2005 Revised	2006 Estimate	2007 Estimate	2008 Estimate
Land, national parks and other land only holdings	**11 176.5**	**11 521.5**	**11 850.8**	**12 179.8**
Buildings [(a)]	13 489.7	14 649.4	15 923.4	17 494.5
Less: Accumulated depreciation	(936.2)	(1 236.8)	(1 595.1)	(2 004.2)
Buildings (written down value)	**12 553.5**	**13 412.6**	**14 328.3**	**15 490.3**
Infrastructure systems	460.2	1 022.9	1 091.9	1 158.5
Less: Accumulated depreciation	(55.6)	(90.9)	(120.3)	(149.6)
Infrastructure systems (written down value)	**404.6**	**931.9**	**971.6**	**1 008.9**
Plant, equipment and vehicles	4 526.8	4 930.0	5 245.1	5 508.6
Less: Accumulated depreciation	(2 511.7)	(2 944.9)	(3 393.1)	(3 856.4)
Plant, equipment and vehicles (written down value)	**2 015.1**	**1 985.1**	**1 852.0**	**1 652.2**
Leased plant, equipment and vehicles	139.8	58.8	44.2	25.2
Less: Accumulated depreciation	(51.4)	(28.8)	(29.1)	(29.3)
Leased plant, equipment and vehicles (written down value)	**88.3**	**30.1**	**15.1**	**(4.1)**
Total property, plant and equipment	**26 238.1**	**27 881.3**	**29 017.8**	**30 327.2**

Note:

(a) Includes amounts not yet allocated to projects in 2005-06 to 2007-08.

Note 11: Road networks

($ million)

	2005 Revised	2006 Estimate	2007 Estimate	2008 Estimate
Road infrastructure	19 978.6	21 637.8	23 318.9	24 883.7
Accumulated depreciation	(6 691.8)	(6 994.1)	(7 305.4)	(7 626.1)
Roads (written down value)	**13 286.8**	**14 643.7**	**16 013.4**	**17 257.6**
Earthworks	4 392.6	4 396.1	4 399.6	4 399.6
Total road networks	**17 679.4**	**19 039.9**	**20 413.1**	**21 657.2**

Note 12: Reconciliation of movements in fixed assets

($ million)

	2005 *Revised*	2006 *Estimate*	2007 *Estimate*	2008 *Estimate*
Carrying amount at the start of the year [(a)]	41 275.6	43 917.5	46 921.1	49 430.9
Additions [(b)]	2 489.8	2 640.3	2 090.6	2 184.7
Disposals at written down value	(61.3)	(45.8)	(41.8)	(107.1)
Revaluations increments	1 695.6	1 797.9	1 821.6	1 841.6
Assets transferred	(302.6)	(164.7)	(75.9)	..
Depreciation/amortisation expense	(1 179.7)	(1 224.1)	(1 284.8)	(1 365.7)
Carrying amount at the end of the year	**43 917.5**	**46 921.1**	**49 430.9**	**51 984.4**

Notes:

(a) Fixed assets comprise land and buildings, infrastructure systems, plant, equipment, vehicles, road networks. Excludes movements in other assets in Note 13 below.

(b) Includes assets acquired under finance lease arrangements.

Note 13: Other assets

($ million)

	2005 *Revised*	2006 *Estimate*	2007 *Estimate*	2008 *Estimate*
Non-current				
Natural resources reserves at valuation	115.5	123.9	132.3	140.7
Other assets - including works of art, museum collection, rare book collections and intangibles	3 322.5	3 414.3	3 476.5	3 550.8
Less: Accumulated depreciation/ amortisation	(153.9)	(175.3)	(192.6)	(210.4)
Total other assets	**3 284.1**	**3 362.9**	**3 416.2**	**3 481.1**

Note 14: Employee benefits

($ million)

	2005 *Revised*	2006 *Estimate*	2007 *Estimate*	2008 *Estimate*
Current				
Accrued salaries and wages [(a)]	843.3	863.2	885.6	907.9
Long service leave	194.3	219.4	244.8	270.1
Total current employee benefits	**1 037.6**	**1 082.7**	**1 130.4**	**1 178.0**
Non-current				
Accrued salaries and wages [(a)]	4.9	4.9	4.9	4.9
Long service leave	2 166.2	2 369.0	2 488.0	2 563.8
Total non-current employee benefits	**2 171.1**	**2 373.9**	**2 492.9**	**2 568.7**
Total employee benefits	**3 208.8**	**3 456.6**	**3 623.2**	**3 746.7**

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.

In the recent triennial actuarial review, the State Superannuation Fund's (SSF) actuary refined the earning rate assumptions for fund assets to recognise that investment returns on assets backing current pension liabilities are not subject to tax, while investment returns on assets backing non-pension liabilities are taxed at 15 per cent. Assets which back current pension liabilities are therefore assumed to earn 7.5 per cent a year, while assets which back non-pension liabilities are assumed to earn 6.6 per cent a year.

As the SSF's pension liabilities exceed its assets, and will do so for the foreseeable future, the actuary has adopted a 7.5 per cent a year investment earnings assumption to reflect the tax free status of earnings.

The actuary for the SSF has also assumed a long-term CPI growth rate of 2.5 per cent a year and a weighted average rate of salary increase of 4 per cent a year (excluding promotions).

All other superannuation liabilities are also consistent with projections provided by the various fund actuaries.

($ million)

	2005 Revised	*2006 Estimate*	*2007 Estimate*	*2008 Estimate*
State Superannuation Fund	11 992.8	12 817.4	13 028.4	13 034.4
Other funds [(a)]	412.3	409.7	473.7	529.2
Total unfunded superannuation liability	**12 405.1**	**13 227.1**	**13 502.1**	**13 563.6**
Current liability	54.9	731.0	997.1	1 198.4
Non-current liability	12 350.2	12 496.1	12 505.0	12 365.2
Total liability	**12 405.1**	**13 227.1**	**13 502.1**	**13 563.6**

Note:

(a) Other consists of Emergency Services Superannuation Fund, Constitutionally Protected Schemes, Parliamentary Contributory Superannuation Scheme, HealthSuper Fund and the general government element of the Local Authorities Fund.

