

## CHAPTER 5: DEPARTMENTAL ASSET INVESTMENT

### Key findings of the Committee:

- 5.1 The Committee is of the view that there is a need for the Department of Treasury and Finance to disclose in the papers how the Total Estimated Investment is determined over the forward estimates period and beyond and its reconciliation to the application of cash resources.
- 5.2 The Committee considers appropriate focus needs to be placed, by water authorities and the department, on reporting on progress with water infrastructure projects to ensure that commensurate attention is given to this expanding area of operation.
- 5.3 The Committee noted that the Treasurer highlighted in the budget that, in addition to the \$16 billion invested in capital works since 1999, the government will invest a further \$13 billion over the next four years.
- 5.4 The Committee found that, while there has been a significant increase in the percentage of net investment in fixed assets to gross state product from 1999-00 to 2007-08, the major increase occurred in 2006-07.
- 5.5 The significant acceleration in the government's asset investment program, by 43 per cent on average over previous years, presents an opportunity for re-evaluation of improvements in disclosure in annual reports and for reassessments confirming net benefits derived from built assets. The Committee will be looking to ensure continual improvements in reporting on these matters in the future.
- 5.6 In the Committee's opinion, the effectiveness and adequacy of education expenditure should be monitored to ensure that fairness of education opportunity is achieved in a balanced manner. Equality of opportunity should ensure that the more disadvantaged areas of Victoria receive appropriate support for their educational needs.

### 5.1 Trend analysis of net investment on fixed assets as a percentage of gross state product

Table 5.1 shows that while there has been a significant increase in the net investment in fixed assets expressed as a percentage of gross state product since 1999-00, the main increase between 1999-00 and 2007-08 occurred in 2006-07.

**Table 5.1: Net investment on fixed assets as a percentage of gross state product**

|   | 1998-99<br>(\$ million) | 1999-00<br>(\$ million) | 2000-01<br>(\$ million) | 2001-02<br>(\$ million) | 2002-03<br>(\$ million) | 2003-04<br>(\$ million) | 2004-05<br>(\$ million) | 2005-06<br>(\$ million) | 2006-07<br>(\$ million) | 2007-08<br>(\$ million) |
|---|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Total net investment in fixed assets (actual)                               | 1,446.6                 | 1,466.2                 | 1,796.6                 | 2,087.2                 | 2,109.6                 | 2,378.4                 | 2,373.3                 | 2,691.5                 | (a) 3,416.8             | (a) 3,621.7             |
| Gross State Product (c)   | 152,994.0               | 162,575.0               | 172,995.0               | 185,085.0               | 196,023.0               | 211,944.0               | 222,221.0               | 233,320.0               | (b) 239,736.0           | (b) 247,528.0           |
| Total net investment in fixed assets as a percentage of Gross State Product | 0.95                    | 0.90                    | 1.04                    | 1.13                    | 1.08                    | 1.12                    | 1.07                    | 1.15                    | 1.43                    | 1.46                    |

- Notes:
- (a) the total net investment in fixed assets for 2006-07 and 2007-08 are derived from the revised and budget figures shown in Budget Paper No.2, p.45
  - (b) the Gross State Product figure for 2006-07 and 2007-08 has been calculated by the Committee using the forecast increase identified in Budget Paper No.2, Strategy and Outlook 2007-08, p.16
  - (c) Gross State Product is the total market value of goods and services produced in a state or territory within a given period, after deducting the cost of goods and services used up in the process of production, but before deducting allowances for the consumption of fixed capital. Thus gross state product, as defined here, is 'at market prices'

