

1972-73

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VICTORIA

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# PROGRESS REPORT

FROM THE

PUBLIC ACCOUNTS COMMITTEE

UPON THE

VICTORIAN RAILWAYS

TOGETHER WITH

APPENDICES

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*Ordered by the Legislative Assembly to be printed, 13th December, 1972.*

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*By Authority:*

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EXTRACTED FROM THE VOTES AND PROCEEDINGS OF THE  
LEGISLATIVE ASSEMBLY.

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TUESDAY, 5TH SEPTEMBER, 1972.

17. PUBLIC ACCOUNTS COMMITTEE.—Motion made, by leave, and question—That Mr. Doube, Mr. Lind, Mr. McDonald (*Rodney*), Mr. McLaren, Mr. Reese, Mr. Trezise, and Mr. Wheeler be members of the Public Accounts Committee ; and that the Committee have power to send for persons, papers and records, to move from place to place, and to sit on days on which the House does not meet ; three to be the quorum (*Mr. Hamer*)—put and agreed to.



# REPORT

THE PUBLIC ACCOUNTS COMMITTEE have the honour to report as follows :—

1. In their Report upon the Auditor-General's Reports for 1969-70 (Parliamentary Paper D. No. 11 of 1970-71) your Committee drew attention to the loss incurred by the Victorian Railways in 1969-70 and indicated their intention to undertake an examination of railway accounts and accounting practices and review the operation of the Railways Department.

2. Following the announcement of their intention to conduct an inquiry, your Committee had consultations with the Chairman of Railways Commissioners, the Auditor-General and the Director of Finance. As a result of these consultations the Committee announced that the following terms of reference had been decided upon as a broad basis for the inquiry :—

Generally, to conduct an examination of the accounts of the Victorian Railways and the operation of that undertaking including, in particular, consideration of the following matters :—

- (a) the viability of the Victorian Railways as a transport system ;
- (b) the profitability or otherwise of the Victorian Railways, differentiating between urban and country services and passengers and freight ;
- (c) the effects of intrastate and interstate competition on railway results, especially constitutional problems ;
- (d) comparison of operations and results with other railway systems ;
- (e) the form and presentation of accounts ; and
- (f) the basic principles connected with the structuring of capital investment, loan advances from the Government, interest charges and depreciation of assets.

3. To date, evidence has been heard from a number of persons and organizations. In addition, inspections have been conducted at numerous locations in Victoria and New South Wales. Details as to the persons who have had discussions with, or tendered evidence to your Committee are contained in Appendix 1 to this Report.

4. As well as hearing evidence, conducting discussions and inspecting various areas, your Committee have examined numerous reports and references. A list of some of the more significant documents, including the submissions made to us, appears as Appendix 2 to this Report. Several of the submissions referred to are also appended to this Report. In addition, during the course of the inquiry the Report of the Board of Inquiry into the Victorian Land Transport System was presented to Parliament. A number of the recommendations contained in this Report have a bearing on the questions under consideration by your Committee and it is therefore being subjected to close examination.

5. This progress report deals with the matters which have been considered by your Committee to date. The subjects covered are as follows :—

- (a) previous inquiries into the Victorian Railways ;
- (b) the form and presentation of the Railways accounts ; and
- (c) the operation of the Stores Branch of the Railways Department.

## GENERAL COMMENTS.

6. Since the establishment of the Railways Department in 1856 the Victorian Railways has developed into a complex, large scale transport undertaking employing a staff in excess of 25,500. A century ago, in 1871-72, 313 miles of track were open. Today, 4,153 miles of track are open for traffic. The railways have seen the days where they virtually monopolized the transport scene in Victoria. In the years since the advent of the motor car, however, competition from commercial road transport and the private motor car has increased dramatically and the Railways no longer enjoy the unique position they formerly held.

7. The pattern of increasing deficits has been a matter of vital concern to your Committee for some time. In recent years these increases have been alarming, have greatly affected the State Budget and have highlighted the need for action. The following table demonstrates the trend over the past five financial years :—

Year.	Deficit as Shown in Annual Report.	Percentage Increase over Previous Year.
1967-68	11,557,108	%
1968-69	17,368,232	50
1969-70	20,998,227	20
1970-71	29,751,633	41
1971-72	36,484,888	22

Given the percentage increases shown in column 3 of the table it would be reasonable to assume that the deficit for 1972-73 could increase substantially again. Reference to the 1972-73 Budget Papers reinforces this assumption, as they reveal that the estimated deficit for 1972-73 is \$47.5 million. It is evident, therefore, that something must be done as a matter of urgency to remedy the situation.

8. In the early stages of their inquiry your Committee sought information on two matters which were considered to be relevant to the inquiry. Firstly, after perusing past reports relating to the Victorian Railways we sought information regarding the implementation of the relevant recommendations and conclusions contained in those reports. Secondly, we sought answers to a series of questions relating to the form and presentation of the Railways accounts from various individuals, departments and organizations. The results of our inquiries are referred to in this Report.

#### PREVIOUS INQUIRIES.

9. As mentioned in paragraph 8, a study was made of earlier Reports relating to the Victorian Railways, as listed in Appendix 2. The purpose of the study was to—(a) ascertain what recommendations and conclusions, if any, could be related to present circumstances and thus be of some assistance to your Committee; and (b) determine whether action had been taken as a result of the reports.

10. As a matter of procedure your Committee drew up a list of selected recommendations and conclusions from past reports and sought answers to the following questions from the Ministry of Transport and the Railways Department :—

- (a) What was the response to the recommendations at the time (if this is a matter of record);
- (b) What action, if any, was taken and when it was taken; and
- (c) In the event that no action was taken, for what reason action was not taken.

11. Several of the recommendations contained in seven Reports covering the period from 1917 to 1964 were found to be relevant to the present situation. For example, there have been many recommendations relating to treatment of depreciation, Railways loan liability, debt charges, separation of finances from the State Budget and many other financial matters. In addition, other important recommendations relating to the setting up of a Ministry of Transport and the establishment of a Transport Authority or Board were also made, as well as numerous recommendations relating to the operation and organization of the Railways.

12. A considerable amount of research was undertaken by the Railways Department and Ministry of Transport in an attempt to answer the questions raised by your Committee and for this we are grateful. However, your Committee were advised that information now available did not enable complete answers to be given in several instances.

13. Given that the information made available to your Committee was incomplete—and assuming that the lack of information indicates a lack of action—it is regretted that the action on the recommendations of earlier reports has been inadequate. With some exceptions, most of the recommendations which seem vital to your Committee have been ignored, whilst in other cases there have been lengthy delays in implementing proposals. To cite two examples, recommendations for the separation of Railway finances from the State Budget have been ignored, whilst recommendations for the establishment of a Ministry of Transport date back as far as 1928. The Ministry was finally established in 1951.

14. Your Committee regret to report the poor response to earlier recommendations. It would appear difficult to justify the expense of inquiries in these circumstances. In our view the present financial situation of the Victorian Railways is critical and something must be done as a matter of urgency if the trend of ever-increasing deficits is to be arrested. Current and future reports must therefore be acted upon to the maximum extent possible if this is to be the goal.

#### THE RAILWAYS ACCOUNTS.

15. As mentioned in paragraph 8, your Committee addressed a number of questions relating to the Railways accounts to various individuals and organizations. We have taken the unusual step of including the submissions we received in relation to these questions in Appendix 3. Your Committee believe that the information contained in the various submissions is of considerable interest and very relevant to the inquiry.

16. Many of the recommendations contained in the submissions—particularly those made by the Joint Committee of the Australian Society of Accountants and the Institute of Chartered Accountants in Australia (hereafter referred to as the Joint Committee of Accountants)—are most important and require careful consideration. Generally speaking, the recommendations of the Joint Committee are acceptable to those persons and organizations consulted by your Committee,

as can be seen from the submissions forming part of Appendix 3. It is, of course, appreciated that there can be a variation in approach to particular questions and, accordingly, it will be necessary to subject each submission to close scrutiny in order to determine the most satisfactory course of action.

17. At the outset we should indicate that we too, find the recommendations of the Joint Committee of Accountants to be generally acceptable. We firmly believe that the time for change to a commercial accounting system is long overdue and strongly endorse the general thesis of the Joint Committee's submission in this regard. Our comments on certain aspects are included in the ensuing paragraphs.

18. The Railway accounts, as presently constituted, are primarily cash accounts and are presented as part of the Budget (Treasury) Accounts. As such, many of the more desirable features of commercial accounting cannot be adequately or properly incorporated in the accounts which the Railways are required by Statute to prepare. It was put to us that many of the recommendations of the Joint Committee could be implemented but to do so would be to cut across a system which is designed to conform with Treasury requirements. No action appears to have been taken in this area until recent times and, indeed, some of the Railway accounting manuals have not changed to any great degree for many years. Certain financial provisions, many of which have remained unaltered for a number of years, are also contained in the *Railways Act 1958*, particularly in Division 3 (Expenditure on Railways) and Division 4 (Funds) of Part III.

#### THE BALANCE SHEET.

19. The balance sheet and other supporting statements which appear in the annual report are also worthy of comment. We were informed that the balance sheet is actually a statement of the source and expenditure of funds and not a balance sheet in the true sense. The Joint Committee and the Auditor-General both produced re-drafted versions of the balance sheet which are included in their submissions. A revision along the lines they have suggested would certainly assist in making it more meaningful, although a complete change as recommended in Appendix B to the Joint Committee's report is far more desirable.

#### SEPARATION OF FINANCES.

20. A matter of particular concern to us was the question of separation of Railway finances from the State Budget. This was recommended as far back as 1928. In 1933 separation was rejected but in 1949 separation was again recommended. No action has been taken to bring about separation to date.

21. We were informed that separation could have taken place in the past and could, indeed, take place without any problems in the future. It was Treasury's view, however, that in the current loss situation nothing would be achieved by effecting separation of the accounts. It was pointed out that from the Treasury viewpoint there would be no real difference, in practical terms, to the present situation. The current position is that Treasury is in the nature of a banker for the Railways, as Railway revenue is paid into Treasury. At present, with the Railways in a loss position, drawings by the Railways exceed the revenue which is paid in by them.

22. It was further put to us that, although a degree of separation is possible, complete separation, as in the case of the State Electricity Commission and the Gas and Fuel Corporation, would not be practicable while Railway deficits continue. The reasoning behind this proposition was that the Railways could find no sponsor, other than Treasury, to bear their losses under these circumstances.

23. If separation of the accounts were to take place under present circumstances it was envisaged that the current detail contained in the Estimates would be eliminated in favour of an entry showing the amount which Treasury expected to pay the Railways in order to make good the operating deficit for the year. The Director of Finance, in commenting on the 1928 recommendation that Railway finances be separated from the budget, agreed that this should be so and indicated that what the State Budget ought to show is the subsidy provided by the taxpayers.

#### SUBSIDIES.

24. The question of subsidies is one which has received a considerable amount of attention. The Railways operate many services of overall community benefit and provide concessions as a matter of Government policy which, in the event that they were required to operate strictly as a business undertaking, they would be forced to abandon. The Commissioners have attempted to highlight this fact in recent annual reports.

25. The current presentation of the accounts gives no indication of the loss on these "social" services activities, the only reference to losses on these services being in the body of the annual report at the discretion of the Commissioners. There was considerable support for the proposition that the Railways ought to be subsidized for losses on these services, but doubt was cast as to

the adequacy of their costing system and the accuracy of the figures quoted by the Commissioners. The question of costs is referred to later in this Report. It would appear that there is a strong case for subsidy in these areas provided accurate figures can be produced as to the losses.

#### DEBT CHARGES.

26. The approach to debt charges is dealt with in a number of the submissions contained in Appendix 3. This matter is complex and the comments contained in the submissions—particularly those of the Joint Committee of Accountants—require careful scrutiny in order to determine the best method of approach. The Railways are now required to pay interest on borrowings since 1960. If they were still required to pay interest on borrowings prior to 1960 the annual deficit would be substantially increased. Your Committee consider that the interest on capital employed should be a cost in running the Railways. It would seem that there is some degree of support for requiring the Railways to be charged interest on the present re-assessed capital employed and not on the total funds provided to date. This is discussed under the next heading.

#### ASSET VALUES AND DEPRECIATION.

27. The true worth or value of the Railways should be determined in conjunction with any change in presentation of accounts. Emphasis in the evidence was placed on the need for a fresh start for Railways finances which would include the writing-off of accumulated losses and a complete review of asset values, as well as an examination of the basis of treating depreciation. It is understood that work is being undertaken by the Railways on many of these matters at present. This is an important preliminary to any fresh approach to accurate accounting for the Railways.

28. The present treatment of depreciation by the Railways was one of the factors which led to this inquiry. The fixed assets and depreciation shown in the balance sheet at 30th June, 1972, are as follows :—

					\$
Expenditure on various assets	..	..	..	..	395,535,232
Add Depreciation Account—				\$	
Not provided for by cash appropriations from					
1st July, 1937 to 30th June, 1971	..	..	95,990,045		
			\$		
Normal depreciation for year			8,603,491		
Less Amount provided	..	..	476,903		
			<hr/>		
Under provision for year	..	..	8,126,588		
			<hr/>		104,116,633
					<hr/>
					499,651,865
					<hr/>

It should be pointed out that the “Balance Sheet” shown in the Reports of the Commissioners is in fact a statement of the nature and source of funds and their disposal.

Some comment should be made on the actual handling of the above depreciation account. It shows that only \$476,903 has been charged to operating expenses for 1971–72. However, the under provision of \$8,126,588 for the year ended 30th June, 1972 has been added back to assets. The effect therefore is that this amount has not been deducted from the value of assets. The same position applies to the accumulated depreciation from 1st July, 1937 to 30th June, 1972, of \$104,116,633. In other words, from a commercial viewpoint the two entries in fact cancel each other out and total assets are overstated by this amount. The present treatment is, in fact, quite misleading.

In defence of the current approach it was argued that, whilst the Railways are in a loss position, depreciation provisions are merely book entries and have no influence on cash losses. Nevertheless, it was conceded that Railway assets should be revalued and depreciation charged in future in order to present a true picture of the financial situation.

#### RAILWAY COSTS.

29. The question of Railway costs is one which has attracted a good deal of attention and critical comment. The Report of the Board of Inquiry into the Victorian Land Transport System dealt very fully with both rail and road costs. An effective costing system is generally recognized as being an essential management tool and, in the evidence and submissions tendered to your Committee, considerable emphasis was placed on the need for a great amount of work to be done by the Railways in this area.

30. The Railways Commissioners in the 1970–71 report and previous reports refer to what they regard as the losses incurred on provision of suburban and country passenger services. Doubt has been cast in the evidence before your Committee as to the accuracy of the figures quoted by the



Commissioners. The Deputy Chairman of Railways Commissioners, Mr. Rogan, conceded that they are working on average costs but, as a defence to doing so, claimed that there is no point in obtaining greater detail if the chances of receiving subsidies for these losses are limited. The Commissioners also claimed, in answer to allegations that they have not pursued the question of closure of lines and cessation of services vigorously enough, that figures have been produced in the past in support of such action but their proposals have not been accepted. It is therefore contended that any effort aimed at producing more accurate figures would be wasted in view of these past failures. In short, it would appear that no positive action has been taken.

31. Another area in which the Railways claim to lose money is in granting concessions to decentralized industry as a matter of Government policy. In the annual report of the Commissioners for 1970-71 reference was made to a loss of \$4.4 million on granting these concessions. Your Committee decided to further investigate this claim which has been the subject of correspondence between the Treasurer, Minister of Transport, Treasury and Railways officials in recent years.

32. From our investigations it would appear that the figure quoted by the Commissioners cannot be taken as an accurate assessment. They admit that a great deal of work would have to be done in order to produce an accurate figure. This, they maintain, should not be done unless the principle of compensating the Railways for granting the concession is adopted. Treasury maintains that the basis on which the figure is determined is meaningless and that resolution of this question ought to be of first priority. In addition, according to Treasury, the Government policy referred to by the Railways, if it exists, relates to last century.

33. Our investigation of this aspect demonstrates the deficiencies in approach to the matter and raised doubts as to whether this could also be the case in relation to other loss figures. The comments of the Board of Inquiry into the Victorian Land Transport System, together with the evidence tendered to us by a number of witnesses, support this view. The Railways are aware of the deficiencies and your Committee are pleased to record the fact that steps are being taken to effect improvements in this most important area.

#### THE RAILWAYS ROLE.

34. In evidence to your Committee the Commissioners indicated their uncertainty as to the role they are expected to fulfil and maintained that this has never been defined. They contended that this uncertainty would continue unless steps were taken to clearly define the role and objectives of the Railways. By letter dated 31st October, 1972, the Secretary for Railways said—

“it should not be overlooked that legislation now before the Legislative Assembly involves a fundamental change in the management controlling the Victorian Railways, although no variation is proposed in the financial control nor is any indication given of the role of the Railways either commercially or otherwise. Without this we are unable to move with any degree of certainty and confidence.”

Other witnesses agreed with this contention, indicating that the general guidelines may have become blurred over the years or might not have been properly defined. It is certainly most essential that the Commissioners be given a clear indication as to what is expected and it is perturbing to find that this has not been done.

#### IMPLEMENTATION OF PROPOSALS.

35. A further matter of great significance was the question as to who should bear responsibility for initiating action aimed at improving the general financial position of the Railways and who was responsible for such action in the past. It seems from our inquiries that many are prepared to cast the blame elsewhere but few are willing to admit liability for past inactivity. Certain action is at last being undertaken and it is to be hoped that more will rapidly follow.

Nevertheless, the responsibility of providing adequate finance for the Railways lies largely with Parliament in general, and the Government of the day in particular. Internal efficiency obviously lies with the Commissioners.

#### THE STORES BRANCH—RAILWAYS DEPARTMENT.

36. As part of our inquiry we have commenced an examination of the organization of the Railways Department. Whilst our investigations into many aspects are incomplete, we have concluded an examination of the Stores Branch. Our comments on this Branch are contained in the ensuing paragraphs.

37. The functions of the Stores Branch, as outlined by the Comptroller of Stores, are “to make all arrangements for the manufacture, supply and delivery of all stores and materials (other than purchases of stock by the Superintendent of Refreshment Services) required for the purposes of the Victorian Railways, including procurement, ordering, receipt, inspection, custody, issue, disposal of an accounting for such stores and materials. In addition, the Branch controls printing, duplicating and photography works, all matters relating to sales of material, the collection, sorting,

storage and disposal of scrap, the reclamation of discarded material, and the delivery of material from storehouses to workshops and other work points". The Branch employs a total of 750 employees who work in areas such as the Spotswood General Storehouse, Printing Works, Workshop storehouses and other smaller stores throughout the State.

38. Our concern in examining the operation of the Stores Branch was to relate this operation to the recommendations contained in the Report of a previous Public Accounts Committee upon the control and management of stores operated by Government Departments and Public Authorities (Parliamentary Paper D. No. 5 1969-70). The Railways Stores were subjected to investigation at the time of the earlier inquiry.

39. It is pleasing to record that many of the principles outlined in the previous report are closely followed by the Branch. For example, every effort appears to be made to keep stock holdings to a minimum, regular surveys are made for obsolescence, there is a comprehensive stores manual and electronic data processing has been applied in certain areas.

40. From the information made available to your Committee the turnover rate on stocks for the year ended 30th June, 1972, was 5.03 times. The value of stock on hand has decreased from \$10,283,304 at 30th June, 1958 to \$6,438,186 at 30th June, 1972. This reduction in value is more dramatic if the rise in the cost of materials is taken into consideration. We were informed that the value of 1972 stock equated to 1958 prices represents a 55 per cent. reduction in stores held since 30th June, 1958.

41. During the course of the inquiry your Committee visited the Railway Printing Works and had discussions with officers from the works. Printing Works staff total 93. Most Railway printing is undertaken at the works but there are some exceptions, for example, weekly and interstate tickets which are produced by the Government Printing Office. The rates charged by the establishment appear to be lower than those of commercial printers. Printing Works officers estimated that the cost of Railway printing could rise by 25 per cent. to 30 per cent. if this work was to be undertaken by commercial operators but your Committee are unable to verify this contention.

42. Your Committee, having examined the operation of the Stores Branch, are satisfied that a sound approach has been adopted by those responsible for this area of Railways activity. With reference to the Printing Works, we consider this operation to be generally satisfactory and are of the opinion that the works should continue to operate whilst they are an economic proposition. However, we recommend that regular comparisons should be made against outside commercial printing operations.

#### CONCLUSIONS.

43. The financial position of the Railways has deteriorated rapidly over recent years and is worsening. Urgent action must be taken to effect an improvement. The lack of such action until recent times is regrettable. It is also a matter of concern that many of those responsible have adopted the approach that losses on the Railways are inevitable and, as a consequence, have done little to rectify them.

44. The cost to the State of financing the Railways is a massive drain on the State Budget but, under present circumstances, it is difficult to obtain a fair and accurate overall picture of the position. The content, form and presentation of the accounts must be changed and updated to achieve this. A vital pre-requisite is that the Railways introduce improved methods of costing and revise procedures in order to produce the required information. Greater emphasis must be placed on the introduction of adequate and effective costing procedures as a matter of urgency.

#### RECOMMENDATIONS.

45. Your Committee recommend as follows :—

- (1) That the Railways convert to a commercial accounting system and present their accounts accordingly. The recommendations contained in the submissions forming Appendix 3—particularly the reports of the Joint Committee of Accountants and the Auditor-General—should be studied with a view to implementing them to achieve this objective ;
- (2) That, as part of a new financial and accounting approach, Railway indebtedness to the State be reviewed, Railway assets be revalued and accumulated losses written off ;
- (3) That Railway finances be separated from the State Budget ;
- (4) That the Railways be fully subsidized for the losses incurred on operating services and providing concessions by direction of the Government ;
- (5) That the Railways pay interest on the present re-assessed capital employed ;
- (6) That full and adequate provision be made for depreciation ;

- (7) That adequate and effective costing procedures be introduced with minimum delay ;  
and
- (8) That the Railways be given specific commercial objectives and a clearly defined role.

#### SUMMARY.

46. Your Committee are of the opinion that these principles must be implemented in order to place the true position before Parliament. These recommendations will not lead to an immediate reduction in the amount which the State will have to provide in order to meet Railway losses. However, they will assist in clarifying the position, thus enabling judgments to be made upon which action can be taken.

47. Your Committee recognize that this progress report sets out some of the major problems inherent in the present Railway position and intend to investigate and report on other aspects of Railway finance and procedures from time to time.

#### ACKNOWLEDGEMENTS.

48. During the course of the inquiry to date your Committee have received assistance from the persons and organizations listed in Appendices 1 and 2. We wish to place on record our sincere appreciation of this valuable assistance.

Committee Room,  
13th December, 1972.

## APPENDIX NUMBER 1.

## LIST OF WITNESSES AND PERSONS WHO APPEARED BEFORE THE PUBLIC ACCOUNTS COMMITTEE DURING THE COURSE OF THE RAILWAY INQUIRY TO 6TH DECEMBER, 1972.