Note 16: Reconciliation of net cash flows from operating activities

($ million)

	2004-05 Revised	*2005-06 Estimate*	*2006-07 Estimate*	*2007-08 Estimate*
Net result	637.6	467.1	515.5	626.8
Non-cash movements	..	..	..	..
Depreciation	1 148.3	1 204.0	1 265.2	1 345.2
Amortisation	54.8	45.6	42.0	33.9
Revaluation of investments	0.1	0.1	0.1	0.1
Assets received /given free of charge	(0.2)	..	..	..
Revaluation of assets	(8.4)	(8.4)	(8.4)	(8.4)
Discount/premium on other financial assets/ interest bearing liabilities	5.1	4.6	4.9	4.2
Movements included in investing and financing activities	**..**	**..**	**..**	**..**
Net revenue from sale of property, plant and equipment	(27.2)	(15.7)	1.9	5.8
Movements in assets and liabilities	..	..	..	..
Increase (decrease) in provision of doubtful debts	77.9	75.9	82.9	82.9
Increase (decrease) in payables	(16.2)	(27.3)	(49.0)	(49.5)
Increase (decrease) in employee benefits	231.5	247.8	166.6	123.5
Increase (decrease) in superannuation	694.5	822.0	275.0	61.5
Increase (decrease) in insurance claims liabilities	(5.4)	(5.1)	(33.4)	(29.9)
Increase (decrease) in other liabilities	(20.6)	(5.3)	(4.3)	(3.7)
(Increase) decrease in receivables	(153.8)	(162.0)	(206.7)	(202.2)
(Increase) decrease in other current assets	(26.8)	(3.2)	28.0	15.9
Net cash flows from operating activities	**2 591.1**	**2 640.2**	**2 080.4**	**2 006.3**

Note 17: Reconciliation of cash

($ million)

	2004-05 Revised	*2005-06 Estimate*	*2006-07 Estimate*	*2007-08 Estimate*
Cash	725.1	754.2	765.2	770.7
Deposits at call	653.8	670.3	706.7	741.3
Cash and deposits	**1 379.0**	**1 424.5**	**1 471.9**	**1 512.0**
Bank overdraft	(3.4)	(3.4)	(3.4)	(3.4)
Cash and deposits held as at 30 June	**1 375.6**	**1 421.1**	**1 468.5**	**1 508.6**

Note 18: General government sector entities

The following is a list of general government sector entities which have been consolidated for the purposes of the Estimated Financial Statements. For further details on consolidation policy, refer to Note 1 (D) 'Basis of consolidation' in the statement of significant accounting policies and forecast assumptions.

General government sector entities
Department of Education and Training
Adult Community and Further Education Board
Adult Multicultural Education Services
Centre for Adult Education
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 (DECA)
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
Alexandra and District Ambulance Service
Alexandra District Hospital
Alpine Health
Ambulance Service Victoria Metropolitan Region
Austin Health (formerly Austin and Repatriation Medical Centre)
Bairnsdale Regional Health Service
Ballarat Health Services
Barwon Health
Bass Coast Regional Health (formerly Wonthaggi and District Hospital)
Bayside Health
Beaufort and Skipton Health Service
Beechworth Health Service
Benalla and District Memorial Hospital
Bendigo Health Care Group
Boort District Hospital

General government sector entities - continued
Casterton Memorial Hospital
Central Gippsland Health Service
Cobram District Hospital
Cohuna District Hospital
Colac Area Health
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
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
Moyne Health Services
Mt Alexander Hospital
Nathalia District Hospital
Northeast Health Wangaratta (formerly Wangaratta District Base Hospital)
Northern Health
Numurkah District Health Service
Omeo District Hospital
Orbost Regional Health
Otway Health and Community Services
Peninsula Health
Peter MacCallum Cancer Institute
Portland District Health
Queen Elizabeth Centre, The
Robinvale District Health Services
Rochester and Elmore District Health Service
Royal Victorian Eye and Ear Hospital
Rural Ambulance Victoria

General government sector entities - continued
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
The Royal Children's Hospital (formerly Women's and Children's Health)
The Royal Women's Hospital (formerly Women's and Children's Health)
Timboon and District Health Care Service
Tweddle Child and Family Health Service
Upper Murray Health and Community Services
Victorian Institute of Forensic Mental Health
West Gippsland Health Care Group
West Wimmera Health Service
Western District Health Service
Western Health
Wimmera Health Care Group
Wodonga Regional Health Service
Yarram and District Health Service
Yarrawonga District Health Service
Yea and District Memorial Hospital
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
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
Southern and Eastern Integrated Transport Authority (SEITA)
Department of Innovation Industry and Regional Development
Prince Henry’s Institute of Medical Research
Regional Development Victoria
Tourism Victoria

General government sector entities - continued
Department of Justice
Country Fire Authority
Domestic Building (HIH) Indemnity Fund
Emergency Communications Victoria
Equal Opportunity Commission
Gambling Research Panel
Legal Practice Board
Liquor Licensing Panel
Metropolitan Fire and Emergency Services Board
Office of Public Prosecutions
Office of the Legal Ombudsman
Office of the Public Advocate
Office of the Victorian Privacy Commissioner
Victoria Legal Aid
Victoria Police (Office of the Chief Commissioner of Police)
Victorian Commission for Gambling Regulation (formerly 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
Department of Sustainability and Environment
Architects Registration Board of Victoria
Building Commission
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
Port Phillip and Westernport Catchment Management Authority
West Gippsland Catchment Management Authority
Wimmera Catchment Management Authority
EcoRecycle Victoria
Environment Protection Authority
Heritage Council
Office of the Commissioner for Environmental Sustainability
Parks Victoria
Plumbing Industry Commission
Royal Botanic Gardens Board
Shrine of Remembrance Trustees

General government sector entities - continued
Surveyors Board
The Smart Water Fund
Trust for Nature (Victoria)
Department of Treasury and Finance
Essential Services Commission
Victorian Competition and Efficiency Commission
Department for Victorian Communities
Victorian Institute of Sport Limited
Victorian Institute of Sport Trust
Parliament
Victorian Auditor-General's Office

CHAPTER 6: 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. Unlike the accounting viewpoint, 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 resulting from discoveries, depletion and destruction of assets. This means that differences arise between the GFS and accounting frameworks, particularly in 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 the 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. 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, also referred to as a statement of financial position, records a government's stocks of financial and non-financial assets and liabilities and 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.

Compared with the balance sheet estimates published in the 2004-05 Budget Papers, the opening balances as at 30 June 2004 and consequent forecast closing balances have been adjusted to reflect actual audited balances as at 30 June 2004. The original estimates were based on audited values at 30 June 2003 adjusted for estimated movements during 2003-04.

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.