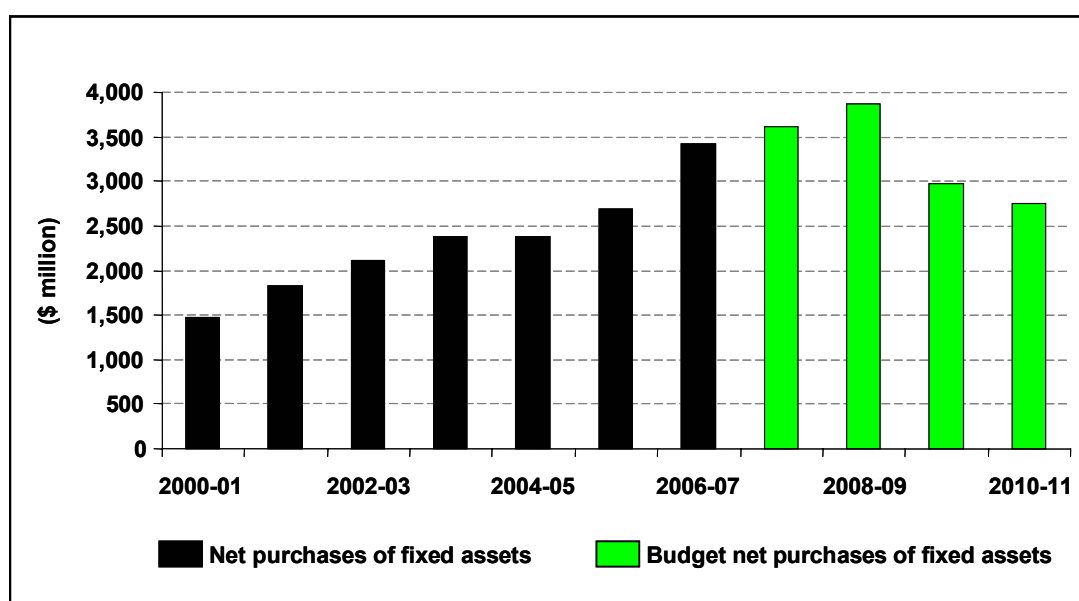
Sources: Australian Bureau of Statistics, Australian National Accounts State Accounts 5220.0 2005-06, p.14, 1999-00 to 2005-06 Financial Reports for the State of Victoria and 2007-08 Budget Papers

## 5.2 Asset investment provisions within the 2007-08 Budget Estimates

The budget speech, delivered to the Parliament on 1 May 2007, identified the significant reduction, since 1999, of the net financial liabilities of the state as the catalyst to the enhanced financial capacity of the government to make critical investments in human capital and infrastructure. The Treasurer highlighted that, in addition to the \$16 billion invested in capital works since 1999, the government will invest a further \$13 billion over the next four years.<sup>95</sup>

Figure 5.2 details the government's asset investment program for the period 2000-01 to 2006-07, and the proposed program covering the forward estimates period 2007-08 to 2010-11.

**Figure 5.2: Government asset investment program 2000-01 to 2010-11**



Source: Budget Paper No.2, 2007-08 Strategy and Outlook, p.5

The Treasurer indicated that, while in the past average annual expenditure averaged \$2.3 billion a year, it is expected to average \$3.3 billion a year over the forward estimates period, a 43 per cent increase. This totals in excess of \$13 billion over the next four year period.<sup>96</sup> Additionally, net infrastructure investment is expected to exceed estimated depreciation by an average of around \$1.7 billion a year and is expected to grow the state's real capital stock by 7.9 per cent over the four years to June 2011.<sup>97</sup> Of this \$13 billion asset investment program, around 60 per cent will be financed from cash operating surpluses with the remainder being financed by borrowings.<sup>98</sup> Additionally, a potential exists for additional expenditure to be incurred from a pool of unallocated funds, which can be distributed to specific departments and projects for the purchase of property, plant and equipment.<sup>99</sup> Budget Information Paper No.1 covering the 2007-08 Public Sector Asset

<sup>95</sup> Budget Paper No.1, 2007-08 Treasurer's Speech, p.3

<sup>96</sup> Budget Paper No.2, 2007-08 Strategy and Outlook, p.5

<sup>97</sup> *ibid.*, p.6

<sup>98</sup> *ibid.*, p.47

<sup>99</sup> Budget Paper No.4, 2007-08 Statement of Finances, p.49

Investment Program, which will be released later this year, will contain relevant information concerning this issue. Amounts available to be allocated include the following forward estimates:<sup>100</sup>

- 2007-08 budget (\$182.1 million) – the budget includes an allowance for departmental underspending in 2007-08, which may be subject to carryover in 2008-09; and
- estimates for 2008-09, 2009-10 and 2010-11 amounting to \$337.0 million, \$605.8 million and \$866.5 million respectively.

