1995-96
territory operating loss

REPORT 3 OF 1997

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1. REPORT SUMMARY

1.1 INTRODUCTION

In *Auditor-General's Report No 5 of 1992* a recommendation was made that accrual accounting should be introduced for the Territory's financial statements. The Report stated:

'"Whole of Government" accrual reporting would provide the Assembly and the electorate with a clear view of the Public Sector's total financial operations in each year and its aggregate assets and liabilities at the close of each year. This is information which is currently not available from any source.

Whole of Government accrual based reports would provide on an ACT Public Sector wide base the following information in a form which is readily understandable by persons with a reasonable knowledge of financial matters:

- *adequacy of Government income to meet the full cost of programs;*
- *the full extent of income derived from grants, taxes, and user charges, etc*
- *the full cost of resources consumed in a period;*
- *the liquidity and solvency of the Government;*
- *all liabilities to be paid for in the short and long term, and*
- *the value of assets owned or controlled.'*

As is well known the Territory, through the Financial Management Act 1996, introduced accrual budgeting and reporting to operate from 1996-97.

Although the Financial Management Act 1996 does not require "Whole of Government" statements to be prepared until the close of the 1996-97 year the Chief Minister's Department has undertaken the task of preparing them for 1995-96 and for this the Department should be commended.

The "Whole of Government" financial statements have not been completed at the time of preparing this Report however the statements have reached a state whereby an analysis can be performed in relation to the first issue mentioned on the previous page '*adequacy of Government income to meet the full cost of programs*' This Report presents the results of an audit analysis of this issue. A summary of the findings from the analysis follow. Further detail is provided in this Report's later Chapters.

Completion of the "Whole of Government" Statements by the Chief Minister's Department might produce figures different to those mentioned in this Report however the figures which are available are sufficiently accurate to support this Report's general conclusions.

1.2 TERRITORY 1995-96 OPERATING LOSS

1.2.1 The Loss

- The accrual operating loss incurred by the ACT from all its operations in 1995-96 was $349m. This comprised $347m loss on General Government Sector operations and $2m from Public Trading Enterprise operations after adjusting for dividends and tax equivalents payable to the Government by the Public Trading Enterprises.

1.2.2 The Loss in Perspective

- The 1995-96 loss eventually will have to be met by future generations of ACT taxpayers;

- The 1995-96 operating loss of $349m is equivalent to around $3000 per ACT household or $1100 for each man, woman and child resident;

- The 1996-97 budgeted loss is $231m; this is the equivalent of more than $2000 per ACT household or $750 for each resident;

- The budget forward estimates forecast large losses continuing through to the limit of the forecasts (year 2000); these losses will increase the amounts to be met by future generations of taxpayers; and

- The size of the losses are sufficient to create the potential for the future standard of living of ACT residents to be significantly affected.

1.2.3 Generation of the Loss

- The loss represents the shortfall between the revenues the Government has available to it in a year and the actual full costs incurred as a result of the Government's activities during that year;

- The Territory's ability to operate at a large loss has been facilitated to a large extent by the Territory being able to defer into the future the cash payments for significant parts of the costs incurred through its activities (e.g. employer superannuation contributions);

- The emergence of the loss has not been a product of the immediate short term; since Self Government revenue from the Commonwealth has been progressively reduced while operating costs have generally increased; and

- If accrual accounting had been in place in the past years the development of the losses would have been clearly evident.

1.2.4 Comparison with Other Governments, Capital Cities and Local Government Authorities

- In comparison with the two States and the Commonwealth which have prepared and published accrual financial statements the ACT's loss in relative terms is very high; the ACT's budgeted loss for 1996-97 represents 13.1% of its revenue (the ACT's 1995-96 percentage would be higher) while the Commonwealth and NSW's latest published losses were 8% and 7.5% respectively of revenue (Western Australia was in surplus);

- Other Australian capital cities and larger NSW Local Government Councils generally operated with sound 1995-96 surpluses in contrast to the ACT's large loss.

Audit Comment

The significance to the ACT community of the existence of the very large 1995-96 loss is that the loss will eventually have to be met from future Government revenues and these revenues, to a large extent, must be supplied by the taxpayers in the community. The large size of the loss is illustrated when it is related to the Territory's number of households and residents i.e. around $2900 per household or around $1100 per person and this is for 1995-96 only.

The 1996-97 ACT budget papers project large losses through to the year 2000 (the limit of the forecasts) meaning that the amounts to be met by future taxpayers will continue to escalate by large amounts each year. The loss is much worse relatively than the operating results of other States and the Commonwealth which have prepared and published accrual financial statements. Also in comparison to other capital cities (which generally operated in surplus in 1995-96) the ACT has a very poor result.

The other capital cities are different from Canberra in that they are not required to provide expensive services such as health, education and law and order.

The problem of the large 1995-96 loss and the projected large further losses has the undoubted potential to significantly effect the future standard of living of ACT residents. The problem is of such a magnitude that solutions to eliminate or significantly reduce the losses are unlikely to be effectively implemented unless a cooperative and constructive approach is taken by all Members of a fully informed Legislative Assembly.

