

Auditing for the Australian Capital Territory

The Auditor-General is head of the Auditor-General's Office. He and his Office act independently of the Government. The Office assists the Auditor-General to carry out his duties, which are set out in the Auditor-General Act 1996, by undertaking audits of management performance and the financial statements of public sector bodies. The aim is to improve public sector management and accountability by firstly, ensuring the Legislative Assembly and the electorate are provided with accurate and useful information about the management of public sector resources and secondly, by providing independent advice and recommendations for improving the management of public resources.

A98/43

8 December 1998

The Speaker
ACT Legislative Assembly
South Building
London Circuit
CANBERRA ACT 2601

Dear Mr Speaker

In accordance with the Authority contained in the *Auditor-General Act 1996*, I transmit to the Legislative Assembly my Report titled “*Territory Operating Losses and Financial Position*”.

Yours sincerely

John A Parkinson

TABLE OF CONTENTS

CHAPTER	PAGE
1. REPORT SUMMARY.....	1
2. ANNUAL FINANCIAL REPORTING FOR THE TERRITORY GOVERNMENT.....	10
3. TERRITORY OPERATING LOSSES.....	13
4. TERRITORY FINANCIAL POSITION.....	23
5. SUPERANNUATION COSTS.....	28
6. ACTIONS TO ADDRESS THE OPERATING LOSS AND THE UNFUNDED LIABILITIES.....	36
7. ANALYSIS OF REVENUE AND EXPENSES.....	46
 <i>APPENDIX 1</i>	
CHIEF MINISTER'S DEPARTMENT LETTER AND SUMMARY.....	53

1. REPORT SUMMARY

1.1 INTRODUCTION

In accordance with the *Financial Management Act 1996* financial statements prepared on an accrual basis have been prepared by the Chief Minister's Department for the Territory. The first set of statements was prepared for 1995-96. The 1997-98 statements are therefore the third set of statements prepared on an accrual basis.

As stated in previous Auditor-General's Reports the preparation and presentation of accrual statements is an excellent initiative which provides the community, the Legislative Assembly and the Government with much more useful information than was previously available.

This Report contains the results of an audit analysis of the financial statements including comparisons with previous years. As the most significant issue which the statements identify are the Territory's operating losses, the Report concentrates mainly on the generation of the losses and the impacts of the losses on the Territory's future finances.

The Report also includes comments on the importance of converting the operating losses to surpluses. Further comment is also made on the inevitable sale of assets to meet unfunded liabilities if substantial surpluses cannot be generated in a relatively short time frame.

Comments are provided on the Territory's unfunded liabilities which continue to grow as a result of the operating losses. The majority of the unfunded liabilities are related to employees

who are members of the Commonwealth Superannuation Scheme (CSS) or the Public Sector Superannuation Scheme (PSS).

1.2 SIGNIFICANT POINTS IN THIS REPORT

Annual Financial Statements (*Chapter 2*)

- *The preparation and presentation to the Legislative Assembly of Consolidated Financial Statements for the Territory prepared in accordance with Australian Accounting Standards, is an excellent initiative which should enable more informed decision making on financial strategies and public resource allocation as well as enhancing accountability; and*
- *An unqualified audit opinion on the Consolidated Financial Statements was provided to the Chief Minister on 30 November 1998.*

Territory Operating Losses (*Chapter 3*)

- *The Territory's 1997-98 operating loss at \$170m is a deterioration from the \$153m 1996-97 loss;*
- *The 1997-98 loss as with previous losses will have to be met from future payments by ACT residents and/or reductions in Government services;*
- *The combined 1996-97 and 1997-98 losses are the equivalent of around \$1,500 annually for each ACT household;*
- *The Territory's ability to operate at a large loss without considerable borrowing has*

been facilitated to a large extent by the Territory being able to defer into the future the cash payments for significant employee costs incurred in delivering services (e.g. employer superannuation contributions);

- *The Territory generated small cash surpluses from operations and net capital expenditure in 1996-97 and 1997-98; however the surpluses are far less than the amounts needed to meet employee costs incurred but not paid for in those years;*
- *The budget forward estimates forecast large operating losses continuing through to the limit of the forecasts (year 2000-01); these losses will increase the amounts to be met in the future by taxpayers; and*
- *The size of the losses are sufficient to significantly affect the future standard of living of ACT residents.*

Territory Financial Position (Chapter 4)

- *Mainly as a result of the Operating Loss the Territory's net assets have reduced by \$240m between 1996-97 and 1997-98;*
- *The Territory's unfunded financial liabilities increased by \$103m in 1997-98;*
- *The Territory's total unfunded liabilities at the end of 1997-98 were \$1,298m; and*
- *In the normal course of operations the Territory's unfunded financial liabilities will continue to grow until the Territory ceases to incur operating losses; in the normal course of operations operating surpluses are essential to reduce the unfunded liabilities.*

Superannuation Costs (Chapter 5)

- *Superannuation liabilities increased by \$164m in 1997-98 to \$1089m;*
- *The unfunded superannuation liabilities at 30 June 1998 were estimated to be \$770m; this equates to around \$7700 for every household in the ACT;*
- *The \$770m unfunded liability is the estimated total superannuation liability at 30 June 1998 of \$1089m less investments of \$319m “dedicated” for the purpose of meeting the superannuation liability;*
- *There is no legislation or other requirement which requires investments currently “dedicated” to meet superannuation liabilities to remain dedicated for that purpose;*
- *The unfunded superannuation liabilities represent 59% of the Territory’s total unfunded liabilities;*
- *The unfunded superannuation liabilities should not be considered in isolation from other unfunded liabilities; and*
- *The ageing profile of ACT employees means that many employees will be reaching retirement age in the early part of the 21st century; at this time it will become necessary for the Territory to meet its obligations (i.e. the liabilities) in cash for an increasing number of retired employees’ superannuation entitlements.*

Actions to Address the Operating Loss and the Unfunded Liabilities (Chapter 6)

- *The Chief Minister’s Department has advised of several initiatives being*

undertaken, planned or considered to address the Territory's operating losses (see Appendix 1);

- *In the ordinary course of events reducing costs and/or increasing revenue would be the solution to converting losses to surpluses; however for the Territory, significantly reducing costs or increasing revenue at least in the short to medium term, is likely to be very difficult;*
- *If the Territory's losses continue, and this seems probable, the Territory's unfunded liabilities will also continue to increase;*
- *If the operating losses continue it is inevitable that major asset sales must take place to provide funds to meet liabilities as they fall due;*
- *If major sales of assets are inevitable, ACTEW is a readily saleable asset; the sale proceeds would significantly contribute to meeting the Territory's growing unfunded liabilities; and*
- *If ACTEW is to be sold, as the selling value is likely to reduce in the future, the most appropriate course would be to sell earlier rather than later.*

1.3 COMMENTARY

The significant points raised in this Report show clearly the extent and consistency of the Territory's losses. The extent of the losses are clearly illustrated when the losses are related to Territory households. The losses are running at the equivalent of \$1,500 per household per

year. These are costs which will have to be met somehow in the future. Budget forecasts are that losses will continue at least for some years.

As in previous Auditor-General's Reports the point is made that the Territory has been able to defer meeting in cash costs being incurred in the present. The most significant of these costs is employer contributions for superannuation.

As a result of the operating losses the Territory's net asset position is falling and its unfunded liabilities are increasing. At 30 June 1998 the unfunded liabilities were \$1,298m.

Of the unfunded liabilities mentioned in the previous paragraph the superannuation component is the largest at \$770m. The \$770m is the result of a total superannuation liability of \$1,089m offset by \$319m of investments "dedicated" to meeting superannuation liabilities as they fall due. It should be noted there is no legislative requirement or other restriction preventing the currently "dedicated" investments being used for other purposes.

The best estimations show that the cash required to meet superannuation liabilities will gradually increase to the year 2019 when the cash payment required will be \$119m for the year. The cash requirement will gradually fall after 2019 but will remain substantial for many years after 2019.

In the normal course of events the best solution to the unfunded liabilities situation would be to take prompt action to convert the operating losses into substantial surpluses by increasing revenue and/or reducing costs. Community attitudes and political realities however would seem to make this solution unachievable. It is likely to be many years before surpluses can be generated.

If the losses continue as seems probable, the Territory's unfunded liabilities will continue to grow. This will make it inevitable that major Territory assets must eventually be sold to meet the liabilities when they fall due.