At the estimates hearing the Committee sought clarification from the Treasurer about reconciling the *Unallocated provision for future allocation* contained in the budget papers totalling \$1.6 billion (estimates of \$263 million for 2008-09, \$532.3 million for 2009-10 and \$815.9 million for 2010-11)<sup>101</sup> and the Treasurer's statement that the Total Estimated Investment (TEI) which is fully funded in future budgets is \$2.9 billion.<sup>102</sup> The Committee also inquired as to whether any component of the \$2.9 billion allocation will extend into the next term of government.<sup>103</sup>

The Treasurer explained that the amount totalling \$1.6 billion represents the first year cash of the TEI (that is, the cash available for the first year spend<sup>104</sup>) and, according to convention, the rule applied by Treasury is that when looking at a capital provision, on average, 28 per cent is allocated in the first, second and third years and 16 per cent in the fourth year. Although this varies from project to project, the use of this formula based on previous budget practice results in an amount of \$2.9 billion to be funded in future budgets<sup>105</sup>, including relevant outyears. The Treasurer advised the Committee that this practice of calculating the TEI has been in operation for more than ten years.<sup>106</sup>

A reconciliation between the \$1.6 billion cash available in the first year and the \$2.9 billion TEI over the forward estimates period is shown below, based on information provided by the Treasurer in response to a question taken on notice:<sup>107</sup>

*During each budget process, the unallocated capital contingency is reduced as ERC approves capital expenditure and allocated funds to departments.*

*Following the 2007-08 budget process, the available unallocated contingency for 2008-09 was \$263 million, for 2009-10 it was \$532.3 million and for 2010-11 it was \$815.9 million – this amounts to **\$1.6 billion of cash flow** over the forward estimates period (this is shown on page 45 of Budget Paper No.2).*

*The Total Estimated Investment (TEI) associated with each year of available unallocated capital contingency is based on the average expenditure profile of capital projects over recent years and assumes the following pattern of expenditure:*

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<sup>100</sup> *ibid.*

<sup>101</sup> Budget Paper No.2, *2007-08 Strategy and Outlook*, p.45

<sup>102</sup> Hon. J Brumby MP, Treasurer, 2007-08 Budget Estimates hearing, transcript of evidence, 4 May 2007, p.7

<sup>103</sup> *ibid.*

<sup>104</sup> *ibid.*, p.18

<sup>105</sup> *ibid.*, pp.6–7

<sup>106</sup> *ibid.*, p.7

<sup>107</sup> Hon. J Brumby MP, Treasurer, response to the Committee's question on notice, received 11 July 2007, p.3

- Year One 28 per cent
- Year Two 28 per cent
- Year Three 28 per cent
- Year Four 16 per cent

Using the historical spend profile, this corresponds to an indicative **announceable TEI totalling \$2.9 billion** over the forward estimates period:

- (a) \$939 million in 2008-09 (that is, \$263 million<sup>108</sup> divided by 0.28)
- (b) \$962 million in 2009-10 (that is, \$532.3 million<sup>109</sup> less \$263 million<sup>110</sup> = \$269 million, divided by 0.28)
- (c) \$1,013 million in 2010-11 (that is, \$815.9 million<sup>111</sup> less \$263 million<sup>112</sup> less \$269 million<sup>113</sup> = \$284 million divided by 0.28)

*This approach has been consistently applied by the Department of Treasury and Finance for at least the last decade.*

The Committee noted that on the basis of average expenditure profiles for capital projects, new projects commence each year with a pattern of expenditure of 28 per cent, 28 per cent, 28 per cent and 16 per cent over four years respectively. This means that projects that commence in 2008-09 (the first year of the forward estimates) will on average incur Total Estimated Investment (TEI) over four years to 2011-12 in line with these percentages with 16 per cent of the TEI being incurred in the first year outside the forward estimates period that is, in 2011-12. It is assumed for the purpose of calculating the TEI over the four years, that the cash available in the first year spend will represent 28 per cent of the TEI which will be incurred over a four year period. It is for this reason that the TEI extends beyond the forward estimates period of 2007-08 to 2010-11 for new projects that commence in each year of the forward estimates for example, unallocated cash flow identified in the last year of the forward estimates of 2010-11 for new projects commenced in that year will represent 28 per cent of the TEI to 2013-14. It is for this reason that the TEI of \$2.9 billion over the forward estimates period is significantly greater than the \$1.6 billion cash flow. The difference between the cash flow of \$1.6 billion and the TEI totalling \$2.9 billion represents the difference between the cash available in the first year of new projects and their TEI over a four year period, which may extend beyond the current forward estimates period. Due to the long term nature of capital spending, there will always be TEI that extends beyond the forward estimates period and it would be misleading to consider the difference between this and cash to represent a shortfall in funding in any one budget. Financing decisions in the relevant outyears for the TEI associated with each year of available unallocated capital contingency will depend on the various funding options that will be available to be considered in future years.<sup>114</sup>