1.3 THE GENERAL GOVERNMENT SECTOR LOSS DISSECTED

- The General Government Sector 1995-96 operating loss was $347m and the Public Trading Enterprise Sector lost $2m after adjusting for dividends and tax equivalents payable to the Government by the Public Trading Enterprise organisations;

- The Territory's 1995-96 loss is therefore almost entirely generated by General Government Sector operations;

- Analyses of agencies' 1995-96 financial statements and other information discloses that the Department of Health and Community Care and the Department of Education and Training contributed the most to the 1995-96 operating loss; and

- A large proportion of the costs of the Department of Health and Community Care and of the Department of Education and Training are employee costs (61% and 72% respectively).

Audit Comment

The fact that health and education operations generated the largest parts of the 1995-96 loss leads to

the obvious conclusion that if the costs of these activities cannot be reduced the Territory's future operating losses will not be lowered significantly by cost reductions.

Although curtailing other agencies' costs will help, the impact would not be great on the overall size of the loss.

Also as employee costs are the major input costs for health and education activities it is these costs which primarily need to be addressed if major savings are to be made.

1.4 SUPERANNUATION COSTS

- As stated earlier the operating losses are being facilitated to a large extent by the Territory's ability to defer to the future the cash payments for significant parts of the costs incurred through its activities; employer superannuation contributions for the Territory's employees are the largest cost deferred;

- The costs deferred at 30 June 1996 (i.e. unfunded superannuation liabilities) were $602m which equates to almost $2000 of superannuation debt for every resident of the ACT; and

- The ageing profile of ACT employees means that many employees will soon reach retirement age and therefore the deferred superannuation costs for these employees will soon have to be met in cash; the Government's consultant actuary has estimated that payments of $175m will have to be made in the four years from 2001 to 2005. Payments will continue to escalate after 2005.

Audit Comment

The unfunded superannuation liabilities are a major component in the accumulating operating losses of the Territory. Meeting these costs unfortunately cannot be deferred indefinitely and, as the consultant actuary's estimates show, very large amounts of cash will need to be found in the relatively near future.

1.5 CONCLUSION

The preparation of accrual financial statements for the first time has provided an answer to the question *"Is the ACT Government's income adequate to meet the full costs of the programs and other services it is providing?"* For 1995-96 the answer is that the operating costs incurred are much greater than the revenues with the result that the 1995-96 financial statements disclose a large operating loss.

The 1996-97 Budget Papers forecast large operating losses as far into the future as the forward estimates reach.

The overall effect is that if the operating losses continue to accumulate the community will inevitably have to meet the losses through greatly increased taxes and other charges. An alternative is that the Government could either reduce, or cease to provide many services. In either case the standard of living of ACT residents will be affected.

2. ADEQUACY OF GOVERNMENT INCOME TO MEET THE FULL COSTS OF PROGRAMS

2.1 INTRODUCTION

The Operating Result presented in the Territory's Operating Statement provides information on whether the Government's income is adequate to meet the full cost of its programs. The Operating Statement shows the operating revenues generated during a year and the operating costs incurred. The difference (surplus or loss) between the revenues and costs shows whether operating revenue generated has been sufficient to meet the operating costs incurred for that year.

As 1995-96 was the first year for which an operating statement was prepared a trend in operating surpluses or loss over time is not available. Trends over time are most valuable as they show whether the position is improving or deteriorating. In the absence of previous years' figures the future budgeted figures have been utilised where appropriate in this Report to indicate "trends".

2.2 WHOLE OF TERRITORY OPERATING STATEMENT

2.2.1 Introduction

A summary table showing the 1995-96 actual Operating Statement prepared from Agencies' audited financial statements, and the 1996-97 Operating Budget follows:

1995-96 TERRITORY OPERATING LOSS

Summary Operating Statement

	1995-96 Actual $m	1996-97 Budget $m
Revenue*		1766
Expenditure*		1997
Loss before Abnormal Items	256	231
Abnormal Items-	91	-
Loss after Abnormal Items	347	231

* As Whole of Territory Financial Statements which eliminate the effects of revenue and expenditure transactions between agencies have not been completed by the Office of Financial Management at the time of preparing this Report actual figures for revenue and expenditure cannot be included in this table.

2.2.2 Operating Results

The Operating Result before Abnormal Items provides the best indication of financial results for comparative purposes between years as it excludes abnormal items. Abnormal 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 revenues or expense because of their size and effect on the operating results for the period. Separating the abnormal items allows the underlying operating results to be disclosed, as well as the total result.

The abnormal item in the 1995-96 results arises from the recognition of increased liabilities for superannuation costs identified in the latest triennial actuarial review of the Territory's liability. The review was conducted during 1995-96. The abnormal item represents the increase in the liability arising from the employment of staff in the years prior to 1995-96.

The Operating Result before Abnormal Items in the summary table reveals an actual 1995-96 loss of

$256m. The 1996-97 Budget provides for a further loss of $230m.