The Territory has a wide range of physical assets that potentially could be considered for sale. These include a public hospital, schools, roads, public housing, parks, electricity, water, sewerage assets and many others. The most valuable are public housing and electricity, water and sewerage assets.

Although the Territory can be regarded as asset rich in the sense of the quality and quantity of its infrastructure assets, very few of its assets would be readily saleable or saleable for a price which would be large enough to address the unfunded liabilities problem.

A major asset currently under consideration for sale by the Legislative Assembly is ACTEW. There is a ready market for ACTEW and if estimates are correct the sale proceeds could make a significant contribution to meeting liabilities as they fall due.

There is also the matter of the timing of an ACTEW sale. All projections seem to be that the selling value of ACTEW will reduce over time. As the sale value of ACTEW is likely to reduce significantly over time an early sale would be more financially beneficial than retaining the asset until liabilities fall due for payment.

There is no doubt that the problem of the large losses and the projected large further losses has the potential to effect the future standard of living of ACT residents. The problem is of a magnitude that solutions to eliminate or significantly reduce the losses will not be

effectively implemented unless a cooperative and constructive approach is taken by all Members of a fully informed Legislative Assembly.

The size of past losses, and the almost certainty that the losses will continue into the future, has created a situation where there seems no choice other than that major assets of the Territory will have to be sold.

1.4 ANALYSIS OF REVENUES AND EXPENSES (*Chapter 7*)

Revenue

- *At \$1,354m, Territory own source revenue rose by \$8m (less than 1%) over the previous year's revenue of \$1,335m;*
- *Commonwealth grant income remained static; and*
- *The main contributions to the increased own source revenue came from rises in Territory Taxes of \$31m and other revenue of \$15m; these rises were partially offset by falls in revenue on investments and interest of \$15m and charges for goods and services of \$20m.*

Expenditure

- *Total expenditure increased by \$61m (3%) over last year; and*
- *The increased expenditure was mostly due to rises in wages, salaries and other employee costs \$20m, superannuation \$41m, administrative and other expenses*

\$18m; these rises were partially offset by a fall in costs of goods sold of \$28m.

Commentary

The overall increase in Territory revenue of \$8m was less than a 1% increase. This represented a significant reduction in the upward trend in revenue compared to the \$129m increase of last year. The overall rise was due to increases in Territory taxes of \$31m and other revenue of \$15m which was partially offset by falls in revenue on investments and interest of \$15m and charges for goods and services of \$20m.

The increase in expenditure (3%) can be attributed to normal cost fluctuations between years.

2. ANNUAL FINANCIAL REPORTING FOR THE TERRITORY GOVERNMENT

2.1 INTRODUCTION

In accordance with the *Financial Management Act 1996* (the Act) the Treasurer prepared Consolidated Financial Statements for the Territory and forwarded these to the Auditor-General for auditing within the timeframe allowed by the Act.

As required by the Act the consolidated financial statements consisted of:

- Operating Statement;
- Statement of Financial Position;
- Statement of Cash Flows;
- Supporting notes which describe the accounting policies applied and other explanatory material; and
- Statement of Appropriation.

The statements have been prepared in accordance with Australian Accounting Standards, in particular, AAS31 *Financial Reporting by Governments*.

2.2 SIGNIFICANT POINTS IN THIS CHAPTER

- *The preparation and presentation to the Legislative Assembly of Consolidated Financial Statements for the Territory, prepared in accordance with Australian Accounting Standards, is an excellent initiative which should enable more*

informed decision making on financial strategies and public resource allocation as well as enhancing accountability; and

- *An unqualified audit opinion on the Consolidated Financial Statements was provided to the Chief Minister on 30 November 1998.*

2.3 AGENCIES CONSOLIDATED

The consolidated financial statements were prepared by consolidating the financial statements of most public sector entities into one set of statements. Some entities are excluded.

The financial statements do not consolidate the Construction Industry Long Service Leave Board, the Rental Bonds Board, or the Registrar of Financial Institutions. Assets and liabilities related to the trust activities of the Public Trustee have also not been consolidated. The entities excluded are not considered to be Government controlled and were therefore not consolidated. Territory agencies are also responsible for a number of other Boards and Trusts which are immaterial in nature. Immaterial Boards and Trusts have not been included in the consolidation.

Audit Comments

The presentation of the Consolidated Financial Statements is an essential conclusion to the annual financial planning and reporting process. The process commences with the Territorial budget being produced on the basis of generally accepted accounting principles (i.e. Australian Accounting Standards) and is

concluded with the preparation of the financial statements prepared on the same basis.

The presentation to the Assembly of Consolidated Financial Statements for the Territory prepared in accordance with Australian Accounting Standards is an excellent initiative.

The statements contribute to more transparent reporting of the Territory's overall financial operations and financial position and should enable more informed decision making on financial strategies and public resource allocation.

Most of the commentary in the later Chapters of this Report are based on information presented in the Territory's Consolidated Financial Statements.

2.4 INDEPENDENT AUDIT OPINION FOR THE TERRITORY STATEMENTS

Section 24 of the Financial Management Act provides that the Auditor General shall provide an audit opinion on the Territory's annual financial statements within 30 days of receiving the statements from the Treasurer. Signed unaudited financial statements were received from the Treasurer on 2 November 1998.

An *unqualified* audit opinion was signed on 30 November 1998 and provided to the Treasurer on that day.

3. TERRITORY OPERATING LOSSES

3.1 INTRODUCTION

This Chapter discusses the Territory's operating loss and illustrates the significance of the size of the loss. Cash results are also presented and how the operating loss prepared on an accrual basis reconciles to the small surplus produced on a cash basis is explained.

3.2 SIGNIFICANT POINTS IN THIS CHAPTER

- *The Territory's 1997-98 operating loss at \$170m is a deterioration from the \$153m 1996-97 loss;*
- *The Territory generated small cash surpluses from operations and net capital expenditure in 1996-97 and 1997-98; however the surpluses are far less than the amounts needed to meet employee costs incurred but not paid for in those years;*
- *The 1997-98 loss as with previous losses will have to be met from future payments by ACT residents and/or reductions in Government services;*
- *The combined 1996-97 and 1997-98 losses are the equivalent of around \$1,500 annually for each ACT household;*
- *The Territory's ability to operate at a large loss without considerable borrowing has been facilitated to a large extent by the Territory being able to defer into the future the cash payments for significant employee*

costs incurred in delivering services (e.g. employer superannuation contributions);

- *The budget forward estimates forecast large losses continuing through to the limit of the forecasts (year 2000-01); these losses will increase the amounts to be met in the future by taxpayers; and*
- *The size of the losses are sufficient to significantly affect the future standard of living of ACT residents.*

3.3 OPERATING RESULT

The operating result is a key measure of the Government's financial performance and highlights the extent to which the costs of service delivery are covered by the revenues raised in the year. When assessed over a sequence of years the operating result is an important indicator of the financial sustainability of the Government's strategies and policies.

The following table summarises the Territory's audited operating results for 1997-98, 1996-97 and 1995-96.

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

Operating Results			
	1997-98	1996-97	1995-96
	Actual	Actual*	Actual
	\$m	\$m	\$m
Revenue	1,915	1,910	1,771
Expenses	2,063	2,010	2,024
Operating Loss before Abnormal Items			
	148	100	253
Abnormal Items (net expenses)	21	53	91
Operating Loss	169	153	344
Extraordinary Item (net expenses)	1	0	0
Operating Loss after Extraordinary Items	170	153	344
* Adjustments have been made to 1996-97 figures to facilitate comparison with the current year.			

The financial statements, disclose that the Territory's 1997-98 *operating loss* was \$170m. This is equivalent to 8.9% of the year's revenue. The *Operating Loss* excluding *abnormal items*, was \$148m. As can be seen both the 1997-98 *operating loss* and the *operating loss before abnormal items* deteriorated from the previous year's results.

The *Operating Result before Abnormal Items* provides the best indication of financial results for comparative purposes between years as it excludes abnormal and extraordinary items. Abnormal and extraordinary items are specifically provided for in Australian Accounting Standards. Abnormal items are items of revenue and/or expenditure which should be disclosed separately from other revenue or expense because of their size and effect on the operating results for the period. Separating the abnormal and extraordinary items allows the underlying operating results to be disclosed.

As an illustration of abnormal items, the 1997-98 abnormal items consisted mainly of the financial effect of the Goodwin Homes transferred at no charge to community organisations and a \$14m write down of the value of certain land and buildings.