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 6.1: General government sector operating statement

($ million)

	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
GFS revenue					
Taxation revenue	10 272	10 295	10 366	10 694	10 984
Current grants and subsidies	12 497	12 756	13 477	13 929	14 695
Capital grants	583	628	583	539	505
Sales of goods and services	3 233	3 307	3 391	3 427	3 455
Interest income	436	350	373	394	397
Other	1 944	1 829	1 905	1 960	1 941
Total revenue	**28 965**	**29 164**	**30 094**	**30 944**	**31 977**
GFS expenses					
Employee expenses	11 702	11 798	12 168	12 550	12 801
Depreciation	1 200	1 194	1 231	1 289	1 370
Other operating expenses	9 123	9 114	9 750	10 078	10 626
Nominal superannuation interest expense	855	855	901	959	971
Other interest expense	453	463	468	462	454
Other property expenses	..	..	..	..	..
Current transfers	4 918	4 801	4 964	5 018	5 093
Capital transfers	184	314	172	116	116
Total expenses	**28 436**	**28 538**	**29 654**	**30 473**	**31 430**
GFS net operating balance	**529**	**626**	**440**	**471**	**547**
Less: Net acquisition of non-financial assets					
Purchases of non-financial assets	2 471	2 481	2 220	2 107	2 191
Sales of non-financial assets	- 81	- 89	- 62	- 40	- 101
Less: Depreciation	1 200	1 194	1 231	1 289	1 370
Plus: Change in inventories	- 3	- 3	1	..	..
Plus: Other movements in non-financial assets	..	..	437	..	..
Total net acquisition of non-financial assets	**1 186**	**1 195**	**1 365**	**778**	**720**
GFS net lending (+) / borrowing (-) [(a)]	**- 658**	**- 569**	**- 926**	**- 307**	**- 173**

Source: Department of Treasury and Finance

Note:

(a) 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)	*- 472*	*- 373*	*- 926*	*- 307*	*- 173*

Table 6.2: Public non-financial corporations sector operating statement

($ million)	2004-05 Budget	2004-05 Revised	2005-06 Estimate
GFS revenue			
Sales of goods and services	3 031	2 928	3 150
Current grants and subsidies	983	1 058	1 039
Capital grants	92	95	114
Interest income	47	118	103
Other	426	501	441
Total revenue	**4 578**	**4 700**	**4 847**
GFS expenses			
Employee expenses	502	534	489
Depreciation	671	714	730
Other operating expenses	2 705	2 445	2 519
Property expenses	506	641	874
Current transfers	123	178	194
Capital transfers	7	17	0
Total expenses	**4 514**	**4 529**	**4 806**
GFS net operating balance	**64**	**171**	**41**
Less: Net acquisition of non-financial assets			
Purchases of non-financial assets	1 600	1 746	1 528
Sales of non-financial assets	- 82	- 77	- 83
Less: Depreciation	671	714	730
Plus: Change in inventories	6	1	- 1
Plus: Other movements in non-financial assets	186	192	174
Total net acquisition of non-financial assets	**1 039**	**1 148**	**887**
GFS net lending (+) / borrowing (-)	**- 975**	**- 977**	**- 846**

Source: Department of Treasury and Finance

Table 6.3: Non-financial public sector operating statement

($ million)

	2004-05 Budget	2004-05 Revised	2005-06 Estimate
GFS revenue			
Taxation revenue	10 264	10 181	10 235
Current grants and subsidies	12 498	12 757	13 477
Capital grants	583	628	583
Sales of goods and services	5 663	5 620	5 905
Interest income	482	406	418
Other	2 066	1 992	1 815
Total revenue	**31 557**	**31 584**	**32 432**
GFS expenses			
Employee expenses	12 204	12 331	12 657
Depreciation	1 871	1 908	1 961
Other operating expenses	11 336	10 915	11 866
Nominal superannuation interest expense	855	855	901
Other interest expense	644	691	739
Other property expenses	..	..	..
Current transfers	3 802	3 517	3 589
Capital transfers	191	324	172
Total expenses	**30 903**	**30 541**	**31 885**
GFS net operating balance	**655**	**1 042**	**547**
Less: Net acquisition of non-financial assets			
Purchases of non-financial assets	4 071	4 256	3 748
Sales of non-financial assets	- 163	- 165	- 145
Less: Depreciation	1 871	1 908	1 961
Plus: Change in inventories	2	- 2	- 1
Plus: Other movements in non-financial assets	186	192	611
Total net acquisition of non-financial assets	**2 225**	**2 373**	**2 253**
GFS net lending (+) / borrowing (-) [(a)]	**-1 571**	**-1 330**	**-1 706**

Source: Department of Treasury and Finance

Note:

(a) 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)	*-1 012*	*-1 134*	*-1 706*

Table 6.4: General government sector balance sheet

($ million)						
as at 30 June	*2004 Opening*	*2005 Budget*	*2005 Revised*	*2006 Estimate*	*2007 Estimate*	*2008 Estimate*
Assets						
Financial assets						
Cash and deposits	1 301	1 377	1 379	1 424	1 472	1 512
Advances paid	205	185	185	165	143	120
Investments, loans and placements	3 043	2 869	3 167	3 372	3 080	2 788
Other non-equity assets	1 798	1 962	1 874	1 960	2 084	2 204
Equity	33 918	34 399	34 449	34 875	35 231	35 405
Total financial assets	**40 265**	**40 792**	**41 054**	**41 796**	**42 010**	**42 028**
Non-financial assets						
Land and fixed assets	43 321	45 789	46 034	49 121	51 719	54 361
Other non-financial assets	1 415	1 428	1 420	1 418	1 383	1 361
Total non-financial assets	**44 736**	**47 217**	**47 454**	**50 539**	**53 103**	**55 722**
Total assets	**85 000**	**88 009**	**88 509**	**92 335**	**95 112**	**97 750**
Liabilities						
Deposits held	446	451	451	457	463	467
Advances received	6	47	47	47	47	47
Borrowing	5 501	5 665	5 666	6 105	6 106	6 092
Superannuation liability	11 711	12 378	12 405	13 227	13 502	13 564
Other employee entitlements and provisions	3 740	3 920	3 952	4 192	4 328	4 426
Other non-equity liabilities	3 402	3 437	3 382	3 358	3 299	3 237
Total liabilities	**24 804**	**25 899**	**25 903**	**27 386**	**27 745**	**27 833**
Net worth	**60 196**	**62 110**	**62 605**	**64 949**	**67 368**	**69 917**
Net financial worth [(a)]	**15 460**	**14 893**	**15 151**	**14 410**	**14 265**	**14 195**
Net debt [(b)]	**1 403**	**1 732**	**1 433**	**1 648**	**1 921**	**2 186**