The magnitude of these operating losses can be illustrated by expressing them as a percentage of the Territory's operating revenue. The following table provides this information for the 1996-97 Budgeted operations:

Operating Revenue and Loss

	Revenue $000	Loss $000	%
1996-97 Budget	1766	231	13.1

As the final 1995-96 operating statement with transactions between agencies eliminated has not been completed at the time of preparing this Report the 1995-96 loss as a percentage of 1995-96 revenue cannot be presented. As the loss before abnormals at $256m is larger than the budgeted 1996-97 loss ($231m), the percentage loss will also be larger.

The Forward Estimates in the Budget Papers indicate large losses will continue to be incurred in each of the years to 1999-2000.

2.2.3 Comparison with other Governments

The New South Wales and Western Australian Governments have been preparing accrual financial statements in recent years. Accrual Financial Statements for 1994-95 for the Commonwealth Government have also been prepared. The following table which shows NSW, WA and Commonwealth latest available operating results as a percentage of revenue is provided to illustrate that other Australian Governments are not operating with the relative losses that the ACT is:

1995-96 TERRITORY OPERATING LOSS

Comparison of Governments' Revenues and Operating Results

Government	Revenue $m	Surplus/(Loss) $m	%
NSW (1995-96)	32571	(2450)	(7.5)
WA (1994-95)	16282	1351	8.3
Australia (1994-95)	133114	(10655)	(8.0)
ACT (1996-97 budget)	**1766**	**(231)**	**(13.1)**

The table shows that the ACT is operating at a loss level which is much larger than the Commonwealth and NSW (WA is in surplus). When considering the Commonwealth's and NSW loss, it needs to be recognised that their revenue raising capacities are much greater and more flexible than the ACT's. It also needs to be taken into account that the Commonwealth has taken substantial steps since 1994-95 to address its loss. The ACT has not taken steps of similar magnitude.

It is also mentioned that NSW has been able to use asset sales in a significant manner to improve its financial results. Notable sales are the State Bank and the Government Insurance Office.

As the Commonwealth and State Government accrual financial statements are still under development complete reliability of the figures presented is not assured however the figures should be sufficiently accurate to support a position that the ACT loss is relatively much larger than the other Governments.

2.2.4 Comparison with Other Australian Capital Cities and Local Government Councils

Australian Local Government Authorities have also been preparing '*accrual*' statements for some time. A sample of these authorities 1995-96 financial results is provided on the following page to illustrate that the Territory's operating loss is considerably worse than other Capital Cities and Local Government authorities.

1995-96 TERRITORY OPERATING LOSS

Comparison with Capital Cities and Local Governments

Council	Revenue $000	Surplus/(Loss) $0000	% (-)
Capital Cities			
Sydney city	126394	26614	21.1
Brisbane city	937644	179629	19.2
Adelaide city	76423	337	0.5
Hobart city	59449	4678	7.9
Melbourne city	175374	7285	4.2
Perth city	59769	14510	24.3
Darwin city	33049	3029	9.2
NSW Cities and Others			
Bankstown	70252	13613	19.4
Blacktown	97850	30551	31.2
Canterbury	47919	8447	17.6
Fairfield	82763	5579	6.7
Lake Macquarie	80142	25819	32.2
Newcastle	81602	(81)	(0.1)
Wollongong	100236	18152	18.1
Campbelltown	60406	11696	19.4
Hornsby Shire	56118	6309	11.2
ACT (Budgeted 1996-97)	**1765798**	**(230618)**	**(13.1)**

The table shows that Capital cities and NSW Local Government councils generally operate with quite healthy surpluses in contrast to the ACT's large loss.

It is acknowledged that comparisons with other Australian capital cities cannot be made without reservations because:

- The ACT is a City/State model with no similar arrangements in Australia. Brisbane City Council is probably the closest but falls short of the range of services provided in the ACT model;

- The cities used in the comparison do not provide expensive services such as Health, Education, Police or Transport; and

- The cities do not have the range of revenue raising options which the ACT has.

Nevertheless the comparisons are included in this Report to illustrate that the municipal type services provided in the ACT should not be expected to contribute to an operating loss for the Territory.

2.2.5 Generation of the Loss

The ACT's large operating loss relative to revenue is produced by the full costs of the day to day services provided through the Territory's public agencies far exceeding available income from Commonwealth grants and the revenue it generates from its own sources (e.g. taxes, fees, fines, user charges, etc).

Because the Government is using its own agencies to provide most services it is able to defer meeting significant parts of the costs incurred in providing the services (e.g. employer superannuation contributions). This ability to conveniently defer meeting costs has facilitated the Territory operating in loss. If the provision of services was ever to be fully outsourced to the private sector the capacity to defer costs would be eliminated.

The emergence of the loss has not been a product of the immediate short term.

Over the years since the introduction of self-government revenue from the Commonwealth has been progressively reduced. Transitional Commonwealth funding to the ACT has declined from $83.3m in 1991-92 to an expected $8.6m in 1997-98. This represents a reduction of $244 per capita over the period.

It should also be noted that the ACT administration has had to evolve from 14 separate Commonwealth Departments in the space of 8 to 9 years and this has added complexity to the tasks of containing costs.

It is contended by the Chief Minister's Department that the level of adjustment which has been required by the ACT is beyond any that has been asked for or achieved by any other Australian jurisdiction and this is probably true. The task which has faced successive ACT Governments has undoubtedly been very difficult.