The deterioration of \$48m in comparison to the 1996-97 *operating loss before abnormals* was due to increased expenditure of \$53m (2.6%) offset by a small increase in revenue of \$5m.

The 1997-98 *operating loss before abnormals* was \$105m less than the 1995-96 loss. As the table shows this was entirely attributable to additional revenue which was \$144m more in 1997-98 than in 1995-96. Expenditure in 1997-98 was \$39m (1.9%) more than in 1995-96.

Some comments on revenue and expenses are provided in *Chapter 7* of this Report.

3.4 GENERATION OF THE LOSSES

The ACT's large operating losses have been produced by the full costs of the delivery of day to day Government services exceeding available income from Commonwealth sources and the revenue the Territory generates from its own sources (e.g. taxes, fees, fines, electricity and water charges, etc).

Because the Government currently uses its own agencies to provide most services, it is able to defer meeting significant parts of the costs incurred in providing the services (in particular. employer superannuation contributions). The ability to conveniently defer meeting costs has

facilitated the Territory not needing to borrow to cover all of its operating losses.

If the provision of services was purchased from the private sector the same capacity to defer costs and avoid borrowings would not exist. The suppliers' prices charged to the Territory would cover all the costs of supply.

3.5 CASH FLOW SURPLUSES

Introduction

Australian Accounting Standards recognise that operating statements prepared on an accrual basis do not provide the full picture of an entity's financial transactions. The importance of cash transactions is recognised by the requirement that the financial statements of a reporting entity must include a statement of cash flows. Accordingly the Territory's financial statements include a cash flow statement. The following information has been extracted from that Statement of Cash Flows.

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

Summarised Operating and Capital Cash Flows		
	1997-98	1996-97
	\$m	\$m
Operating		
Receipts	1,850	1,820
Payments	(1,659)	(1,634)
Net Inflow	191	186
Capital		
Purchase of Capital Assets	(194)	(206)
Sale of Capital Assets	38	39
Net Outflows	(156)	(167)
Total Net Inflow	35	19
Note: The Territory's published cash flow statement includes other transactions however these are for purposes of financing and therefore are not presented in this table.		

The table shows that on a cash basis the Territory has operated with small cash surpluses in each of the last two years. This means that after the Territory met the year's cash requirements for the normal delivery of services and the capital program there was some cash remaining. This remaining cash however was far less than is needed to meet costs which were incurred in the delivery of the services during the year but not paid for by cash (i.e the deferred costs mentioned earlier in this Chapter). These costs will have to be met in cash some time in the future. As should now be well known the Territory has significant costs of this nature, employees' superannuation entitlements being the main one.

3.6 RECONCILIATION BETWEEN OPERATING LOSSES AND OPERATING CASH FLOWS

Introduction

As previously indicated Australian Accounting Standards recognise the importance of both Operating Statements prepared on an accrual basis and Cash Flow Statements prepared on a cash basis. The Standards also recognise that the reasons for differing results presented in Operating Statements and Cash Flow Statements should be available to users of the statements. Accordingly the Standards require a note to be included with the financial statements which reconciles the Operating Statement's operating results with the operating results shown in the Cash Flow Statement. As required, a note of this nature was included in the Territory's 1997-98 financial statements.

The items disclosed in the reconciliation note identify deferred service delivery costs and other costs and revenues not paid for in cash or received in cash during the year. The costs are costs which have been incurred in the year, and therefore included in the year's Operating Statement, but not paid in cash in the year so therefore not included in the Cash Flow Statement. Correspondingly reconciling revenues are those which have been generated in the year but not received in cash in that year (e.g. increases in the value of shares).

The information in the following table has been extracted from the reconciliation note.

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

Reconciliation Between Net Cash Inflows from Operations and Operating Loss Before Abnormal Items		
	1997-98	1996-97
	\$m	\$m
Cash Flow Statement — <i>Net Cash Inflows from Operations</i>	191	186
<i>Add</i>		
Unrealised Investment Income (e.g. increases in share values)	26	40
Decrease in Net Operating Liabilities other than Employee Entitlements	13	-
Decrease in Net Operating Assets other than Employee Entitlements	5	-
Gain on Disposal of Assets	2	-
	237	226
<i>Less</i>		
Increase in Provision for Employee Entitlements	(173)	(115)
Depreciation	(212)	(208)
Loss on Disposal of Assets	-	(2)
Increase in Net Operating Assets other than Employee Entitlements	-	(1)
Operating Statement — <i>Operating Loss before Abnormal Items</i>	(148)	(100)

Deferred Employee Costs Identified in Operating Statement/Cash Flow Reconciliation

As the table shows the increase in *Provision for Employee Entitlements* contributed \$173m to the difference between the 1997-98 *Net Cash Inflow* and the *Operating Loss*.

The major part of the *Provision for Employee Entitlements* increase arises from Superannuation Entitlements which accounted for \$166m of the \$173m. That is, employee superannuation costs incurred as a result of employing staff to deliver services in 1997-98 generated costs of \$166m which were not met by cash payments during 1997-98. This \$166m however will have to be paid in cash sometime in the future.

The remaining \$7m of the \$173m is mostly long service leave which is similar to superannuation in that the costs will have to be met in cash sometime in the future. The

liability for long service leave at 30 June 1998 was \$129m.

3.7 COMPARISON WITH BUDGET

The following table sets out the 1997-98 operating result compared to budget.

Operating Result Comparisons with Budget		
	1997-98 Actual \$m	1997-98 Budget \$m
Revenue	1,915	1,822
Expenses	2,063	2,058
Operating Loss before Abnormal Items	148	236
Abnormal and Extraordinary Items	22	0
Operating Loss	170	236

When compared with budget the *operating loss before abnormal items* shows a significant positive variance of \$88m. As the table shows the entire positive result was generated by revenue being \$93m more than budgeted.

As actual revenue in the previous year (1996-97) was \$1,910m, setting the 1997-98 revenue budget at \$1,822m (\$88m less) was clearly very conservative. On this basis the better than budget operating result is clearly more attributable to a conservative revenue budget than other factors.

3.8 SIGNIFICANCE OF THE OPERATING LOSSES

The operating loss for 1997-98 was a deterioration on the previous year's result.

Previous Auditor-General's Reports have commented on the eventual effects if the Territory continues to operate with revenue generation being less than expenditure incurred. The losses for 1996-97 and 1997-98 continue to represent significant amounts.

The significance to the ACT Community of the existence of the large losses is that the losses will eventually have to be met from future Territory revenues and these revenues must be supplied by the taxpayers in the community. Alternatively the Territory will have to significantly reduce services, and/or sell some of the taxpayers' significant public assets. Also almost certainly the capital works program will have to be cut.

The size of the losses over 1996-97 and 1997-98 is illustrated when the aggregate loss of \$323m for the two years is related to the Territory's number of households i.e. an average of around \$1,500 per household for each of the two years. What this means is that each household will eventually have to meet these amounts through rates, taxes, etc, unless some way can be devised to convert the current chronic loss situation into substantial surpluses without imposing large additional charges on Territory residents.

The 1997-98 ACT budget papers project losses through to the year 2001-02 (the limit of the forecasts) meaning that the amounts to be met by future taxpayers will continue to escalate by large amounts each year.

4. TERRITORY FINANCIAL POSITION

4.1 INTRODUCTION

The Territory's Statement of Financial Position (also known as the Balance Sheet) is an important indicator of the Territory's financial strength and, when comparative balances are presented, of changes in the overall financial position.

This Chapter summarises the Statement of Financial Position and provides comments on recent trends.

4.2 SIGNIFICANT POINTS IN THIS CHAPTER

- *Mainly as a result of the Operating Loss the Territory's net assets have reduced by \$240m between 1996-97 and 1997-98;*
- *The Territory's unfunded financial liabilities increased by \$103m in 1997-98;*
- *The Territory's total unfunded liabilities at the end of 1997-98 were \$1,298m; and*
- *In the normal course of operations the Territory's unfunded financial liabilities will continue to grow until the Territory ceases to incur operating losses; in the normal course of operations operating surpluses are essential to reduce unfunded liabilities.*

4.3 STATEMENT OF FINANCIAL POSITION

Net Assets

The following table summarises the Territory's Statement of Financial Position at the end of 1995-96, 1996-97 and 1997-98.