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)	*1 600*	*1 743*	*1 433*	*1 648*	*1 921*	*2 186*

Table 6.5: Public non-financial corporations sector balance sheet

($ million)

as at 30 June	*2004 Opening*	*2005 Budget*	*2005 Revised*	*2006 Estimate*
Assets				
Financial assets				
Cash and deposits	435	417	428	437
Advances paid	194	155	154	125
Investments, loans and placements	1 140	971	913	706
Other non-equity assets	1 790	1 766	1 676	1 590
Equity	..	..	..	..
Total financial assets	**3 558**	**3 309**	**3 172**	**2 858**
Non-financial assets				
Land and fixed assets	35 373	36 925	37 080	38 424
Other non-financial assets	113	100	92	72
Total non-financial assets	**35 486**	**37 025**	**37 172**	**38 496**
Total assets	**39 044**	**40 334**	**40 343**	**41 354**
Liabilities				
Deposits held	80	78	65	53
Advances received	30	28	30	30
Borrowing	3 716	3 970	4 034	4 335
Superannuation liability	49	51	48	48
Other employee entitlements and provisions	2 442	2 450	2 404	2 388
Other non-equity liabilities	593	588	622	672
Total liabilities	**6 910**	**7 165**	**7 202**	**7 525**
Shares and other contributed capital	**32 135**	**33 169**	**33 141**	**33 829**
Net worth	**..**	**..**	**..**	**..**
Net financial worth	**-35 486**	**-37 025**	**-37 172**	**-38 496**
Net debt [(a)]	**2 057**	**2 534**	**2 634**	**3 150**

Source: Department of Treasury and Finance

Note:
(a) 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 6.6: Non-financial public sector balance sheet

($ million)

as at 30 June	*2004 Opening*	*2005 Budget*	*2005 Revised*	*2006 Estimate*
Assets				
Financial assets				
Cash and deposits	1 736	1 794	1 807	1 861
Advances paid	278	240	239	210
Investments, loans and placements	4 182	3 840	4 080	4 078
Other non-equity assets	2 202	2 342	2 202	2 202
Equity	1 783	1 803	2 105	2 289
Total financial assets	**10 182**	**10 018**	**10 434**	**10 641**
Non-financial assets				
Land and fixed assets	78 695	82 714	83 147	87 647
Other non-financial assets	1 530	1 530	1 524	1 500
Total non-financial assets	**80 224**	**84 244**	**84 670**	**89 147**
Total assets	**90 406**	**94 263**	**95 104**	**99 788**
Liabilities				
Deposits held	525	529	515	510
Advances received	35	75	77	77
Borrowing	9 096	9 535	9 600	10 360
Superannuation liability	11 760	12 429	12 453	13 275
Other employee entitlements and provisions	5 201	5 322	5 370	5 553
Other non-equity liabilities	2 699	2 730	2 766	2 859
Total liabilities	**29 317**	**30 621**	**30 781**	**32 633**
Net worth	**61 089**	**63 642**	**64 323**	**67 155**
Net financial worth	**-19 135**	**-20 603**	**-20 347**	**-21 993**
Net debt [(a)]	**3 460**	**4 265**	**4 066**	**4 798**

Source: Department of Treasury and Finance

Note:

(a) 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)	*3 656*	*4 276*	*4 066*	*4 798*

Table 6.7: General government sector cash flow statement

($ million)

	2004-05 Budget	2004-05 Revised	2005-06 Estimate	2006-07 Estimate	2007-08 Estimate
Cash receipts from operating activities					
Taxes received	10 249	10 272	10 340	10 664	10 945
Receipts from sales of goods and services	3 141	3 198	3 310	3 338	3 364
Grants/subsidies received	13 080	13 383	14 060	14 469	15 199
Other receipts	2 324	2 150	2 220	2 258	2 259
Total receipts	**28 795**	**29 003**	**29 930**	**30 730**	**31 767**
Cash payments from operating activities					
Payment for goods and services	-20 713	-20 764	-21 644	-23 015	-24 037
Grants and subsidies paid	-4 356	-4 638	-4 609	-4 556	-4 649
Interest paid	- 453	- 401	- 409	- 407	- 402
Other payments	- 730	- 609	- 626	- 677	- 681
Total payments	**-26 252**	**-26 413**	**-27 289**	**-28 655**	**-29 768**
Net cash flows from operating activities	**2 543**	**2 591**	**2 642**	**2 075**	**1 999**
Net cash flows from investing in non-financial assets					
Sales of non-financial assets	81	89	62	40	101
Purchases of non-financial assets	-2 471	-2 481	-2 220	-2 107	-2 191
Total cash flows - non-financial assets	**-2 390**	**-2 392**	**-2 159**	**-2 067**	**-2 090**
Net cash flows from investments in financial assets for policy purposes	**- 462**	**- 208**	**- 241**	**- 258**	**- 151**
Net cash flows from investments in financial assets for liquidity	**174**	**- 125**	**- 204**	**292**	**292**
Net cash flows from financing activities					
Advances received (net)	42	42	..	..	..
Borrowings (net)	165	168	2	..	- 14
Deposits received (net)	5	5	6	6	4
Other financing (net)	..	..	..	..	..
Net cash flows from financing activities	**211**	**215**	**8**	**6**	**- 10**
Net increase in cash held	**76**	**80**	**46**	**47**	**40**
Net cash from operating activities and investments in non-financial assets	153	199	483	8	- 91
Acquisitions under finance leases	..	..	437	..	..
Surplus (+) /deficit (-) [(a)]	**153**	**199**	**46**	**8**	**- 91**

Source: Department of Treasury and Finance

Note:

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

Surplus (+) /deficit (-) (excluding Growing Victoria)	*338*	*395*	*46*	*8*	*- 91*

Table 6.8: Public non-financial corporations sector cash flow statement

($ million)