Although there have been major increases in the level of own source income these increases have been insufficient to offset the combined effect of reduced Commonwealth grants and increasing costs.

If accrual operating statements had been prepared in the past years the emergence of the loss would have been evident.

2.2.6 Size of The Loss in Perspective

The unavoidable effect of the ACT's revenue shortfalls is that the loss eventually will have to be met by future generations of ACT taxpayers.

The budgeted loss for 1996-97 is $231m. To put this loss into perspective this is the equivalent of around $2000 per household in the ACT or approximately $756 for each man, woman and child resident.

The figures mentioned in the previous paragraph relate to 1996-97 only. The published forward estimates show that large operating loss are expected to continue at least through to the year 2000 (the limit of the forward estimates). These future losses will continue to increase the amounts to be met by future taxpayers.

It is acknowledged that with the current economic difficulties which both the ACT Government and the ACT business community are encountering the present time may not be appropriate for revenues and costs to be balanced. The sizes however of the 1995-

96 loss, the budgeted 1996-97 loss and the forecasts for later years has the obvious potential to establish a situation of future long term financial 'pain' for the ACT community.

In the best interests of the community the position should not be ignored and effective strategies should be developed now on how the loss can be eliminated, or at least significantly reduced, over a relatively short term.

2.2.7 Dissection Between Budget Sector and Public Trading Enterprise Transactions

The preceding comments in this Chapter have been directed at the Territory's total operations. That is the combined activities of budget sector agencies, public trading enterprises and Territory owned corporations.

The Whole of Territory financial statements which are in the process of being prepared by the Office of Financial Management differentiate between the General Government Sector and the Government's other enterprises. The Budget Papers also differentiate between the General Government Sector and Public Trading Enterprises. The Budget Papers' concentration is on the General Government Sector. *Appendix 1* to this Report sets out the classification of agencies into General Government Sector and Public Trading Enterprises.

The following table shows the 1995-96 actual outcome dissected between General Budget Sector and Public Trading Enterprises.

1995-96 TERRITORY OPERATING LOSS

1995-96 Actual Results

	General Government Sector $m	Enterprises $m	Total $m
Loss (Surplus) before Abnormal Items	256	2	258
Abnormal Item	91		91
Loss (Surplus) after Abnormal Items	347	2	349

In aggregate the public trading enterprises and the Territory owned corporations are operating around break even. The Territory's loss is being generated by its budget sector agencies as the table clearly illustrates.

The 1996-67 Budget papers present a similar forecast picture.

2.2.8 Responses to the Serious Financial Operating Position

Examination of the 1996-97 Budget Papers does not reveal any planned major initiatives to rein in the deficiency to significantly lower levels.

The Chief Minister's Department has advised of significant progress which has been made in addressing issues of expenditure throughout the Budget Sector. The initiatives advised seek to address underlying structural issues of expenditure and include:

- Reductions in Travel costs;
- Reductions in Workers' Compensation Premiums;
- Savings in Accommodation costs (e.g. Consolidation of Chief Minister's Department in one building;

- Savings in the Car Fleet (e.g. reduction in the number of pool vehicles);

- Establishment of InTACT to deliver recurrent savings in Information Technology;

- Savings in Telecommunication costs by the establishment of ACTNET;

- Productivity Savings realised through the implementation of Enterprise Agreements; and

- Recent success in gaining Commonwealth assistance for obtaining increases in Cross-Border payments for Health from NSW.

It is also understood that an "Office Accommodation Strategy" and an "Asset Management Strategy" are being developed.

The initiatives outlined by the Chief Minister's Department are important management actions which should reduce costs without affecting services. Successful implementation of the two new strategies will also reduce costs without affecting services. The potential cost reductions from the initiatives and strategies appear however to be insufficient to make a major impression on the size of the Territory's operating losses.

The initiatives mentioned in the previous paragraphs have, or will require considerable strategic planning and hard work to develop and implement. That this effort will not make a major contribution to eliminating the deficit illustrates the difficulty of the task to be accomplished if the Territory's losses are to be eliminated or significantly reduced.

The "*Canberra: A Capital Future*" ACT Strategic Plan released by the Government in December 1996 makes various references to the difficult financial

position the Territory faces. The plan contains a response to the financial position which is reproduced below:

"To a considerable extent the infrastructure and 'national capital' financial pressures discussed above are beyond the control of the ACT Government.

Further, even with relatively favourable outcomes, the ACT's finances will remain out of balance, and major action within the ACT Government's own direct spheres of financial responsibility will be required.

The ACT Government's current 'low debt' policy will be continued.

Two other key issues also need to be addressed:

- *Whether the encouragement and guidelines already provided to ACT Government agencies to extend competitive tendering will be sufficient to ensure that every opportunity is taken, as quickly as possible, to realise the potential for cost savings.*

- *Whether there are opportunities to outsourcing opportunities with other economic development activities in the ACT.*

Changes in ACT Government spending in comparison with state averages will be difficult to achieve and will take time.

In view of the strategies identified later in this Strategic Plan for encouraging the development of the private sector in the ACT, it is not appropriate, in general, for increased taxation to fall on businesses. Nor does it make sense for increases to be applied to goods and services where the effect would be to shift transactions into NSW or other states."