Summarised Statement of Financial Position			
	1997-98	1996-97	1995-96
	\$m	\$m	\$m
Assets			
Cash, Investments and Receivables	976	877	804
Physical Assets	8,151	8,288	8,409
	9,127	9,165	9,213
Liabilities			
Borrowings, Finance Leases and Creditors	915	867	823
Employees' Superannuation Entitlements	1,099	934	820
Other Employee entitlements	229	222	221
Other	31	49	52
	2,274	2,072	1,916
Net Assets	6,853	7,093	7,297

The table shows that the Territory's *Net Asset* position has diminished by \$240m between the beginning and end of 1997-98 from \$7,093m to \$6,853m. The reduction was predominantly through the loss incurred from operations in 1997-98. Over the two years since the end of 1995-96 the *Net Assets* position has diminished by a total of \$444m.

As the table shows, the majority of the Territory's assets are physical assets i.e. roads, land, office buildings, public housing, schools, hospitals, electricity and water assets, other plant and equipment and various other public infrastructure. These physical assets account for \$8,151m (89%) of the Territory's total assets. The majority of these assets are used to

deliver services to the community and therefore, in the normal course of events are not readily realisable assets.

Almost any asset of course can be realised. In the normal course of events however it would be expected that the Territory will retain physical assets until they are no longer needed or must be replaced because of deterioration or obsolescence. Unfortunately the expected continuation of the Territory's losses as they have been in recent years is likely to make maintaining the "normal course of events" very difficult. If losses continue selling physical assets will become inevitable.

In contrast to the physical assets the Territory's financial assets (i.e. cash, investments and receivables) at \$976m represent 11% of the total assets.

The Territory's liabilities arise from various requirements to repay past borrowings and other financing arrangements, to pay creditors for services provided prior to year end but not paid for at year end, and to meet employees' entitlements arising as a result of work performed prior to year end but which does not need to be paid for in cash until sometime in the future.

All of the Territory's liabilities will have to be met in cash at some time in the future and therefore can be categorised as financial liabilities. Some will need to be met in cash in the immediate future while the majority will be payable over a much longer term.

The importance of superannuation liabilities is clear in that these liabilities are now the largest of the Territory's liabilities.

Territory's Unfunded Liabilities

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

In effect the shortfall between financial assets and financial liabilities represents the Territory's overall *unfunded liabilities*. The following table compares the Territory's *unfunded liabilities* as they stood at the close of each of the last three years.

Net Financial Liabilities (Unfunded Liabilities)			
	1997-98	1996-97	1995-96
	Actual	Actual	Actual
	\$m	\$m	\$m
Financial Assets	976	877	804
Financial Liabilities	2,274	2,072	1,916
Net Unfunded Financial Liabilities	1,298	1,195	1,112

The table shows that unfunded financial liabilities (i.e. the excess of financial liabilities over financial assets) increased by \$83m in 1996-97 and by a further \$103m in 1997-98.

Summary

It is acknowledged that the majority of the Territory's liabilities do not have to be met for some years and there is therefore no current threat to the Territory's solvency or its credit ratings. The table does however reflect that the Territory's unfunded liabilities are growing quickly.

If the forecast losses reported in the budget papers eventuate, the differences between financial assets and financial liabilities will continue to grow. The unfunded liabilities will continue to grow unless the Territory's operating losses can be eliminated. For the net liabilities to be reduced through normal operations the generation of operating surpluses is essential.

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

As the summarised financial position statement presented earlier in this Chapter shows *Superannuation Entitlements* are now the largest component of the Territory's financial liabilities. Comment is provided on the superannuation liability in the next Chapter of this Report.

5. SUPERANNUATION COSTS

5.1 INTRODUCTION

In *Chapter 2* the ACT's Operating Loss was discussed. In that Chapter comment was made that the ACT was able to operate with large operating losses without large borrowings as it was able to defer into the future meeting in cash significant costs incurred in delivering its services to the community. The most significant deferred cost is the ACT's superannuation employer contributions for its employees. The deferred costs relate to employer contributions for employees in the Commonwealth Superannuation Scheme (CSS) and the Public Sector Superannuation Scheme (PSS). The costs and liabilities referred to in this Report relate only to these schemes.

In *Chapter 3* the Territory's growing excess of financial liabilities over financial assets (i.e. the Territory's total unfunded liabilities) were discussed. Comment was also made that the liability arising from deferring employer contributions for superannuation is now the largest component of the Territory's liabilities.

This Chapter provides information on the superannuation liability.

5.2 SIGNIFICANT POINTS IN THIS CHAPTER

- *Superannuation liabilities increased by \$164m in 1997-98 to \$1,089m;*

- *The unfunded superannuation liabilities at 30 June 1998 were estimated to be \$770m; this equates to around \$7,700 for every household in the ACT;*
- *The \$770m unfunded liability is the total superannuation liability at 30 June 1998 of \$1,089m less investments of \$319m “dedicated” for the purpose of meeting the superannuation liability;*
- *There is no legislation or other requirement which requires investments currently “dedicated” to meet superannuation liabilities to remain dedicated for that purpose;*
- *The unfunded superannuation liabilities represent 59% of the Territory’s total unfunded liabilities;*
- *The unfunded superannuation liabilities should not be considered in isolation from other unfunded liabilities; and*
- *The ageing profile of ACT employees means that many employees will be reaching retirement age in the early part of the 21st century; at this time it will become necessary for the Territory to meet its obligations (i.e. the liabilities) in cash for an increasing number of retired employees’ superannuation entitlements.*

5.3 UNFUNDED SUPERANNUATION LIABILITIES

As at 30 June 1998, the ACT Government had total unfunded superannuation liabilities of around \$770m, funding for which, in the normal course of events, will need to be

obtained from future revenues. This equates to around \$7,700 for every household in the ACT. It is also the equivalent of around \$35,000 average for each Territory employee. Under current projections the unfunded liabilities will continue to significantly increase over future years.

Investments Held for Superannuation

The policy of previous and current Governments has been to “dedicate” certain financial assets as being set aside for eventual conversion to cash to meet retiring employee’s entitlements when they become payable. The income earned from these dedicated investments is reinvested and also becomes dedicated to superannuation.

It is necessary to point out that the dedicated investments can become undedicated at any time simply through changes of Government policy or if other higher priority needs are seen to exist. There is currently no legislation which will ensure that the investments remain dedicated.

The process of dedicating investments is currently facilitated through the “Superannuation Provision Unit” of the Chief Minister’s Department. This unit was established to receive funds and make payments in connection with the management of the superannuation liabilities of the Territory, Territory Authorities and Territory Owned Corporations. The investments dedicated to superannuation are recorded as assets in the records of the Unit.

The Superannuation Unfunded Liabilities

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

At any time the difference between the total liability for employees' superannuation entitlements and the investments dedicated as being to meet the superannuation liability is referred to as the *unfunded superannuation liabilities*.

The level of *unfunded superannuation liabilities* as reported in the *Superannuation Provision Unit* financial statements over the past five years has been as follows:

	1993-94	1994-95	1995-96	1996-97	1997-98
	\$m	\$m	\$m	\$m	\$m
Total Superannuation Liabilities	465	577	821	925	1089
Less Investments Held	<u>149</u>	<u>192</u>	<u>219</u>	<u>274</u>	<u>319</u>
Unfunded Liabilities	<u>316</u>	<u>385</u>	<u>602</u>	<u>651</u>	<u>770</u>
<i>Unfunded Liabilities as a % of Total Liabilities</i>	68.0%	66.5%	73.3%	69.5%	70.3%

Note: Total superannuation liabilities varies by \$10m from the amount of \$1.099m shown in the Territories consolidated statements due to the emerging cost deficit of \$5m shown in the Superannuation Provision Unit's financial statements and \$5m in liabilities relating to external superannuation funds.

The Superannuation Liabilities in the Context of All Liabilities

It must be recognised that conceptually the superannuation liability is no different from any other liability (e.g. borrowings) and therefore it could be misleading to consider the superannuation liabilities in isolation from other liabilities. The following table illustrates the superannuation liabilities in the context of all Territory liabilities.