- Archer, E. D., Signal and Telegraph Engineer, New South Wales Government Railways.  
 Bawden, L. F., Hon. Secretary, Land Values Research Group.  
 Booley, S. W., Assistant Comptroller of Accounts, Victorian Railways.  
 Brown, G. F. W., Chairman, Victorian Railways Commissioners.  
 Brown J. J., State Secretary, Australian Railways Union (Victorian Branch).  
 Brownbill, E. C., Economist, State Treasury.  
 Buckley, N. W., Chairman, Victorian State Council, Institute of Chartered Accountants in Australia.  
 Coates, E. W., Director of Finance.  
 Crute, J. C., Chief Traffic Manager, Victorian Railways.  
 Easson, J., Manager, Electronic Data Processing Department, New South Wales Government Railways.  
 Easton, E. W., Business Consultant.  
 Evans, R. H., Senior Auditor, State Audit Office.  
 Feller, B., Dr., Technical Officer, Australian Society of Accountants.  
 Forster, G. A., Member of Research Panel, Land Values Research Group.  
 Freeman, L. J., Chief Accountant, New South Wales Government Railways.  
 Geyer, A. H., Assistant Comptroller of Accounts and Audit, New South Wales Government Railways.  
 Hamilton, B., Auditor-General.  
 Hickson, K. M., Assistant Signal and Telegraph Engineer, New South Wales Government Railways.  
 Hutchinson, A. R., Hon. Director of Research, Land Values Research Group.  
 Jackson, W. T., Chief Staff Superintendent and Chairman, Board of Examiners, New South Wales Government Railways.  
 Kemp, A. E., Comptroller of Accounts and Audit, New South Wales Government Railways.  
 Mack, D. G., representing the Town and Country Planning Association of Victoria.  
 Macpherson, P. A. W., Accountant to the Treasury.  
 Maloney, N. C., Principal Budget Officer, New South Wales Government Railways.  
 McCallum, L. A., Assistant Chief Civil Engineer, Victorian Railways.  
 McCusker, N., Commissioner for Railways, New South Wales Government Railways.  
 McGowan, J., Comptroller of Accounts, Victorian Railways.  
 Meech, G. J., Director of Transport.  
 Neander, K. F.  
 Nicholson, A. J., Assistant Chief Mechanical Engineer, Victorian Railways.  
 Ninnis, L. R., representing the Town and Country Planning Association of Victoria.  
 Priddle, M. N., Investigating Officer, State Treasury.  
 Rashleigh, N. H., Development and Planning Officer, Victorian Railways.  
 Rogan, E. P., Deputy Chairman, Victorian Railways Commissioners.  
 Ronald, M. B. W., Assistant Chief Traffic Manager, Victorian Railways.  
 Sears, K., Acting Accounting Officer, Printing Works, Victorian Railways.  
 Smith, C. L., Assistant Printing Manager, Printing Works, Victorian Railways.  
 Thomson, A. W., Comptroller of Stores, Victorian Railways.  
 Tisdall, J. P., representing the Town and Country Planning Association of Victoria.  
 Watson, D. H., Secretary for Railways, New South Wales Government Railways.  
 Webb, K. D., Outdoor Assistant to the Secretary for Railways, New South Wales Government Railways.  
 Weeks, A. W., Chief Commercial Manager, Victorian Railways.  
 Winspur, P. P., representing the Town and Country Planning Association of Victoria.

## APPENDIX NUMBER 2.—PART A.

## LIST OF PERSONS AND ORGANIZATIONS WHO PRESENTED SUBMISSIONS TO THE COMMITTEE TO 6TH DECEMBER, 1972.

A Joint Committee of the Australian Society of Accountants and The Institute of Chartered Accountants in Australia.  
 Mr. G. T. Webb, Commissioner for Transport, Tasmania.  
 Mr. G. R. Webb, Senior Lecturer in Economics, University of New South Wales.  
 The Institute of Chartered Secretaries and Administrators (Australian Division) Victorian Branch.  
 Treasury.  
 The Auditor-General.  
 Ministry of Transport.  
 Victorian Railways.  
 Mr. E. C. Brownbill, Economist, State Treasury.  
 The Town and Country Planning Association of Victoria.  
 The Land Values Research Group.  
 Australian Railways Union (Victorian Branch).  
 Mr. K. F. Neander.

## APPENDIX NUMBER 2—PART B.

## SELECT LIST OF DOCUMENTS EXAMINED BY THE COMMITTEE TO 6TH DECEMBER, 1972.

Annual Reports of several State Railway systems and the Commonwealth Railways.  
 Annual Reports of the Victorian Railways Commissioners for the years ended 30th June, 1957 to 30th June, 1972, inclusive.  
 London Transport—Annual Report and Accounts for the year ended 31st December, 1970.  
 Canadian National Railways Annual—Report for the year 1970.  
 The Report of the Board of Inquiry into the Victorian Land Transport System. (Parliamentary Paper No. 29/1971-72).  
 Final Report of the Royal Commission on the Working as a Business Undertaking of the Victorian Railways—1917. (Parliamentary Paper No. 19/1917.)  
 Report of the Royal Commission appointed to inquire into and report upon the Control, Management, Working and Financial Position of the Victorian Railways—1928. (Parliamentary Paper No. 32/1928.)  
 Transport Regulation Board—Further (Second) Report under section 15 (2) of the *Transport Regulation Act* 1932 relating to the Better and more Economic Co-ordination and the Better Regulation and Control of Railway and Road Motor Transport—1933. (Parliamentary Paper No. 4/1933).  
 Report of Special Committee appointed to Investigate and report on Certain Specific Questions relating to the Capital Indebtedness of the Victorian Railways—1933. (13th April, 1933).  
 Report on the Finances of the Victorian Railways in relation to the State Budget. Prepared by the State Economic Committee—1939.  
 Report on Transport in Victoria—Prepared by John Elliot—1949.  
 Report from the Public Accounts Committee upon Derailments on the Victorian Railway System. (Parliamentary Paper D. No. 5/1964-65).  
 Report from the Public Accounts Committee upon the Control and Management of Stores operated by Government Departments and Public Authorities. (Parliamentary Paper D. No. 5/1969.)  
 Report of Committee of Transport Economic Research relating to Road and Rail Transport—Australian Transport Advisory Council—1958.  
 “The Comparative Study of Railway Systems”—Paper by G. F. W. Brown, Chairman, Victorian Railways Commissioners. (1970).  
 “Towards a New Era in Australian Rail Transport”. Paper by G. R. Webb. (CEDA—October, 1970).  
 Great Britain—Railway Policy—Ministry of Transport—Command Paper 3439, November, 1967.

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## APPENDIX NO. 3.—PART A.

## PUBLIC ACCOUNTS COMMITTEE.

Questions raised in regard to the financial principles to be applied in considering the accounts of the Victorian Railways.

1. *Form and presentation of accounts.*

- (a) The Australian Society of Accountants and The Institute of Chartered Accountants have stated that "the annual accounts of the Victorian Railways should be drawn up and presented on the basis of the same accounting principles and in the same manner as for any commercial undertaking". In the light of this statement would you be prepared to redraft the Railways balance sheet and other accounts, and comment on the accompanying statements in the Annual Report, for consideration by the Committee?
- (b) How should the capital investment or net worth of the Victorian Railways be shown, taking into account that this amount represents the funds provided by the State Treasurer less some amounts written off in 1936?
- (c) How should the assets of the Railways be valued from time to time?
- (d) Are there any charges not shown in the Victorian Railways accounts which should be included in your view?
- (e) Should the Auditor-General certify the accounts in similar form to that required for companies under the terms of the *Companies Act 1961*?

2. *Operation of Railways as a commercial undertaking.*

Should Railway finances be separated from the State Budget?

3. *"Social" Charges.*

As the Railways claim that they have to meet many charges of a "social" nature, such as reduced rates for decentralized industry, pensioner concessions, losses on unprofitable passenger services &c., should they be reimbursed by the Government for such charges?

4. *Depreciation.*

As depreciation is not at present included in working expenses, how should it be dealt with for—  
(a) past accounts; and (b) future operations?

5. *Interest.*

What principles should be associated with the charging of interest on Government investment in undertakings of a commercial nature? Should these apply to the Victorian Railways?

6. *Insurance.*

- (a) Is the provision of \$200,000 in the Railway Accident and Fire Insurance Fund adequate?
- (b) Do you agree with the present policy of charging losses on account of fire and accident against working expenses?

7. *Payroll and other taxes.*

What charges of this kind should be included in working expenses?

## APPENDIX NO. 3.—PART B.

REPORT OF A JOINT COMMITTEE OF THE AUSTRALIAN SOCIETY OF ACCOUNTANTS AND THE INSTITUTE OF  
CHARTERED ACCOUNTANTS IN AUSTRALIA

ON

## THE ACCOUNTS OF THE VICTORIAN RAILWAYS.

## INTRODUCTION.

Following invitations from the Public Accounts Committee of the Parliament of Victoria to the Australian Society of Accountants and to The Institute of Chartered Accountants in Australia, a Joint Committee (hereinafter referred to as "the Committee") was set up by these bodies to study and report on the accounts of the Victorian Railways. This document contains the findings of the Committee.

The terms of reference for the Committee's assignment were provided by a series of questions asked by the Public Accounts Committee in a letter dated 5 August, 1971.

The material considered by the Committee in connection with its assignment included—

- The Report of the Victorian Railways Commissioners for the year ended June 30, 1970, and in particular the accounts, statements and schedules, included therewith ;
- The Treasurer's Statement and the Report of the Auditor-General for the same year ;
- Answers supplied by the Victorian Railways to written questions of the Committee, seeking to obtain an understanding of the meaning and origin of the various items shown in the accounts of the Victorian Railways ;
- The Commonwealth Railways annual report 1969–70 ;
- The annual reports and accounts of the State Railways of New South Wales, Queensland, South Australia, Western Australia and Tasmania ;
- A number of annual reports of major railroad operators in the United States of America and Canada ;
- The Report (dated 7th January, 1972) of the Board of Enquiry into the Victorian Land Transport System (hereinafter referred to as "the Bland report").

The questions asked by the Public Accounts Committee and the answers provided by the Committee are as follows :—

## 1. FORM AND PRESENTATION OF ACCOUNTS.

(a) 'As you have stated that "the annual accounts of the Victorian Railways should be drawn up and presented on the basis of the same accounting principles and in the same manner as for any commercial undertaking", would you be prepared to redraft the enclosed Balance Sheet and Trading and Profit and Loss Accounts, and comment on the accompanying statements . . . ?'

1.1. The Committee believes that for any type of enterprise, institution, organization or utility, the form and contents of its published accounts must depend largely on the objectives pursued in making available such accounts.

1.2. Although, historically, the Railways accounts may have come to be looked upon as a means of satisfying a number of quite different needs, their main purpose should be to inform the people of Victoria, through their constitutional representatives in the Parliament of Victoria, on the result of the Railways operations for a particular fiscal period, and on the financial position of the Railways enterprise at a particular point of time. It follows that the Railways accounts should be presented in a form in which they can be readily understood by persons who, as members of the Victorian Parliament, represent the people of Victoria, and likewise by informed members of the public at large who take an interest in the Railways operations.

1.3. As a subordinate objective, the Railways accounts should be usable, as far as is reasonably practicable, for comparing the financial implications of the Victorian Railways operations with those of other railway operators, both in Australia and overseas.

1.4. Having regard to the objectives set out in the preceding paragraphs, the Committee concluded that the Railways accounts should be drawn up and presented on the same basis and in the same manner as the accounts for commercial undertakings and with due regard for the needs of inter-system comparisons. This would ensure that the Railways accounts could be appreciated without undue difficulty by members of the public reasonably accustomed to studying the financial reports of commercial undertakings. Furthermore, accounts prepared on such a basis and in such a manner could be used as a starting point for comparative evaluation of the Victorian Railways and other railroad operators.

1.5. The recommendation contained in paragraph 1.4 confirms the opinion expressed by the Australian Society of Accountants and The Institute of Chartered Accountants in Australia in their letters to the Public Accounts Committee, dated 7 July, 1971. It also accords, in relation to the narrower field of financial reporting, with the recommendations made more broadly in the Bland Report with respect to the financial management of the Railways.

1.6. The Committee sees no need for discussing in the context of this report all the principles which govern the preparation of accounts for commercial undertakings. In broad terms, application of these principles to the Railways accounts would mean that—

- (a) the accounts would follow, as far as is practicable, the overall arrangement, classifications and terminology ordinarily adopted in the published reports of commercial undertakings ;

## APPENDIX NO. 3—PART B.—(cont.)

- (b) the accounts would give full recognition to such basic accounting concepts as properly matching cost and revenue, accruing known liabilities and providing for expected liabilities, and determining details of disclosure and presentation on the basis of the materiality of the data in question ;
- (c) the accounts would clearly disclose the capital structure of the Railways, distinguishing between funds which must be considered the State's permanent investment in the Railways, and funds which are repayable loans in the commercial sense.

1.7. It must be stressed that a change-over to a new accounting basis would be a major undertaking. It would require a complete restructuring of the financial basis of the Railways, and a complete revaluation of the Railways fixed assets, matters discussed in full in paragraphs 1.27–1.30 and paragraphs 1.31–1.42 respectively.

1.8. So as to illustrate the application of the Committee's recommendation, two sets of accounts have been prepared which, together with accompanying explanations, are attached as Appendices 'A' and 'B'.

1.9. The accounts shown in Appendix 'A' are merely a rearrangement of the data to be found in the published Railways accounts for 1970. Whilst indicating the Committee's thinking on certain aspects, they must not be taken as its final recommendation for preparing and presenting the Railways accounts.

1.10. The accounts shown in Appendix 'B' portray what the Committee considers to be a desirable presentation, incorporating in full the various recommendations which are made in this report. For obvious reasons, it has not been possible to include actual figures, as these would be dependent on a number of major policy decisions which would have to be made by the Railways in conjunction with the Treasury, and furthermore would have to be based on data that is obtainable only from the Railways records.

The Committee wishes to emphasize that these accounts, being intended as annual accounts on the lines followed for commercial undertakings, are not designed to disclose in themselves cash flows arising in connection with the Railways operations and, in particular, as between the Railways and the Treasury. If information on such cash flows is desired or if, under present law, it is a statutory requirement, it would have to be provided in a suitable supplementary statement.

1.11. It will be observed that the profit and loss statement proposed in Appendix 'B' provides for separate disclosure of the operating result in each major area of operations. Such disclosure is considered a most desirable feature in view of the magnitude of the State's overall investment in the Railways and the operating problems generally faced by Railway systems.

1.12. It should be noted, furthermore, that in the accounts layout given in Appendix 'B', debt repayments by way of contributions to the national debt sinking fund are ignored. This matter is discussed more fully in paragraph 1.29.

1.13. It is emphasized that the Railways accounts when prepared in accordance with the principles followed for the accounts of commercial undertakings, would include under operating expenses various charges in the nature of non-cash items, e.g., provision for depreciation, accrued annual leave, provision for long service leave, provision for doubtful debts (if any), provision for obsolescence of maintenance spares, &c. It follows that where the Railways make a loss, the cash funds which the Treasury would be required to provide towards the deficit, would differ from the loss disclosed in the accounts as there would be no need to cover the non-cash items.

1.14. The more serious criticisms of the Railways accounts as published at present can be summarized as follows :—

- (a) Terminology, classifications and general arrangement appear to be conditioned predominately by departmental procedures as they apply between the Railways and the Treasury. In consequence, the accounts do not present the financial results and position of the Railways in a form which is readily understood by the average interested reader.
- (b) The balance sheet is overburdened with details which would be placed better in notes or supporting schedules.
- (c) The balance sheet does not give a clear picture of the funds currently invested in the Railways, corresponding broadly to equity capital and loan funds of a commercial undertaking.
- (d) The amounts shown for fixed assets may not be realistic when viewed in relation to the use of these assets in current Railways operations.
- (e) The results presented must be considered misleading due to the omission, on the one hand, of proper charges for depreciation, and the inclusion, on the other hand, of interest charges in respect of funds which more properly should be considered capital permanently invested in the Railways undertaking. The question of a target for a reasonable return on the funds invested in the Railways is a separate issue, discussed in paragraph 5.4 of this report.
- (f) The results presented must be considered misleading also because they do not disclose separately the losses incurred by reason of the Railways being required, as a matter of public policy, to provide services which are not economically or commercially justifiable at the rates that are charged. Reference to these losses is made in the report of the Railways Commissioners, but for the Railways accounts to be complete within themselves, such losses should be dealt with in the profit and loss statement ("Summary of Results").
- (g) Details that would be helpful in evaluating information, which is given in broad terms only in the balance sheet and the summary of financial results, are not included by way of notes to the accounts, but are given instead in the Treasurer's statement and in the



## APPENDIX NO. 3—PART B.—(cont.)

Auditor-General's report. Thus the Treasurer's statement (page 70) provides a functional break-down of working expenses and discloses the annual amount paid to the Commonwealth Government under the Railways Standardization Agreement 1958 ; whilst the Auditor-General's report (pages 98–103) discloses the amount of pension and insurance fund contributions charged against working expenses, and gives details of the items making up sundry debtors and sundry creditors respectively.

- (h) The accounts do not include a break-down of the operating surplus or loss according to major areas of operations, such as suburban traffic, main lines traffic, secondary lines traffic.

1.15. The published Railways accounts are at present accompanied by a number of statements and schedules as under—

Reconciliation of the Railway and the Treasury Figures Relating to Revenue and Working Expenses ;  
 Statistical Statement ;  
 New Lines Under Construction ;  
 Lines Closed for Traffic During the Year ;  
 Mileage of Railways and Track ;  
 Railways Stores Suspense Account ;  
 Railways Renewals and Replacement Fund ;  
 Depreciation—Provision and Accrual ;  
 Statement of Capital Expenditure.

The Committee's comments on these statements and schedules are contained in paragraphs 1.16 to 1.25.

1.16. Whilst a "*Reconciliation of the Railway and the Treasury Figures relating to Revenue and Working Expenses*" may have a place in the working papers of the Railways accounts department or those of the Auditor-General, it cannot be said to serve a useful purpose as an attachment to the published Railways accounts. The last section of this reconciliation, in any case, merely repeats information contained already in the "*Summary of Financial Results*".

1.17. The Committee appreciates that any statement designed to provide operating statistics on a vast and complex undertaking must of necessity be a selection from many possible and potentially desirable data. Nevertheless it is felt that the "*Statistical Statement*" could be rendered more informative by inclusion of at least some figures pertaining to the cost of rendering the various Railways services and the relation between such costs and the corresponding revenues, or to the capital value of the assets employed in relation to certain units used for measuring service potential and service actually performed, e.g., operating cost per train mile, surplus per train mile, capital cost per mile open for traffic, and so on.

1.18. It is recommended that in selecting data for inclusion in published operating statistics, regard be had to their usefulness in inter-system comparisons, embracing the various Australian Railways and possibly also extending to overseas railroad operators. Perhaps the Commonwealth Government could be approached with a view to co-ordinating the development of uniform statistics to facilitate such comparisons.

1.19. The details given in the schedules "*New Lines Under Construction*" and "*Lines Closed for Traffic During the Year*" appear to belong more properly to the Commissioner's Report itself.

1.20. The statement of "*Mileage of Railways and Tracks*" seems unduly involved for a supporting schedule to the annual accounts. The more significant totals could be included quite easily in the "*Statistical Statement*". Perhaps it should be mentioned also that the average interested reader may have some difficulty in appreciating the distinction between "tracks" and "railways". It would be overcome if "lines" were substituted for "railways".

1.21. The "*Railways Stores Suspense Account*" seems a curious mixture of, on the one hand, a historical account of cash advances established over the years in order to provide working capital for stores and materials (other than catering services supplies), and, on the other hand, the disclosure of a technical device for setting and policing a ceiling for the investment in such stores and materials. The account may be necessary as a departmental or audit working paper, but it does not seem to merit inclusion with the published accounts. With the exception of the advance in question (\$9,000,000), all the items shown in the account are dealt with already in one way or another in the balance sheet. In regard to the advance itself attention is drawn to explanatory note (1) on the redrafted balance sheet, presented in Appendix 'A'.

1.22. Information on renewals and replacements undoubtedly is of value. However, it must be questioned whether the statement on the "*Railways Renewal and Replacement Fund*" provides this information in an adequate manner. Firstly, the reader is left wondering whether the expenditure listed in the statement as having been incurred during the year, is in addition to, or alternatively is included in the capital expenditure, listed in the "*Statement of Capital Expenditure*". From the Report of the Railways Commissioners it is clear that the total capital expenditure dealt with in the latter statement contains a substantial element of renewals and replacements.

Secondly, it is doubtful whether the reader of the Railways accounts will be greatly concerned with the Treasury procedures applicable to the provision of finance for renewals and replacements.

Thirdly, the Committee fails to see the significance of showing under total expenditure between July 1st, 1937, and June 30th, 1970, a separate total for advances made to the Agent-General during that period. If unspent at balance date, such advances would represent cash on hand and would be shown as such in the balance sheet. To the extent that they were spent, one would expect them to be added, as applicable, to the totals shown for "traffic", "rolling stock", "way and works", "electrical engineering".

## APPENDIX NO. 3—PART B.—(cont.)

The Committee recommends that the information on replacements and renewals be combined with the information on capital expenditure. For further details, refer paragraph 1.24 below.

1.23. As regards "*Depreciation—Provision and Accrual*", the Committee, as will be seen from the redrafted balance sheet presented in Appendix 'A', prefers the respective provisions to be shown in the balance sheet itself as deductions from the assets to which they relate. The Committee furthermore advises against linking charges for depreciation with cash resources available under Acts of Parliament or otherwise for financing renewals and replacements (see also paragraph 4.7 below). On a point of terminology, it is unusual to refer to "provision and accrual" when dealing with depreciation. "Provision" by itself would be sufficient.

1.24. The "*Statement of Capital Expenditure*" could be improved. The origin of the credits is nowhere indicated. As the Committee understands, they represent proceeds from the sale of assets as well as write-offs. Having regard to the nature of these credits, the statement would be better described as a statement of movements in fixed assets. Comparison on a year-to-year basis, where capital expenditure is concerned, is not particularly meaningful. Comparison of the annual expenditure with the total expenditure over an extended period would provide more significant information. A suggested layout is contained in Appendix 'C'.

1.25. It was noted that quite a number of the statements appended to the published balance sheet give amounts in dollars and cents. It is recommended that all amounts quoted in the published accounts or in notes or statements forming part of or accompanying such accounts, be rounded off to the nearest dollar.

1.26. The Committee considers that the informational value of the Railways accounts would be enhanced if the annual balance sheet and summary of financial results were accompanied by, for example, a five to ten year summary, highlighting key figures of the Railways operations, results and financial position. An example of a review, covering a number of years, is provided in the annual report of the Department of Railways, New South Wales.

(b) "*How should the capital investment or net worth of the Victorian Railways be shown, taking into account that this amount represents the funds provided by the State Treasurer less some amounts written off in 1936?*"

1.27. As has been remarked already, the first and obvious impression given by the Railways accounts in their present form is that their format was conceived with heavy emphasis on Treasury requirements and procedure rather than from the viewpoint of the Railways as an undertaking that, with a given investment, is to perform as efficiently as possible the tasks for which it has been created. The accounts reflect an historical situation rather than the current situation determined on the basis of a realistic appraisal. They do not make it clear what portion of the total funds invested in the Railways over the years is to be considered their basic capital, corresponding in function to the share capital of a commercial undertaking, and what portion (if any) is in the nature of long-term loans, to be liquidated by the Railways by specified dates or over specified periods.

1.28. The Committee believes that the Railways accounts should show separately—

- (a) under a heading such as perhaps "consolidated funds", the funds, however obtained, which are to be considered the State's permanent investment in the Railways to the extent it is represented by assets, properly valued ;
- (b) loan funds repayable by the Railways in due course, distinguishing between long-term loans, whether from the Treasury or any other source, and current advances from the Treasury with a function equivalent to that of a bank overdraft.