	2004-05 Budget	*2004-05 Revised*	*2005-06 Estimate*
Cash receipts from operating activities			
Receipts from sales of goods and services	3 018	2 923	3 176
Grants/subsidies received	1 074	1 263	1 235
Other receipts	315	434	356
Total receipts	**4 408**	**4 620**	**4 767**
Cash payments from operating activities			
Payment for goods and services	-2 569	-2 163	-2 331
Grants and subsidies paid	- 56	- 79	- 61
Interest paid	- 183	- 289	- 313
Other payments	- 786	- 831	- 874
Total payments	**-3 594**	**-3 362**	**-3 579**
Net cash flows from operating activities	**814**	**1 258**	**1 188**
Net cash flows from investing in non-financial assets			
Sales of non-financial assets	82	77	83
Purchases of non-financial assets	-1 600	-1 746	-1 528
Total cash flows from investing in non-financial assets	**-1 517**	**-1 669**	**-1 444**
Net cash flows from investments in financial assets for policy purposes	**508**	**228**	**250**
Net cash flows from investments in financial assets for liquidity purposes	**169**	**229**	**210**
Net cash flows from financing activities			
Advances received (net)	- 2	- 0	- 0
Borrowings (net)	259	298	321
Deposits received (net)	- 6	- 15	- 12
Distributions paid	- 244	- 337	- 505
Other financing (net)	1	..	..
Total net cash flows from financing activities	**9**	**- 55**	**- 195**
Net increase in cash held	**- 18**	**- 8**	**9**
Net cash from operating activities, dividends paid, and investments in non-financial assets	- 948	- 748	- 761
Acquisition of assets under finance leases and similar arrangements	2	..	..
Surplus (+) /deficit (-)	**- 945**	**- 748**	**- 761**

Source: Department of Treasury and Finance

Table 6.9: Non-financial public sector cash flow statement

($ million)

	2004-05 Budget	2004-05 Revised	2005-06 Estimate
Cash receipts from operating activities			
Taxes received	10 242	10 159	10 209
Receipts from sales of goods and services	5 559	5 506	5 851
Grants/subsidies received	13 081	13 387	14 076
Other receipts	2 345	2 131	1 959
Total receipts	**31 226**	**31 182**	**32 094**
Cash payments from operating activities			
Payment for goods and services	-23 432	-23 079	-24 249
Grants and subsidies paid	-3 172	-3 298	-3 157
Interest paid	- 636	- 628	- 663
Other payments	- 874	- 676	- 699
Total payments	**-28 113**	**-27 681**	**-28 769**
Net cash flows from operating activities	**3 112**	**3 501**	**3 325**
Net cash flows from investing in non-financial assets			
Sales of non-financial assets	163	165	145
Purchases of non-financial assets	-4 071	-4 256	-3 748
Total cash flows from investing in non-financial assets	**-3 907**	**-4 091**	**-3 603**
Net cash flows from investments in financial assets for policy purposes	**26**	**20**	**9**
Net cash flows from investments in financial assets for liquidity purposes	**342**	**105**	**6**
Net cash flows from financing activities			
Advances received (net)	40	42	- 0
Borrowings (net)	444	505	323
Deposits received (net)	- 1	- 10	- 5
Other financing (net)	1	**..**	**0**
Total net cash flows from financing activities	**484**	**537**	**318**
Net increase in cash held	**58**	**72**	**55**
Net cash from operating activities and investments in non-financial assets	- 795	- 590	- 278
Acquisition of assets under finance leases and similar arrangements	2	..	437
Surplus (+) /deficit (-) [(a)]	**- 793**	**- 590**	**- 715**

Source: Department of Treasury and Finance

Note:

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

Surplus (+) /deficit (-) (excluding Growing Victoria)	*- 607*	*- 393*	*- 715*

Table 6.10: General government AAS 31 net result reconciled to GFS measures

($ million)

	2004-05 Budget	*2004-05 Revised*	*2005-06 Estimate*	*2006-07 Estimate*	*2007-08 Estimate*
General government net result	**545**	**638**	**467**	**515**	**627**
Plus:					
Operating revaluations and gains on sale of physical assets	- 20	- 36	- 24	- 7	- 3
Expense for doubtful debts	85	78	76	83	83
Amortisation not included as GFS expenses	10	10	18	18	9
Change to provision for employees superannuation (difference between nominal interest and expense)	- 91	- 64	- 98	- 139	- 169
Gains and losses on re-valuation of financial instruments	..	..	..	..	..
General government net operating balance (GFS)	**529**	**626**	**440**	**471**	**547**
Less: Gross fixed capital formation	2 390	2 392	2 159	2 067	2 090
Plus: Depreciation	1 200	1 194	1 231	1 289	1 370
Less: Change in inventories	- 3	- 3	1	..	..
GFS net lending(+)/borrowing(-) [(a)]	**- 658**	**- 569**	**- 926**	**- 307**	**- 173**
Plus:					
Superannuation expense (difference between operating statement, including nominal interest, and cash flow statement)	758	758	920	414	231
Other non-cash expenses	52	10	52	- 99	- 149
GFS cash surplus(+)/deficit(-)	**153**	**199**	**46**	**8**	**- 91**
Add back: *Growing Victoria* cash flow	186	196	..	..	..
GFS cash surplus (+) /deficit (-) (excluding *Growing Victoria*)	**338**	**395**	**46**	**8**	**- 91**
Less: Net contributions to other sectors of government	482	229	261	281	174
Decrease in general government net debt (excluding *Growing Victoria*)	**- 143**	**167**	**- 215**	**- 273**	**- 265**

Source: Department of Treasury and Finance

Note:

(a) The table below shows GFS net lending (+)/borrowing (-) excluding the impact of Growing Victoria.

GFS net lending (+) / borrowing (-) (excluding Growing Victoria)	*- 472*	*- 373*	*- 926*	*- 307*	*- 173*

Victoria's 2004-05 Loan Council Allocation

As required under the Uniform Presentation Framework, Victoria is required to publish the revised Loan Council Allocation (LCA) estimates. The LCA is a measure of each government's net call on financial markets in a given financial year to meet its budget obligations. The method of public release is the responsibility of each individual jurisdiction. Victoria discloses its LCA information through the Annual Financial Statement, Budget Papers and *Budget Update*.

Table 6.11 compares Victoria's 2004-05 LCA as approved by Loan Council in March 2004 with the revised LCA based on *2004-05 Budget Update* estimates.