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

	1997-98 \$m	% of Total Liabilities	1996-97 \$m	% of Total Liabilities
Superannuation Liabilities	1,089		925	
<i>Less - Dedicated Financial Assets</i>	319		274	
<i>Unfunded Superannuation Liabilities</i>	770	59.3	651	54.5
Other Liabilities	1,185		1,147	
<i>Less - Non Superannuation Dedicated Financial Assets</i>	657		603	
<i>Unfunded Other Liabilities</i>	528	40.7	544	45.5
Total Unfunded Liabilities	1,298	100.0	1,195	100.0

The purpose of presenting the previous table is to help to explain that if actions are taken to reduce the *unfunded superannuation liabilities* by dedicating investments to superannuation which were previously undedicated will simply result in a corresponding increase to *unfunded other liabilities*. If this happens clearly the Territory is no better off. For example an administrative or budget decision effectively achieves nothing if all that happens is that \$100m of non superannuation dedicated investments becomes dedicated superannuation investments. It could legitimately be stated that the decision has resulted in *unfunded superannuation liabilities* being reduced by \$100m. The decision however would also result in *other unfunded liabilities* increasing by the same amount.

Similarly requiring Departments to contribute their superannuation costs to the Superannuation Unit, and providing the Departments with the money to cover the contributions by borrowing, has no overall effect on the Territory's total net unfunded liabilities.

5.4 PAYMENT OF THE SUPERANNUATION LIABILITY

The ACT Government meets in cash the reimbursement of the emerging costs of benefits paid each year to members of the Commonwealth Superannuation Scheme (CSS) and the Public Sector Superannuation Scheme (PSS) for ACT Government Service after 1 July 1989.

The cash amounts which the ACT will have to pay to Comsuper in future years to meet superannuation payments to past employees have been estimated by the Government's superannuation consultants Towers Perrin. A sample of the estimated annual payments are shown in the following table.

Emerging Cost Payment Schedule¹	
Year Beginning	\$m
July 1998	13.9
1999	17.1
2000	20.4
2001	25.3
2007	55.9
2013	94.0
2019	118.7
2025	112.0
2031	88.9
2037	67.9
2043	39.8

The table illustrates the rapidly escalating rate of payments which will be required until 2019. The annual payment requirement then will gradually decline after 2019.

¹ Towers Perrin Report to ACT Government 29 April 1998 page 65

This escalation is the result of the combination of the short period of ACT responsibility for employees' superannuation and the ageing profile of ACT employees. The primary factor in the initial years is that the ACT liability related only to CSS/PSS members employed with the ACT Public Service from 1 July 1989. The Commonwealth is liable prior to that date. This means that the ACT share of the superannuation payments to long-serving retirees is at present quite low. This share will increase as service with the ACTPS becomes a larger proportion of total service. The second factor is the ageing profile of ACT employees. In the earlier part of the 21st century many of these employees will be reaching retirement age when it will become necessary for the Territory to meet its obligations for their superannuation entitlements in cash. The table also illustrates that after about the year 2025 the emerging cost will reduce in line with the decreasing number of members of the CSS and PSS. This is the result of the closure of the CSS to new members in 1990 and the anticipated closure of the PSS to new members from 1 July 1999.

5.5 SUMMARY

The ACT has been responsible for meeting the superannuation costs incurred in respect of its employees since Self Government was implemented in 1989. These costs generally are not required to be met in cash until the employees retire from the Territory's employ. Although these payments are not required to be paid in cash until sometime in the future they are costs generated during each year that an employee works. The requirement to pay the

superannuation contribution is generated when the employees perform their duties (i.e. the cost is unavoidably incurred at that time).

As Territory Governments to date have not invested funds to match the costs as they were being incurred '*unfunded liabilities*', (i.e. the cash which will have to be found in the future), have inevitably grown.

The repayment schedule prepared by the Government's consultant shows that within a relatively short time large amounts of the '*unfunded liabilities*' will need to become funded when Comsuper seeks reimbursement of ACT's share of the superannuation payments it makes to retired ACT employees. The payments will continue to grow rapidly to 2019. It is estimated the cash required in 2019 will be \$119m.

It should be noted that the unfunded superannuation liabilities at 30 June 1998 represented 59% of total unfunded liabilities. As unfunded superannuation liabilities comprise only part of total unfunded liabilities any consideration of the superannuation liabilities should not occur in isolation from other liabilities.

6. ACTIONS TO ADDRESS THE OPERATING LOSS AND THE UNFUNDED LIABILITIES

6.1 INTRODUCTION

This Chapter comments generally on the feasibility of converting the Territory's operating losses into surpluses in the normal course of events. There is also comment on whether assets sales will be necessary.

Given the seriousness of the prospect of continuing operating losses and growing unfunded losses, comments are provided on the sale of ACTEW which is currently being considered by the Legislative Assembly.

6.2 SIGNIFICANT POINTS IN THIS CHAPTER

- *The Chief Minister's Department has advised of several initiatives being undertaken, planned or considered to address the Territory's operating losses;*
- *In the ordinary course of events reducing costs and/or increasing revenue would be the solution to converting operating losses to surpluses; however for the Territory, significantly reducing costs or increasing revenue at least in the short to medium term, is likely to be very difficult;*
- *If the Territory's losses continue, and this seems probable, the Territory's unfunded liabilities will also continue to increase;*
- *If the operating losses continue it is inevitable that major asset sales must occur*

to provide funds to meet liabilities as they fall due;

- *If major sales of assets are inevitable, ACTEW is a readily saleable asset; the sale proceeds would significantly contribute to meeting the Territory's growing unfunded liabilities; and*
- *If ACTEW is to be sold, as the selling value is likely to reduce in the future, the most appropriate course would be to sell earlier rather than later.*

6.3 ACTIONS INITIATED OR PLANNED

The Chief Minister's Department has provided a comprehensive summary of actions to increase revenue and reduce or contain costs which are being planned, initiated, or considered. A copy of the summary is provided as *Appendix 1* to this Report with the Chief Minister's Department covering letter.

6.4 ADDRESSING THE OPERATING LOSSES

In the normal course of events the Territory's avenues to address the operating losses include:

- converting the current operating losses into Surpluses by
 - reducing services or service quality to reduce costs; and

- generating additional revenue from the ACT community through increased taxes, charges etc.

It is not proposed to discuss the avenues in detail here however the potential for each to contribute in the current circumstances to a feasible solution to address the operating losses is briefly mentioned.

Reducing Services or Service Quality to Reduce Costs

The Territory's community mostly enjoys better quality service and better quality infrastructure than do residents living in the Australian States or the Northern Territory. The good quality services and infrastructure however come with a cost as various independently published statistics have regularly shown. The ACT's services and infrastructure are good but also expensive.

As well as the quality and quantity of services provided, a significant factor in the expensiveness of services is the comparatively high remuneration (including superannuation) payable to the Territory's employees.

Efforts by the current Government and previous Governments to reduce costs through initiatives which contained any hint of resultant reductions in the quantity and/or quality of services have invariably encountered strong opposition from political opponents, community or corporate groups, unions etc. This has frequently resulted in the intended actions being abandoned or at least watered down. Past history does not provide much support for believing that reducing costs by reducing the quantity and/or quality of services currently enjoyed by the ACT community is likely to be a major contributor to converting the Territory's losses into surpluses.

There are undoubtedly significant efficiencies to be achieved and these should be pursued. Given the size however of the operating losses savings through efficiencies will be insufficient to fully redress the operating losses.

Increasing Revenue

As the ACT is surrounded by NSW, charges on business have to be maintained generally in line with NSW. As most charges are currently similar to NSW's charges, additional revenue from this source will only occur if NSW increases its charges.

One would like to think that ACT residents who enjoy the high standard of ACT services and infrastructure, would be prepared to pay higher prices than those paid in other less well served jurisdictions. Realistically though while it may be possible for a Territory Government to make increases in charges, the need for a large "hike" in charges to cover the current high expenditure on services is unlikely to be understood or accepted by the ACT community no matter how good the services are. On past history the potential for increasing revenue through significantly increased charges to the general community does not seem a political reality unless there is a change in community attitudes.

Borrowing to Meet Liabilities

Meeting liabilities as they fall due by borrowing is simply eliminating one liability by creating another. Although in the short term, it may be appropriate to do this in some circumstances, it is not an effective long term solution. Borrowing only further defers the time when taxpayers will have to eventually meet the liabilities. It also creates additional financing costs.

6.5 ASSET SALES

The previous section outlined the difficulties existing for the Territory to convert its operating losses into surpluses by increasing revenue and/or reducing costs and commented that if this could not be done unfunded liabilities will continue to rise.

If available operating revenue and cost reduction measures are not capable of providing funds to meet liabilities as they fall due, the Territory's next option would appear to be asset sales.