The Committee considers that to enhance transparency and accountability surrounding budget presentation, the budget papers should contain an explanation of how the TEI is determined over the forward estimates period and beyond and its reconciliation to the application of cash resources.

<sup>108</sup> Refer table 3.5 in Budget Paper No.2, 2007-08 Strategy and Outlook, p.45

<sup>109</sup> *ibid.*

<sup>110</sup> Equals the second year cash flow of the \$939 million TEI based on use of the historical spend profile

<sup>111</sup> Refer table 3.5 in Budget Paper No.2, 2007-08 Strategy and Outlook, p.45

<sup>112</sup> Equals the third year cash flow of the \$939 million TEI based on use of the historical spend profile

<sup>113</sup> Equals the second year cash flow of the \$962 million TEI based on use of the historical spend profile

<sup>114</sup> Hon. J Brumby MP, Treasurer, 2007-08 Budget Estimates hearing, transcript of evidence, 4 May 2007, p.8

The Committee recommends that:

**Recommendation 15:**                      **The Department of Treasury and Finance disclose in the budget papers how the TEI is determined over the forward estimates period and beyond and its reconciliation to the application of cash resources.**

### 5.3            Asset investment funding during 2007-08

The separately identified projects detailed in table 5.3 below, comprise, cumulatively, a sample summary of at least 50 per cent of the budgeted asset investment expenditure of each department for the year 2007-08. This table includes funding for both new and existing asset investment projects.

**Table 5.3:                                      Departmental Asset Investments  
for funding during 2007-08**

| Department                   | Project title  | 2007-08 budget (\$ million) | Total (\$ million) |
|------------------------------|--|-----------------------------|--------------------|
| Parliamentary departments    | Additional Infrastructure at 55 St. Andrews Place, Cabling upgrade and Replacement of switchboards in Parliament House | 1                           | 1                  |
| Department of Education      | Land acquisitions  | 35                          | 238                |
|                              | Modernisation  | 110                         |                    |
|                              | Regeneration projects  | 27                          |                    |
|                              | Various other projects   | 66                          |                    |
| Department of Human Services | Royal Children’s Hospital redevelopment  | 141                         | 429                |
|                              | Health Information and Communication Technology (ICT) Strategy   | 30                          |                    |
|                              | Box Hill Hospital – Outpatients and Dialysis Centre and Associated Works   | 21                          |                    |
|                              | Royal Melbourne Hospital Emergency Department redevelopment  | 20                          |                    |
|                              | Casey Residential aged care  | 18                          |                    |
|                              | Various other projects   | 199                         |                    |
| Department of Infrastructure | West Gate Monash Freeways Improvement Project  | 177                         | 1,543              |
|                              | Geelong Ring Road – Sections 1 to 4  | 132                         |                    |
|                              | New Ticketing Solution   | 99                          |                    |
|                              | Western Highway – Deer Park Bypass and Leakes Rd Interchange Upgrade   | 97                          |                    |
|                              | Calder Highway Sec 2 and Kyneton to Faraday Faraday to Ravenswood  | 129                         |                    |
|                              | Metropolitan Train Projects  | 70                          |                    |
|                              | Road Safety Infrastructure programs 2 and 3  | 47                          |                    |
|                              | Pakenham By-pass   | 41                          |                    |
|                              | Various other projects   | 751                         |                    |