Table 6.11: Loan Council Allocation 2004-05

($ million)

	2004-05 Nomination [(a)]	2004-05 Revised
General government sector cash (+) deficit / (-) surplus	12	- 199
Public non-financial corporation sector cash (+) deficit / (-) surplus	- 128	748
Non-financial public sector cash (+) deficit / (-) surplus [(b)]	- 186	590
Less: Net cash flows from investments in financial assets for policy purposes [(c)]	48	20
Plus: Memorandum items [(d)]	221	345
Loan Council Allocation	**- 13**	**915**
Tolerance limit (2% of non-financial public sector cash receipts from operating activities) [(e)]	589	589

Source: Department of Treasury and Finance

Notes:

(a) *2004-05 Budget Paper No. 4.*

(b) *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.*

(c) *The non-financial public sector surplus/deficit relating to 2004-05 includes net cash flows from investments in financial assets for policy purposes.*

(d) *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).*

(e) *A tolerance limit equal to 2 per cent of 'total non-financial public sector cash receipts from operating activities' (2003-04 Budget Update) applies to jurisdictions' LCA nomination and revised LCA at budget time, and between the budget time LCA and LCA outcome. The tolerance limit applying to Victoria in 2004-05 is $589 million (2 per cent of $29 448 million – sourced from 2003-04 Budget Update).*

As part of the Loan Council arrangements, Loan Council has agreed that if at any time a jurisdiction finds that it is likely to exceed its tolerance limit, in either direction, it is required to provide an explanation to Loan Council and, in line with the emphasis of the increased transparency, to make explanation public. The 2004-05 revised LCA exceeded the tolerance limit by $339 million. The change of $928 million in the LCA between 2004-05 nomination and 2004-05 revised is mainly due to revisions in the cash position in the public non-financial corporations (PNFC).

The revision in the PNFC sector cash position from $128 million surplus to $748 million deficit is largely due to a decrease increase in net cash flows from operating activities ($99 million) and an increase in investment in capital expenditure ($799 million).

Infrastructure Projects

In the interests of transparency, the State is required to disclose the details of infrastructure projects with private sector involvement and to report full contingent exposure, if any. Exposure is to be measured by the Government's termination liabilities in a case of private sector default and disclosed as a footnote to, rather than a component, of LCAs. Listed below are details of Central Highlands Water, Royal Melbourne Showgrounds redevelopment and Royal Women's Hospital redevelopment infrastructure projects which are expected to be contracted in the 2004-05 financial year. The contract for the Mitcham-Frankston Freeway Project has been signed in the 2004-05 financial year. 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.

Central Highlands Water – North Ballarat Wastewater Plant and Re-use Project

This 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 re-use of effluent. Central Highlands Water and their consultants are focusing on *Partnerships Victoria* opportunities.

The scope of the Request for Proposal offer consists of a Design, Build, Finance, Operate arrangement where a private proponent would take responsibility of upgrading the Ballarat North and Creswick Wastewater Treatment Plants, including the construction, ownership and operation of the assets as well as the responsibility of developing the water reuse market in the Central Highlands area.

The term of the contract is proposed to be 25 years.

Royal Melbourne Showgrounds redevelopment

The project seeks private sector involvement in the design, construction, finance and maintenance of the new facilities and the provision of venue management and event attraction services. It aims to transform the Showgrounds site into a high quality multipurpose venue for the staging of the Royal Melbourne Show and other events.

The Government has allocated $100.7 million to this project. The term of the contract is proposed to be 25 years. The preferred proponent has been appointed to undertake the redevelopment. The Joint Venture Board, comprising the State and the Royal Agricultural Society of Victoria, is currently finalising contract documentation with the preferred proponent.

Royal Women's Hospital redevelopment

The Royal Women's Hospital redevelopment project will be built adjacent to the Royal Melbourne Hospital site in Parkville.

The Government has allocated $190 million to this project. The term of the contract is proposed to be 25 years.

Mitcham-Frankston Project

This project is a transport solution designed to provide a vital urban north-south link connecting 40 per cent of Melbourne's manufacturing sector and one million people to Victoria's transport network.

In August 2002, the Government combined the Eastern Freeway Extension Project with the Scoresby Freeway Project to be delivered under *Partnerships Victoria*.

The capital cost of the project is $2.5 billion.

A concession deed was executed for the Mitcham-Frankston Project with the ConnectEast consortium on 14 October 2004.

APPENDIX A: SPECIFIC POLICY INITIATIVES AFFECTING THE BUDGET POSITION

Appendix A outlines output, asset investment and revenue initiatives since the May 2004 Budget.

OUTPUT AND ASSET INITIATIVES

Government-wide initiatives

Output initiatives

Table A.1: Output initiatives – Government-wide

($ million)

	2004-05	*2005-06*	*2006-07*	*2007-08*
Veterans package	1.2	0.9	0.9	0.9
Total output initiatives	**1.2**	**0.9**	**0.9**	**0.9**

Source: Department of Treasury and Finance

Veterans package

Funding has been provided for a package of measures to support Victoria's ex-service men and women and enhance opportunities for Victorians to commemorate their service. The initiatives funded across various Government departments under this package are aimed at providing or extending concessions to veterans and supporting Anzac Day and other commemoration activities. The initiatives include extension of free Anzac Day public transport, funding for the ANZAC Day Parade in Melbourne, widening of Senior V/Line travel concessions to non-senior veterans, financial support to restore and repair Victorian Memorials and Honour Rolls and government-led overseas visits around Anzac Day by students to significant battle and commemorative sites.

Departmental initiatives

Education and Training

Table A.2: Asset initiatives – Education and Training

($ million)

	2004-05	2005-06	2006-07	2007-08	TEI
Air conditioning for schools	1.1	..	..	..	1.1
Total output initiatives	**1.1**	**..**	**..**	**..**	**1.1**

Source: Department of Treasury and Finance

Air conditioning for schools in North East Victoria

Funding is provided in 2004-05 for the upgrade/installation of air conditioners for 19 schools in North East Victoria.

Human Services

Output initiatives

Table A.3: Output initiatives – Human Services

($ million)

	2004-05	2005-06	2006-07	2007-08
Our Water Our Future - concessions	3.4	6.1	7.7	9.9
Total output initiatives	**3.4**	**6.1**	**7.7**	**9.9**

Source: Department of Treasury and Finance

Our Water Our Future - Securing Our Water Future Together

Funding is provided to increase water and sewerage concessions and expand eligibility criteria to provide consistent entitlements to all cardholders.

Asset initiatives

Table A.4: Asset initiatives – Human Services

($ million)

	2004-05	2005-06	2006-07	2007-08	TEI
Williamstown Hospital	..	2.0	..	..	2.0
Total asset initiatives	**..**	**2.0**	**..**	**..**	**2.0**

Source: Department of Treasury and Finance

Williamstown Hospital

Funding is provided to upgrade facilities at the Williamstown Hospital. The upgrade will include the enhancement of the emergency department and an increase in elective surgery and outpatient services. Design development work will be undertaken in 2004-05 with construction to commence in 2005-06.