The two specific issues mentioned in the plan i.e. '*competitive tendering'* and '*outsourcing opportunities'* while potentially financially beneficial will not make a major impact on the size of the loss.

On the revenue side the Strategic Plan appears to rule out increased taxation on businesses or for increases to be applied to goods and services.

In relation to the Strategic Plan the Chief Minister's Department has advised:

"the focus of the Strategic Plan was on promoting and encouraging a sustainable future for the ACT. In doing this, it sets direction for

- *the ACT Government's corporate and budget planning over the next three to five years;*

- *improved capital works planning such as for schools, roads and community centres over the next five to ten years; and*

- *major urban redevelopment planning for Canberra's growth and redevelopment for the next ten to fifteen years...".*

The Strategic Plan ruled out increased taxation on business as a means of addressing the revenue issue, however it clearly states that benefits to the ACT will be generated by a real increase in the level of private sector activity in Canberra. Increased investment will by definition increase the revenue base without needing to increase the rate of revenue initiatives.

- *Increases in the rate of taxation as a revenue measure would clearly result in the ACT not being competitive against NSW and Victoria, resulting in business migration from the ACT. The key is then to expand the revenue base rather than to increase*

the rate of revenue applicable by encouraging economic growth.

- *Further, a number of significant projects are currently being investigated with the private sector which have the potential of generating additional employment and investment in the ACT.*

- *Clearly, these initiatives have a significant capacity to expand the revenue base of the ACT Government and assist in addressing the operating result without the need to increase revenue rates."*

The Government's current responses, although significant, cannot be seen as directly producing large reductions in the operating losses. If the expansion of the revenue base occurs as a result of implementing the strategic plan then some improvements in the loss position would be generated.

Government policy statements on increases in revenue from rates and certain other own source revenue indicate these are to be contained generally to CPI variations. Financial benefits from these sources are therefore not likely to reduce the losses.

2.2.9 Borrowing and Leaseback Arrangements as a Source of Funds

The "*Canberra - A Capital Future*" plan stated that the Government would continue with a 'low debt' policy. However it is difficult to see how a "low debt" policy can be continued unless the loss is addressed.

It is recognised that the ACT currently has low debt relative to most States and the other Territory and the ACT can also borrow at attractive rates due to its AAA credit rating.

The Territory can also enter into "sale and leaseback" or other financing type arrangements to meet its

liabilities as they emerge however these are similar in financial terms to borrowings. In any evaluation of the ACT's current financial position or planning for the future they should be treated the same as borrowings. Substantial increases in these types of arrangements would be contrary to a 'low debt' policy.

Borrowings and finance type arrangements can be used in the short term to ensure sufficient cash is available to meet the Government's operating and/or capital requirements. In the long term however these borrowings and arrangements need to be repaid from future revenues. As well interest or other finance charges need to be met. The effect of using these methods to obtain funds results in the costs being met by future taxpayers. It is acknowledged that this can be appropriate if the borrowings are for capital purposes.

2.3 SUMMARY

The size and the significance of the Territory's operating losses have been outlined in this Chapter. The introduction of 'accrual' accounting has enabled this loss to be reliably identified for the first time.

The comparisons in this Chapter support the fact that in relative terms the ACT is operating with much greater loss than NSW, Western Australia or the Commonwealth. Comparisons in the Chapter also disclose that in contrast with other Australian capital cities and some larger NSW local government cities and municipalities, the ACT has a large loss. The compared cities and municipalities generally operate with sound operating surpluses.

The development of the loss to its current size has occurred over several years and under different Governments. The loss can be said to be a product of falling Commonwealth grants not being offset by

reductions in operating costs or sufficient increases in own source revenue.

The Chapter reviewed the Government's responses to the difficult financial position and concluded that actions currently taking place or to take place will not significantly reduce the loss. If the Territory's revenue base is expanded through implementation of actions foreshadowed in the "*Canberra: A Capital Future*" Strategic Plan some reduction of the loss could be expected.

Figures from the Whole of Territory financial statements for 1995-96 and the budget for 1996-97 show that the entire loss is generated from the operations of the General Government Sector. In the next Chapter the General Government Sector agencies which generate most of the loss will be identified.

The problem of the 1995-96 loss and the projected further losses has the potential to significantly effect the future standard of living for ACT residents. The problem is of such a magnitude that solutions which can be effectively implemented are unlikely to be developed unless a cooperative and constructive approach is taken by the Members of a fully informed Legislative Assembly.

3. THE GENERAL GOVERNMENT SECTOR LOSS DISSECTED

3.1 INTRODUCTION

The previous Chapter illustrated the overall size of the loss in relation to the size of the Territory's revenue base and in comparison relatively to other Governments, cities and councils. The Chapter also disclosed that the General Government Sector activities generate the whole of the loss. This Chapter sets out the activities of the General Government Sector which make the greatest contributions to the ACT's loss.

3.2 1995-96 AGENCY OPERATING RESULTS

The table on *page 25* summarises the 1995-96 operating revenues, expenditures and results for each Government agency as extracted from the agencies' audited financial statements by the Chief Minister's Department for the purposes of preparing the Whole of Territory Statements.