**Table 5.3: Departmental Asset Investments for funding during 2007-08 (continued)**

| Department  | Project title  | 2007-08 budget (\$ million) | Total (\$ million) |
|---|--|-----------------------------|--------------------|
| Department of Innovation, Industry and Regional Development | South West Institute of TAFE – Warrnambool Stage 3                 | 8                           | 16                 |
|   | Swinburne University – Wantirna Sustainability and Land Management | 5                           |                    |
|   | Various other projects   | 3                           |                    |
|   | City of Literature – centre for books and ideas                    | 6                           |                    |
|   | Various other projects   | 18                          |                    |
| Department of Justice                                       | Melbourne Legal Precinct Master Plan                               | 15                          | 123                |
|   | Justice Statement – Integrated Courts Management System            | 11                          |                    |
|   | Police Stations (Metropolitan and regional)                        | 33                          |                    |
|   | Law Enforcement data System  | 8                           |                    |
|   | Various Other projects   | 56                          |                    |
| Department of Premier and Cabinet                           | Melbourne Recital Centre and Melbourne Theatre Company             | 55                          | 79                 |
| Department of Primary Industries                            | Melbourne Wholesale Market Redevelopment                           | 32                          | 57                 |
|   | New Biosciences research centre                                    | 10                          |                    |
|   | Various other projects   | 15                          |                    |
| Department of Sustainability and Environment                | Wimmera-Mallee Pipeline (Commonwealth and State)                   | 83                          | 288                |
|   | Goldfields Superpipe (Bendigo Interconnection)                     | 33                          |                    |
|   | Water Recycling for Melbourne (Shepparton Irrigation Area)         | 12                          |                    |
|   | Sustainable Management of Victoria's Parks                         | 13                          |                    |
|   | Footscray Transit Cities   | 10                          |                    |
|   | Various other projects   | 137                         |                    |
| Department of Treasury and Finance                          | Standard Corporate ICT Infrastructure Strategy                     | 4                           | 14                 |
|   | Intra-government secured network                                   | 4                           |                    |
|   | Various other projects   | 6                           |                    |
| Department for Victorian Communities                        | Rectangular Sports Stadium   | 78                          | 81                 |
|   | Various other projects   | 3                           |                    |
| <b>Total</b>  |  |                             | <b>2,869</b>       |

Sources: Responses to the Committee's 2007-08 Budget Estimates questionnaire: Parliamentary departments p.10, Department of Education p.15, Department of Human Services pp.21–22, Department of Infrastructure pp.18–22, Department of Innovation, Industry and Regional Development p.22, Department of Justice pp.25–26, Department of Premier and Cabinet p.15, Department of Primary Industries p.17, Department of Sustainability and Environment pp.25–26, Department of Treasury and Finance pp.15–16, Department for Victorian Communities pp.13–14

## 5.4 Asset Investment Observations

The Committee noted that net infrastructure investment is projected to reach a record \$3.6 billion in 2007-08<sup>115</sup> (this figure includes net contributions to other sectors of government<sup>116</sup> such as water authorities). In relation to new projects, the 2007-08 budget provides funding for new asset investment projects with a total estimated investment of \$2.9 billion<sup>117</sup>, some of which extend over four years based on a notional average expenditure profile of capital projects over recent years and assuming the following pattern of expenditure – 28 per cent in year one; 28 per cent in year two; 28 per cent in year three; and 16 per cent in year four.

Asset investments on new and ongoing capital projects across all 10 departments and the parliamentary departments are estimated to cost \$2,869 million in 2007-08. Of this expenditure, \$1,543 million (53.8 per cent) has been allocated to the Department of Infrastructure, with \$429 million (15 per cent) to the Department of Human Services, \$288 million (10 per cent) to the Department of Sustainability and Environment, and \$238 million (8.3 per cent) to the Department of Education. The remaining \$371 million (12.9 per cent) is distributed amongst the other seven departments. Those four departments are considered ones with the larger infrastructure asset delivery imperatives to satisfy *Growing Victoria Together* (GVT) objectives.

The nature and scale of asset investment programs, and of individual projects, to be undertaken depend on departmental responsibilities in the delivery of services to meet projected community needs. Certain types of infrastructure, such as transport networks, water projects and health services facilities are more capital intensive.

The Committee offers the following comments on the four departments.

### 5.4.1 Department of Infrastructure

The budgeted expenditure of the Department of Infrastructure of \$1.5 billion includes the VicRoads programs totalling \$880 million.

The department's allocation of asset investment expenditure for 2007-08 is shown in figure 5.4.