1.29. A question which in the Committee's view requires careful consideration, is the general policy for and the accounting treatment of loan repayments, including contributions to loan sinking funds.

- (a) The Railways appear at present committed to make an annual contribution to the national debt sinking fund, whether or not funds are available for making such contribution. The contribution is shown in the "summary of results" as a charge against operating revenue, and the Railways equity in the national debt sinking fund which broadly would comprise contributions over the years and compound interest earned thereon, is shown in the balance sheet as a deduction from the loan funds made available by the Treasury, with an off-setting credit described as "national debt sinking fund reserve". Much the same applies in respect to the repayments which the Railways are required to make against the uniform Railways gauge trust fund.
- (b) From the viewpoint of accepted accounting practice, this method of accounting for loan repayments must be criticized for not distinguishing between items which properly belong to the profit and loss statement, being in the nature of expenses to be matched with revenue, and items which properly belong to the balance sheet only, being appropriations of cash funds with effect as between assets and liabilities. A repayment of a loan or a contribution to a loan sinking fund is an appropriation of cash funds and must not be considered an expense, chargeable against revenue.
- (c) If the Railways make a profit or generate cash funds through a sale of fixed assets, they, no doubt, will be in a position to reduce loan liabilities by a repayment of loan principal or a contribution to the national debt sinking fund. If, on the other hand, they make a loss and do not have cash resources available from a sale of fixed assets, the Committee can see no point in recording in the Railways accounts a contribution to the national debt sinking fund, or requiring the Railways to make a payment in reduction of the uniform railways gauge loan, either of which would have to be met by a further Treasury grant or loan to the Railways for that purpose.

## APPENDIX NO. 3—PART B.—(cont.)

- (d) The Committee recommends that loan repayments and loan sinking fund contributions made by the Railways out of profits or otherwise available cash funds, be recorded in the balance sheet only as a reduction of the respective loan accounts with a corresponding reduction of the appropriate cash fund accounts.
- (e) The Committee is not informed on the origin of the present method of accounting for sinking fund contributions and loan repayments, i.e., whether it is prescribed by law or has developed as a Treasury device. If it is required by law, it is recommended that the situation be reviewed with the object of having the law changed so as to permit more meaningful accounting in this area.

1.30. No good purpose appears to be served by a recital of contributions made by the Treasury over the years to meet past Railways losses. Such losses should be written off with a corresponding adjustment to capital account (“consolidated funds”).

(c) “How should the assets of the Railways be valued from time to time?”

1.31. This question could be taken to imply that a periodic revaluation of assets is contemplated by the Railways management. Alternatively one may read it to refer simply to the asset values to be shown in the Railways accounts as presented for each financial year.

1.32. The approach of accountants to the valuation of assets for balance sheet purposes is far from settled. The controversy continues between those advocating acquisition (or historical) cost and those advocating present-day values. Present-day value accounting implies regular revaluation of assets. Acquisitions (or historical) cost accounting does not, but even where it is employed, it has become accepted practice to revalue some or all of the assets of an undertaking where the circumstances so warrant.

1.33. The amount of, in round figures, \$466,000,000, shown in the Railways balance sheet for fixed assets at 30th June, 1970, represents an historical accumulation of expenditure ever since inception of the Railways, including, the Committee understands, a quite substantial proportion of monies spent on renewals and replacements over the years, less a very limited charge for depreciation and after writing off \$60,000,000 (pursuant to the *Railways (Finances Adjustment) Act 1936*) and making several smaller adjustments. Fairly obviously, in these circumstances the book balances of the fixed assets cannot be accepted as reflecting accurately their historical cost after provision for depreciation calculated to write off the historical cost over the expected asset lives. Even less could the book balances be said to give a realistic view of the fixed assets having regard to their present-day values and to their potential usefulness in future Railways operations. A proper determination of the value of fixed assets currently held by the Railways is essential for two reasons. First, it is a prerequisite to establishing the net worth of the Railways as part of a general restructuring of the Railways finances. Second, it is necessary so that there will be an adequate basis for future depreciation charges. It does not appear feasible to reconstruct on an historical cost basis the amounts at which fixed assets should be carried in the Railways accounts. The Committee therefore concluded that a complete revaluation of all fixed assets would be required.

1.34. The “how” of a revaluation concerns both its basis and its procedure. The procedure is a matter for experts in areas other than accounting, and their opinion should be sought. An approach to possible valuation bases is discussed in paragraphs 1.35 to 1.38.

1.35. The revaluation should proceed from a suitable classification of fixed assets. A distinction should be made between depreciable assets, e.g., way, works, buildings, machinery, plant, equipment, rolling stock, and non-depreciable assets, e.g., land.

1.36. The Committee understands that for some time now the Railways have studied avenues for restructuring their operations. Further impetus in this direction may be expected as a result of the Bland Report. A restructuring of operations can be expected to affect the utilization of fixed assets, a factor to be taken into account in their revaluation. It would be necessary to determine the probability of early or reasonably early redundancy, as it could arise from the curtailment of some services, as well as from an upgrading or updating of others.

1.37. The Committee recommends that all fixed assets which are to be retained in accordance with overall plans for restructuring operations, be revalued on the basis of their present-day values, whilst all fixed assets already redundant or scheduled to become redundant in the near future as a result of the restructuring of operations, should be written off or down to the expected disposal value.

1.38. The determination of present-day values will involve judgments to be arrived at after considering, for each class or category of fixed assets, *inter alia* the following factors:—

Current market selling value on a going concern basis;

Current replacement cost less depreciation covering the expired portion of each asset’s total expected life;

A value established by capitalization of the actual or potential profit yield.

Replacement cost would have to be viewed as the cost of replacing an existing asset with an asset of like structure, function, capacity, and operational features.

1.39. It is reasonable to expect that a revaluation according to the principles just outlined, could produce a result vastly different from the amount at which fixed assets currently stand in the Railways books. The disposition of this difference would have to be a significant factor in the restructuring of the Railways capital, recommended in paragraphs 1.27 to 1.29.

1.40. The Committee is furthermore aware that a revaluation of fixed assets could significantly affect future depreciation charges. Depreciation based on restated asset values is likely to differ from and may in the aggregate well exceed depreciation based on strictly historical costs.

## APPENDIX NO. 3—PART B.—(cont.)

1.41. Given a one-time revaluation as recommended, additions to fixed assets after the date of the revaluation and likewise all replacements thereafter (to the extent they are not considered to be in the nature of maintenance, chargeable to working expenses) should be recorded and taken up at cost. A periodical review of all fixed asset values would be most desirable.

1.42. Current assets in general do not call for special comment. Stocks on hand should be carried at cost with due allowance, as necessary, for deterioration and possible obsolescence, the latter quite likely a significant factor in the area of maintenance spares.

(d) “*Are there any charges not shown in the Victorian Railways accounts which should be included in your view?*”

1.43. The “*Summary of the Financial Results*”, taken by itself, sheds little light on the charges comprised in the total of “*Railways working expenses*”. A note to the “*balance sheet*” indicates that these expenses do not include accrued annual leave or, but for a token charge, provision for depreciation, whilst Statement No. 5 (entitled “*Railways Accounts*”) in the Report of the Auditor-General indicates that they do include contributions to the Railways accident renewals and replacement fund, and pension fund contributions. No mention is made of any long service leave liability and no provision appears to be made to cover it. This the Committee considers a deficiency.

1.44. There is, furthermore, no evidence of any provision being made for doubtful debts. Perhaps it is assumed that this contingency is taken care of by securities held by the Railways. In their aggregate, these securities can be said to cover a fair proportion of the total Railways debtors. However, situations could well arise where an individual debt may prove irrecoverable in excess of the amount of security held against it. In such cases proper accounting according to commercial principles would require provision to be made for the possible loss.

1.45. In regard to pension fund contributions, the question is raised whether these are adequate to cover the accruing entitlements of Railways employees in accordance with the terms of their employment. It is suggested that if this is not already the practice, these contributions be based on regular actuarial assessment of the Railways obligations.

1.46. The Committee understands that the Railways are liable to payroll tax and water rates, but are exempt from sales tax, land tax and also municipal rates (except to the extent the latter are levied on dwellings occupied by Railways employees).

1.47. The absence of adequate depreciation charges has been the subject of earlier comment and this matter will be discussed in full in section 4 of this report. The Committee also is aware that it may be current Railways practice to capitalize certain renewal and replacement expenditure which would be treated more properly as a charge to working expenses. Paragraph 4.8 elaborates this point.

1.48. The Committee understands that the Railways operations benefit from the use of certain Crown lands which are made available to the Railways free of charge. It recommends that the Railways accounts should disclose by way of note the estimated rental value of such lands.

(e) “*Should the Auditor-General certify the accounts in similar form to that required for companies under the terms of the Companies Act 1961?*”

1.49. The present certificate of the Auditor-General on the Railways balance sheet must be criticized on two grounds, firstly that it contains no definite statement whatsoever, either positive or negative, on the accounts, so that it could hardly be called an audit report in the accepted sense; secondly that it refers to another document, i.e., the Auditor-General’s annual report to the Legislative Assembly, with the result that the accounts themselves can be assessed fully only after reference to that other document.

1.50. The Committee strongly believes that an audit report which is complete in itself should be attached to the Railways accounts so that these can be read and evaluated without need for consulting any other document.

1.51. The form and content of the audit report obviously will be governed by the statutory provisions applying in respect thereof. In the case of a public utility or similar enterprise which is constituted as a corporation under the Companies Act, the audit report, as to form and contents, would have to comply with the relevant requirements of the Companies Act (see, for example, the audit report on the accounts of Qantas Airways Limited). Where, on the other hand, such utility or enterprise is constituted under some special State or Commonwealth Act, the audit report relating to its accounts would have to comply with the requirements of that particular Act, and furthermore may have to include references to specific sections thereof (see, for example, the audit reports on the accounts of the Commonwealth Railways, Australian National Airlines Commission, Australian Coastal Shipping Commission, State Electricity Commission of Victoria, Gas and Fuel Corporation of Victoria).

If the present audit certificate on the Railways balance sheet is what is required under the *Railways Act 1958*, (as amended by the *Railways (Funds) Act 1964*), then the Committee recommends that an amendment to the legislation be sought so as to permit a more meaningful and complete audit report to accompany the Railways accounts.

1.52. The Committee considered whether the audit of the Railways accounts should remain the sole responsibility of the Auditor-General. It was noted that the audit of certain other public utilities in Australia involves to varying extents non-government auditors, with advantages resulting from such a blending of skills and experience.

## APPENDIX NO. 3—PART B.—(cont.)

## 2. OPERATION OF RAILWAYS AS A COMMERCIAL UNDERTAKING.

*“ Should Railway finances be separated from the State Budget ? ”*

2.1. The Committee had some difficulty in determining whether the question asked under this heading should be read as relating to the sources from which Railways operations are funded or as referring to the manner in which Railways accounts should be presented.

2.2. If interpreted the first way, it would not properly come within the scope of recommendations which could be made as a result of the Committee's deliberations. Members, however, observed that it would be difficult to imagine Railways finances being divorced altogether from the State budget until such time as the Victorian Railways become fully self-supporting financially.

2.3. If interpreted the second way, the question appears to be answered largely by the comments made in section 1 of this report. In general, the Committee believes that accounting for the Railways as a commercial undertaking would be facilitated if the Railways were reorganized as an independent public authority, as, for example, the State Electricity Commission, the Gas and Fuel Corporation or, on the Federal scene, the Australian National Airlines Commission, or Qantas Airways Limited. In any event, the Railways should be treated as a separate accounting entity and their accounts presented accordingly.

## 3. “ SOCIAL ” CHARGES.

*“ As the Railways claim that they have to meet many charges of a “ social ” nature, such as reduced rates for decentralized industry, pensioner concessions, losses on unprofitable passenger services &c., should they be reimbursed by the Government for such charges ? ”*

3.1. The Committee believes that accounting for the Railways as a commercial undertaking should be merely a corollary of managing the Railways as a commercial undertaking.

3.2. A commercial undertaking has power to determine—  
 what business to take and what business not to take ;  
 the prices or rates at which to sell its goods or services ;  
 operations to be curtailed or relinquished and areas into which to expand.

If for reasons of public policy or welfare the Railways are required to maintain services which are not commercially justified, then they should be reimbursed for the cost of providing these services to at least a point where no losses are incurred on their account.

3.3. The reimbursements should be disclosed as separate revenue items in the profit and loss statement as indicated in the accounts layout presented in Appendix ‘ B ’. If no reimbursements are made, or if Government subsidies for the respective services fall short of covering their full cost, the accounts should disclose, by way of note or otherwise, the unrecouped cost of rendering each such service.

## 4. DEPRECIATION.

*“ As depreciation is not at present included in working expenses, how should it be dealt with for—(a) past accounts ; and (b) future operations ? ”*

4.1. As already stressed, proper depreciation charges would have to be a feature of the Railways accounts if the latter were to conform to the principles adopted for a commercial undertaking. The need for such charges follows from the concept of matching cost and revenue. Depreciation must be seen as a means of charging against revenue that portion of the net cost of a fixed asset which has been consumed in the operations of a particular financial period.

4.2. The Committee having regard to its recommendation that all fixed Railways assets be revalued, considers that no good purpose would be served by attempting any depreciation adjustments in respect of past financial periods, quite apart from the very considerable practical difficulty and expense which such an attempt would involve.

4.3. Concerning future operations, it is suggested that concurrently with a revaluation of fixed assets a proper basis be established for their depreciation from then on.

4.4. For this purpose it would be necessary to—  
 suitably classify these assets, with regard to functional and technical characteristics ;  
 assess for each class the probability of technological obsolescence ;  
 determine for each class an average asset life taking into consideration the utilization rate and the probability of technological obsolescence, and assuming at the same time adequate maintenance which, in the case of certain assets such as way, works, buildings, would include the necessary renewals and replacements ;  
 establish for each class a basic depreciation rate which would write off the cost or book value of any asset in that class over the full average life ;  
 calculate for each class a supplementary scale of depreciation rates based on the unexpired portions of the full average life so that they could be applied to all assets covered by the revaluation according to their age at that time.

4.5. The Committee is not in a position to make recommendations regarding specific depreciation rates as these would have to be evolved through a careful assessment for each asset class. It has been noted that the Bland report, in Appendix X, contains a suggested depreciation basis, in terms of estimated life years, for the principal assets making up way and works. In general, the Committee favours depreciation on a straight-line basis as distinct from depreciation under the diminishing value method.

4.6. Depreciation rates should be reviewed regularly, taking into account changes in the factors on which they were originally based.

## APPENDIX NO. 3—PART B.—(cont.)

4.7. Depreciation by itself should not be seen as a means of providing funds for renewals or replacements. The provision of such funds is a function of financial management, performed with the aid of financial and operational budgets. However, if depreciation is adequately allowed for in the Railways operating costs and if revenue, including reimbursement for “social charges”, is based on a rate structure covering, in overall effect, these operating costs, then it could be expected that at least a proportion of the funds for renewals and replacements would be generated out of revenue.

4.8. When determining future depreciation policy and procedure, careful consideration should be given to the accounting treatment of renewals and replacements. It would be necessary to distinguish between renewals and replacements introducing new assets to take the place of assets that have been retired, and renewals and replacements carried out on existing assets to ensure that their actual working life will reach the average life laid down as basis for their depreciation. Renewals and replacements of the first type should be treated as capital expenditure subject to depreciation. Renewals and replacements of the second type should be treated as working expenses. So as to avoid confusion in the accounting reports, it is desirable to limit the use of the term “renewals and replacements” to capital expenditure, and to describe expenditure of the second type as “maintenance and repairs”.

4.9. The accounting treatment of renewals and replacements must be divorced from any questions of how they are to be financed.

## 5. INTEREST.

*“What principles should be associated with the charging of interest on Government investment in undertakings of a commercial nature? Should these apply to the Victorian Railways?”*

5.1. The question of interest is closely tied to the broader question of how to rearrange the financial basis of the Railways operations. It has already been said that, in the Committee’s opinion, a realistic approach to this issue would require a clear-cut distinction between funds permanently invested in the Railways undertaking which should be considered the Railways’ equity capital, and loan funds, in the commercial sense, which would imply a definite obligation of repayment on the part of the Railways. The committee strongly supports the view that the Railways should not be charged interest on funds which in the overall structure of the Railways financial base would in fact represent equity capital irrespective of the sources from which such funds were obtained. The Railways should be charged interest on any loan funds, short-term or long-term, that, as far as the Railways are concerned, carry a definite liability to repayment for which appropriate provision would have to be made in the financial budgets of the Railways.

5.2. To expand on the above, no interest charges should be incurred on—

- the initial capital of the Railways upon changeover to the proposed new accounting base, as established in conjunction with a revaluation of the Railways’ fixed assets ;
- any additional funds made available thereafter by the Treasury (from whichever source) for investment in Railways fixed assets, unless in the form of a repayable loan.

5.3. In so far as interest charges would apply in accordance with these recommendations, the interest rates should be—

- (a) in respect to public or private loans specially negotiated by or on behalf of the Railways, the individual rates applicable to these loans ;
- (b) in respect of other funds made available by the Treasury on a strict loan basis, the average rate for the time being for long-term semi-government loans.

5.4. Commercial undertakings, so as to survive under competitive conditions, are required to show a reasonable return on funds employed with, in due course, a reasonable reward, in the form of dividends or otherwise, for those who have contributed the risk capital. The question could be asked whether Railways, similarly, should be expected to meet certain profit targets in their operations. The Committee believes that, as a long term objective, profit targets should be feasible and would have merit. However, they would be impracticable in application to the immediate future as they would depend on a restructuring of Railways operations which obviously could be achieved only over an extended period of time. In any event the level at which profit targets are set, would have a direct bearing on the rates at which the Railways would have to be reimbursed for “social charges”.

5.5. Pending the introduction of profit targets, the Committee considers it desirable that the accounts indicate, by way of a note, the opportunity cost, commercially viewed, of the State’s non-interest bearing investment in the Railways. It is suggested that such amount could be assessed on the basis of the average interest rate for long-term semi-government loans.

## 6. INSURANCE.

*“(a) Is the provision of \$200,000 in the Railway Accident and Fire Insurance Fund adequate ?*

*(b) Do you agree with the present policy of charging losses on account of fire and accident against working expenses ?”*

6.1. The first question to be resolved is whether insurance cover for an undertaking the size of the Railways, and with the risk factors inherent in Railways operations, should be provided under a scheme of self-insurance or by an outside agency. The Committee believes that some extensive studies would be required before an answer could be attempted. It recommends that the advice of an independent insurance expert be sought in connection with this matter.

6.2. In whichever way insurance cover is provided, it would have to be adequate for the risks involved. On further analysis it may well prove an acceptable proposition to limit insurance cover to the consequences of major disasters, and to treat minor losses and claims as an element of normal operating expenses.

## APPENDIX NO. 3—PART B.—(cont.)

6.3. The Auditor-General's reports contain fairly full information on the payments made annually out of the " Railway accident and fire insurance fund " and charged to working expenses. Between 1964 and 1971 these ranged from as low as \$1,162,576 in 1964 to as high as \$2,115,823 in 1969, with a yearly average of \$1,577,000, and with workers compensation payments accounting for approximately 60 per cent. of the total. Payments made from the insurance fund in the years ended 30th June, 1969, 1970 and 1971 respectively did not include an amount of \$1,587,000 spent on the reinstatement of carriages and locomotives lost or damaged in the Violet Town collision in February 1969, nor a further amount of \$122,000 spent on sundry repairs as a result of the collision. Having regard to these facts, the Committee concluded that the balance of \$200,000, held in the insurance fund, cannot be considered to provide adequately against the contingency of a major disaster.

6.4. If it is decided to continue with self-insurance, the Committee recommends that the level of the funds held for insurance purposes be increased substantially. It is also considered desirable that the assets in which these funds are invested, be earmarked by the Treasury so that they will be readily available for meeting claims without the delays which could arise if special appropriation by Parliament was required.

## 7. PAYROLL AND OTHER TAXES.

*" What charges of this kind should be included in working expenses ? "*

7.1. The Committee believes that working expenses should include only rates and taxes actually paid or payable by the Railways (refer paragraph 1.46 of this report). Should it be desired to compare the Railways results with those of other organizations bearing different rate and tax charges, the figures of those other organizations would have to be adjusted accordingly.

7.2. Whether the obligations of the Railways to pay rates and taxes should be extended, is a matter the Committee considered to lie outside its terms of reference.

## 8. ADDITIONAL CONSIDERATIONS.

8.1. The Committee is conscious of the rather fundamental nature of some of the changes recommended for the preparation and presentation of the Railways accounts. It may become necessary to rearrange, as a result, the general accounting system of the Railways, including the underlying classifications of revenue, expenditure, assets, liabilities, provisions, funds and reserves, so that it readily permits the production of accounts as set out in Appendix ' B ' and adequate supporting information. Modifications may also be needed in the Railways costing and statistical records if the recommendations made in paragraphs 1.17 and 1.18 are to be implemented.

8.2. Needless to say, these changes would also involve the Treasury in no small degree. They would require adjustments to Treasury records following a reconstruction of the Railway capital and, in addition, the machinery for reimbursing the Railways for " social " charges would have to be reconsidered.

8.3. It is recognised that certain of these changes may well cut across current statutory requirements. However, the Committee believes that the possibility of some amendments to existing legislation, in the main in relation to administrative matters, would be a small price, indeed, for placing the Railways accounts on a basis appropriate to the role the Railways play in serving the needs of the community.

## 9. SUMMARY OF RECOMMENDATIONS.

9.1. This report contains numerous recommendations, some express, others implied, for reorganizing the accounting for the Victorian Railways so that improved published accounts will result. The following is a summary of these recommendations.

9.2. It is recommended that—

- the accounting for the Railways should proceed from the notion that the Railways are, in fact, a business undertaking ; (para. 3.1).
- the Railways should be treated as a separate accounting entity instead of being dealt with as part of the Treasury complex ; (para. 2.3).
- consideration should be given to reconstituting the Railways as an independent public authority ; (para. 2.3).
- the annual Railways accounts should be drawn up and presented on the same basis and in the same manner as the accounts for commercial undertakings ; (para. 1.4).
- the accounts should follow as far as possible the classifications and terminology ordinarily adopted in the published reports of commercial undertakings ; (para. 1.6).
- the accounts should give full recognition to such basic accounting concepts as matching cost and revenue, accruing known liabilities and providing for expected liabilities, determining details of disclosure and presentation according to the materiality of the items in question ; (para. 1.6).
- the accounts should disclose the contributions from each major area of operations to the total operating result ; (para. 1.11).
- the " Reconciliation of the Railway and Treasury Figures " should be deleted from the published accounts ; (para. 1.16).
- the " Statistical Statement " should be extended to cover key aspects of operating costs ; (para. 1.17).
- operating statistics which accompany the accounts should be so designed that they can be readily used in inter-system comparisons ; (para. 1.18).