Infrastructure

Output initiatives

Table A.5: Output initiatives – Department of Infrastructure

($ million)

	2004-05	*2005-06*	*2006-07*	*2007-08*
Mitcham Frankston Project Wellington Rd SmartBus	..	..	1.8	4.4
Regional Fast Rail	15.3	..	..	..
Total output initiatives	**15.3**	**..**	**1.8**	**4.4**

Source: Department of Treasury and Finance

Mitcham Frankston Project - Wellington Road SmartBus

Funding is provided to implement a SmartBus service along Wellington Road. The service will provide Rowville with a direct, high frequency service linking up with Monash University, existing SmartBus services on Springvale and Blackburn roads and with the rail network at three stations – Huntingdale, Oakleigh and Caulfield. This encompasses road-related bus works, and widens Wellington Road east of Springvale Road to provide for three continuous lanes each way between Huntingdale Station and Stud Road Rowville.

Regional Fast Rail

An increase in funding is provided for this project, mainly to deliver additional works required to improve the overall operational safety and efficiency of the regional fast rail services for the long-term.

Asset initiatives

Table A.6: Asset initiatives – Department of Infrastructure

($ million)

	2004-05	*2005-06*	*2006-07*	*2007-08*	*TEI*
Mitcham Frankston Project Wellington Rd SmartBus (a)	1.0	8.5	12.5	11.0	33.0
Station Pier – Safety and Security Program	8.0	7.3	..	..	15.3
Calder Highway Upgrade - Kyneton to Faraday	..	29.0	4.0	20.0	53.0
Regional Fast Rail (a)	41.4	77.1	..	..	118.5
Total Asset initiatives	**50.4**	**121.9**	**16.5**	**31.0**	**219.8**

Source: Department of Treasury and Finance

Note:
(a) Refer to the output initiatives above for a description of this initiative.

Station Pier safety and security upgrade

Funding is provided to undertake priority safety and security upgrade works on Station Pier.

Calder Highway upgrade – Kyneton to Faraday

This funding represents the remaining state contribution to the Calder Highway – Kyneton to Faraday $175 million TEI project. This project will realign the highway and provide a four lane divided road from Kyneton to Faraday and is being delivered in partnership with the Commonwealth Government.

Innovation, Industry and Regional Development

Output initiatives

Table A.7: Output initiatives – Innovation, Industry and Regional Development

($ million)

	2004-05	*2005-06*	*2006-07*	*2007-08*
Wind Energy Support Package	5.0	..	..	..
Total output initiatives	**5.0**	**..**	**..**	**..**

Source: Department of Treasury and Finance

Wind Energy Support Package

Funding of $5 million has been provided, via the Regional Infrastructure Development Fund, for the implementation of the Wind Energy Support Package. The objectives of the package are to accelerate the installation of wind turbines in environmentally acceptable locations in Victoria, to maximise Victoria's share of a limited national market for renewable energy products, and to support the development of wind energy manufacturing in Victoria.

Justice

Output initiatives

Table A.8: Output initiatives – Justice

($ million)

	2004-05	*2005-06*	*2006-07*	*2007-08*
Justice System Major Crime Resourcing Needs	4.7	8.8	8.9	7.5
Office of Public Prosecutions funding increase	3.5	3.6	3.7	2.7
Total output initiatives	**8.2**	**12.4**	**12.6**	**10.2**

Source: Department of Treasury and Finance

Justice system major crime resourcing needs

The initiative will ease the pressure on the criminal justice and corrections systems caused by expected major crime cases over the next three years. Cases will be processed up to 18 months earlier, thereby reducing the number of bail applications due to delayed cases. The initiative will fund facilities, security, two additional judges and two additional magistrates, as well as support staff and operating costs.

Office of Public Prosecutions funding increase

The funding will support the ongoing work of the OPP, which has increased as a result of the investigations of the Ceja and Purana task forces, and asset confiscation work.

Asset initiatives

Table A.9: Asset initiatives – Justice

($ million)

	2004-05	*2005-06*	*2006-07*	*2007-08*	*TEI*
Justice System Major Crime Resourcing Needs [(a)]	13.9	..	..	..	13.9
Total Asset initiatives	**13.9**	**0.0**	**0.0**	**0.0**	**13.9**

Source: Department of Treasury and Finance

Note:
(a) Refer to the output initiatives above for a description of this initiative.

Premier and Cabinet

Output initiatives

Table A.10: Output initiatives – Premier and Cabinet

($ million)

	2004-05	*2005-06*	*2006-07*	*2007-08*
Ombudsman's Office	10.0	10.2	10.5	10.7
State Library of Victoria Storage Facility	1.1	3.4	2.1	2.1
Total output initiatives	**11.1**	**13.6**	**12.6**	**12.8**

Source: Department of Treasury and Finance

Ombudsman's Office

On 3 June 2004, the Premier announced that the Victorian Government would increase funding to the Office of the Ombudsman. The Office of the Ombudsman's funding will support additional in-house capacity enabling the Office to handle its new legislative requirements and more high-profile inquiries with greater independence.

State Library of Victoria storage facility

On 22 September 2004, the Premier announced the building of a new State Library of Victoria (SLV) storage facility in Ballarat. This facility will enable improved storage as well as the consolidation of the SLV's offsite collection, which is currently stored at five different locations. Additional operating funding was provided for the management of the project and the State Collection, depreciation expenses and capital assets charge requirements due to the new building.

Asset initiatives

Table A.11: Asset initiatives – Premier and Cabinet

($ million)	2004-05	2005-06	2006-07	2007-08	TEI
State Library Victoria Storage Facility [(a)]	7.6	3.9	..	..	11.5
Total Asset initiatives	**7.6**	**3.9**	**..**	**..**	**11.5**

Source: Department of Treasury and Finance

Note:
(a) Refer to the output initiatives above for a description of this initiative.

Sustainability and Environment

Output initiatives

Table A.12: Output initiatives – Sustainability and Environment

($ million)	2004-05	2005-06	2006-07	2007-08
Our Water Our Future	41.1	58.0	60.1	62.9
Total output initiatives	**41.1**	**58.0**	**60.1**	**62.9**

Source: Department of Treasury and Finance

Our Water Our Future

Environmental contributions from water authorities will be used to fund water-related initiatives to address environmental degradation to waterways and reduce demand on water resources. The initiatives to be funded from the environmental contribution are:

- contribution to COAG Living Murray;
- smart urban water initiative and recycling;
- protecting and repairing our water sources;
- boosting the water smart farms and sustainable irrigation and land management initiatives; and
- water security for cities, farms and the environment.