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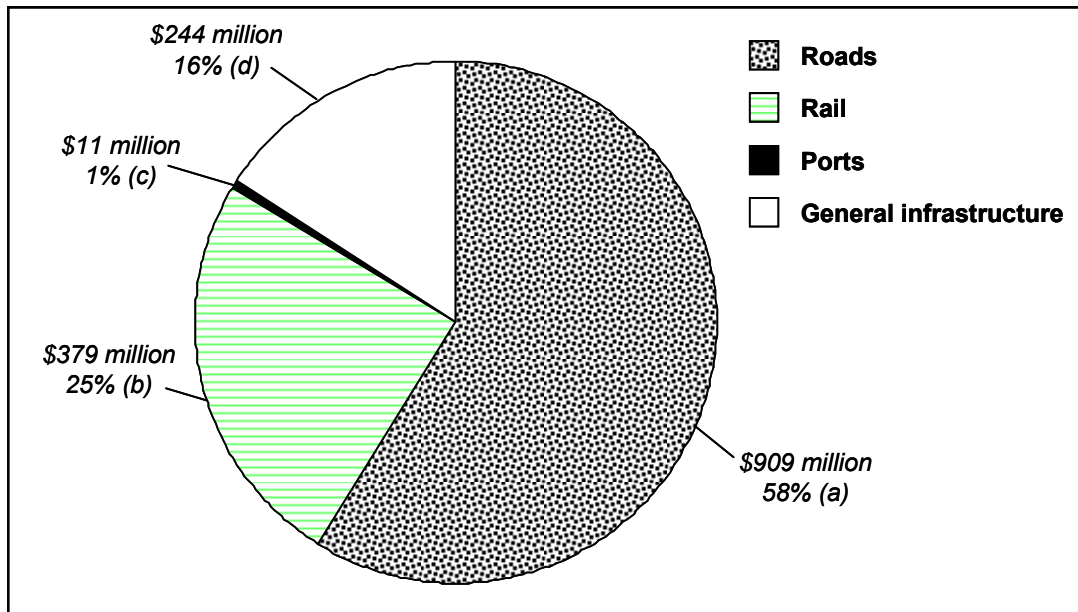
<sup>115</sup> Budget Paper No.2, 2007-08 Strategy and Outlook, p.5

<sup>116</sup> *ibid.*, p.5 (note a)

<sup>117</sup> *ibid.*, p.6



**Figure 5.4: Department of Infrastructure  
Budgeted expenditure 2007-08**



- Notes:
- (a) comprising \$403 million for regional roads, \$272 million for Melbourne metropolitan roads, \$47 million for general road safety infrastructure programs and \$187 million for other projects
  - (b) comprising \$291 million for regional rail and \$88 million for metropolitan rail
  - (c) \$11 million relating to the Princes Pier Restoration project
  - (d) general infrastructure projects, including accessible public transport in Victoria, \$39 million and whole of government revitalising central Dandenong, \$22 million

Source: Department of Infrastructure, email, received 1 June 2007

In *Budget Paper 2 Strategy and Outlook 2007-08*, the government indicated that it has also allocated \$10.5 billion to the *Meeting Our Transport Challenges* Statement, released in May 2006, to fund a range of transport infrastructure projects over a ten year period.<sup>118</sup>

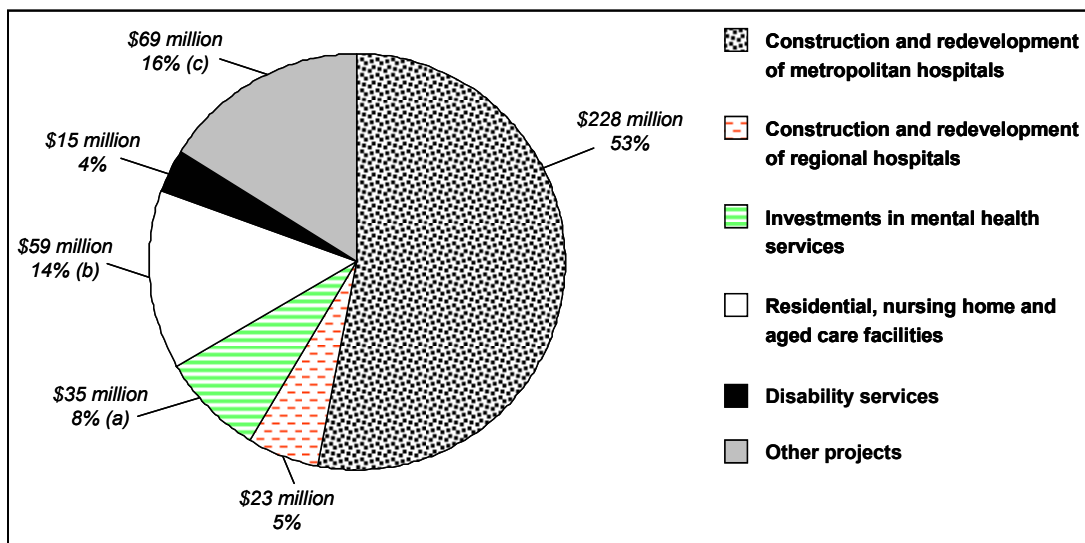
The Committee acknowledges that the proposed expenditure to be applied to the enhancement and construction of Victoria's infrastructure network is likely to make a contribution towards the state's economic growth and employment levels.