## APPENDIX NO. 3—PART B.—(cont.)

- the "Railways Stores Suspense Account" should be deleted from the published accounts ; (para. 1.21).
- the statement on the "Railways Renewal and Replacement Fund" should be merged with the "Statement of Capital Expenditure" ; (para. 1.22).
- the "Statement of Capital Expenditure" should be redesigned ; any comparative figures given in this statement should be averages over an extended period ; (para. 1.24).
- amounts quoted in the accounts and supporting schedules should be in round dollars ; (para. 1.25).
- the annual accounts should be accompanied by a summary of financial and operational highlights for an extended period ; (para. 1.26).
- the financial basis of the Railways should be restructured so that there will be a distinction between capital permanently invested in the Railways, and loan funds including current advances from the Treasury, carrying a definite liability to repayment ; (paras. 1.6, 1.28).
- loan repayments and contributions to loan sinking funds should be made and recorded in the accounts only if there are sufficient cash funds available for this purpose from profits or a sale of fixed assets ; (para. 1.29).
- loan repayments and contributions to loan sinking funds should be treated as an appropriation of cash funds and should be reflected only in the balance sheet as a reduction of loan liabilities with a corresponding reduction of cash assets ; they should not be considered as an item of financial expense and should not be included in the profit and loss statement as a charge against revenue ; (para. 1.29).
- if the present method of accounting for contributions to the national debt sinking fund is prescribed by law, a change of the law should be sought to permit a more meaningful accounting treatment ; (para. 1.29).
- accumulated losses of past years should be written off with a corresponding adjustment to capital account ; (para. 1.30).
- all fixed assets should be revalued and book amounts in excess of valuation should be written off with a corresponding adjustment to capital account ; (paras. 1.33, 1.39).
- as a general rule, present-day values should be used for the purpose of such revaluation ; (para. 1.37).
- all fixed asset values should be reviewed periodically ; (para. 1.41).
- in the valuation of stocks and stores proper allowance should be made for obsolescence, particularly in the area of maintenance spares ; (para. 1.42).
- provision should be made for long service leave liabilities ; (para. 1.43).
- provision should be made for doubtful debts and be shown as a deduction from gross book debts ; (para. 1.44).
- pension fund contributions should be determined on the basis of regular actuarial assessment ; (para. 1.45).
- the accounts should show, by way of note, the annual rental value of Crown land made available to the Railways ; (para. 1.48).
- the audit report attached to the Railways accounts should be complete within itself ; (para. 1.50).
- legislation should be amended, as necessary, to permit such an audit report to be furnished ; (para. 1.51).
- the Railways should be subsidised fully in respect of all services to be maintained in the public interest at rates which will not allow the Railways to cover their costs ; (para. 3.2).
- such reimbursements should be disclosed separately in the profit and loss statement ; (para. 3.3).
- if there are no reimbursements or if the reimbursements do not fully cover the cost of the respective services, the unrecouped portion of such cost should be disclosed in a note to the accounts ;
- following a revaluation of fixed assets, the Railways should thereafter be required to make proper depreciation charges before arriving at the result for any period ; (para. 4.1).
- no depreciation adjustments should be made in respect of past financial years ; (para. 4.2).
- depreciation charges should be determined by the straight-line method ; (para. 4.5).
- depreciation rates should be reviewed periodically ; (para. 4.6).
- renewals and replacements in the nature of maintenance relating to such assets as way, works and buildings, should be treated as a charge to working expenses ; (para. 4.8).
- the use of the term "renewals and replacements" should be restricted to capital expenditure ; (para. 4.8).
- the accounting treatment of renewals and replacements should be divorced from any considerations of how they are to be financed ; (para. 4.9).
- the Railways should not be charged interest on funds which are to be considered their equity capital ; (para. 5.1).
- The Railways should be required to pay interest on all loans and advances, short or long term, which carry a definite obligation to repayment, interest being calculated either at the specific rates applying to particular loans, or at the average rate for long-term semi-government loans, as the case may be ; (paras. 5.1, 5.3).



## APPENDIX NO. 3—PART B.—(cont.)

- in the long term, consideration should be given to setting profit targets for the Railways operations ; (para. 5.4).
- the accounts should indicate by way of note the opportunity cost of the State's investment in the Railways ; (para. 5.5).
- the possibility of obtaining insurance cover through an outside agency should be explored as an alternative to continuing the present scheme of self-insurance ; (para. 6.1).
- insurance cover should be adequate for the risks involved ; the level of \$200,000 presently set for the Railways accident and fire insurance fund should be increased substantially ; (paras. 6.2, 6.4).
- if self-insurance is continued, assets representing the insurance fund should be earmarked by the Treasury so as to facilitate prompt settlement of claims ; (para. 6.4).
- working expenses should include only rates and taxes actually payable by the Railways ; (para. 7.1).
- the general accounting records and procedures of the Railways should be adjusted to permit the preparation of more informative annual accounts ; (para. 8.1).

## ACKNOWLEDGMENTS.

The Committee wishes to record its appreciation of the assistance received from officers of the Railways Department and the State Audit Office who on numerous occasions were approached to clarify technicalities of the Railways accounts. Without their support the Committee's review of these accounts would have proved a most difficult undertaking.

Melbourne,  
29th September, 1972.

N. W. BUCKLEY,  
Chairman, Joint Committee.

## APPENDIX NO. 3—PART B.—(cont.)

*Appendix 'A'.*

## EXPLANATORY NOTES ON REDRAFTED BALANCE SHEET AND PROFIT AND LOSS STATEMENT.

(1) The published accounts for 1970, (page 24), and also the report of the Auditor-General for that year (page 102), indicate that at 30th June, 1970, there were advances from loan account totalling \$9,000,000 for the purpose of financing stores and stock. As the balance sheet does not disclose these advances as a separate item, it must be assumed that they form part of one or several of the amounts shown in the balance sheet as "funds provided by the State Treasurer". The Committee believes that it would be preferable to bracket these advances together with the other cash advances made for the purpose of meeting immediate operating expenditures.

(2) This item appears inadequately described in the published accounts.

(3) The Committee considers that the only securities which should be formally recorded by means of an entry in the accounts, are cash deposits received from customers or suppliers. Any other securities, such as bank guarantees or bonds, should be recorded in special separate registers and disclosed in the accounts by way of note only. See also note (4) below.

(4) This amount represents securities from customers and suppliers given other than in the form of a cash deposit. The Committee would prefer such securities to be shown by way of note only.

(5) This total includes the amount of \$15,721 shown in the published balance sheet against "road motor public services—buildings and equipment".

(6) This total includes the amount of \$4,750 shown in the published balance sheet against "road motor public services—rolling stock".

(7) The Committee understands that the total of \$753,424 shown in the published balance sheet as "work in progress, manufacturing account" under the general heading of current assets, includes items which in fact represent capital expenditure in progress and thus should be shown under the general heading of fixed assets. However, no adjustment was made as the amount involved could not be ascertained.

(8) The Committee can see no good reason for showing separately the two items "construction board" (\$3,544) and "equalization account" (\$25,162), having regard to the amounts involved. They have been included with "operating and maintenance stores and materials". The Committee has noted certain comments of the Auditor-General concerning the operation of the "stores stock equalization account" (Auditor-General's report, page 103). It is furthermore conscious of the possibility that the total shown for stores and materials may include maintenance spares which more correctly should be treated as a fixed asset subject to depreciation.

(9) The Committee considers it desirable to indicate against each class of debtors the amount (if any) of securities held. It has been noted that the Auditor-General's report refers to the fact that debtors for "works" (\$1,491,223), included in the total for "other debtors" (\$2,124,298), comprise a number of accounts which have been outstanding for more than two years. The question must be asked whether securities that may be held against these accounts are adequate to cover any losses that could arise should the accounts prove irrecoverable. In this connection the Committee recommends that some consideration be given to setting up a provision for doubtful debts.

(10) The description given to these funds in the published balance sheet, i.e., "Railway charges in suspense", does not assist an understanding of their nature or purpose.

(11) The Committee can see no need for separate disclosure of advances held by the Agent-General, having regard to the amounts involved.

(12) The Committee understands that this item arose by way of a special grant in connection with a railways rehabilitation program initiated immediately after the last war; the corresponding credit being included in "sundry provisions prior to 30th June, 1969" under the general heading of "special funds for working purposes". It would appear that for some specific reason the particular expenditure was not regarded as renewals and replacements that should be charged to the respective fixed asset accounts. The Committee recommends that it be written off to "accumulated losses" as a prior period adjustment.

(13) The Committee considers that, in line with generally accepted commercial practice, expenditure connected with the raising of loans should be written off over an appropriate short period. At present the Railways accounts do not provide for amortization of these expenses.

(14) Payments to the Commonwealth under the Uniform Railways Standardization Agreement 1958 have been eliminated and are shown separately under the heading "finance charges".

BALANCE SHEET AS AT 30TH JUNE, 1970.

Appendix (A)

Note		\$	Note		\$
	FUNDS PROVIDED BY TREASURY			FIXED ASSETS.	
	For capital purposes (see schedule)	483,601,382		Way, works, buildings, machinery, plant—at cost	316,168,294
	Less—		(5)	Less depreciation	46,530,940
	Equity in national debt sinking fund	62,080,117			269,637,354
	Repayments/uniform railway gauge trust fund	870,701			
(1)			(6)	Rolling stock—at cost	179,819,768
	To meet Railways deficits (see schedule)			Less depreciation	72,532,989
	Sundry cash advances (see schedule)			Surveys	306,411
	Less—			Lines under construction	125,549
	Accumulated losses (see schedule)	193,062,714		Lines closed for traffic—at cost	n.a.
	Depreciation not provided in accounts (see schedule)	87,979,849		Less depreciation	n.a.
					1,034,940
	RESERVES.		(7)		378,391,033
	National debt sinking fund reserve	62,080,117	(8)	STORES AND SPARES.	
	Uniform railways gauge reserve	870,701		Work in progress	753,424
	Railway accident and fire insurance reserve	200,000		Stores and materials	8,648,347
					9,401,771
	CURRENT LIABILITIES.				200,000
(2)	Creditors and accrued charges	9,786,163		SPECIAL FUNDS AT TREASURY.	
(3)	Revenue in advance	604,536		Railway accident and fire insurance fund	
	Security deposits	6,541			
			(9)	CURRENT ASSETS.	
				Stock and equipment—refreshment services (less	
				\$13,441 provision for losses and breakages)	744,048
			(9)	Debtors—	
				Revenue (against which securities of \$ . . . . are	
				held)	4,937,673
			(9)	Other (against which securities of \$ . . . . are	
				held)	2,124,298
				Cash at Treasury—	
			(10)	Security deposits	6,541
			(10)	General funds to meet working expenses	6,126,579
				Funds for purchasing stores and materials	1,079,931
				Cash on hand and in transit	2,918,942
					17,738,012
(4)	TRUST ACCOUNT	4,076,015	(12)	INTANGIBLES.	
				Loans for renewals, replacements and maintenance	
			(13)	works not represented by assets	1,050,000
				Discounts and expenses on loans	7,159,328
			(4)	TRUST ACCOUNT	4,076,015
					418,216,159

## APPENDIX NO. 3—PART B.—(cont.)

## Appendix 'A'.

## VICTORIAN RAILWAYS.

## STATEMENT OF PROFIT AND LOSS FOR YEAR ENDED 30TH JUNE, 1970.

Note							\$	\$
	GROSS REVENUE—							
	Normal Operations—							
	Passenger services—suburban	..	..	..	..	..	24,174,507	
	—country	..	..	..	..	..	7,521,290	
	Freight services	..	..	..	..	..	61,766,036	
	Parcels and mail	..	..	..	..	..	4,118,912	
	Miscellaneous	..	..	..	..	..	7,052,355	104,633,100
	Special Subsidies—							
	Pensioners fares concessions	..	..	..	..	..	200,000	
	Country freight recoup	..	..	..	..	..	224,000	
	Parcels recoup	..	..	..	..	..	62,000	486,000
								105,119,100
(14)	WORKING EXPENSES	..	..	..	..	..		118,410,416
	DEFICIT ON CURRENT OPERATION	..	..	..	..	..		13,291,316
	FINANCE CHARGES—							
	Interest charges and exchange	..	..	..	..	..	7,160,965	
	National debt sinking fund contribution	..	..	..	..	..	330,179	
	Interest and repayment on Uniform railway gauge trust fund	..	..	..	..	..	301,143	7,792,287
	TOTAL DEFICIT FOR YEAR	..	..	..	..	..		21,083,603
	Accumulated Losses to 30th June, 1969	..	..	..	..	..		171,979,111
	Accumulated Losses to 30th June, 1970	..	..	..	..	..		193,062,714

*Appendix ' B '.*

## EXPLANATORY NOTES ON SAMPLE BALANCE SHEET AND PROFIT AND LOSS STATEMENT.

1. This amount would represent the 'equity' capital of the Railways as determined in the restructuring of the Railways finances upon revaluation of the Railways' fixed assets. This capital would not be subject to any interest charges.
2. Additions to the Railways' equity capital after the initial restructuring of the Railways finances. These additions, too, would be interest free.
3. Profits or losses accumulated since the re-structuring of the Railways finances. Losses accumulated prior to the change-over date would have been eliminated from the Railways accounts.
4. This amount would represent all loans from the Treasury, (other than current advances for working purposes) which carry a definite liability to repayment. It would comprise—
  - (a) outstanding loans as determined in the initial re-structuring of the Railways finances, upon revaluation of the Railways' fixed assets ;
  - (b) any additional loans since then.
 Details (if desired) could be given in an appropriate schedule. All loans would be subject to interest charges.
5. Long term loans obtained by the Railways other than from the Treasury. Details (if desired) could be given in an appropriate schedule.
6. For the purposes of this illustration it has been assumed that a scheme of self-insurance is continued.
  7. These could include, for example, a provision for future maintenance.
  8. Accrued charges would include accrued annual leave.
  9. Current advances from Treasury for working purposes, being equivalent in nature to a bank overdraft. Details (if desired) could be given in an appropriate schedule.
  10. Cash deposits received from customers or suppliers (contractors) by way of securities.
  11. The balance determined in the initial revaluation of the Railways' fixed assets.
  12. Additions since the date of the initial revaluation.
  13. Details (if desired) could be given in an appropriate schedule.
  14. It will be observed that in this sample layout a distinction is made between capital works in progress (e.g., construction of rolling stock) and other work in progress (e.g., maintenance spares in process of manufacture). Details of capital works in progress (if desired) could be given in an appropriate schedule.
  15. All items at present included under "stores and materials", also catering equipment (except major items which would be included under fixed assets).
  16. This provision would be set up to cover possible obsolescence of maintenance spares.
  17. Securities held would include bank guarantees and the like as well as cash deposits, recorded in the accounts as "security deposits".
  18. "Accounts receivable—other" would include prepayments of expenses.
  19. Stocks held for resale such as stocks used in refreshment and similar services. Catering equipment would be included under "plant and equipment" and "stores and spares", as applicable.
  20. Being the unspent portion of advances from Treasury for working purposes (see current liabilities).
  21. Including all cash imprests and cash floats at Railways offices, stations and depots, also cash in transit and cash advances held by Agent-General.
  22. As far as not written off to "finance charges".
  23. Including goods, livestock, parcels and mail.
  24. Catering, refreshment and similar services.
  25. Profits or losses accumulated to end of preceding financial year.
  26. Including renewals and replacements in the nature of long-term maintenance.
  27. If such a provision is set up.

BALANCE SHEET AS AT 30TH JUNE, 19 . . .

Note	This Year		Last Year		Note	This Year		Last Year	
	\$	×	\$	×		\$	×	\$	×
(1)					(11)				
(2)					(12)				
(3)					(11)				
(4)					(12)				
(5)					(11)				
(6)					(12)				
(7)					(13)				
(8)					(14)				
(9)					(15)				
(10)					(16)				
					(14)				
					(6)				
					(17)				
					(17, 18)				
					(19)				
					(20)				
					(10)				
					(21)				
					(22)				

**CAPITAL AND RESERVES**  
Consolidated Funds—  
Balance . . . /19 . . . /19 . . .  
Additions since . . . /19 . . . /19 . . .  
  
Reserves (to be described) . . . since  
Accumulated Profits/Losses . . .  
. . . /19 . . . /19 . . .  
  
**LONG TERM LOANS**  
Loans from Treasury (see schedule) . . .  
Other Loans (see schedule) . . .  
  
**PROVISIONS**  
Provision for Insurance . . .  
Provision for Long Service Leave . . .  
Other Provisions (to be described) . . .  
  
**CURRENT LIABILITIES**  
Accounts Payable and Accrued Charges  
Advances from Treasury (see schedule)  
Revenue in Advance . . .  
Security Deposits . . .

**FIXED ASSETS**  
Land, Way, Buildings, Structures—  
at valuation ( . . . /19 . . . /19 . . . )  
at cost (since . . . /19 . . . /19 . . . )  
  
Less provision for depreciation . . .  
Rolling Stock—  
at valuation ( . . . /19 . . . /19 . . . )  
at cost (since . . . /19 . . . /19 . . . )  
  
Less provision for depreciation . . .  
Plant, Machinery, Equipment—  
at valuation ( . . . /19 . . . /19 . . . )  
at cost (since . . . /19 . . . /19 . . . )  
  
Less provision for depreciation . . .  
Lines Under Construction (see schedule)  
Other Capital Works in Progress (see  
schedule) . . .  
  
**STORES AND SPARES**  
Stores and Spares (at cost) . . .  
Less Provision for Obsolescence . . .  
  
Work in Progress (at cost) . . .  
  
**SPECIAL FUNDS AT TREASURY—**  
Insurance Fund . . .  
Other Funds (to be described) . . .  
  
**CURRENT ASSETS**  
Accounts Receivable—  
Revenue (against which securities of  
\$ . . . . . are held) . . .  
Other (against which securities of  
\$ . . . . . are held) . . .  
  
Less Provision for Doubtful Debts . . .  
  
Trading Stock (at cost) . . .  
Cash at Treasury—  
Working Funds . . .  
Security Deposits . . .  
Cash on Hand and in Transit . . .  
  
**INTANGIBLES**  
Loan Discounts and Expenses . . .

## APPENDIX NO. 3—PART B.—(cont.)

## Appendix 'B'.—continued.

VICTORIAN RAILWAYS.  
PROFIT AND LOSS STATEMENT.

Note		This Year	Last Year
		\$	\$
	<b>SUBURBAN TRAFFIC</b>		
	Ordinary Revenue .. .. .	×	×
	Government Subsidies .. .. .	×	×
		×	×
	Operating Expenses .. .. .	×	×
	Operating Surplus/Loss .. .. .	×	×
	<b>MAIN LINES TRAFFIC</b>		
(23)	Ordinary Revenue—Passengers .. .. .	×	×
	—Freight .. .. .	×	×
	Government Subsidies—Passengers .. .. .	×	×
	—Freight .. .. .	×	×
		×	×
	Operating Expenses .. .. .	×	×
	Operating Surplus/Loss .. .. .	×	×
	<b>SECONDARY LINES TRAFFIC</b>		
(23)	Ordinary Revenue—Passengers .. .. .	×	×
	—Freight .. .. .	×	×
	Government Subsidies—Passengers .. .. .	×	×
	—Freight .. .. .	×	×
		×	×
	Operating Expenses .. .. .	×	×
	Operating Surplus/Loss .. .. .	×	×
(24)	<b>OTHER OPERATIONS</b>		
	Revenue .. .. .	×	×
	Operating Expenses .. .. .	×	×
	Operating Surplus/Loss .. .. .	×	×
	<b>TOTAL OPERATIONS</b>		
	Ordinary Revenue .. .. .	×	×
	Government Subsidies .. .. .	×	×
		×	×
	Operating Expenses (see schedule) .. .. .	×	×
	Operating Surplus/Loss .. .. .	×	×
	Profit/Loss on Disposal of Fixed Assets .. .. .	×	×
	Finance Charges (see schedule) .. .. .	×	×
	Net Profit/Loss for Year .. .. .	×	×
(25)	Accumulated Profits/Losses to 30th June, 19 . . . .	×	×
	Accumulated Profits/Losses to 30th June, 19 . . . .	×	×

## APPENDIX NO. 3—PART B.—(cont.)

## Appendix 'B'—continued.

VICTORIAN RAILWAYS.  
SCHEDULE OF OPERATING EXPENSES AND FINANCE CHARGES.  
for year ended 30th June, 19 . . . .

Note		This Year		Last Year		
		\$	\$	\$	\$	
	<b>OPERATING EXPENSES</b>					
	<i>Operating Expenses According to Functions—</i>					
	<b>Traffic Operations—</b>					
	Motor Power .. .. .	×		×		
	Coach and Goods Vehicle Service .. .. .	×		×		
	Electrical .. .. .	×		×		
	Other .. .. .	×		×		
			×		×	
	<b>Other Operations</b>					
	Maintenance and Repairs .. .. .		×		×	
(26)	Way and Works .. .. .	×		×		
	Rolling Stock .. .. .	×		×		
	Electrical .. .. .	×		×		
	Other .. .. .	×		×		
	Stores Expenses .. .. .		×		×	
	Administration Expenses .. .. .		×		×	
	General Charges (including Long Service Leave, Pension Fund Contributions, Insurance, Depreciation) .. .. .		×		×	
	TOTAL .. .. .		×		×	
	<i>These expenses are made up of</i>					
	Salaries and Wages (inc. accrued leave) .. .. .		×		×	
	Provision for Long Service Leave .. .. .		×		×	
	Pension Fund Contributions .. .. .		×		×	
	Payroll Tax .. .. .		×		×	
	Electrical Energy .. .. .		×		×	
	Fuel .. .. .		×		×	
	Stores and Spares Consumed .. .. .		×		×	
	Trading Stock Consumed .. .. .		×		×	
	Insurance—Workers Compensation .. .. .		×		×	
	Insurance—Other .. .. .		×		×	
	Depreciation .. .. .		×		×	
(27)	Provision for Maintenance .. .. .		×		×	
	Other Charges .. .. .		×		×	
	TOTAL as above .. .. .		×		×	
	<b>FINANCE CHARGES</b>					
	Loan Interest, Exchange .. .. .		×		×	
	Loan Expenses .. .. .		×		×	
	TOTAL .. .. .		×		×	

## NOTES FORMING PART OF THE ACCOUNTS.

1. The rental value of Crown land, made available to the Railways free of charge, is estimated at \$ . . . . . per annum.

2. The cost to the State of its investment in the Railways (as represented by the Railways' consolidated funds) is assessed at \$ . . . . . per annum, based on the average interest rate for long-term semi-government loans.

3. The following losses were incurred during the year on services maintained as a matter of Government policy, or at rates determined in accordance with Government policy :—

Suburban traffic \$ . . . . .  
Country passenger traffic \$ . . . . .  
Country goods traffic \$ . . . . .

(N.B. This note would be needed only if Government subsidies for such services are insufficient to meet their full cost.)





## APPENDIX NO. 3.—PART C.

## MATERIAL PRESENTED BY MR. G. T. WEBB, COMMISSIONER FOR TRANSPORT—TASMANIA

1. *Form and Presentation of Accounts.*

(a) The Australian Society of Accountants and the Institute of Chartered Accountants have stated that—

“ the annual accounts of the Victorian Railways should be drawn up and presented on the basis of the same accounting principles and in the same manner as for any commercial undertaking ”.

In the light of this statement would you be prepared to redraft the enclosed Balance Sheet and other Accounts, and comment on the accompanying statements, for consideration by the Committee ?

Because of pressure of work in Tasmania at present I regret being unable to give sufficient time to redrafting the Balance Sheet and accounts of the Victorian Railways.

However, the following comments are offered on the Balance Sheet as at June 30th, 1970, and the accounts for 1969-70.