Asset initiatives

Table A.13: Asset initiatives – Sustainability and Environment

($ million)	2004-05	2005-06	2006-07	2007-08	TEI
Additional funding for Piping the System - Wimmera Mallee (State component only) [(a)]	..	7.9	7.9	0.5	48.2
Our Water Our Future [(b)]	3.5	3.5	3.5	2.5	13.0
Total Asset initiatives	**3.5**	**11.4**	**11.4**	**3.0**	**61.2**

Source: Department of Treasury and Finance

Note:
(a) The balance of funds is in the out-years.
(b) Refer to the output initiative above for a description of this initiative.

Additional funding for *Piping the System* – Wimmera-Mallee (State component only)

The Victorian Government has committed, subject to new matching funding from the Commonwealth, additional funding of $48 million to provide for the replacement of the existing 17 500 kilometres of open channels with a new pipeline in the Wimmera-Mallee region. This funding is in addition to the $76.8 million already committed by the Victorian Government in the 2002-03 Budget.

REVENUE INITIATIVES

Table A.14 – Revenue initiatives

($ million)	2004-05	2005-06	2006-07	2007-08
Our Water Our Future	44.7	60.4	60.4	61.6
Land tax exemption for caravan parks	-3.0	-3.0	-3.0	-3.0
Total Revenue initiatives	**41.7**	**57.4**	**57.4**	**58.6**

Source: Department of Treasury and Finance

Our Water Our Future

From 1 October 2004, urban water authorities will be required to pay 5 per cent of their existing revenue base, and from 1 July 2005 rural authorities will be required to pay 2 per cent of their existing revenue base towards the environmental contribution.

Land tax exemption for caravan parks

The Government is providing a full land tax exemption to owners of caravan parks in Victoria. The land tax exemption will be available to caravan park owners who continue to use their land for the provision of caravan park accommodation and will apply from the 2005 land tax year.

The land tax exemption will cease if the land is sold for an alternative use, or if the current owner uses the land for a different purpose. A special land tax rate of five per cent of the unimproved value of the land would apply where previously exempt land is no longer used as a caravan park.

APPENDIX B: TAX EXPENDITURES AND CONCESSIONS

TAX EXPENDITURES

Part of the higher level of disclosure required under the *Financial Management Act 1994* is an overview of tax expenditures.

Tax expenditures are tax concessions granted to certain taxpayers, activities or assets, which are a deviation from the normal taxation treatment. This includes tax-free thresholds and can also take the form of exempting or applying a lower rate, deduction or rebate of a tax for a certain class of taxpayer, activity or asset (this excludes generally applying marginal tax rates).

Table B.1 shows aggregate tax expenditures by the main categories of tax for the period 2003-04 to 2007-08. The 2004-05 Budget estimate for total estimated tax expenditures for 2004-05 was $2 052 million, only $9 million lower than the current estimate of $2 061 million. The variations from the forecast estimates published in the 2004-05 Budget are mainly associated with minor revisions to the taxation revenue estimates. The rise in the estimates of the payroll tax expenditures since the 2004-05 Budget reflects the increase in the total wage bill for various exempt sectors. This is partly offset by a decline in the estimated tax expenditures since the budget for other stamp duties.

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

($ million)

Description	*2003-04 Estimate*	*2004-05 Estimate*	*2005-06 Estimate*	*2006-07 Estimate*	*2007-08 Estimate*
Land tax	1 170	1 282	1 466	1 395	1 329
Payroll tax	512	504	516	529	543
Gambling tax	64	69	73	77	75
Other stamp duties	113	142	145	138	139
Motor vehicle taxes	124	64	67	71	75
Total estimated tax expenditures	**1 983**	**2 061**	**2 267**	**2 210**	**2 161**

Source: Department of Treasury and Finance and State Revenue Office

CONCESSIONS

The 2004-05 Budget was the first time that concessions were reported on by the Victorian Government. The aim was to improve transparency of an important and growing component of state assistance to disadvantaged Victorians. This enhanced reporting of concessions formed part of the broader reform of concession programs in the 2004-05 Budget.

Concessions are a direct budget outlay or reduction in government charges that has the effect of reducing the price of a good or service for particular groups. Certain characteristics of the consumer, such as possession of a Commonwealth pensioner card or a health care card, are the basis for entitlement. Concessions allow certain groups in the community to access and/or purchase important amenities like energy, education, health and transportation at a cheaper rate or zero cost.

Table B.2 classifies the major concessions provided by the Victorian Government by the various categories. The current estimated total value of concession for 2004-05 is $893 million, up slightly from the $890 million estimated in the 2004-05 Budget.

Table B.2: Estimated concessions by category[(a)]

($ million)

Description	*2002-03 Estimate*	*2003-04 Estimate*	*2004-05 Estimate*
Energy	99	106	91
Municipal rates	56	55	66
Water and sewerage	63	65	69
Education	89	96	110
Health [(b)]	291	291	309
Hardship assistance [(b)]	12	11	11
Transport [(b)]	196	208	237
Total for items estimated	**806**	**832**	**893**

Source: Department of Treasury and Finance and Department of Human Services Concessions Unit Annual Report

Notes:

(a) These figures include the cost of administration.

(b) Department of Treasury and Finance estimates have been used for some of the 2003-04 and 2004-05 figures.

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

The *Financial Management Act 1994* (the Act) requires the Minister to prepare a budget update for tabling in Parliament each financial year. The provisions of the Act have been complied with in the *2004-05 Budget Update*.

Table C.1 details the statements required to be included in this document under the provisions of the Act together with appropriate chapter references.

Table C.1: Statements required by the *Financial Management Act 1994* and their location in the *2004-05 Budget Update*

Relevant section of the Act 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 H-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 5, *Estimated Financial Statements and Notes*

Table C.1: Statements required by the *Financial Management Act 1994* and their location in *2003-04 Budget Update* (cont.)

Relevant section of the Act and corresponding requirement	*Location*
(Section 23 K of the *Financial Management Act 1994*)	
Accompanying statement to estimated financial statements which:	Chapter 2*, Economic Conditions and Outlook* and Chapter 5, *Estimated Financial Statements and Notes*
– outlines the material economic assumptions used in preparation of the estimated financial statements;	
– discusses the sensitivity of the estimated financial statements to changes in these assumptions;	Chapter 4, *Statement of Risks*
– provides an overview of estimated tax expenditures in the budget; and	Appendix B, *Tax Expenditures*
– provides a statement of the risks that may have a material effect on the estimated financial statements.	Chapter 4, *Statement of Risks*