#### **5.4.2 Department of Human Services**

The budgeted 2007-08 expenditure of the Department of Human Services of \$429 million is shown in figure 5.5

<sup>118</sup> *ibid.*, p.45

**Figure 5.5: Department of Human Services  
Budgeted expenditure 2007-08**



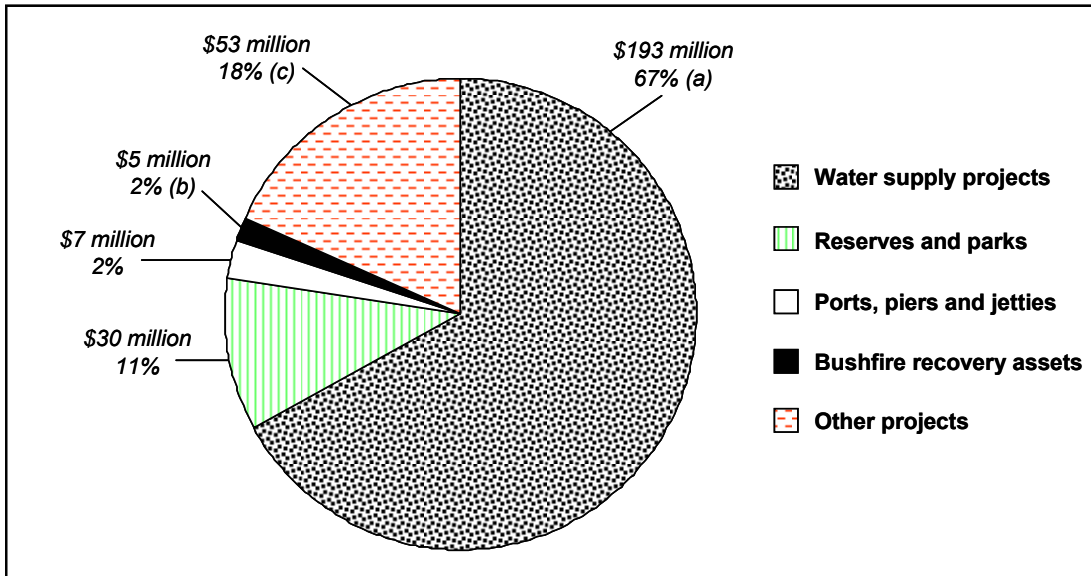
Notes: (a) comprising \$5 million to be spent in regional Victoria and \$30 million in the metropolitan area  
 (b) comprising \$25 million in regional Victoria and \$34 million in metropolitan Melbourne  
 (c) includes health information and community technology (ICT) expenditure, food centre upgrades and drug and alcohol programs

Source: Department of Human Services, email, received 23 May 2007

### 5.4.3 Department of Sustainability and Environment

The department's budgeted asset investment expenditure for 2007-08 totals \$288 million. The allocation of expenditure is shown in figure 5.6.