During preparation by the Chief Minister's Department of the Whole of Territory financial statements inconsistencies were noted between agencies in accounting treatments for certain transactions and their consequent presentation in the Agencies' financial statements. Adjustments have been made by the Chief Minister's Department to remove these inconsistencies and for this reason the results presented in the table may differ from Agencies' published financial statements.

The table shows that the Chief Minister's Department, with a loss of $286m, is the major contributor to the overall loss. This however is misleading as the majority of superannuation costs incurred by other agencies in producing their outputs is included in the

Chief Minister's Department's costs. This has occurred because superannuation costs have been recognised as a whole of government cost rather than costs incurred by each agency in the delivery of its services. This has clearly resulted in most agencies' losses being significantly understated and the Chief Minister's correspondingly overstated. It is acknowledged that the treatment used is an alternative allowed by the relevant Australian Accounting Standard however it also needs to be pointed out that it is not a mandatory treatment under the Standard.

Another superannuation issue affecting agencies' operating results is that the total increase in the ACT's liability for superannuation costs has not been charged as an expense in agencies' operating statements.

Agencies were required to follow a formula provided to them by the Office of Financial Management to estimate the amounts to be brought to account in their operating statements. Use of the formula resulted in a total of $82.5m expense being brought to account by agencies while the increase in the Territory's liability was $217.5m comprising $117m for 1995-96 operations and the abnormal item (referred to previously in this Report) of $91m. As a result overall the operating expenses in individual agencies' statements have been understated by $135m.

1995-96 TERRITORY OPERATING LOSS

Agencies' 1995-96 Operating Results

	Operating Surplus (Loss) before Abnormal Expenses $000	Abnormal Expenses $000	Operating Surplus (Loss) $000
Education & Training	(21386)		(21386)
Health & Community Care	(31505)		(31505
Urban Services	(7377)		(7377)
Chief Minister's	(195198)	(91176)	(286374)
Housing Bureau	625		625
Attorney-General's	(753)		(753)
Business, Arts, Sport & Tourism	1916		1916
Canb Institute of Technology	(2957)		(2957)
Canb Theatre Trust	(578)		(578)
Agents Board	800		800
Legislative Assembly	(344)		(344)
Auditor-General's	192		192
Cemeteries Trust	(49)		(49)
Casino Surveillance Authority	(17)		(17)
Executive	(36)		(36)
Emergency Services Bureau	(741)		(741)
Public Trustee	121		121
Legal Aid Commission	(306)		(306)
Total Care Ltd	813		813
Exhibition Park	69		69
Healthpact	981		981
	(255730)	(91176)	(346906)

To better illustrate the activities which are the major contributors to the loss, adjustments have been made to the results set out in the previous table of agency results. The adjustments involve allocating the total increase in the superannuation liability to the Agencies and also reducing the Chief Minister's Department's expenses by this amount

As stated the total increase in the superannuation liability during 1995-96 was $217.5m. The following table shows the adjusted agency results.

1995-96 TERRITORY OPERATING LOSS

Agencies' Operating Results Adjusted for Superannuation

	Operating Results Surplus (Loss) $000	Superannuation Reallocated $000	Adjusted Surplus (Loss) $000
Education & Training	(21386)	(70023)	(91409)
Health & Community Care	(31505)	(57193)	(88698)
Urban Services	(7377)	(47189)	(54566)
Housing Bureau	625		625
Attorney-General's	(753)	(8699)	(9452)
Business, Arts, Sport & Tourism	1916	(4784)	(2868)
Canb Institute of Technology	(2957)	(14787)	(17744)
Canb Theatre Trust	(578)		(578)
Agents Board	800		800
Legislative Assembly	(344)	(435)	(779)
Auditor-General's	192		192
Cemeteries Trust	(49)		(49)
Casino Surveillance Authority	(17)		(17)
Executive	(36)		(36)
Emergency Services Bureau	(741)	(6307)	(7048)
Public Trustee	121		121
Legal Aid Commission	(306)		(306)
Total Care Ltd	813		813
Exhibition Park	69		69
Healthpact	981		981
Chief Minister's	(286374)	(8046)	
Superannuation reallocated to other Agencies		*217463*	(76957)
	(346906)	0	(346906)

Some smaller agencies meet their liabilities for superannuation as they arise by payments to the Superannuation Trust Fund which is an account maintained by the Chief Minister's Department to record '*Whole of Territory*' superannuation transactions. No adjustments were therefore necessary to these agencies' operating results.

The adjusted results from the above table are summarised in the following table to show the major contributors to the loss.

Major Contributors to the Loss

	$m	%
Health and Community Care	88.7	25.6
Education and Training	91.4	26.3
Urban Services	54.6	15.7
Chief Minister		
Banker activities*	70.0	20.2
Other activities	7.0	2.1
	311.7	89.9
Other	35.2	10.1
	346.9	100.0

* see comment below

3.2.1 Chief Minister's Department Loss

The Chief Minister's Department acted as the central banker for the other agencies in 1995-96. This role will be filled by the Central Financing Unit in 1996-97. The banker responsibility generated a loss of some $70m for the Department as the cash inflows into the Department from Commonwealth grants and own cash sources fell short by this amount of the operating cash outflows. The shortfall, which was financed from borrowings, makes up the majority of the Chief Minister's Department loss.