It is considered that :—

The following amounts should be written off—

	\$
(a) Loan for renewals, replacements and maintenance works not represented by assets .. .. .	1,050,000
(b) Discounts and expenses on loans .. .. .	7,159,328
(c) Lines closed for traffic .. .. .	1,034,940

Expenditure on fixed assets should be shown at cost, less provisions for depreciation.

A supplementary statement should be provided, showing the original cost and depreciation provided, for each class of fixed asset.

The fixed assets of the railways, shown as—

	\$
(a) way, works, building, machinery and plant .. .. .	269,621,633
(b) rolling stock general equipment .. .. .	107,282,029

should be shown in sufficient detail (in the supplementary statement) to identify each major class of asset. The following might be shown separately :—

Track	Workshop buildings (incl. land)
Bridges and overpasses	Workshop plant and equipment
Level crossing protection	Way and works plant
Signals and communications	Locomotives
Electrification	Wagons
Operation buildings (incl. land)	Service rolling stock
Dwellings (incl. land)	Passenger cars.

The amounts shown in the statements at pages 21 and 24 should be rounded to the nearest \$.

The Commonwealth Railways changed to a commercial accounting basis as from July 1st, 1961, and the accounts prepared under the new basis have been quite satisfactory. Reference might be made to the annual accounts of Commonwealth Railways prior to and after this change over.

It is considered the accounts of the Victorian Railways should be prepared on a commercial accounting basis to the following extent :—

the working expenses should include, not only all expenses paid, but all expenses accrued.

provision should be made for—

- (a) long service leave accrued
- (b) annual leave accrued
- (c) superannuation or retirement benefit allowances accrued
- (d) outstanding claims
- (e) normal depreciation

revenue should include claims submitted but not paid, less provision for doubtful debts— but should not include transfers to general reserve.

(b) How should the capital investment or net worth of the Victorian Railways be shown, taking into account that this amount represents the funds provided by the State Treasurer less some amounts written off in 1936 ?

## APPENDIX NO. 3—PART C.—(cont.)

It is considered that all existing assets should be shown at cost, less depreciation provided and amounts written off in lieu of charging depreciation.

See also comments on amounts still in the Balance Sheet which should be written off, and provisions which should be made for depreciation of fixed assets.

(c) How should the assets of the Railways be valued from time to time ?

It is considered the fixed assets should not be revalued, and should be shown at all times at cost, less depreciation provided and amounts written off.

In this regard see my "Depreciation of Fixed Assets in Accountancy and Economics", Law Book Co., 1954.

Assets sold, scrapped or retired, should be deleted from the list of assets at their cost price ; depreciation provided on such assets should be deleted from the depreciation provisions ; a deficiency between sale value and depreciated value should be charged to depreciation account ; any excess of sale value over depreciated value should be credited to depreciation account ; and an excess of sale value over cost (if any) should be shown as profit on sale of fixed assets.

Stocks on hand should be valued at cost. Any deterioration of stock or items no longer usable should be written off.

(d) Are there any charges not shown in the Victorian Railways accounts which should be included in your view ?

This is dealt with under other items.

(e) Should the Auditor-General certify the accounts in similar form to that required for companies under the terms of the *Companies Act* 1961 ?

In my opinion—no.

Subject to the accounts of the Victorian Railways being prepared on a commercial accounting basis, I would expect the State Auditor-General to examine and certify these accounts along the lines that he examines and certifies the accounts of State undertakings whose accounts are prepared in a similar manner, and in no different a manner to the certification given by the Commonwealth Auditor-General to the accounts of the Commonwealth Railways.

## 2. Operation of Railways as a Commercial Undertaking.

Should railway finances be separated from the State Budget ?

Having regard to the following :

The Victorian Railways operate as a Commission under the direction of three Railways Commissioners.

The Victorian Railways is not a statutory body along the lines of other large scale instrumentalities in the State, such as the State Electricity Commission and the Melbourne and Metropolitan Board of Works.

The income and expenditure of the Victorian Railways are the largest items in the income and Expenditure Statements of the annual budget of the Victorian Government.

Since the end of the war, the losses incurred by the Victorian Railways have been responsible, in the main, for the deficits shown over this period by the Victorian Government.

I am of the opinion that consideration should be given to taking the following action :—

The Victorian Railways to be constituted as a statutory corporation, reporting annually to the Victorian Parliament.

The Accounts of the new statutory corporation to be audited by the State Auditor-General, and these accounts should be excluded from the annual budget statements of the Victorian Government.

## APPENDIX NO. 3—PART C.—(cont.)

The present Commission, consisting of three full-time Railways Commissioners, to be replaced by a Commission (or Board) consisting of :—

- (a) One full-time Railway Commissioner, who would be the executive director and Chairman of the new authority.
- (b) Four part-time Commissioners (or Directors), who would be appointed by the Government having regard to their financial, economic, administrative and engineering ability and experience. These part-time Commissioners could be leading executives in industry, finance and commerce in the State. It is envisaged they would function as a Board of Directors, would meet once or twice a month (half day meeting), would formulate policy, approve major projects, and direct long term planning. Formal minutes of such meetings would be held, and copies would be supplied promptly to the Government for information.

## 3. "Social" Charges.

As the Railways claim that they have to meet many charges of a "social" nature, such as reduced rates for decentralized industry, pensioner concessions, losses on unprofitable passenger services, &c., should they be reimbursed by the Government for such charges ?

I consider that the Victorian Railways should be reimbursed by the State Government for any special concessions granted, or operations maintained, by direction of the Government. This would include :—

- (a) Reduced freight rates for decentralized industries,
- (b) pensioner fare concessions,
- (c) reduced freight rates for goods carried for export,
- (d) reduced freight rates for fertilizers and manures,
- (e) concession freight rates for carriage of fodder and supplies for drought relief,
- (f) losses on operating unprofitable country passenger services,
- (g) losses on operating unprofitable country freight services,
- (h) losses on keeping open unprofitable country stations and sidings.

Note re (f), (g) and (h)—

The revenue from operations under (f), (g) and (h) should at least cover direct costs, i.e. costs which could be avoided if the services were closed down. Where the revenue is less than the direct costs, and there is no prospect of improvement, the services should be closed down as railway operating ventures. If on social or community grounds the Government requires such services to be continued, the Victorian Railways should be reimbursed the difference between the revenue received and the direct costs of providing the service. Such amounts should be shown separately in the annual Government budget.

## 4. Depreciation.

As depreciation is not at present included in working expenses, how should it be dealt with for—(a) past accounts ; and (b) future operations ?

Having regard to the following :

No amounts that can be identified as depreciation appear in the accounts of the Victorian Railways up to June 30th, 1957.

As from July 1st, 1957, an annual amount of around \$600,000 a year has been allowed for depreciation in the annual accounts of the Victorian Railways, comprising approx. \$200,000 a year provided in working expenses for sundry depreciation charges, and \$400,000 a year as a contribution to the Railway Renewals and Replacement Fund.

Under the Railways (Finances Adjustment) Act, No. 4429 of 1936, \$60 million of railway loan liability was transferred to the State's General Account as at July 1, 1937, and the following amounts, previously included as assets in the annual balance sheets of the Victorian Railways, were written off :

	\$
way, works, buildings, equipment and rolling stock .. .. .	51,432,186
closed lines, surveys, &c. .. .. .	1,916,002
discounts and flotation charges (net) on loans .. .. .	6,651,812
	\$60,000,000

Since then insufficient amounts have been provided for the depreciation assessed on railway assets in Victoria.

At June 30th, 1970, the amount short provided on this account totalled \$87,979,849, including \$7,195,935 under-provided in 1969–70.

## APPENDIX NO. 3—PART C.—(cont.)

It would appear that the depreciation under-provided (based on historical costs of assets not written off) at June 30th, 1971, would be of the order of \$95 million.

I am of the opinion that the following action should be taken :

(a) for past accounts—

similar action should be taken at June 30th, 1972, as was taken in 1936, by special Act of Parliament,  
fixed assets to the order of \$95 million should be written off,  
railway loan liability, to the extent of the assets written off, to be transferred to the State's General Account.

(b) for future operations—

normal depreciation provisions should be made each year to write off all fixed assets over a reasonable working life (with some allowance for earlier obsolescence in certain fields, if considered desirable), and such be included as annual charges in the working expenses.

Note re (b)—

Over a long period, the Tasmanian railways have adopted the procedure suggested above ; except that special provisions have not been made for obsolescence. The following depreciation rates are used :

<i>Assets.</i>	Annual Rate %
Buildings .. .. .	3
Track and Track Structures .. .. .	2
Shop Equipment .. .. .	3
Track Equipment .. .. .	3
Station Yard Equipment .. .. .	3
Furniture and Office Equipment .. .. .	3
Rolling Stock .. .. .	3
Miscellaneous .. .. .	3
Land .. .. .	Nil
<i>Interstate Equipment—</i>	
Refrigerated Containers .. .. .	10
Trailers .. .. .	7½

### 5. Interest.

What principles should be associated with the charging of interest on Government investment in undertakings of a commercial nature ? Should these apply to the Victorian Railways ?

It is considered that the following principles should apply with the provision of loan funds by Governments to undertakings of a commercial nature.

In the case of investments in new undertakings, or investments in existing undertakings which would represent major modifications or extensions, and investments in assets having an anticipated life in excess of 20 years (with an individual cost in excess of \$10,000)—

cost benefit studies to be undertaken, and investment funds to be made available only where the projects are shown to be economic at a discount rate of not less than the long term bond rate.

In the case of continuing and minor investments in existing undertakings (e.g. replacement of motor vehicles and office machines)—

an assessment to be made of the economics of continuing with the present assets or of replacing them.

It is considered these principles should apply to the Victorian Railways—

in respect of the construction of new lines, extension and upgrading of existing lines, replacement and substantial improvement of existing facilities, and replacement of locomotives, freight rolling stock and interstate passenger cars,

but not to capital funds required exclusively for improvements and extensions to the suburban railway system (including provision of new passenger cars).

In the case of the suburban railway system, the transport provided (at rates the community can afford to pay) is not an undertaking of a commercial nature, but really the provision by Government of a community and social service.

## APPENDIX NO. 3—PART C.—(cont.)

In this case it is considered the required capital funds should be provided, without interest charges, by the Commonwealth or State Governments.

The amount of the funds to be made available for suburban railway purposes, and the type and extent of the facilities to be provided, would depend not only on the existing and projected needs of the community for this service, but also on other competing needs by the community in other fields, having regard to existing fixed capital investment of a social nature (including that in the suburban railway system).

Note re economic evaluation of new projects—

The procedure suggested above is well known, and is being adopted extensively by the Commonwealth Treasury, the Commonwealth Bureau of Roads and the Bureau of Transport Economics, before advice and recommendations are submitted to the Commonwealth Government in respect of proposals for transport projects involving Commonwealth funds.

Two detailed studies along these lines have been made in the last two years by the Commonwealth in respect of proposals for construction of new railways, namely, the proposed new standard gauge railway from Tarcoola to Alice Springs (to replace the existing standard and narrow gauge railway from Port Pirie to Alice Springs, via Marree), and the proposed new standard gauge railway from Yass to Canberra.

The study of the proposed Tarcoola/Alice Springs railway showed a favourable result, but the study of the proposed Yass/Canberra railway showed an unfavourable result. It can be expected that the former project will be proceeded with and that no further action will be taken in respect of the latter project.

6. *Insurance.*

(a) Is the provision of \$200,000 in the Railway Accident and Fire Insurance Fund adequate ?

(b) Do you agree with the present policy of charging losses on account of fire and accident against working expenses ?

Having regard to the nature and size of operations of the Victorian Railways, the value of the fixed assets, and the possibility (ever present) of very large claims arising as a result of a serious railway accident or heavy losses occurring as a result of an extensive fire, it is considered the present provision of \$200,000 is not adequate.

In essence, this amount represents a special reserve, while actual losses on account of accidents and fires are charged each year against working expenses.

The effect of this procedure is that operating results in any one year may be distorted because of abnormal heavy or light claims in that year.

I would suggest that consideration might be given to the following :—

An amount of \$200,000 to be charged against working expenses for each of the next four years and credited to the Railway Accident and Fire Insurance Fund to bring it up to \$1 million.

During these four years, actual payments on account of accidents and fires to be met from working expenses.

Thereafter, actual payments on account of accidents and fires to be met from the Railway Accident and Fire Insurance Fund ; with this Fund being credited each year with a fixed amount, which would be charged against working expenses, the annual amount being based on an assessment of the provision required to meet the average of claims in a normal year and to maintain the Fund at around \$1 million—the Fund being used as a reserve against the possibility and for the purpose of meeting abnormal claims.

7. *Payroll and other taxes.*

What charges of this kind should be included in working expenses ?

It is considered that :

Whilst payroll tax is charged, by agreement between the Commonwealth and State Governments, on wage costs in State "business" undertakings, payroll tax on wages charged against working must be included as an item of working expenses.

Full municipal rates and service charges, water and sewerage rates and excess water charges, relating to railway properties and railway activities, should be included in working expenses. (Note—this principle is followed by the Tasmanian Government Railways).

State land tax should not be charged against railway properties.

## APPENDIX NO. 3.—PART D.

EVIDENCE SUBMITTED TO THE VICTORIAN PUBLIC ACCOUNTS COMMITTEE BY  
G. R. WEBB, SENIOR LECTURER IN ECONOMICS, UNIVERSITY OF  
NEW SOUTH WALES.*Question 2.*

I believe that the Railway Department should be reconstituted as a semi-government undertaking to be called the Victorian Railways Commission. The granting of administrative autonomy would remove political influence from many aspects of railway operation (especially the pricing of passenger and freight services), and would promote efficient operation.<sup>1</sup>

If administrative independence was allowed, financial autonomy would have to be granted also. Indeed, one could not operate without the other. Once the Railways Commission established its own operating budget, it should be responsible for its capital expenditure budget and for raising the necessary funds, in similar fashion to the State Electricity Commission. The Railways Commission could still operate uneconomic services to satisfy social requirements, but the losses associated with these services would have to be met by direct subsidies from the State Government.

The question of separation of the railway finances from the State budget has been considered on a number of occasions. Thus the Elliot Report in 1949 directed attention to a long standing weakness in railway administration in Victoria in "that the Railways finances have been an integral part of those of the State."<sup>2</sup> This problem had been discussed 20 years before by the 1928 Royal Commission on the finances of the Victorian Railways. The Commission notes that railway finances had been separated from State finances in a number of countries, including Switzerland, Italy, South Africa and New Zealand, and particular attention was paid to the separation of the Indian Railways budget from the general budget in 1924-25.<sup>3</sup>

Mr. Norris, then Auditor-General for Victoria, gave evidence to the above Commission, and argued that the finances of the Victorian Railways should be placed on a similar footing with those of the State Electricity Commission. "The finances of that Commission have been separated from the State Budget, also the finances of the Harbour Trust and the Melbourne and Metropolitan Board of Works. They have to live on their own income and provide for their own expenditure."<sup>4</sup> The Commission recommended that the finances of the Victorian Railways should be separated from the State budget, but this was not acted upon.

The relationship between the finances of the Victorian Railways and the State budget was considered again in 1933 by the Nixon Committee.<sup>5</sup> This Committee, which was appointed by the Victorian Government to report upon the capital indebtedness of the Victorian Railways, declared that separation of finances was impracticable until the Railways Commissioners were completely freed from Government control.

*Question 3.*

The Railway Department should be given specific subsidies to meet the cost of unremunerative services which it is obliged to operate, in order to satisfy social requirements. This principle has been adopted by several overseas Governments in recent years. For example, the Canadian Government has taken the view that if the railways are required to maintain a service which is basically uneconomic, then the Government should pay the loss incurred. Thus section one of the National Transportation Act of 1967 states that "where the Government to satisfy a particular public interest feels that a requirement must be imposed upon a mode of transportation, any losses experienced in consequence must be paid by the government."<sup>6</sup>

Similarly in the United Kingdom, the 1968 White Paper on Transport announced that the Government intended to "introduce a new system under which the (Railways) Board will be relieved of the burden placed on its accounts by any unremunerative but socially necessary services which, with the Government's agreement, it continues to maintain."<sup>7</sup> In line with this policy, the Ministry of Transport is now providing grants, totalling about \$130 million, for over 200 separate railway passenger services.<sup>8</sup>

It is interesting to note that the American Government has also taken steps to support unprofitable rail passenger services. A new Federal Agency—The National Railroad Passenger Corporation—was set up by Congress in 1970 and commenced operations in May 1971. The task of the Corporation is to ensure that a minimum of inter-city rail passenger operations is maintained in the public interest. As the operation of long distance trains would be unprofitable for railroad companies, they have been invited to operate the services under contract to the Corporation, which will then compensate them for their losses.<sup>9</sup>

1. See "Autonomous State Railways," *Transport and Communications Review*, Department of Economic Affairs, United Nations, (April-June, 1951), p. 34.

2. John Elliot, *Report on Transport in Victoria*, (May, 1949), p. 23.

3. *Report of the Royal Commission on the Control, Management, Working and Financial Position of the Victoria Railways*, 1928, p. 33.

4. *Ibid*, p. 33.

5. E. V. Nixon, *Report on the Capital Indebtedness of the Victorian Railways*, 1933.

6. Cited by J. R. Baldwin in "Transport Policy in Canada. The National Transportation Act of 1967", *Transportation Journal*, (Fall, 1967), p. 11.

7. U. K. Ministry of Transport, *Transport Policy*, London, H.M.S.O., (1966), para. 25.

8. See S. Joy, "The Development of the Concept of Social Railway Passenger Services", *Institute of Transport Journal*, (Nov., 1970), pp. 14 and 17.

9. See G. Johnson, "Should Australia's Long Distance Passenger Trains be Nationalized?", *Railway Transportation*, (May, 1971), p. 20. Also *The Economist*, (May, 8, 1971), p. 56.

## APPENDIX NO. 3—PART D.—(cont.)

If the Victorian railways was given subsidies for unremunerative passenger and freight services, it would present a better financial image to the public, and there would be an improvement in the morale of railway employees. In addition, passenger subsidies would help to bring about a better co-ordination of traffic in that the railways would be able to concentrate on the maximum development of freight services. This latter point has been strongly emphasized by the Chairman of Commissioners of the Victorian Railways. Thus, in a paper delivered to the recent Australian Transportation Conference, he stressed that "if the railway freight pricing structure is ever to be brought more closely into alignment with true costs . . . and thus strengthen the railways' ability to compete for those traffic tasks which they can perform at lowest community cost, it is essential that . . . hidden subsidies and losses be identified, accepted as expressions of Government policy, and reimbursed to the railways from the public purse."<sup>10</sup>

*Question 4.*

As regards future operations, depreciation should be shown in an expanded statement of income and expenditure, similar to Appendix B in the annual report of the New South Wales Railways. Of course this would reveal that the provision for depreciation by the Victorian Railways is grossly inadequate.

Since July 1st, 1937, amounts totalling \$13.6 million have been set aside for depreciation. Most of this represents amounts authorized by Parliament from time to time, and the interest earned on an accumulation of these amounts which built up during the war years. In addition, a token amount of around \$600,000 a year has been provided for depreciation of railway assets in Victoria since July 1st, 1958. This comprises approximately \$200,000 a year charged against working expenses for depreciation of sundry equipment, and \$400,000 a year as a contribution to the Railway Renewals and Replacement Fund.

Each year the Victorian Railway Commissioners assess the depreciation which should be provided, based on the historical cost of assets still in use, but without allowing for obsolescence. Thus, the normal depreciation assessed for 1969-70 was \$7,756,000, but the amount actually provided was only \$560,000. The amount of depreciation under-provided has steadily accumulated, and by June 30th, 1970 totalled \$8,979,000.

By restricting the Victorian Railway's depreciation provisions to only nominal amounts, the Victorian Government has been able to avoid fare and freight increases which otherwise would have been necessary to provide funds for the replacement of assets. In fact the Victorian Government made it clear some years ago that lower rail charges and a less modern railway were preferable to higher charges and a more modern railway. Thus when speaking in the Budget Debate on September 30th, 1964, the then Minister of Transport (Mr. Meagher) remarked that Governments in Victoria had not been prepared to provide proper depreciation for the Victorian Railways, "because the only way an undertaking can provide for depreciation of its plant is to utilize surplus revenue for this purpose. Victorian transport services could obtain surplus revenue of any appreciable kind only by increasing fares and freights."<sup>11</sup> After admitting that the Victorian Railway's depreciation was grossly inadequate, the Minister went on to say that no Government had "been prepared to tell the people of Victoria that in order to have a modern railway service, they must be prepared to pay sufficient in fares and freights to make such a financial provision possible."<sup>12</sup>

But whilst rail users have enjoyed what has virtually been a hidden subsidy, the Victorian Railways has been adversely affected in several ways. First, the Railways has been forced to finance renewals and replacements from interest bearing loan funds. For example, in 1969-70 loan funds totalling \$16.0 million were allocated to the Victorian Railways, but only \$7.3 million was spent on capital works. The remaining \$8.7 million was spent on renewals and replacements. In fact, since July 1st, 1960 nearly \$94 million of interest bearing funds have been spent on renewals and replacements. This type of financing has intensified the interest problem of the Victorian Railways because it has meant the expenditure of loan funds on assets which do not contribute additional earning capacity towards meeting the interest charges on these loans. Second, the diversion of a large proportion of loan funds to maintenance and renewals has markedly reduced the level of investment by the Victorian Railways. In turn, this has had a serious effect on the competitive position of the Railways, because it has been forced to delay many new projects aimed at enlarging capacity, increasing productivity and lowering costs. To put the problem another way, if the Railway Department was granted the same amount of loan funds each year, but was able to employ the whole of these funds on capital works, instead of having to spend half or more on maintenance and renewals, it would be able to accelerate the following types of work :

- (i) provision of multiple tracks in the Melbourne suburban area,
- (ii) extension of automatic power signalling throughout the suburban area,
- (iii) centralization of signal boxes controlling the inner suburban lines,
- (iv) construction of additional new suburban trains (as distinct from replacements) to handle increased peak period traffic,
- (v) provision of heavier track, improved alignments, more and longer crossing loops, and automatic power signalling with centralized traffic control on main interstate and certain intrastate trunk routes.

10. G. F. Brown, "Identifying Australian Problems of Surface Transport", *Australian Transportation Conference*, Canberra, (March 24th, 1971), p. 7.

11. *Victorian Parliamentary Debates*, 1964-65, volume 300, p. 476.

12. *Ibid.*



## APPENDIX NO. 3.—PART E.

*The Institute of Chartered Secretaries and Administrators*

(AUSTRALIAN DIVISION).

VICTORIAN BRANCH.

PATRON  
HER MAJESTY  
THE QUEENE. Eugene Falk, F.C.I.S.  
Branch Secretary.327 Collins Street,  
Melbourne, Vic. 3000  
Telephone 61 3502

30th November, 1971.

The Chairman,  
Public Accounts Committee,  
Legislative Assembly,  
Parliament of Victoria,  
Melbourne, Vic. 3002

Dear Sir,

*Victorian Railways.*

We acknowledge your letter of 9th August, 1971 and have endeavoured to answer your questions as follows :—

1. *Form and Presentation of Accounts.*

(a) We agree with the view of The Institute of Chartered Accountants and the Australian Society of Accountants that “ the annual accounts of the Victorian Railways should be drawn up and presented on the basis of the same accounting principles and in the same manner as for any commercial undertaking ”. However, we consider that re-drafting the accounts would require a survey in depth of the method of operating and accounting generally, and of the various items presently appearing. We are inclined to suggest that it might be helpful to the committee to have such a survey carried out on a professional basis by an independent consultant or firm of consultants.