Selling Physical Assets to Provide Cash to Meet Unfunded Liabilities

The Territory has a wide range of physical assets. These include a public hospital, schools, roads, public housing, parks, electricity, water and sewerage assets and many others. These assets are all used in providing various services to the ACT community. By most standards the Territory can be regarded as asset rich.

As previously mentioned if the Territory's operating losses continue it will be necessary for the Territory to sell physical assets in order to provide the cash to meet the liabilities.

Arguments against selling assets (or privatisation) are generally similar to those against reducing services. There is an additional argument in the few cases where the assets being considered for sale are income producing assets, and that is that the income which the assets produce will be lost

Unfortunately, on the basis that operating losses are likely to continue for some years, it seems inevitable that assets will have to be sold irrespective of the benefits, including income, which will have to be given up as a result of the sales. The eventual problem will be to decide what to sell and when.

The Territory has a wide range of valuable assets. Amongst the most valuable are public housing and ACTEW's electricity, water and sewerage assets. Both public housing and ACTEW assets are valued at over \$1b.

While it is understood that major asset sales, other than ACTEW, are not presently being contemplated, consideration could be given to sales of public housing or other similar major community assets.

6.6 SALE OF ACTEW AS A SOLUTION TO THE TERRITORY'S UNFUNDED LIABILITIES

Recently the future of ACTEW Corporation Ltd has been extensively debated. The debate is continuing.

ACTEW is wholly owned by the Territory and is a Territory Owned Corporation. As such its operating profits and assets and liabilities are consolidated each year into the Territory's Consolidated Financial Statements. ACTEW's assets, liabilities and operations are therefore included in the Territory's financial losses and financial position referred to in this Report.

At 30 June 1998 ACTEW's Balance Sheet showed net assets of \$1.2bn. Consultants engaged by the Government have estimated a

trade sale price of the whole of ACTEW as between \$1.1bn and \$1.275bn. There is therefore consistency between by the “book value” shown in ACTEW’s published financial statements and the trade sale selling price estimated the consultants. The book value of ACTEW is included in the Territory’s Consolidated Balance Sheet.

The immediate effect on the Territory’s Balance Sheet of selling ACTEW would be to convert the ACTEW net assets (i.e electricity network, water infrastructure less liabilities etc) into financial assets. If the sale price was similar to the book value of ACTEW there would be little change in the Territory’s net assets however the Territory’s physical assets would be reduced and financial assets correspondingly increased.

In 1997-98 ACTEW contributed \$79m profit to the Territory’s operating result. In simplistic terms if the Territory had not owned ACTEW through 1997-98 the Territory’s operating loss of \$171m would have been greater by ACTEW’s profit i.e. the Territory’s loss would have been around \$250m.

Of course if ACTEW had been sold at the beginning of the year the sale proceeds would have been available to invest. The returns from the invested sales proceeds would have offset (or potentially exceeded), the profits ACTEW earned for the Territory.

The net effect on the Territory’s operating results and unfunded liabilities would depend on the sale proceeds achieved and the rate of earnings from the investment of the proceeds.

The major benefit from selling ACTEW would be the conversion of physical assets into financial assets thereby providing funds to meet the Territory’s financial liabilities as they fall

due. As previously explained it seems there is little possibility of funds to meet the liabilities becoming available through surpluses generated from normal operations.

The proceeds of an ACTEW sale should be sufficiently large to solve the present unfunded liabilities problem if the proceeds are in the order of the estimates prepared by the Government's consultants. The proceeds, of course, would need to be invested until required to meet the liabilities as they fall due. The purpose of the sale would be defeated if the proceeds were to be used to expand services or infrastructure for the community.

There appears to be no doubt that a competitive market of potential buyers for ACTEW exists.

Timing of ACTEW Sale

The preceding discussion has presented the view that a significant sale of assets will inevitably be necessary to provide sufficient funds to meet liabilities as they fall due. ACTEW is an appropriate asset to consider for sale to provide funds to meet the liabilities.

The timing of any ACTEW sale is relevant. Obviously if ACTEW was significantly growing in value the financially sensible course would be to delay the sale as long as practicable. If the value of ACTEW was growing, and since a large proportion of the Territory's unfunded liabilities do not have to be met for some years, delaying the sale of ACTEW until the sale proceeds are required to meet the liabilities would be the financially sensible approach.

Unfortunately because of the introduction of the National Electricity Market, Competition Policy and regulation of the prices ACTEW may charge to its non contestable customers all

responsible projections are that ACTEW, in its current form, will not grow in value, and in fact its value is most likely to fall significantly.

On the basis that ACTEW's sale value is likely to reduce over time the most financially appropriate course would be to sell earlier rather than later.

Other Considerations

There are of course many other factors to be taken to account in considerations of a sale of ACTEW. These include the impacts on overall employment in the ACT, the gross Territory product, disposable household incomes, etc. Effective regulatory regimes and other relevant policies need to be developed and implemented including ensuring that the new owners protect the environment, continue services at least at present levels and also meet community service obligations.

Summary

The practicality of the Territory's operating losses being converted to surpluses through increasing revenue and/or reduced costs was discussed in this Chapter. It was concluded because of current community attitudes and politically realities that there was little possibility of this occurring. The point was made that the continuing losses will force unfunded liabilities to rise further.

If no operating surpluses are available to provide funds to meet the liabilities as they fall due significant asset sales will become inevitable. Reductions in capital programs are also likely.

In view of the seeming inevitability of having to sell significant assets, ACTEW is an appropriate asset to consider for sale because of

its estimated potential current sale price and the existence of a ready market. If ACTEW is to be sold it is suggested that an early sale is desirable because of likely future falls in the value of ACTEW in its current form.

7. ANALYSIS OF REVENUE AND EXPENSES

7.1 SIGNIFICANT POINTS IN THIS CHAPTER

Revenue

- *At \$1,354m, Territory own source revenue rose by \$8m (less than 1%) over the previous year's revenue of \$1,346m;*
- *Commonwealth grant income remained static; and*
- *The main contributions to the increased own source revenue came from rises in Territory taxes of \$31m and other revenue of \$15m; these rises were partially offset by falls in revenue on investments and interest of \$15m and charges for goods and services of \$20m.*

Expenditure

- *Total expenditure increased by \$61m (3%) over last year; and*
- *The increased expenditure was mostly due to rises in wages, salaries and other employee costs (\$20m), superannuation (\$41m) and administration and other expenses (\$18m); these rises were partially offset by a fall in costs of goods sold of \$28m.*

7.2 REVENUE

Territory revenue is summarised in the following table:

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

Summary of Territory Revenue			
	1997-98	1996-97	1995-96
	\$m	\$m	\$m
Territory Sources			
Territory Taxes	526	495	437
Regulatory Fees and Fines	92	95	88
Charges for Goods and Services	567	587	551
Interest	45	51	49
Gains on Investments	26	35	10
Other	98	83	82
	1,354	1,346	1,217
Commonwealth Grants			
General Purposes	275	280	293
Specific Purposes	266	257	234
Other Fines and Fees	20	23	23
	561	560	550
Total Revenue	1,915	1,906	1,767
*Adjustments were made to 1996-97 figures to facilitate comparison with the current year.			

As the above table above shows, revenue generated by the Territory rose by \$8m (less than 1%) over last year while Commonwealth grant income was relatively static. This rise represented a significant reduction in the upward trend in Territory sourced revenue when compared to last year's rise of \$129m.

Following is comment on the major categories of revenue.

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

Territory Taxes

Territory taxes comprised:

Summary of Territory Taxes			
	1997-98	1996-97	1995-96
	\$m	\$m	\$m
Stamp Duty	128	119	71
General Rates	89	85	86
Land Tax	32	32	29
Payroll Tax	109	104	97
Financial Institutions Duty	19	28	26
Bank Account Debit Tax	16	-	-
Liquor and Franchise Fees	88	82	80
Gambling Taxes	44	42	45
Other Taxes	1	3	3
	526	495	437

Territory taxes rose by \$31m. This rise came from the introduction of the new bank account debit tax of \$16m and moderate rises in most other taxes (in particular stamp duty revenue \$9m, liquor and franchise fees \$6m and payroll tax \$5m). This rise was partially offset by a fall in the financial institutions duty of \$9m.

This year's rise represented a continuation of the upward trend in taxation revenue experienced over the last two years although this year's \$31m rise was not as significant as the \$58m rise of last year.

Fines and Regulatory Fees

The table following sets out the composition of fines and regulatory fees.