The loss suffered through the 'banker' role was generated through the Territory's financial situation rather than through the provision of any services or production of outputs by the Department.

This loss will only be reduced if the Territory's shortfall between operating revenues and expenditures is improved.

3.2.2 Major Contributors to the Loss

The Departments which generate the majority of the Territory's General Government Sector loss are Health and Community Care, Education and Training

and Urban Services. Combined these three agencies generate 67.7% of the loss or almost $234.7m.

A significant factor which effects the Department of Urban Services results is depreciation expense. Most of the ACT's infrastructure assets (e.g. roads, bridges and drains) are included in the Departments balance sheet and consequently the related depreciation expense is accounted for in the Department's Territory operating statement. The expense arises from existing assets and must therefore be regarded as a fixed cost which cannot be reduced significantly without disposing of or reducing the value of the assets.

3.2.3 Commonwealth Grants Commission Assessments

The Commonwealth Grants Commission (CGC) assessed the ACT as spending $53.5m above the standardised level of expenditure in 1994-95 on education. For hospital services, the ACT was assessed at $25.4m above the standardised level in 1994-95. On the other hand, Total General Public Services was assessed as not greatly above the standardised level of expenditure in 1994-95.

The CGC assessments support the view that Health and Education are major contributors to the Territory's losses.

The Territory Government has recently sought an extension to transitional funding from the Commonwealth through the CGC. The extension of the Territory transitional allowances timeframe from the original estimate of 8 years to 15 was sought only in respect of education and hospital services as the two primary areas of the ACT Budget still requiring major structural reform.

The Territory's proposal to the CGC is that for the hospital services and education categories that the

Commission extend the transitional period to ensure that a systematic process is put in place thereby allowing the ACT to adjust to reduced levels of Commonwealth funding over a more realistic timeframe. It is understood that the Territory believes that the Commission's original judgement understated the effects of the policies inherited from the Commonwealth and the 'period of grace' to take control of policies was insufficient with hindsight.

3.3 SUMMARY

In this Chapter through analysis of agencies' financial statements and from other available information the agencies which generated the majority of the Territory's operating loss for 1995-96 were identified. The analysis showed that the activities of the Departments of Health and Community Care, Education and Training, and Urban Services generate most of the loss. The finding in relation to Health and Education is supported by Commonwealth Grants Commission assessments.

Although the 1996-97 budget has not been analysed in detail the indications are that the same three agencies will generate the largest proportions of the planned 1996-97 loss.

Considering the size of the Territory's loss it is clear that if any significant reductions are to be achieved through reducing costs then most attention will need to be given to these agencies although flexibility to reduce Urban Services costs is limited because of large relatively fixed depreciation charges.

Reducing costs in other agencies, while being something which should be addressed, will not materially impact the Territory's overall operating loss.

For 1995-96 the Department of Health and Community Care's employee costs were $228m or 60% approximately of total operating costs. In the Department of Education employee costs were $218m or 71% approximately of total operating costs. As employee costs represent such a large proportion of these Departments' operating costs it is these costs which primarily need to be addressed if major savings are to be made.

The next Chapter refers to the impact of superannuation costs which comprise approximately 20% or more of employee costs.

4. SUPERANNUATION COSTS

4.1 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 a large operating loss as it was able to defer into the future meeting costs incurred in delivering its services to the community. The most significant cost which is being deferred is the ACT's employer contributions for its employees.

This Chapter provides information on the superannuation liability.

4.2 UNFUNDED SUPERANNUATION LIABILITIES

The level of *unfunded liabilities* for superannuation over the past three years has been as follows:

	1993-94 $000	**1994-95 $000**	**1995-96 $000**
Total Superannuation Liabilities	465 028	577 456	820 614
Less Investments Held	148 718	193 165	218 861
Unfunded Liabilities	316 310	384 291	601 753
Unfunded Liabilities as a % of Total Liabilities	68.0%	66.5%	73.3%

As at 30 June 1996, the ACT Government had total unfunded superannuation liabilities of $601.8m, funding for which will need to be obtained from future revenues. This equates to around $2,000 of superannuation debt for every person in the ACT. Under current projections the proportion of unfunded liabilities will continue to significantly increase over future years.

4.3 PAYMENT OF THE SUPERANNUATION LIABILITY

The ACT Government meets the reimbursement of the emerging costs of benefits paid each year to members of CSS/PSS for ACT Government Service after 1 July 1989. Payments to the Commonwealth to reimburse the costs of superannuation benefits paid to ACT retirees for each three year period are based on preliminary estimates agreed with the Commonwealth. The amount paid during 1995-96 was $10.638m (1994-95 $7.948m) which included the emerging cost of $8.360m ($6.192m) plus an amount of $2.278m ($1.756m) to cover prior years 'deficiencies' including interest.

The amounts which the ACT will have to pay to Comsuper in future years to meet the superannuation liability have been estimated by the Government's consultant actuary. The estimated payments are shown in the following table.