(b) To show the capital investment or net worth of the Victorian Railways it is suggested that the total investment by the State should be shown under one heading “ Funds provided by the State ”, and should differentiate between those which are interest bearing and those which are regarded as capital (i.e. no servicing cost). Details of the accumulated deficits should be grouped herein and the current deficit deducted from this total investment. Special Reserves would also appear under this heading.

(c) In our opinion the valuation of the assets from time to time on the basis of historical cost less the appropriate allowance for depreciation based on the economic working life of the assets is appropriate but in a number of commercial undertakings, for example the Broken Hill Proprietary Co. Ltd., charges are made to profits to provide for the increased cost of replacement. While we support this in principle, and suggest that it be thoroughly examined, we are not prepared at this stage to make a positive recommendation that such a provision is desirable or essential in the case of the Victorian Railways.

(d) There is insufficient information in the documents surveyed for us to express an opinion as to whether there are any charges not shown in the Victorian Railways accounts which should be included.

(e) We consider it desirable that the Auditor-General certify the accounts in similar form to that required for companies under the terms of the *Companies Act 1961*.

2. *Operation of Railways as a Commercial Undertaking.*

We would favour any proposal that railway finances should be separated from the State budget and draw the attention of the committee to the Constitution of the Australian National Airlines Commission. We consider that the financial constitution of this commission is a good example because—

- (a) it is a transport operator,
- (b) it borrows from the Commonwealth Government which raises money on its behalf, and
- (c) the accounts are presented on a commercial basis, more readily understood by the public and financial press.

3. *“ Social ” Charges.*

We consider that the railways should be reimbursed by the Government for charges of a “ social ” nature such as for decentralized industry and pensioner concessions and that such reimbursements should be disclosed in the financial accounts of the enterprise.

4. *Depreciation.*

We consider that depreciation should be included in working expenses as a cost and not omitted as at present. In principle we would agree that depreciation underprovided in past years should be written off the capital of the enterprise.

## APPENDIX NO. 3—PART E.—(cont.)

5. *Interest.*

We can see no reason for not charging interest on Government investment in undertakings of a commercial nature. It is a political decision as to whether all funds invested should bear interest or some portion should be regarded as capital (on which any surplus made is the return) and the balance interest bearing. As the State eliminates losses from general revenue, it appears that the Railways do not pay interest on past losses.

Interest should be charged at commercial rates in the accounts on the amounts as agreed and the basis of these charges set out in detail in the accounts.

6. *Insurance.*

The information presented is insufficient to enable us to offer any comment as to whether :

- (a) the provision of \$200,000 in the Railway Accident and Fire Insurance Fund is adequate, or
- (b) that the present policy of charging losses on account of fire and accident against working expenses is appropriate.

7. *Payroll and other taxes.*

In principle we support the view that Government commercial enterprises should bear payroll and similar charges, to be consistent with the view expressed in paragraphs 2 and 3 above.

We will be pleased to confer further with the Committee if requested.

Yours faithfully,

T. A. STEVENSON, F.C.I.S.,  
Victorian Branch Chairman.

## APPENDIX NO. 3.—PART F.

## TREASURY SUBMISSION.

## SUBMISSION TO THE COMMITTEE OF PUBLIC ACCOUNTS IN RELATION TO FINANCIAL PRINCIPLES TO BE APPLIED IN CONSIDERING THE ACCOUNTS OF THE VICTORIAN RAILWAYS.

This submission provides answers to seven specific questions raised by the Committee of Public Accounts in its letter of 27th January, 1972, in relation to the accounts of the Victorian Railways and comments on the replies to these questions furnished to the Committee by two individuals and two professional bodies.

The two individuals are,

Mr. G. R. Webb, Senior Lecturer in Economics, University of New South Wales, and  
Mr. G. T. Webb, Commissioner for Transport, Tasmania.

The two professional bodies are,

Institute of Chartered Secretaries and Administrators (Australian Division) Victorian Branch,  
and

A Joint Committee of the Australian Society of Accountants and the Institute of Chartered Accountants in Australia.

There have been three communications with the Committee of Public Accounts by Treasury in relation to the Committee's Inquiry into the Victorian Railways.

(i) At the outset the Committee of Public Accounts sought the views of the Director of Finance in relation to tentative terms of reference for an inquiry by the Committee into the Victorian Railways.

(ii) Later in September, 1972, the Committee received a comprehensive submission from Mr. E. C. Brownbill, in answer to questions put by the Committee in relation to his work in connection with the report of the Board of Inquiry into the Victorian Land Transport System and in relation to aspects of the Committee's Inquiry into the Railways.

(iii) On 3rd October, 1972, the Director of Finance provided the Committee with comments on certain recommendations made by the 1928 Royal Commission on Railways.

Quite apart from these three matters, the Board of Inquiry into the Victorian Land Transport System presented its report in January, 1972.

These three communications and the Report of the Board of Inquiry into the Victorian Land Transport System provide the background to this submission to the Committee of Public Accounts. Some of the points made in the three communications and raised in the Report of the Board of Inquiry, and which have application to the matters dealt with in this submission, are listed hereunder.

1. *Evidence given by the Director of Finance before the Public Accounts Committee on 18th May, 1971.*

(i) It would be a mistake to assume that the basic problem of the Railways lies either in management efficiency or accounting methods. The problem is not the method or manner of the presentation of financial statements and, although in certain ways things may be done better or differently, it is practically impossible for the Railways to turn out an attractive financial result however efficiently they are managed.

(ii) There are two basic problems which should be tested—

(a) The Victorian Railways have insufficient high density bulk freight traffic.

(b) The geography of the State has been shrunk by decisions under Section 92 of the Constitution.

If these problems are not examined and tested, the Committee will spend a lot of time chasing hares without getting to the fundamentals of the problem.

(iii) Whatever is done to trim off the undesirable features of the Railways system you still will not come up with a viable operating transport unit, because in my view it is not possible.

(iv) Transport experts have suggested that the South Australian and Victorian systems could be combined into a South-Eastern system which might be a viable unit. This holds interesting prospects and should be examined.

(v) If an answer to the Railways' problem is not found, the State itself will become an unviable unit because of the financial burden of carrying an unviable railway system.

(vi) A State Government is not really in a position to pass public transport subsidies on to the taxpayer because it has no access to adequate tax fields. The theory of public subsidies depends on government being able effectively to pass subsidies on to the community through a broad based tax system.

2. *Submission on 19th September, 1972, to the Public Accounts Committee from Mr. E. C. Brownbill.*

Mr. Brownbill replied in general terms to 21 specific questions. During the course of the submission, compensation or subsidies for "social" charges, net worth of the Railways, valuation of assets, depreciation and interest charges (all appearing again in the questions under discussion) were dealt with at some length.

## APPENDIX NO. 3—PART F.—(cont.)

3. *Comments provided to the Public Accounts Committee by the Director of Finance on 3rd October, 1972, on certain recommendations made by the 1928 Royal Commission on Railways.*

The Director's letter of 3rd October, 1972, is relevant in that in the course of commenting on 18 different matters, reference was made to two subjects which appear again in the questions now under discussion.

- (i) In reply to the comment "That railway finances be separated from the State Budget" the Director wrote—"I agree. What the State Budget ought to show is the subsidy provided by the taxpayer."
- (ii) The subject of depreciation was also raised and the comment there was that unless Railways' income exceeds costs, depreciation provisions would be merely book entries as there was nothing available to make a provision for depreciation.

4. *Report of the Board of Inquiry into the Victorian Land Transport System dated 7th January, 1972.*

(i) The role of the Railways in future should be to perform that part of the total transport task for which they have inherent advantages over road transport. They should be freed of tasks which are causing their annual deficits to grow and which can be taken over by road transport.

(ii) The Railways should be required to operate in such a way that their total revenues cover their total costs, including capital charges and proper provision for depreciation.

(iii) The Railways should function as a commercial undertaking with an appropriate corporate structure, determine their own fares and freight rates and the services they will provide, curtail or terminate. Subject to proper investment analyses, they should have access to capital funds.

(iv) Where the State, for reasons of social policy, decides that Railways' proposals to raise fares or freight rates or to curtail or terminate services are unacceptable, the Railways should be recouped the cost of complying with the decisions taken.

(v) Early tasks of the new corporate body should be to develop an overall financial management concept, to eradicate the philosophies and concepts related to the old railway monopoly days, institute effective cost determination procedures, to recast the fares and rating structure, to introduce personnel recruitment and other policies permitting external recruitment and emphasis on efficiency in promotion and to revamp the marketing function.

The Board's report makes it clear that the Board considers that the Railways can eventually operate as a viable unit. However this assumes that the Railways are compensated for losses on any service which it is required to maintain at Government direction. Therefore Government expenditure on subsidies to the Railways will increase. On the other hand the Board clearly expects that many uneconomic services will be curtailed or eliminated and there is also an inference that Railways' customers will pay higher fares and freights. The overall result should be that although the State will pay more in subsidies, eventually it will not have to meet operating deficits of the magnitude of recent years.

Decisions have yet to be taken as to the extent to which this report will be implemented but if it is reasonable to assume that certain fundamental changes are to take place in the Railways' method of operation, then it would appear to be premature for the Committee of Public Accounts to be considering the Railways' annual published accounts which after all represent the final result of an accounting system which has been described as inadequate by those who have studied it in depth. The Committee may be more profitably engaged in pursuing some of the matters raised in the Board's report which must be implemented if the Railways are to operate as a viable unit. Examples of matters suitable for the Committee's attention are :—

- (a) The structure of the General Rate Book has been virtually unaltered since 1925 and is based on last century traditions.
- (b) The Rate Book is hopelessly complicated.
- (c) Not knowing their costs, the Railways have been in no position to know what rates are necessary to cover costs.
- (d) Lack of cost information goes back to monopoly days and a captive market and the knowledge that Treasury will foot the bill.
- (e) Losses quoted by the Railways on country and suburban passenger services cannot be substantiated because present costing methods provide a questionable basis for determining profits or losses on different types of services.
- (f) Not knowing their costs of handling different types of goods, the Railways are in no position to know the consequences of seeking out traffic or taking action to discourage particular traffic.
- (g) The course of the future must surely be to ensure that funds made available to the Railways are concentrated on projects which will enable the Railways to maximize the efficiency of their services in areas where they have inherent advantages over road operators.

Rather than concentrating on improving the annual published accounts of the Railways, one would expect that the first priority for the Committee would be to analyse the more basic accounting and costing procedures with a view to instituting a system which overcomes the deficiencies listed above.

## APPENDIX NO. 3—PART F.—(cont.)

## ANSWERS TO QUESTIONS PUT BY THE COMMITTEE OF PUBLIC ACCOUNTS IN RELATION TO THEIR INQUIRY INTO THE ACCOUNTS OF THE VICTORIAN RAILWAYS AND COMMENTS ON OTHER SUBMISSIONS MADE IN RELATION THERETO.

1. *Form and Presentation of Accounts.*(a) *Accounting on a commercial basis—*

There is no reason why the Railways could not present their annual accounts in the same manner as, for example, the State Electricity Commission of Victoria, the Australian National Airlines Commission or any other large commercial undertaking. However this in itself will not change the final financial result.

The presentation of financial statements can no doubt be improved but this does not go to the root of the problem and the danger is that if too much attention is paid to this aspect then the fundamentals of the Railways' problems will not be analysed in sufficient depth. A viable operating transport unit is what is required and trimming off the undesirable features of an accounting system does not go far in achieving the required result.

In Treasury's view, changes in the form and presentation of accounts have little priority at this stage. Many desirable changes in accounting procedures may not even become obvious until the major problems of what is now a completely unviable unit are examined. It is therefore Treasury's view that changes in the physical operations of the transport unit will determine the extent of changes necessary in the presentation of accounts. It is fundamental that before changes in physical operations can be made, costing procedures must be analysed in depth and improved to ensure that the Railways have adequate information on costs in order to know what services are profitable and to produce an appropriate freight and fares structure.

Ideally, the Railways' accounts, when presented on a commercial basis, should show the operating result for each type of service provided. However it seems clear from the Report of the Board of Inquiry into the Victorian Land Transport System that the Railways do not have the necessary information on costs, and furthermore, present costing methods provide a questionable basis for determining profits or losses on different types of services.

Although there is a variety of ideas for improving the presentation of the Railways' accounts, the lack of adequate cost information would prevent any significant improvement. Therefore any exercise aimed at making the accounts more informative can be tackled only on the assumption that all the necessary costing data will be incorporated.

In summary, the Railways' accounts would be more informative if presented on a commercial basis, but the extent to which appropriate information can be provided will depend on a great deal of work being done in devising a system to provide adequate information on costs in specific service areas.

(b) *Capital investment or net Worth—*

The Railways' capital investment consists of the funds provided over the years by the State. At present funds provided for capital works from the proceeds of loans raised by the State and funds provided to finance operating deficits are in excess of the value of assets on an historical cost basis. In this situation the Railways' net worth must be negative.

If the Railways are to be reconstituted on a commercial basis to operate as a viable unit, the first step in the reconstitution would be to disregard existing valuations and previous losses, revalue assets on a going concern basis and assess an appropriate figure for loans which should reasonably be repaid.

(c) *Revaluation of assets—*

Although the present valuation of Railways' fixed assets is supposed to be based on historical cost, so many complications have developed over the years as a result of Railway accounting methods that figures at present in the "balance sheet" do not reflect the proper value of assets. In these circumstances a revaluation is essential, particularly as stated in (b) above as the first step in a reconstituted organization, and the revaluation should refer only to assets which are to remain in use and should have regard to their worth on a going concern basis.

(d) *Charges not shown in accounts—*

The Railways' equivalent of a commercial undertaking's profit and loss account i.e. the published statement headed "Summary of Financial Results", is abbreviated to such an extent that it is impossible for the reader to assess whether or not proper charges have been excluded. If the accounts are to be converted to a commercial basis then one would expect that there would be adequate disclosure of all proper charges.

(e) *Certificate of Auditor-General—*

The responsibilities of the Auditor-General are quite different to those of an auditor appointed under the Companies Act. The former has obligations to Parliament which are derived from the Audit Act and these obligations culminate in an annual report to Parliament. Where a statutory authority is involved, the Auditor-General may derive certain other obligations from the Act establishing that authority with the end result being a certificate on the authority's published accounts.

In the case of the Railways there is no relevant statutory requirement prescribed in the Railways Act and the Auditor-General has linked his certificate on the published accounts with a comprehensive summary of Railways' financial affairs as set out in his annual report to Parliament. As both the certificate and the report are directed to Parliament, Treasury can see no harm in the present practice of the Auditor-General as it surely results in more comprehensive information being presented to the Parliament by linking two documents which are freely available to Members.

## APPENDIX NO. 3—PART F.—(cont.)

2. *Operation of Railways as a commercial undertaking—Should Railway finances be separated from the State Budget ?*

In the present circumstances with the Railways making large operating losses and therefore unable to set aside any funds for capital expenditure, Treasury will continue to be called upon for finance for both operating and capital expenditure so long as the Railways remain a State responsibility.

Had the Railways been separated from the State Budget in previous years, Treasury would still have provided the same net funds and the overall State Budget result would have remained unchanged.

However Treasury does not disagree with the idea that the Railways operate as a commercial undertaking. So long as they remained the responsibility of the State, the Annual Appropriations could provide for subsidies rather than for working expenses as at present.

3. *“ Social ” Charges—As the Railways claim that they have to meet charges of a “ social ” nature, such as reduced rates for decentralized industry, pensioner concessions, losses on unprofitable passenger services, &c., should they be reimbursed by the Government for such charges ?*

The Railways' claim may be valid to a certain extent but further detailed work would have to be done to clearly establish the amounts involved. In addition the Government would have to be satisfied that operations are being conducted at the most economic and efficient level possible.

Of course one must realise that the reimbursement by the State of “ social ” charges would mean that Victorian taxpayers in general rather than rail users in particular would have to provide the necessary subsidy. However Victoria is in effect powerless to determine a community subsidy because it does not have access to adequate taxation measures.

In any event, the amount represented in subsidies to the Railways would only reduce the Railways' deficits at the expense of the State Budget. In Treasury's view any examination of the Railways' finances could not properly be divorced from the State's financial problems over-all transferring deficits from one part of the Budget to another is no answer.

4. *Depreciation—As depreciation is not at present included in working expenses how should it be dealt with for—(a) past accounts ; and (b) future operations ?*

The basic purpose of depreciation is to spread the capital cost of an asset over the accounting periods during the asset's estimated working life. Depreciation charged to each period reduces profits or, in the case of the Railways, increases losses. However it has no effect on cash—whether depreciation is charged or not has no influence on the Railways' cash losses.

However if the question is directed at setting aside funds for the replacement of spent assets or the purchase of new ones that is an entirely different aspect. With continual deficits, the Railways of course have been unable to set aside any funds and the depreciation question is purely one of book-keeping. Had depreciation been charged at correct rates, the Railways' book losses would have been larger and the assets would have appeared in the Balance Sheet at more realistic valuations but cash deficits would have been the same. As Treasury makes good cash deficits and also provides for capital expenditure, there is no purpose in pursuing the argument in regard to past accounts.

For the future, it is Treasury's view that all the Railways' assets should be realistically revalued and appropriate depreciation charged thereafter so that the operating result provides a true picture. However until the Railways operate profitably, this new procedure would have no effect at all on the provision of funds for the replacement of assets. That is a different question altogether.

5. *Interest—What principles should be associated with the charging of interest on Government investment in undertakings of a commercial nature ? Should these apply to the Victorian Railways ?*

If the Government provides the initial capital (equity capital) to establish a commercial undertaking, the Government is surely entitled to expect a return on that capital in the same way as a shareholder would expect a return on the equity capital which he subscribed. If the Government then provides further capital (repayable interest-bearing loans) for developing the business, it would be entitled to expect that these funds would be expended on income-earning assets and that the income would be sufficient to enable the undertaking to pay adequate interest to the Government.

These principles cannot possibly apply to the Railways in its present financial situation, nor do they apply to the State itself when our capital has to be expended on such non-income earning assets as schools, police stations and the like. However once the Railways are restructured one would expect that fares and freights would be set at a level which provided for the payment of interest and a dividend on equity capital.

6. *Insurance—*

(a) *Is the provision of \$200,000 in the Railway Accident and Fire Insurance Fund adequate ?*

(b) *Do you agree with the present policy of charging losses on account of fire and accident against working expenses ?*

In any organization which finds it desirable to accept its own insurance risks, it is also desirable to establish a fund from which fire and accident losses are to be met. The purpose of the fund is to spread such losses over accounting periods so that one period does not have to bear a disproportionate loss.

## APPENDIX NO. 3—PART F.—(cont.)

However the credits to the fund are still charged to working expenses and the amount charged to each period will be constant provided that the initial estimate of such losses is correct. Again, where the organization is conducted continually in deficit, this procedure whether desirable or not is not particularly meaningful and would remain so until the Railways operate profitably. The assessment of true profit would then become important and spreading fire and accident losses would be an integral part of the process of matching costs with income.

## 7. Payroll and other taxes—What charges of this kind should be included in working expenses ?

In a loss situation all taxes payable to the State could be omitted as they are only internal transactions within the State Budget. However as all concerned in examining the Railways' finances are aiming to ensure that the correct financial situation is disclosed, whether it be a sound situation or not, then it follows that payroll and other taxes paid should appear in the Railways' accounts. Even those which are not actually paid e.g. land tax, rates &c., could appear in the published accounts as noting entries.

*Comments on other submissions—*

The submissions from—

- (i) The Institute of Chartered Secretaries and Administrators,
- (ii) Mr. G. R. Webb,
- (iii) Mr. G. T. Webb, and
- (iv) The Australian Society of Accountants and the Institute of Chartered Accountants in Australia,

have all been studied by Treasury.

Generally speaking, their comments were found to be of interest and there does not appear to be any particular subject about which either Treasury or the four individuals or organizations have any significant disagreement. The submission from the Accountants was extremely thorough and obviously reveals the great deal of thought and preparation devoted to the subject.

However in the Treasury view there are two key issues which failed to receive adequate consideration in these submissions. The first is that before the Railways can produce financial statements which are meaningful in the widest sense, a great deal of preparatory work must be done in instituting a new system of costing and financial reporting to supply the necessary information.

The other point was that all four submissions failed to appreciate the inescapable fact that whilst the Railways are in a loss situation they must receive financial assistance from the State. Changes in the presentation of accounts will not change that fact or even assist in reducing losses—losses which these days are threatening the financial security of the State itself.

Treasury,  
31st October, 1972.

## APPENDIX NO. 3.—PART G.

## AUDITOR-GENERAL'S SUBMISSION.

*No. 1. (a) Re-draft of Balance Sheet and Revenue Account.*

A re-drafted Balance Sheet together with a Revenue Account is attached.

The Balance Sheet is very similar to that prepared by the Joint Committee of Accountants but shows a little extra detail in respect of funds provided by Treasury. The net of funds so provided differs by \$3,151,975 which amount is considered more appropriately grouped as a Current Liability. The erosion of the capital invested by the State is clearly shown.

In view of the similarity of the attached Balance Sheet to that of the Joint Committee any major differences are included in the following comments on the explanatory notes submitted by the Joint Committee.

*Comments on Joint Committee's notes to Appendix "A".**Note No.*

- 1 The \$3,151,975 is more accurately shown as a current liability. This is a temporary advance.
- 2 This is a reasonable description. It represents the unexpired portion of services paid for but not yet provided.
- 3 and 4 Agree with these comments.
- 5 and 6 Agree with this grouping.
- 7 Manufactured for stock. Any capital items will be included in fixed assets at time of issue from stock.
- 8 Agree no good purpose served by showing separately.
- 9 Showing the securities held would add to the information content of the Balance Sheet. Under present Treasury system of cash accounting, institution of a provision for doubtful debts would be impracticable.
- 10 Suggest be grouped as Current Assets—"Funds Held in Treasury Trust Accounts".
- 11 Agree with grouping.
- 12 Agree with grouping and comments.
- 13 Under the present system of Treasury accounting, of which Railways is a part, amortisation of these expenses cannot be made by the Railways. The figure shown for Railways is that portion of the total State discounts and expenses which Treasury has said relates to loan proceeds allocated to Railways.
- 14 Agree with method of charging.

*No. 1. (b) How should the capital investment or net worth of the Victorian Railways be shown ?*

By re-stating the Railways final statement in the form of the normal commercial type undertaking Balance Sheet, the ability to see the amount of the net worth of the department is provided.

The capital and other funds injected into the Railways are clearly defined including any moneys provided for special purposes outside normal capital requirements, such as in the case of the Railway Accident and Fire Insurance Fund. It should be borne in mind the Railways as such have no borrowing powers of their own.

In considering the total provided by the State from loan moneys, and which has been treated in the *pro-forma* Balance Sheet as injections of capital, regard must be had to the fact that these moneys have not necessarily been applied to capital purposes. To some extent this position was corrected—although arising from different considerations—as a result of the write off following the 1933 Nixon Committee report. By writing down the Railways loan liability, or actually by relieving the Railways from liability by transfer of a part to the State's general account, the State recognized that a substantial portion of the capital injected into the Railways was not represented by tangible and productive assets. That Committee was satisfied that correct accounting procedures had not been followed to relieve capital of the cost of abandoned or non-existent assets and the amount of liability transferred consisted of an estimate of the cost of these assets and an estimate of the loss of value of other assets through use. This latter amount was arrived at by endeavouring to compute the amount of depreciation which would have accrued on the remaining productive assets but which had not been provided. Subsequent to the Nixon Committee's report, the Renewals and Replacements Fund was established with the object of providing the funds for replacements and so avoid any inflation of capital through use of loan moneys for this purpose. The Renewals and Replacements Fund has not, however, been sufficiently solvent over the years to meet the costs of renewals and replacements, and loan moneys, as well as direct charges to revenue funds, have been applied. It has been possible to apply loan moneys in this manner as the relevant item in the Loan Application Acts, by its wording, allowed of such a charge. This means then that the very position which the Nixon recommendations sought to correct could well have been reached again—over-capitalization and the need to service borrowings, part of which were not represented by productive assets. (Item 5 loans, of course, were not serviced by the Railways).