**Figure 5.6: Department of Sustainability and Environment  
Budgeted expenditure 2007-08**



- Notes:
- (a) includes water recycling, water saving and irrigation projects. Additional funding for water infrastructure projects is also available through the government's Our Water, Our Future Action Plan
  - (b) this expenditure reflects only the expenditure necessary to rebuild or construct public assets and does not include financial assistance provided by government to rural communities through other means
  - (c) includes land acquisitions, transit cities projects and equipment funding

Source: Department of Sustainability and Environment, response to the Committee's 2007-08 Budget Estimates questionnaire, received 8 May 2007, p.25

The Committee considers that the recent shift in focus, by government, towards water saving and water reticulation projects is widely supported by the broader community. However the Committee believes appropriate focus needs to be placed on reporting, by water authorities and the department, on progress with water infrastructure projects to ensure that commensurate attention is given to this expanding area of operation. Community information and ongoing consultation will be important components of water policy and programs into the future.

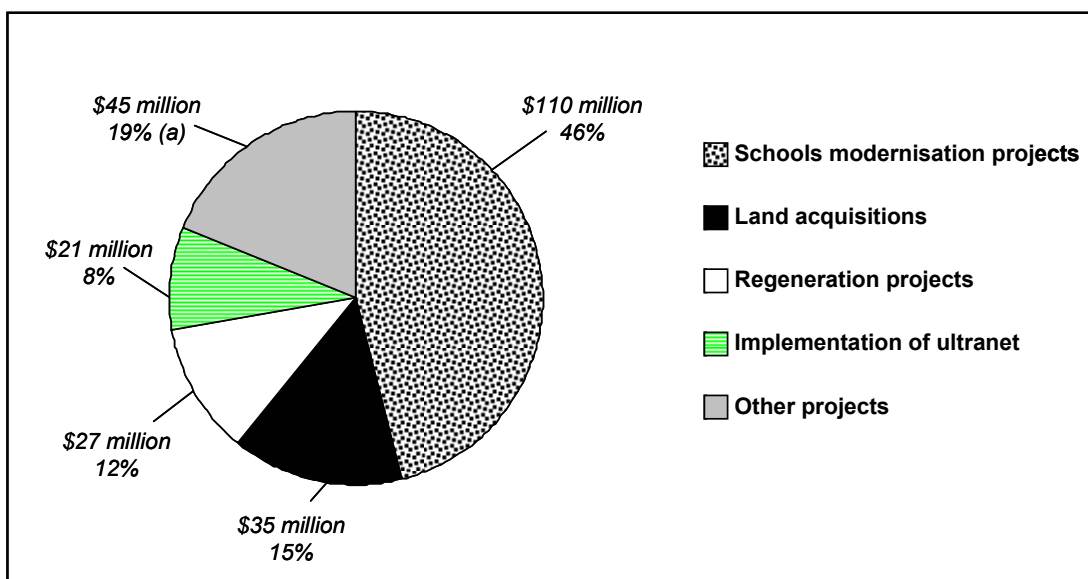
The Committee recommends that:

**Recommendation 16:** To enhance accountability and provide a means of disseminating information to the community and engaging the community in the formulation of water policy in future, the Department of Sustainability and Environment and water authorities report regularly on progress made on the construction of the major water supply projects.

#### 5.4.4 Department of Education

The department's allocation of the total asset investment budget for 2007-08 of \$238 million is shown in figure 5.7

**Figure 5.7: Department of Education Budgeted expenditure 2007-08**



Note: (a) includes replacements schools, new schools in growth areas and increased access to computers

Source: Department of Education, response to the Committee's 2007-08 Budget Estimates questionnaire, received 4 May 2007, p.15

The expenditure outlined above is intended to deliver the government's commitment to undertake significant upgrading and construction of education facilities, including TAFE colleges.<sup>119</sup> The expenditure is also consistent with the government's *Building Futures* policy statement which outlines the government's proposed capital investment in school infrastructure and with the government's *Building Tomorrow's Schools Today* Program.

In the Committee's opinion, the effectiveness and adequacy of education expenditure should be monitored to ensure that fairness of education opportunity is achieved in a balanced manner. Equality of opportunity should ensure that the more disadvantaged areas of Victoria receive appropriate support for their educational needs.

The Committee recommends that:

**Recommendation 17:** Asset investment connected with the upgrading and construction of education facilities be monitored from the viewpoint of ensuring that this spend occurs in an equitable manner so that the more disadvantaged areas receive appropriate support to meet their infrastructure and educational needs.

<sup>119</sup> *ibid.*, p.44