Emerging Cost Payment Schedule

Year	$m
1996-1997*	17.6
1997-1998*	20.8
1998-1999*	24.3
1999-2000	19.2
2000-2001	23.7
2001-2002	30.6
2002-2003	39.0
2003-2004	47.7
2004-2005	57.5

* includes payment of 'arrears' from earlier years

The table shows the rapidly escalating rate of payments which will be required.

This escalation is the result of the ageing profile of ACT employees. As the 21st century commences many of these employees will be reaching retirement

age and the ACT will be required to meet its obligations towards their superannuation.

4.4 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 put aside funds in investments to match the costs as they were being incurred *'unfunded liabilities'* representing the cash which will have to be found in the future have inevitably grown.

The repayment schedule prepared by the Government's consultant actuary shows that within a relatively short time what are currently *'unfunded liabilities'* will need to be funded. Over the four years to 2004-2005 approximately $175m will need to be paid to Comsuper. The payments will continue to grow rapidly after 2005.

One assumption on which the consultant's payment schedule is based is that the superannuation liabilities will generally remain unfunded i.e. there will be no funds invested by the Government to meet the liabilities prior to the payments being due to Comsuper. Unless the Territory is able to convert its current operating losses into surpluses the consultant actuary's assumption is correct as the Territory will not have surplus funds to invest in order to meet the

liabilities as they emerge. If the losses continue the emerging payments will have to be met from increased taxes and charges on the ACT community. Alternatively meeting the costs could be deferred further by borrowing the cash required. The borrowings of course only further defer when taxpayers will have to meet the costs and also add interest charges which must also be met.

5. IMPROVEMENT TO AGENCIES OPERATING STATEMENT PRESENTATION

5.1 INTRODUCTION

The 1995-96 operating results for the ACT's General Government Sector agencies were presented earlier in this Report. Issues in relation to superannuation were also raised. Methods to address the issues of financial statement presentation of superannuation costs are outlined in this Chapter.

5.2 OPERATING STATEMENT PRESENTATION

In order to arrive at the results disclosed in *Chapter 3* it was necessary to make adjustments to the results disclosed in the agencies' financial statements. In this Chapter an alteration to the format of agencies' operating statements is put forward which would obviate the need for similar adjustments in future years to arrive at more useful operating results than currently being presented.

5.2.1 Current Presentation

As stated earlier, the current presentational method for superannuation costs in agencies financial statements involves the amount of the superannuation cost brought to account as expenses being fully offset by a notional revenue item titled "*Liabilities Assumed by Government*". As a consequence of this treatment the superannuation cost has no effect on agencies' operating results and this could present a potentially misleading representation of the result to readers of the statements.

5.2.2 Suggested Altered Format for Agencies' Operating Statements

A relatively minor change can be made to eliminate the existing possibility that readers could gain an

incorrect view of agencies' operating results. The change involves treating the *'Assumption of Superannuation Liabilities'* item as allocations to the agencies' accumulated funds in their Operating Statements rather than as a revenue item. The following dummy chart illustrates the suggested change.

Department XYZ

	Current Presentation	Alternate Presentation
REVENUES	**$m**	**$m**
Govt Payment for Outputs	400	400
*Liabilities Assumed by Government (Superannuation)**	*30*	
Other	60	60
	490	460
EXPENSES		
Employee Expenses	300	300
Administration Costs	100	100
Depreciation	20	20
Other	80	80
	500	500
Operating Loss before Extraordinary and Abnormal Item	10	40
Abnormal Item	-	-
Extraordinary Item	-	-
Operating Loss	-10	-40
Accumulated Funds at beginning of the period	1000	1000
Amounts transferred to or from Reserves	-	
Capital Injection(s)	20	20
Distribution(s) to Government	-	
*Liabilities Assumed by Government (Superannuation)**		*30*
Increase/Decrease in Net Assets from Administration Restructuring	-	
Accumulated Funds at the end of the period	1010	1010

* As shown the difference in the two presentations is that in the current presentation "Liabilities Assumed" are shown as operating revenue while in the alternate presentation they are shown as a deduction from Accumulated Funds.

5.3 AMOUNTS CHARGED BY AGENCIES FOR SUPERANNUATION COSTS

Mention was also made in a previous Chapter that the total amount expended in Agencies' statements for superannuation fell well short of the actual total cost. The total increase in the liability for superannuation (i.e. the cost) was $217m in 1995-96 while the total amount brought to account in Agencies' operating statements was only $82.5m i.e. agencies understated the costs generated by their activities by approximately $135m in total.

Instructions were issued by the Office of Financial Management (OFM) to agencies on how to calculate the superannuation cost. Agencies were required to apply a percentage figure to their total salaries cost in order to arrive at the superannuation cost. The OFM percentage however produced amounts far lower than the total increase in the liability for 1995-96. There was apparently no action to ensure that the amounts being taken up by agencies aggregated to the liability increase over the year.

To address this matter it is suggested that the OFM formula should be re-examined and more appropriate guidance issued to agencies. The basis for this should be that the aggregate amount brought to account by agencies should be equivalent to the increase in the annual total liability as recorded in the Superannuation Provision Unit.