A consideration of this method of finance could result in a conclusion of imprudence in the methods followed, but this conclusion must be considered in the light of the knowledge that this undertaking is by legislation another department providing a service to the public, the cost of providing such service being met from the Consolidated Revenue of the State, that all revenue earned by this undertaking is revenue earned on account of the Consolidated Revenue and that all Railway funds are Treasury funds. There is



## APPENDIX NO. 3—PART G.—(cont.)

nothing in the legislation which requires the Railways to be regarded as a commercial undertaking nor is there anything in the legislation which requires the usual methods of commercial financing to be applied. Any consideration of under-provision or non-provision of depreciation or of a method of providing for renewals and replacements, or of financing renewals and replacements from loan moneys should be made in the knowledge that generally in the Treasury system depreciation is not an item in the accounts which are cash accounts and that capital assets are replaced from fresh capital.

The position of the Railways accounts as part of the Treasury accounts has brought about the position mentioned by the Joint Committee of Accountants in para. 1.27. The only legislative requirement is for the Commissioners to prepare an annual statement of "moneys received and expended" but the annual statements have gone further than that by providing, in effect, an historical account of the provision of funds and their application towards the acquisition of fixed and other assets and the financing of operations and resultant deficits. I am inclined to view the present form of final statement as a reasonable compromise between the statement required by the legislation and a Balance Sheet expected to be produced by an undertaking of this size and nature. I do not disagree with the opinion expressed in para. 1.28 (division of funds) and the present statement would require few amendments to show the particulars mentioned.

In para. 1.29 the Joint Committee has clearly set out the accounting treatment of sinking fund contributions and loan redemption payments and points to what it regards as faults in the Railway procedures. The procedures followed by the Railways and the method of recording and reporting the loan and sinking fund position is, in my view, quite satisfactory when considered in the light of the statement required by statute to be presented—one of moneys received and expended—and when it is understood that the Railways of itself has no sinking fund and makes no loan redemptions. The Railways are required to include in the accounts as debt charges that part of the total contribution by the State to the National Debt Sinking Fund which relates to the Railways portion of the State's total loan indebtedness. The final statement would be wholly wrong if the Railways did not record the fact that against the loan advances received from the Treasury there is a part of the State's National Debt Sinking Fund which is "earmarked" as belonging to the Railways and available for redemption purposes in respect of that part of the State's debt which has been incurred through advances to the Railways.

As to inclusion of the contribution to the National Debt Sinking Fund in the revenue statement as a charge for the year, it should again be remembered that this is basically a statement of cash received and expended and not, as the Joint Committee seemed to regard it, a commercial type profit and loss statement. I think the comments of Fitzgerald in his "Form and Content of Financial Statements" on these two types of statement are appropriate. "In profit and loss statements, the distinction between 'pure' accounting and financial policy may be preserved by strict attention to such matters as accounting terminology (particularly the careful use of the terms reserves and provisions) and by consistent application of accounting doctrine: in revenue cash statements, financial policy exercises a positive influence in determining the facts recorded; and, since the statement is purely a record of facts, the distinction between 'pure' accounting and financial policy is necessarily blurred and difficult, if not impossible, to preserve."

*No. 1. (c) How should the assets of the Railways be valued from time to time?*

I read your Committee's question as meaning how the assets should be shown in the final statements as presented from time to time and I am of the opinion that generally the assets should be presented on an historical cost basis. I hold this opinion in full knowledge that the Balance Sheet does not at present show this basis—because of factors mentioned earlier such as over-capitalization of expenditure and failure to write out abandoned or replaced assets.

To enable the final statement to show the fixed asset position on as accurate a basis as possible, it would be necessary to undertake a complete review of all fixed assets to catalogue their existence and location, their position from a consideration of redundancy, their probable remaining life, whether they are of a depreciable nature or not, and their present day value. The factors mentioned by the Joint Committee in para. 1.38 are most relevant in determining present day value.

If this action were taken, the re-valuation of the assets would need to be followed by a review and, almost certainly, a writing down of the State's capital investment in the Railways. It would also mean that the opportunity would be present for a review of the annual depreciation assessment and the ability to place the Renewals and Replacements Fund on a basis where retirement &c., of assets could be treated in the accounts in the generally accepted accounting manner, and over-capitalization avoided. To implement the results of a revaluation, enabling legislation would be necessary, as was the case in 1936.

*No. 1. (d) Are there any charges not shown in the Victorian Railways Accounts which should be included?*

The comments of the Joint Committee and those of Mr. G. T. Webb cover fully those items which should, if accounts were required to be presented on a commercial basis, be provided for.

Non-inclusion of the full depreciation and the provision for accrued annual leave is fully disclosed in the final statement with the accumulated totals of the under-provision or the estimated liability being stated.

Inclusion of other items, except by way of note, while the accounts remain part of the Treasury system is impracticable.

*No. 1. (e) Should the Auditor-General certify the accounts in similar form to that required for companies under the terms of the Companies Act 1961?*

The comments of the Joint Committee in paragraphs 1.49 to 1.51 must surely be based on a complete misunderstanding of the statutory duty of the Auditor-General in relation to the final statement prepared by the Railways and included in its annual report presented to Parliament.

## APPENDIX NO. 3—PART G.—(cont.)

The Railway accounts are a part of the Treasurer's accounts and as such are included in the Treasurer's Annual Statement presented to Parliament accompanied by the full report on such accounts by the Auditor-General. There is no statutory requirement for the Auditor-General to certify to any other statement of accounts prepared by the Railways.

However, the Auditor-General has taken the attitude that as the statutory statement of "moneys received and expended" is presented to Parliament as an integral part of the Railways Annual Report, Parliament should be made aware of the fact that the accounts from which it was prepared have been audited and fully reported upon with or without qualification. The endorsement by the Auditor-General on the final statement is designed for this purpose and, in an endeavour to assist Parliament in its consideration of the Report, the endorsement indicated that the statement of account is only complete when read in conjunction with the audit comments referred to and to be found in the Auditor-General's Annual Report to Parliament. The Joint Committee has confused the Auditor-General's endorsement with an audit report and certification.

The implied suggestion in para. 1.52 of the Joint Committee's notes that responsibility for the audit of the Railway accounts should be shared by the Auditor-General with outside public accountants could only be based on a misunderstanding of the fact that these accounts are part of the public accounts. No suggestion could be entertained that the public accounts should be audited other than by the Auditor-General.

If the Railways were constituted a separate statutory authority with accounts prepared on a commercial basis, I would agree with the comments of Mr. G. T. Webb at page three of his notes.

I see no advantage in trying to apply companies legislation which has been designed for application to a particular type of enterprise with particular types of interested parties, financial and otherwise, and with a different motivation to an entirely different type of enterprise with different sources of funds, powers, duties, and motivation such as a government or semi-government authority.

*No. 2. Should Railway finances be separated from the State Budget ?*

I consider it inappropriate that I express an opinion on this question as the inclusion or otherwise of the finances of any undertaking in the State Budget is a matter of government policy and decision. I hold this opinion in the full knowledge that, at the 1928 Royal Commission on Railways, the Auditor-General of the time, Mr. J. A. Norris, in evidence before the Commission expressed definite views on the matter.

Other authoritative references may be found in the Nixon report and the Elliott report.

*No. 3. As the Railways claim that they have to meet many charges of a "social" nature, such as reduced rates for decentralized industry, pensioner concessions, losses on unprofitable passenger services &c., should they be reimbursed by the Government for such charges ?*

While the Railways finances continue to form part of the total State's finances, and if these "social" charges are borne by the Railways in keeping with a governmental policy that they form part of the public service provided by the department, I see no reason for any change in present practice.

However, if the Railways finances were to be completely separate from the State Budget and the public accounts, and were to be subject to separate budget provision, I consider then that reimbursement would be justified. If reimbursement were not made, the separate accounts would need to include and show the charges so borne.

*No. 4. As depreciation is not at present included in working expenses, how should it be dealt with for—(a) past accounts ; and (b) future operations ?*

Part only of the assessed annual charge for depreciation is charged against working expenses. The amount under-provided for the year and the accumulated under-provision to date are fully disclosed in the final statement presented to Parliament.

The development of this position has been covered in notes on earlier questions (1 (b) and 1 (c)) and any question of dealing with past under-provisions would be dependent upon decisions taken and any legislation that might be passed to adjust the loan liability and the fixed assets value.

In regard to future operations, if the Railway accounts are to remain part of the Treasurer's accounts, and if funds to the full extent of the assessed provision continue, as at present, not to be made available for placing in the Renewals and Replacements Fund, I see no advantage in altering the present system of charging working expenses to the extent possible and recording by note on the final statement the accumulated under-provision. I see no reason why the entry to incorporate the under-provision should be included in what, after all, is primarily a set of cash accounts and part of the overall cash accounts of the Treasurer.

If the finances and accounts were to be completely separated from the Treasury, it would be necessary, as stated elsewhere, for a revaluation of assets to be made and for the accounts to be kept on a commercial basis. In this event, the full amount of the assessed depreciation would require to be charged against the year's operations. The year's charge would be quite independent of the amount (if any) available for funding purposes.

*No. 5. What principles should be associated with the charging of interest on Government investment in undertakings of a commercial nature ? Should these apply to the Victorian Railways ?*

If the Railways were to be constituted as a separate undertaking designed to "stand on its own feet", freed from Treasury finances and influence and divorced from any thought that it was required, as part of its undertaking, and at its cost, to provide or subsidize a community or public service, then some case could be made for charging a notional rate of interest on the State's investment of moneys other than borrowed moneys.

## APPENDIX NO. 3—PART G.—(cont.)

A notional interest charge would be primarily for use as a measuring stick to gauge the return on the State's investment, but the same result could be obtained by applying to the State's investment the final revenue result. The 4 per cent. contribution to the Consolidated Fund based on its revenue and made by the Gas and Fuel Corporation is somewhat akin to the principle of a charge on the State's investment.

It goes without saying that any moneys advanced by the State for capital purposes from the proceeds of loans raised by the State should carry an appropriate interest rate. The rate would depend on the source from which the moneys were provided and would be either the specific rate applicable to the particular loan from which the advance was made or the average rate on State borrowings where the source could not be identified.

No. 6—

- (a) *Is the provision of \$200,000 in the Railway Accident and Fire Insurance Fund adequate ?*  
 (b) *Do you agree with the present policy of charging losses on account of fire and accident against working expenses ?*

If the Railways are regarded as being self-insured, expenditure over a period of years on accident and fire claims shows that the \$200,000 fund is inadequate. This was the limit fixed for the fund when established in 1891 and when it was solely for the purpose of accident claims, not fire. The extension of the fund to fire claims as well, and the retention of the limit at its 1891 figure would serve to indicate a state of inadequacy.

If any other course were available, I would prefer fire and accident claims not to be charged against the year's operations. Under present circumstances, the Railways has no alternative but to charge the year if the Railway Accident and Fire Insurance Fund is to be retained as at present. Perhaps this position could be met if an appropriation of a fixed amount for credit to the Fund were provided each year.

No. 7. *What charges of this kind should be included in working expenses ?*

As presently constituted with its accounts being a part of the Treasury accounts and funds for meeting working and other expenses forming part of the Annual Appropriation Act, it will depend entirely on the way in which Parliament appropriates funds for taxes payable by Railways, whether or not such taxes will lodge as a charge against working expenses. In the Estimates for 1972/73 an item No. 2 has been provided in subdivision 1 of Division No. 750 for Railways payroll tax and, of course, all charges of this nature would lodge in this item. Item No. 1 of the same subdivision is the appropriation for working expenses excluding payroll tax.

If the Railways were to be constituted a separate statutory body with its finances and accounts separate from the Treasury, I would expect to find all taxes payable by the Railways included in the working expense charges for the year. The taxes that would be payable by such a statutory body would be a matter for government decision.

*Brief comments on the summary of recommendations of the Joint Committee of Accountants, pages 26–30.*

- Paras. 3.1, 2.3, 1.4, 1.6, 1.11 The Railways, by legislation, is not a commercial undertaking and while part of the Treasury accounts these recommendations are not wholly practicable. If government decision to constitute as statutory authority separate from State finances and Treasury accounts, I would agree with the recommendations re commercial accounting and the observance of basic accounting concepts.
- Paras. 1.16, 1.17, 1.18 These are matters for administrative decision.
- Paras. 1.21, 1.22 These are statutory accounts and, in my opinion, warrant inclusion in a report to Parliament.
- Paras. 1.24, 1.25, 1.26 Although matters for administrative decision, I agree with the recommendations.
- Paras. 1.6, 1.28 I agree with this re-grouping of funds.
- Para. 1.29 While part of the Treasury accounts, the recommendations are not practicable.
- Paras. 1.30, 1.33, 1.39, 1.37 A matter for government decision. I agree it would be a desirable course.
- Para. 1.41 I do not agree with suggestion of periodical valuation.
- Paras. 1.42, 1.43, 1.44, 1.45, 1.48 Agree if Railways constituted as separate statutory authority.
- Paras. 1.50, 1.51 Recommendation based on a misunderstanding of the Auditor-General's endorsement on the funds statement.
- Paras. 3.2, 3.3 A matter for government decision. If constituted as separate authority, should be incorporated and clearly shown in the accounts, whether reimbursed or not.
- Paras. 4.1 to 4.9 While part of Treasury accounts, these recommendations should not be implemented. The ability to fund the assessed depreciation is linked with State Budget provisions, and the present method of disclosing the annual and accumulated under provision is, in my opinion, a satisfactory procedure within the confines of the Treasury cash system of accounting.  
 If created a separate statutory authority, I would agree that the recommendations should be adopted as they conform with accepted accounting practices.
- Paras. 5.1 to 5.5 While part of Treasury accounts, I would not support these recommendations. They would have my agreement in relation to a separate statutory body.
- Paras. 6.1 to 6.4 Generally agree with these recommendations.
- Para. 7.1 I agree.



VICTORIAN RAILWAYS.  
REDRAFT OF BALANCE SHEET AS AT 30TH JUNE, 1970.

	\$		\$		\$
FUNDS PROVIDED BY STATE TREASURY—					
For Capital Purposes—					
Non-Interest Bearing .. .. .	151,834,058				316,168,294
Interest Bearing .. .. .	278,405,485				46,530,940
Less Equity in National Debt Sinking Fund .. .. .	430,239,543				269,637,354
	62,080,117				107,286,779
	368,159,426				431,960
For Special Purposes—					1,034,940
Non-Interest Bearing .. .. .	48,569,985				..
Interest Bearing .. .. .	4,791,854				..
Less Repayments .. .. .	53,361,839				..
	870,701				..
	52,491,138				378,391,033
	420,650,564				9,401,771
For Revenue Deficits and Sundry Purposes—					
To 30th June, 1969 .. .. .	176,833,883				7,061,971
Deficit 1969–70 .. .. .	20,998,227				7,413,051
	197,832,110				2,918,942
Deduct—					
Accumulated losses to 30th June, 1969 .. .. .	171,979,111				744,048
Loss 1969–70 .. .. .	21,083,603				1,050,000
Add—Depreciation not provided in accounts .. .. .	193,062,714				7,159,328
	87,979,849				8,209,328
	281,042,563				4,076,015
	337,440,111				..
RESERVES—					
National Debt Sinking Fund .. .. .	62,080,117				..
Accident and Fire Insurance .. .. .	200,000				..
Uniform Rail Gauge .. .. .	870,701				..
CURRENT LIABILITIES—					
Accounts Payable .. .. .	9,786,163				..
Revenue in Advance .. .. .	604,536				..
Security Deposits .. .. .	6,541				..
Repayable Advances from Public Account .. .. .	3,151,975				..
	13,549,215				..
TRUST—					
Bank Guarantees &c. .. .. .	4,076,015				..
	418,216,159				418,216,159

## APPENDIX NO. 3.—PART (H) (i).



Telephone 654 4455

100 Exhibition Street,  
Melbourne, Vic. 3000  
13 September, 1972

Mr. A. V. Bray,  
Secretary,  
Public Accounts Committee,  
Legislative Assembly,  
Parliament House,  
Melbourne, 3002.

Dear Mr. Bray,

*Victorian Railways.*

I acknowledge your letter, 6th March, 1972, enclosing questions relating to the financial accounts of the Victorian Railways and copies of the replies received from other parties. I have not replied earlier awaiting the one other reply to your questionnaire referred to in your letter. However, time is moving along and I feel I should submit the following.

1. *Form and Presentation of Accounts.*

(a) What the Australian Society of Accountants and the Institute of Chartered Accountants mean by "same accounting principles and in the same manner as for any commercial undertaking" is difficult to know as this can mean many things and vary between sections of the "commercial world"—we, however, accept the principle as we understand it in the most general sense of the expression. We begin in this way to accent one matter, the special nature of the Railways which cannot be viewed in the broad and general terms often used in the "commercial world". We believe that the Victorian Railways' Annual Accounts should—

identify and show all costs.

relate the cost of earning revenue to that revenue.

show the profit or loss on operations for all major types of services, for example—

Passengers	—suburban country interstate
Parcels	—suburban country interstate
General Goods	—suburban country interstate

Livestock

identify in so far as this is practicable, the costs of granting concessions which would not be granted by the Railways for the reason of attracting increased net revenues.

give a true and fair view of the results of the business of the Victorian Railways for the period under review and of its assets and liabilities at the end of the accounting period.

The establishment of the "true and fair" value for the assets of the Victorian Railways will be initially a considerable task. A general statement would not be appropriate. The job must be done by investigating the age, use and operational profitability of each class of assets.

As the Victorian Railways are currently operating at a substantial annual deficit, there are grounds for adopting a liquidation approach to the valuation of the business. This would result in writing the assets down by large amounts. Much of what was written off would, in truth, really be depreciation not charged against revenue in previous years.

We believe that such an approach is necessary to put the Victorian Railways on to a firm footing so that they can be operated on a proper basis into the future.

(b) The capital investment in the Victorian Railways should be split to show "interest bearing" and "interest free" funds.

(c) The question of initial revaluation of the Railways' assets has been alluded to in 1 (a) above. Once a new starting point has been established, future asset values for account presentation should be determined by cost and depreciation based on each asset's economic life as determined by standard methods.

(d) Clearly, the most important factor not adequately treated in the Railways' accounts is depreciation.

(e) As we see it, the Companies Act, as such, has no special relevance to the Railways—the Railways are a unique organization.

## APPENDIX NO. 3—PART H.—(cont.)

The Auditor-General has an obligation to Parliament to audit the Railways' Accounts and they should be certified by him in a similar manner to other State Authorities such as the State Electricity Commission of Victoria.

There are perhaps conflicting problems in the proper disclosure of precise accounting and statistical information by a Government Authority and safeguards necessary for Railway management to be protected from "one way" disclosures where they operate in a competitive area. The balance of these problems must be solved so that the Parliament will be provided with adequate information. I suggest, however, that care must be taken in this matter.

2. *Operation of the Railways as a commercial undertaking.*

It is desirable that the Railways operate as a commercial undertaking and that, as far as possible, its finances be separated from the State Budget.

However, care must be taken to place and maintain the Railways in a competitive position with the road transport industry in the transport arena.

The road transport operator depreciates his vehicles in accordance with the rates of depreciation allowable by the Commonwealth Commissioner of Taxation and pays portion of his track costs in road charges each year.

The present system whereby the Treasury announces the funds to be provided for the Railways at the beginning of the period and accepts responsibility for the Railways' annual deficit requires review. This situation takes no cognizance of who benefits from the provision of railway services at less than cost, fails to reflect the commercial efficiency of the Railways and may have adverse effects on management incentives.

With the same total funds provided at the beginning of the period and greater flexibility given as to the allocation of these funds to costs and capital expenditure, it is possible that the operation of the Railways could be made more capital intensive and the position improved.

The method of annual allotment of capital funds without guarantee into the future also requires examination with accent on the possibility of the Railways receiving their own funds as part of an allocation from a specially raised Transport Fund.

3. *"Social" Charges.*

Yes, to maintain a competitive situation between road and rail transport and make the best use of the State's transport resources, the Railways should be reimbursed by the Government for charges of a social nature—that is reimbursement for functions undertaken at the direction of the Government. This reimbursement must be on a basis which maintains management incentive and not be on a straight reimbursement of loss basis.

Before these charges can be accurately calculated, the Railways' costing system must be improved.

There is also a need for further research in these areas to ensure that the maximum social benefits are provided at the minimum cost to the Government.

4. *Depreciation.*

The need to include depreciation in working expenses has already been stated and the treatment of depreciation in past and future accounts has been mentioned in answers to previous questions.

The final treatment of depreciation is dependent on acceptance of the principles outlined earlier in this letter.

However, positive steps must be taken otherwise the Railways' Accounts will continue to reflect an unrealistic valuation of assets.

5. *Interest.*

The charging of interest on Government investment in undertakings of a commercial nature is a matter of policy to be decided by Parliament.

However, in relation to track costs, if as we believe desirable, costs of operating the Victorian Railways are to be used as a basis for determining further capital investment in transport facilities and allocation of traffic as between modes—

it is desirable that the Government adopt a common interest policy for funds made available to both modes of land transport.

a bold approach to adjust the past must be accepted.

6. *Insurance.*

(a) It would be prudent to increase the \$200,000 currently provided in the accounts as "Railway Accident and Fire Insurance Reserve".

(b) In accordance with clause 118 (3) of the Railways Act, no money is paid into the Fund once it reaches \$200,000.

This may cause operating results to be distorted in years of high and low claims experience. Amounts charged to operating expenses for this item have varied by over 40 per cent. during the last four years from \$1,497,062 to \$2,115,823.

It is preferable that—

actual costs be charged to the Reserve with working expenses being charged each year with an average amount based on claims experience over a number of years.

ability be given to insure with commercial companies where this is deemed beneficial.

## APPENDIX NO. 3—PART H.—(cont.)

7. *Pay-roll tax and other taxes.*

We support the current procedure followed by the Railways of including pay-roll tax in working expenses.

This letter contains a brief discussion of most complex matters. Should the Committee wish further information on any particular subject we would, of course, be very pleased to expand on any specific question.

One final general comment—In the question of subsidies and provision of capital there is good argument for these amounts being provided from a transport fund—the Railways cannot be treated in isolation from other forms of land transport.

Yours faithfully,

G. J. MEECH,  
Director of Transport.

## APPENDIX NO. 3.—PART (H) (ii).



Telephone 654 4455

100 Exhibition Street,  
Melbourne, Vic. 3000  
31st October, 1972

Mr. A. V. Bray,  
Secretary,  
Public Accounts Committee,  
Parliament House,  
Melbourne, 3002.

Dear Mr. Bray,

I refer to your letter, 5th October, enclosing a Report on the Accounts of the Victorian Railways submitted by a Joint Committee of the Australian Society of Accountants and the Institute of Chartered Accountants in Australia.