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

Summary of Fines and Fees

	1997-98	1996-97	1995-96
	\$m	\$m	\$m
Motor Vehicle Registrations	45	50	47
Betterment Fees	4	5	6
Drivers' Licenses	5	5	7
Traffic Infringements	4	5	4
Parking Fines	6	5	4
Other Fines and Regulatory Fees	28	25	20
	92	95	88

* Adjustments were made to the 1996-97 figures to facilitate comparison with the current year.

Overall, revenue from fines and fees remained at similar levels to the previous year. This year's \$5m fall in motor vehicle registration revenue was mostly offset by the \$3m rise in other regulatory fines and fees.

Charges for Goods and Services

The composition of *Charges for Goods and Services* is set out in the following table:

Summary of Charges for Goods and Services

	1997-98	1996-97	1995-96
	\$m	\$m	\$m
ACTEW Electricity Services	197	227	223
ACTEW Water and Sewerage	104	84	79
Housing Rentals	92	92	93
Hospital and Other Health Services	54	57	40
Totalisator Sales	18	19	17
Bus Services	18	18	16
Milk Sales	16	16	15
Vocational, Tertiary Education and Training	20	21	18
Parking Fees	10	9	7
Forestry Log Sales	8	7	7
Fire and Ambulance Services	7	7	6
Other	23	30	30
	567	587	551

*Adjustments were made to the 1996-97 figures to facilitate comparison with the current year.

At \$567m, revenue from *Charges for Goods and Services* fell by \$20m (3%) from last year. The main reason for this fall was the \$30m fall in revenue from ACTEW's electricity services and other revenue of \$7m. These falls were partially offset by rises in ACTEW water and sewerage revenue of \$20m. Most of the other charges for goods and services remained at similar levels to last year.

Summary

The major factors noted in the analysis of revenue was that overall Territory revenue rose by \$8m or less than 1%. This rise represented a significant reduction in the upward trend in revenue compared to the \$129m increase of last year. The overall rise was due to increases in Territory taxes of \$31m and other revenue of \$15m which was partially offset by falls in revenue on investments and interest of \$15m and charges for goods and services of \$20m.

7.3 EXPENDITURE

The composition of Territory expenditure is set out in the following table:

--

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

Summary of Territory Expenditure			
	1997-98	1996-97	1995-96
	\$m	\$m	\$m
Wages, Salaries and Other Employee Costs	756	736	731
Superannuation	184	143	162
	940	879	893
Administration and Other Expenses	490	472	500
Cost of Goods Sold	165	193	213
Depreciation	212	206	182
Grants and Subsidies	194	187	172
Interest and Finance Costs	62	65	60
	1,123	1,123	1,127
Total Expenses	2,063	2,002	2,020

*Adjustments were made to the prior year figures to facilitate comparison with the current year.

Total expenditure increased by \$61m (3%) over last year. This rise was mostly due to rises in wages, salaries and other employee costs (\$20m), superannuation (\$41m), administration and other expenses (\$18m). These rises were partially offset by a fall in cost of goods sold of \$28m.

The audit is unaware of any increases or decreases in the quantity or quality of Government's services provided which would have a major impact on costs. The increase in expenses can be attributed to normal cost fluctuations between years.

7.4 ABNORMAL ITEMS

Abnormal items are items that relate to Territory operations however, they are disclosed separately because of their "abnormal" nature and significant impact on the operating loss of the Territory.

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

Abnormal losses of \$21m were included in the Territory's operating result compared to \$53m last year.

This year's abnormal items were mainly comprised of downward land and building valuations of \$14m and the transfer of Goodwin Homes to Community Organisations of \$8m.

Appendix 1

**CHIEF MINISTER'S DEPARTMENT
LETTER AND SUMMARY**

Mr John A. Parkinson
Auditor-General
Scala House
11 Torrens Street
BRADDON ACT 2601

Dear Mr Parkinson

STRATEGIES TO ADDRESS THE TERRITORY'S OPERATING LOSS

Thank you for your letter of 11 November 1998 concerning your report to the Assembly on the Territory's 1997-98 operating loss. I note that you are intending to repeat previous practice by including and commenting on the Government's plans and strategies to address the loss.

The management of the operating loss is a clear priority for the Government. The first of the Government's Key Result Areas identified in the Government Plan is the elimination of the operating loss by the 2004-05 Budget. It is also very desirable to move beyond this to a position which enables ongoing surpluses to be achieved which are sufficient to fund the Government's capital investment needs.

You will also be aware that Territory's accrued superannuation liability is the single largest financial concern facing the Territory, and the Government is actively pursuing options to ensure there are sufficient financial assets to provide for this liability. Should this not be achieved by the sale of ACTEW or other equity or asset sales, then obviously the target for the operating surplus will have to be much in excess of that required to fund our capital investment program alone.

I have attached a range of strategies available to the Government to address the operating loss. While these will be considered by the Government, a decision on which strategies to pursue will not be made until the 1999-2000 Budget.

Yours sincerely

Alan Thompson

STRATEGIES TO ADDRESS THE OPERATING LOSS**Introduction**

Over the past three years a significant reduction has been made in the Territory's operating loss. In 1995-96, the first year under the new accrual accounting and reporting arrangements, the Territory's operating loss was \$349m. By 1997-98 this loss had been reduced to \$166m.

The substantial improvement in performance has been in an adverse economic environment in which the Commonwealth Government cutbacks have resulted in a smaller revenue base, both in terms of property values and business activity. At the same time the Government has taken specific action such as down-)sizing the Public Service and reducing the cost of public sector travel, workers' compensation, accommodation, car fleet and telecommunications.

The 1998-99 Budgeted loss is \$149m and the forward estimates indicate the loss will reduce to \$62m in 2001-02. This is based on expenditure constraint and modest growth in revenue.

The Government has identified the elimination of the operating loss by the year 2004-05 as one of its Key Result Areas (KRA), although it is recognised that reductions in the operating loss beyond the present level will be considerably more difficult than the improvement achieved so far. The process will require a fundamental reconsideration of the assets and liabilities of the Territory together with the level, quality and the mix of services the Government currently provides to the community. It will also require a rigorous assessment of the cost of services, to drive further efficiencies and achieve a benchmark cost structure.

Superannuation

The Government recognises the need to provide for its massive superannuation liability for its employees. In the 1998-99 Budget, the Government commenced the implementation of a strategy to address the issue of superannuation provision for its employees, including:

- the closure to new employees of the existing PSS/CSS defined benefits scheme (effective from 30 June 1999). From that date new employees will be able to join an accumulation superannuation scheme of their choice with employer and employee payments made concurrently; and
- the injection of some \$200m into the provision account over the next four years to partially respond to the emerging defined benefits scheme liability for existing employees.

While a good start, these initiatives do not fully address the existing outstanding unfunded liability (estimated to be at least \$690m at 30 June 1999). It will therefore be necessary to fund this liability through:

- equity sales and investment in the fund; and / or
- achieving substantially larger operating surpluses.

Clearly the proposed sale of ACTEW could provide the opportunity for an investment of sufficient size and performance to overcome the unfunded superannuation liability. However, the ultimate strategy will almost certainly need to be a combination of assets and equity sales and surpluses. Even if sufficient sales were realised to address the superannuation liability, the necessity for operating surpluses would remain in order to fund ongoing capital/infrastructure investments.

Legislative Reform

The Government supports the amendments to the Financial Management Act 1996 proposed by Mr Osborne, which require prudent management of assets and liabilities, and the achievement of operating surpluses. In order to develop a comprehensive strategy for this outcome, all the Government departments are required to prepare medium term financial plans covering the period to 2004-05.

Contestability and Contracting Out

In order to improve the efficiency and effectiveness of service delivery, the Government has an ongoing emphasis on contestability and contracting out. A number of areas have already been subject to contestability. These include:

- maintenance services, cleaning and facilities management in The Canberra Hospital and in Government schools;
- management of youth centres;
- management of public swimming pools; and
- employee program support.

Further areas being examined or market tested include:

- payroll services;
- pathology services and hospital food preparation;
- horticultural maintenance, urban parks and sports ground maintenance
- adult correctional services; and
- accommodation and property services.

Comparative Pricing

In 1998-99, the attribution of the Territory's operating loss to individual agencies commenced, with costs formerly borne at whole of government level, such as

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

superannuation and the interest on government debt, now recognised in departmental expenses.