We have now had the opportunity to study the Report. We find ourselves in general agreement with the major points raised by the Joint Committee of Accountants.

It would seem to us that many of their recommendations are in line with the comments made in our letter to the Committee on 13th September, 1972.

I trust that our submissions and comments have assisted the Committee with its inquiry.

Yours faithfully,

G. J. MEECH,  
Director of Transport.



VICTORIAN



RAILWAYS

In your reply please refer to : 114

RAILWAYS ADMINISTRATIVE OFFICES ☐ 67 SPENCER STREET, MELBOURNE 3000 ☐ TELEPHONE 6 1001 EXTENSION 1055

31st October, 1972.

The Secretary,  
Public Accounts Committee,  
Legislative Assembly,  
Parliament House,  
Melbourne, 3002.

Dear Sir,

As requested, the comments of my Commissioners are attached in regard to the Report of a Joint Committee of the Australian Society of Accountants and The Institute of Chartered Accountants of Australia, forwarded with your letter of 5th October.

Where appropriate, additional comment has been furnished in regard to the documents forwarded with your letter of 1st February.

Generally speaking, the views of the Commissioners in regard to the specific questions propounded by your Committee are incorporated in these comments.

At the outset the Commissioners would emphasize that their Annual Report is a report to Parliament in accordance with the requirements of the *Railways Act* 1958. It is significant that there has been a singular lack of inquiry seeking explanations of the contents which suggests that to those who are interested the report is self-explanatory.

All our financial activities are subordinate to Parliament, through the Treasury, and while that situation remains unchanged, the general content and presentation of accounts will be strongly Treasury oriented. However in successive annual reports attention has been directed to the desirability of separating the strictly commercial activities of the service and those more related to what we regard as social service activities ; also the untenable practice of using interest bearing funds for renewals and replacements. It has evinced no response from either Parliament or the Treasury.

However it will be noted from our comments that the related subjects of capital indebtedness, interest, asset valuation, depreciation, financial treatment of renewals and replacements, restructuring of the balance sheet, and the form and presentation of the accounts and financial statements are currently the subject of intensive studies which will take some time to complete. In the meantime, the Commissioners feel that it would be inappropriate to commit themselves to firm views on many of these aspects.

Furthermore it should not be overlooked that legislation now before the Legislative Assembly involves a fundamental change in the management controlling the Victorian Railways, although no variation is proposed in the financial control nor is any indication given of the role of the railways either commercially or otherwise. Without this we are unable to move with any degree of certainty and confidence.

Nevertheless we venture to suggest the conditions which must be satisfied if the railways are to function even partially as a commercial undertaking.

Paramount among these is the prescription of at least some degree of administrative and financial autonomy for the Railways. However, for two important reasons, namely, the poor physical condition of many railway assets because of inadequate past provisions for depreciation, and the many social objectives which the Railways, as an instrument of Government policy, are required to pursue, this in turn would be dependent upon fulfilment of the stipulations outlined in our comments on Mr. G. R. Webb's proposals and repeated below :—

- (i) adequate and specific reimbursement for the cost of implementing social objectives ;
- (ii) adequate provisions for depreciation as a cost ;
- (iii) a ' fresh start ' approach in respect of railway indebtedness, interest charges, &c. ;
- (iv) an adequate infusion of funds over a reasonably short period to replace assets which are obsolete, or costly to operate and/or maintain ;
- (v) suitable financial arrangements, including appropriate provision of interest-free funds, for future renewals and replacements expenditure.

Yours truly,

C. S. MORRIS,  
Secretary for Railways.

## VICTORIAN RAILWAYS.

## COMMENTS OF THE VICTORIAN RAILWAYS COMMISSIONERS ON REPLIES TO THE PUBLIC ACCOUNTS COMMITTEE'S QUESTIONNAIRE REGARDING THE VICTORIAN RAILWAY ACCOUNTS

For convenience this commentary is divided into sections as under :—

## SECTION A.

Comments on the specific recommendations contained in paragraph nine on pages 26–30 of the Report of a Joint Committee of the Australian Society of Accountants and the Institute of Chartered Accountants in Australia (for reference purposes these recommendations have been numbered from 1 to 49).

## SECTION B.

Supplementary comments on matters referred to in the body of the Joint Committee's Report but not included in the specific recommendations.

## SECTION C.

Comments on suggested financial statements (Appendices 'B' and 'C' to the Joint Committee's Report).

## SECTION D.

Comments on views conveyed in reports attached to Public Accounts Committee's letter of 1st February, 1972 (comments made in Section A in regard to similar matters are not, in general, repeated).

\* \* \* \* \*

## SECTION A.

Comments on the specific recommendations contained in paragraph nine on pages 26 to 30 of the Report of a Joint Committee of the Australian Society of Accountants and The Institute of Chartered Accountants in Australia (for reference purposes these recommendations have been numbered from 1 to 49).

1. *The accounting for the Railways should proceed from the notion that the Railways are, in fact, a business undertaking : (para. 3.1).*

In agreeing the Commissioners point out that it is quite notional because—

- (i) the present Railways Act does not specify commercial objectives ;
- (ii) the existing financial arrangements are not suited to a commercial undertaking ;
- (iii) a prerequisite is that funds are made available to upgrade and modernize railway services to competitive standards and that heavy duty road vehicles be required to meet their true road costs or the railways be relieved of track costs to a similar basis.
- (iv) substantial amendment to the Railways Act, giving the administration freedom to follow its business judgement, would be necessary before commercial objectives could be pursued.

2. *The Railways should be treated as a separate accounting entity instead of being dealt with as part of the Treasury complex : (para. 2.3).*

The Commissioners agree that this is essential to operation of the Railways on business lines and to a fully management-oriented accounting and costing system.

3. *Consideration should be given to reconstituting the Railways as an independent public authority : (para. 2.3).*

This can only be determined after the role of the Railways has been defined by Parliament.

4. *The annual Railways accounts should be drawn up and presented on the same basis and in the same manner as the accounts for commercial undertakings : (para. 1.4).*

The comment under recommendation 3 also applies.

This seems to conflict with recommendation 7.

5. *The accounts should follow as far as possible the classifications and terminology ordinarily adopted in the published reports of commercial undertakings : (para. 1.6).*

The Commissioners point out that the Railway accounts represent a report to Parliament and not to the shareholders of a commercial undertaking. However, there would be merit in distinguishing between "permanent" investment and loans which are specifically repayable. This would distinguish between funds which should be free of interest and those subject to interest charges.

6. *The accounts should give full recognition to such basic accounting concepts as matching cost and revenue, accruing known liabilities and providing for expected liabilities, determining details of disclosure and presentation according to the materiality of the items in question : (para. 1.6).*

The Commissioners would like some clarification before commenting.

7. *The accounts should disclose the contributions from each major area of operations to the total operating result : (para. 1.11).*

The Commissioners agree in principle. However, it would be preferable not to incorporate information on the financial results of specific areas of operation but to show this in a separate statement. The major reason is that extensive apportionments of costs and resources are involved, many of which would

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have to be allocated on the basis of statistical samples. Therefore, they should not form an integral part of audited profit and loss accounts. The question of budgeting for and reviewing progress of financial results in specific operating areas (which would differ from those suggested in the report) is currently being investigated.

8. *The “ Reconciliation of the Railway and Treasury Figures ” should be deleted from the published accounts : (para. 1.16).*

The Commissioners agree. The need for any such statement would disappear if the Railways were a separate accounting entity.

9. *The “ Statistical Statement ” should be extended to cover key aspects of operating costs : (para. 1.17).*

The Commissioners could not agree to publication of information which would prejudice its competitive position.

10. *Operating statistics which accompany the accounts should be so designed that they can be readily used in intersystem comparisons : (para. 1.18).*

The Commissioners know that indices in general use are misleading. Operating conditions and traffic patterns vary so widely from System to System that uninformed readers of Reports have drawn very misleading conclusions from such comparisons. In deciding what figures to produce and publish in Victoria, the needs of the Victorian Railways must be the prime consideration.

11. *The “ Railways Stores Suspense Account ” should be deleted from the published accounts : (para. 1.21).*

The Commissioners agree that the major significance of this account is internal.

12. *The statement on the “ Railways Renewal and Replacement Fund ” should be merged with the “ Statement of Capital Expenditure ” : (para. 1.22).*

13. *The “ Statement of Capital Expenditure ” should be redesigned : any comparative figures given in this statement should be averages over an extended period : (para. 1.24).*

The whole question of treatment of renewals and replacement is bound up with a review, now in progress, of asset values, depreciation and associated matters, including restructuring of the balance sheet.

14. *Amounts quoted in the accounts and supporting schedules should be in round dollars : (para. 1.25).*

The Commissioners have no objection.

15. *The annual accounts should be accompanied by a summary of financial and operational highlights for an extended period : (para. 1.26).*

The Commissioners consider that this should be deferred until a “ fresh start ” basis of accounting has been in operation for a sufficient period.

16. *The financial basis of the Railways should be reconstructed so that there will be a distinction between capital permanently invested in the Railways, and loan funds including current advances from the Treasury, carrying a definite liability to repayment : (para. 1.6, 1.28).*

Proposals for a restructured financial basis for the Railways will be developed following completion of the review referred to under recommendation 13.

17. *Loan repayments and contributions to loan sinking funds should be made and recorded in the accounts only if there are sufficient cash funds available for this purpose from profits or a sale of fixed assets : (para. 1.29).*

The National Debt Sinking Fund is not strictly analogous with ordinary sinking funds, and presents complexities which require special consideration.

However, any cash available from sale of assets might preferably be reinvested in the business. It would be a matter of judgment according to circumstances at the time.

18. *Loan repayments and contributions to loan sinking funds should be treated as an appropriation of cash funds and should be reflected only in the balance sheet as a reduction of loan liabilities with a corresponding reduction of cash assets ; they should not be considered as an item of financial expense and should not be included in the profit and loss statement as a charge against revenue : (para. 1.29).*

See comment on 17 above.

19. *If the present method of accounting for contributions to the national debt sinking fund is prescribed by law, a change of the law should be sought to permit a more meaningful accounting treatment : (para. 1.29).*

It is pointed out that the present arrangements flow from the Commonwealth/States financial agreement of 1927.

20. *Accumulated losses of past years should be written off with a corresponding adjustment to capital account : (para. 1.30).*

The Commissioners agree. They consider it most important to have a “ fresh start ” approach in any reconstruction of Railways accounts.

21. *All fixed assets should be revalued and book amounts in excess of valuation should be written off with a corresponding adjustment to capital account : (para. 1.33, 1.39).*

22. *As a general rule, present-day values should be used for the purpose of such revaluation : (para. 1.37).*

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23. *All fixed asset values should be reviewed periodically ; (para. 1.41).*

See comment under recommendation 13. The whole matter is exceedingly complex, but the approach includes consideration of these principles.

24. *In the valuation of stocks and stores proper allowance should be made for obsolescence, particularly in the area of maintenance spares : (para. 1.42).*

In general, this is the current practice.

25. *Provision should be made for long service leave liabilities : (para. 1.43).*

The Commissioners agree.

26. *Provision should be made for doubtful debts and be shown as a deduction from gross book debts : (para. 1.44).*

Credit arrangements with freight forwarders include the lodging of suitable Bank guarantees and doubtful debts are accordingly small. The provision made would be quite insignificant in relation to the total annual income.

27. *Pension fund contributions should be determined on the basis of regular actuarial assessment : (para. 1.45).*

The Commissioners agree that this is the correct approach for a normal business, but in the case of a permanent entity such as the Railways they consider that the more practical approach is for their employers' liability for payments to the Superannuation Fund to be met as it falls due, particularly in the light of the long time it has operated that way.

28. *The accounts should show, by way of note, the annual rental value of Crown land made available to the Railways : (para. 1.48).*

The Commissioners cannot see what justification there is for this proposal or what practical purpose it would serve. The staff whose time would be engaged in preparing the necessary assessments would be far better employed in measures to augment the Department's annual revenue from the leasing of surplus lands.

29. *The audit report attached to the Railways accounts should be complete within itself : (para. 1.50).*

30. *Legislation should be amended, as necessary, to permit such an audit report to be furnished : (para. 1.51).*

The Commissioners think these are matters for the Auditor-General.

31. *The Railways should be subsidised fully in respect of all services to be maintained in the public interest as rates which will not allow the Railways to cover their costs : (para. 3.2).*

32. *Such reimbursements should be disclosed separately in the profit and loss statement : (para. 3.3).*

The Commissioners agree. Such reimbursements, which must include full depreciation, are an essential prerequisite to operation of the Railways as a commercial undertaking, and must be wide enough in their scope to cover the financial effect on railway revenue or expenditure of any Government interference with the business judgment of the Railway administration. Wherever practicable, these reimbursements should be specific in nature.

33. *If there are no reimbursements or if the reimbursements do not fully cover the cost of the respective services, the unrecouped portion of such cost should be disclosed in a note to the accounts : (para. 3.3).*

The Commissioners are strongly of opinion that full reimbursements are essential to the effective operation of a commercial undertaking. The suggestion of the Committee would not assist the Railways in the vital financial aspect of funding some at least of its capital expenditure from internal resources.

34. *Following a revaluation of fixed assets, the Railways should thereafter be required to make proper depreciation charges before arriving at the result for any period : (para. 4.1).*

The Commissioners agree full depreciation should be provided.

35. *No depreciation adjustments should be made in respect of past financial years : (para. 4.2).*

The Commissioners have not yet reached a conclusion on this aspect, which is associated with the current study referred to under recommendation 13.

36. *Depreciation charges should be determined by the straight-line method : (para. 4.5).*

37. *Depreciation rates should be reviewed periodically : (para. 4.6).*

The Commissioners agree. Straight-line depreciation is the current practice and periodical review of rates is considered essential to cover technological developments, obsolescence and other factors.

38. *Renewals and replacements in the nature of maintenance relating to such assets as way, works and buildings, should be treated as a charge to working expenses : (para. 4.7).*

39. *The use of the term " renewals and replacements " should be restricted to capital expenditure : (para. 4.8).*

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40. *The accounting treatment of renewals and replacements should be divorced from any consideration of how they are to be financed : (para. 4.9).*

The Commissioners consider that it is essential that a high proportion of funds for renewals and replacements should be generated from internal resources and not through an increase in interest bearing funds. The appropriate basis for distinction between renewals and replacements representing capital expenditure and those in the nature of maintenance is currently under review.

41. *The Railways should not be charged interest on funds which are to be considered their equity capital : (para. 5.1).*
42. *The Railways should be required to pay interest on all loans and advances, short or long term, which carry a definite obligation to repayment, interest being calculated either at the specific rates applying to particular loans, or at the average rate for long-term semi-government loans, as the case may be : (para. 5.1, 5.3).*

The Commissioners agree in general. Principles for distinguishing “equity capital” from loans will have to be clearly established and expressed—an exercise of some magnitude.

43. *In the long term, consideration should be given to setting profit targets for the Railways operations : (para. 5.4).*

The Commissioners agree. However, targets—which may have to be negative—can only be set in the context of overall objectives defined at Government level. So far, no such guidance from the Government has been forthcoming.

44. *The accounts should indicate by way of note the opportunity cost of the State’s investment in the Railways : (para. 5.5).*

The Commissioners disagree. The proposal would be of no practical benefit and appears to conflict with recommendation 41. To prepare a set of accounts ignoring interest on “permanent” (equity) capital and then quote such a figure in a footnote would also be most confusing to the Parliament and the public. If subsidies are full and sufficient to cover the “opportunity cost” of such capital, the Commissioners’ view is that it would be preferable to think in terms of a determined rate of return rather than interest.

45. *The possibility of obtaining insurance cover through an outside agency should be explored as an alternative to continuing the present scheme of self-insurance : (para. 6.1).*
46. *Insurance cover should be adequate for the risks involved ; the level of \$200,000 presently set for the Railways accident and fire insurance fund should be increased substantially : (paras. 6.2, 6.4).*
47. *If self-insurance is continued, assets representing the insurance fund should be earmarked by the Treasury so as to facilitate prompt settlement of claims : (para. 6.4).*

The Commissioners do not favour outside insurance cover, which they consider would in the ultimate involve additional cost to no real purpose. Moreover, with insurance carried internally, the Railways are in a position to gain immediate benefit from improved performance, particularly in fields such as loss, delay or damage to goods. An increase in the present level of \$200,000 presently set for the Railway Accident and Fire Insurance Fund is not considered necessary as the Railways, as a very large scale undertaking, are able to cope with all but the infrequent major disasters, where any temporary advances necessary could be written off over a relatively short period. If an insurance fund is established by the Treasury from charges against railway revenue, the Railways should be allowed interest on daily balances in this Fund.

48. *Working expenses should include only rates and taxes actually payable by the Railways : (para. 7.1).*

The Commissioners are in complete agreement.

49. *The general accounting records and procedures of the Railways should be adjusted to permit the preparation of more informative annual accounts : (para. 8.1).*

The Commissioners recognise the need for a major change in the accounting system if and when the Railways becomes a commercial undertaking.

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## SECTION B.

Supplementary comments on matters referred to in the body of the Joint Committee’s Report but not included in the specific recommendations.

*Paragraph 1.10.*

In this paragraph the Joint Committee states that it “wishes to emphasize that these accounts . . . . are not designed to disclose in themselves cash flows arising in connection with the Railways operations.”

In this connection the Commissioners consider that it is most important that the Railways be given an incentive to manage cash flows. No such incentive exists or is possible with the present financial arrangements between the Railways and the Treasury.

*Paragraph 1.22.*

In this paragraph the Joint Committee comments that “Information on renewals and replacements undoubtedly is of value. However, it must be questioned whether the statement on the “*Railways Renewal and Replacement Fund*” provides this information in an adequate manner.”

In this connection the Commissioners point out that any such “inadequacy” is a direct result of the current financial arrangements.

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## SECTION C.

Comments on suggested Balance Sheet and financial statements (Appendices 'A', 'B' and 'C' to the Joint Committee's Report).

## APPENDIX 'A'.

Item 7 on the first page of Appendix 'A' reads as follows :—

"The Committee understands that the total of \$753,424 shown in the published balance sheet as "work in progress, manufacturing account" under the general heading of current assets, includes items which in fact represent capital expenditure in progress and thus should be shown under the general heading of fixed assets. However, no adjustment was made as the amount involved could not be ascertained."

The Commissioners wish to point out that the total of \$753,424 shown in the published balance sheet as "Work in Progress, Manufacturing Account", represents items which are being manufactured for stock.

Subsequent issue of these items may be to working expenses or capital but initially they are manufactured for stock, and therefore should appear under the heading of "Current Assets" as shown.

*Appendix 'B'.*(i) *Suggested form of Balance Sheet.*

The Commissioners consider that the form of Balance Sheet suggested in Appendix 'B', although reasonably suited to operation of the Railways as a commercial undertaking, could be improved even further.

They think that the Balance Sheet should be prepared on a 'fresh start' basis as soon as the future status of the Railways has been clarified. A good deal of work in progress on asset valuation and depreciation will facilitate the ultimate reconstruction of the Balance Sheet to provide a realistic and informative picture of Railways finances. The aim is to present meaningful information in a simple and concise manner, in harmony with modern accounting principles and practices.

Our view is that the general approach should be on a basis which would—

- (a) take no cognizance of past accumulated losses ;
- (b) bring to account as "Funds provided" at the most only those advances invested in existing fixed assets or represented by current assets or advantages ;
- (c) make appropriate adjustments in such funds in respect of expenditure on Renewals and Replacements ;
- (d) provide for appropriate valuation of assets.

The type of Balance Sheet we are developing would show—

*Funds Provided.*

For Fixed Assets	}	distinguish between "permanent" capital, repayable loans, &c.
For Working Capital		

*Provisions and Reserves.*

Provision for Long Service Leave.  
Reserves—to be specified.  
Total—Funds, Provision and Reserves.

These Funds, Provisions and Reserves are represented by—

*Current Assets.*

To be specified in order of liquidity—including Stores, and Work in Progress, Manufacturing Account.

*LESS—Current Liabilities.*

To be specified

*Net Surplus of Current Assets over Current Liabilities.**Fixed Assets.*

At cost less depreciation	}	in appropriate groups.
At Commissioners' valuation		
Total		

*Total Assets.*

Appropriate notes would amplify and expand the information shown in the Balance Sheet.

*Appendix 'B'.*(ii) *Suggested form of Profit and Loss Statement.*

The Commissioners agree generally, subject to—

- (a) their comments on Recommendation 7 (see also para. 1.11) concerning financial results of areas of operation ;
- (b) the exclusion of accumulated losses, at least up to the time of the first reconstructed Balance Sheet.

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However, the areas of operation suggested by the Joint Committee are not considered suitable. A more appropriate initial separation could be the one employed since 1966-67, namely—

- Suburban passenger and parcels operations
- Country passenger and parcels operations
- Intersystem passenger and parcels operations
- Intersystem goods operations
- Victorian goods and livestock operations.

This subdivision does not exclude specific line costing, which has always been applied to branch line operation and is currently being developed further as an aid to commercial rate fixing, and to the determination of appropriate grants in aid.

*Appendix 'B'.*(iii) *Suggested Schedule of Operating Expenses and Finance Charges.*

The form and content of such a statement must await resolution of a number of factors, including possible organizational changes.

*Appendix 'C'.**Suggested Statement of Capital Expenditure.*

The Commissioners agree with some reservations, including the need for—

- (a) redefinition of asset groupings following completion of the current study ; and
- (b) expansion of the item " Other " under " Funds generated within railways operations ".

## SECTION D.

Comments on views contained in reports attached to Public Accounts Committee's letter of 1st February, 1972 (comments made in Section A in regard to similar matters are not, in general, repeated).

1. *Letter dated 30th November, 1971 from the Institute of Chartered Secretaries and Administrators, Victorian Branch.*

Question 1. *Form and presentation of accounts*—(a), (c) and (d) are not considered to call for further comment.

- (b) *Capital Investment*—The Commissioners agree with the suggestion that accumulated deficits should be deducted from capital indebtedness. They consider that a ' fresh start ' approach should be adopted.
- (e) *Certification by Auditor-General*—the proposal that this should be in similar form to that required for companies is arguable. The form of the certification is a matter for the Auditor-General himself.

Question 2. It should be remembered that the Australian National Airlines Commission is a shared monopoly.

Question 3 to 7 inclusive do not call for further comment.

2. *G. R. Webb, Senior Lecturer in Economics, University of New South Wales.*

The Commissioners are in general agreement with the views expressed by Mr. Webb. The effective implementation of greater administrative and financial autonomy for the Railways would be dependent upon—

- (i) adequate and specific reimbursement for the cost of implementing social objectives ;
- (ii) adequate provisions for depreciation as a cost ;
- (iii) a ' fresh start ' approach in respect of railway indebtedness, interest charges, &c. ;
- (iv) an adequate infusion of funds over a reasonably short period to replace assets which are obsolete, or costly to operate and/or maintain ;
- (v) appropriate financial arrangements, including the provision of interest-free funds, for future renewals and replacements expenditure.

3. *G. T. Webb, Commissioner for Transport, Tasmania.*

With one notable exception, the views of the Commissioners on the ground traversed by Mr. G. T. Webb are included in the preceding commentaries.

Mr. Webb has, however, expressed views as to the constitution of a Railways Board. The Government's proposals in this regard have now been embodied in a bill now before the Legislative Assembly and the Commissioners' views are expressed in their Annual Report for the year ended 30th June, 1972.