In support of this initiative, the prices paid for the Government's outputs has also been reviewed, based on a comparison with a standardised average for each output across Australian jurisdictions. This is to ascertain whether the Government is incurring costs or providing services at a level higher than the Australian average. The initial benchmarks included in the 1998-99 Budget, and to be refined for 1999-2000 included:

- hospital services where expenditure is about \$24m above standardised;
- Government primary schools which are \$19m above benchmark;
- Government high schools and secondary colleges which are \$14m above benchmark;
- Canberra Institute of Technology which is \$15m above benchmark; and
- cost of commissioning and contract management in Urban Services.

The 1999-2000 budget will also include new benchmarks identified for other major outputs. One aim of this process is to focus management attention on containing cost structures. For example, in 1998-99, the Government decided to streamline the Central Office of the Department of Education and Community Services, as part of a strategy to reduce overhead costs while maintaining support to schools and other users of the department's central services.

Reconsideration of Level and Mix of Service

The ACT community rightly expects high quality services and is articulate in its advocacy of them. It also expects prudent financial management from the Government, with an outcome which does not unduly burden future generations. In balancing these expectations, it is incumbent on the Government to regularly review the level, quality and the mix of its services, to ensure that needs can be met in the most appropriate and cost-effective way. The review process is an ongoing one, but it has been given added impetus by the contestability and comparative pricing processes described above.

The reconsideration of level and mix of services needs to take account of the pressures on the two large areas of service delivery, i.e., health and education. The demand for hospital and acute services has grown at a rate which is larger than the rate at which the population is growing or aging. In *Setting the Agenda - A Healthy Community*, which sets the directions for health and community care in the ACT, the Government has made a commitment to reduce the ACT health costs closer to national average, as part of its effort to tackle the operating loss.

Numerous reports including those of the Auditor-General, the Industry Commission, the Commonwealth Grants Commission etc. have recognised the high level and mix

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

of services in the ACT. The areas and services now to be considered by the Government include:

- examining whether regulation is appropriate, cost effective and relevant in comparison with other states, or whether it adds unduly to the burden carried by individuals or business;
- increasing patronage and making ACTION more efficient and to achieve at least an average “public operator” cost structure;
- managing demand for hospital beds, including implementing strategies to reduce the need for people to enter the hospital system;
- improving community health through cost-effective interventions such as the establishment of an asthma support service;
- targeting cost effective measures to promote better health such as the Health for Life campaign and the infant immunisation program;
- examining current school and preschool infrastructure planning for demographic change to better utilise existing facilities and minimise new construction;
- improving the efficiency and effectiveness of educational services;
- ensuring that vocational and educational training meets the needs of students and employers in the most cost effective manner;
- addressing the cost of sportsground maintenance by promoting management of sportsgrounds by sporting and community groups;
- ensuring that the delivery of corrective services is efficient and effective, particularly given the opportunity to overhaul prison and remand processes as part of establishing a prison facility in the ACT;
- in emergency services, considering the provision of an optimal mix of prevention and response services, and to address the growth in both these areas of service delivery; and
- reassessing the level of the capital works program to ensure that the ACT maintains a sustainable level of infrastructure, given that infrastructure is frequently a driver of the recurrent cost of services.

Increasing Productivity

Continuous improvement in work practices and increase in productivity remains an essential part of the reform agenda, and a strategy to reduce the overall cost structure. The Government has already made some advances in bringing work practices and employment conditions in line with other jurisdictions. For example:

- the introduction of ‘split shifts’ in ACTION through the recently negotiated EBA; and
- the negotiation of new VMO contracts.

Further areas to consider and pursue are:

TERRITORY OPERATING LOSSES AND FINANCIAL POSITION

- in the renegotiation of teachers' EBA, seek to build in improved practice;
- introduction of 8/8/8 roster for nurses, in line with the industry practice;

Annexure

Reports Published in 1992

- 1 Information Technology Management Policies in the ACT Government Service**
- 2 Financial Audits with Years Ending to 30 June 1991**
- 3 GAO Annual Management Report for Year Ended 30 June 1992**
- 4 ACT Board of Health - Management of Information Technology**
- 5 Budget Outcome Presentation and the Aggregate Financial Statement for the Year Ended 30 June 1992**
- 6 Financial Audits with Years Ending to 30 June 1992**

Reports Published in 1993

- 1 Management of Capital Works Projects**
- 2 Asbestos Removal Program**
- 3 Various Performance Audits Conducted to 30 June 1993**
 - **Debt Recovery Operations by the ACT Revenue Office**
 - **Publicity Unaccountable Government Activities**
 - **Motor Vehicle Driver Testing Procedures**
- 4 Various Performance Audits**
 - **Government Home Loans Program**
 - **Capital Equipment Purchases**
 - **Human Resources Management System (HRMS)**
 - **Selection of the ACT Government Banker**
- 5 Visiting Medical Officers**
- 6 Government Schooling Program**
- 7 Annual Management Report for the Year Ended 30 June 1993**
- 8 Redundancies**
- 9 Overtime and Allowances**
- 10 Family Services Sub-Program**
- 11 Financial Audits with Years Endings to 30 June 1993**

Annexure (continued)

Reports Published in 1994

- 1 Overtime and Allowances - Part 2**
- 2 Department of Health - Health Grants
 - Management of Information Technology**
- 3 Public Housing Maintenance**
- 4 ACT Treasury - Gaming Machine Administration
 - Banking Arrangements**
- 5 Annual Management Report for Year Ended 30 June 1994**
- 6 Various Agencies - Inter-Agency Charging
 - Management of Private Trust Monies**
- 7 Various Agencies - Overseas Travel - Executives and Others
 - Implementation of Major IT Projects**
- 8 Financial Audits with Years Ending to 30 June 1994**
- 9 Performance Indicators Reporting**

Reports Published in 1995

- 1 Government Passenger Cars**
- 2 Whistleblower Investigations Completed to 30 June 1995**
- 3 Canberra Institute of Technology - Comparative Teaching Costs and Effectiveness**
- 4 Government Secondary Colleges**
- 5 Annual Management Report for Year Ended 30 June 1995**
- 6 Contract for Collection of Domestic Garbage/Non-Salary Entitlements for Senior Government Officers**
- 7 ACTEW Benchmarked**
- 8 Financial Audits With Years Ending to 30 June 1995**

Reports Published in 1996

- 1 Legislative Assembly Members - Superannuation Payments/Members' Staff - Allowances and Severance Payments**
- 2 1995 Taxi Plates Auction**

Annexure (continued)

- 3 VMO Contracts
- 4 Land Joint Ventures
- 5 Management of Former Sheep Dip Sites
- 6 Collection of Court Fines
- 7 Annual Management Report For Year Ended 30 June 1996
- 8 Australian International Hotel School
- 9 ACT Cultural Development Funding Program
- 10 Implementation of 1994 Housing Review
- 11 Financial Audits with Years Ending to 30 June 1996

Reports Published in 1997

- 1 Contracting Pool and Leisure Centres
- 2 Road and Streetlight Maintenance
- 3 1995-96 Territory Operating Loss
- 4 ACT Public Hospitals - Same Day Admissions
Non Government Organisation - Audit of Potential Conflict of Interest
- 5 Management of Leave Liabilities
- 6 The Canberra Hospital Management's Salaried Specialists Private Practice
- 7 ACT Community Care - Disability Program and Community Nursing
- 8 Salaried Specialists' Use of Private Practice Privileges
- 9 Fleet Leasing Arrangements
- 10 Public Interest Disclosures - Lease Variation Charges
- Corrective Services
- 11 Annual Management Report for Year Ended 30 June 1997
- 12 Financial Audits with Years Ending to 30 June 1997
- 13 Management of Nursing Services

Annexure (continued)

Reports Published in 1998

- 1 Management of Preschool Education**
- 2 Lease Variation Charges - Follow-up Review**
- 3 Major IT Projects - Follow-up Review**
- 4 Annual Management Report for Year Ended 30 June 1998**
- 5 Management of Housing Assistance**
- 6 Assembly Members' Superannuation and Severance Payments to Former Members' Staffers**
- 7 Magistrates Court Bail Processes**
- 8 Territory Operating Losses and Financial Position**

Availability of Reports

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

ACT Auditor-General's Office
Scala House
11 Torrens Street
BRADDON ACT 2601

or

PO Box 275
CIVIC SQUARE ACT 2608

Phone (02) 62070833 / Fax (02) 62070826