3 September 2001

Dr John Carter
Sectional Committee Secretary
Joint Committee of Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

Dear Dr Carter

REVIEW OF THE ACCRUAL BUDGET DOCUMENTATION

I refer to your letter of 23 August in which you referred two additional questions to the ANAO for further comment.

I enclose our responses to these questions for the Committee. If the Committee has any further queries, please do not hesitate to contact Ms Lynne O'Brien (phone 6203 7572).

Yours sincerely

Ian McPhee
Acting Auditor-General

ANAO FOLLOW UP QUESTIONS

Q1 : It has been suggested that 'price' may not be a valid concept in the accrual based outcomes and outputs framework in relation to outputs given that most public sector expenditure occurs in the General Government Sector, which by definition, provides public services which are mainly non-market in nature. That is, if there is no market, price is not an applicable concept.

Would you care to comment on whether 'price' is a valid concept in the accrual based outcomes and outputs framework despite most public sector expenditure being for public services which are mainly non-market in nature?

The following questions need to be addressed in considering the merits of using 'price' rather than 'cost' to fund general government sector outputs. These are:
- how is 'price' established in the absence of an active market?
- what happens when the market prices differ from the cost of delivering outputs?

Traditionally, the general government sector has delivered outputs which are non-market in nature. However, recent history shows that it is possible to develop an active market for some types of general government sector outputs with this market then setting prices. An example of this is the Commonwealth's job network program, whereby an active market has been developed for the delivery of services which were previously delivered from within central government.

This will not be possible, nor desirable, in all cases. However the absence of an active market does not mean that 'price' is not a relevant concept, rather it makes it more difficult to strike a 'market price'. Techniques such as benchmarking and market testing can be used to estimate market prices where these are not readily available.

As an alternate to market prices, agencies may use 'cost plus' pricing models. This has been the approach in the Commonwealth during implementation of the accrual budgeting framework where agencies are funded for the cost of their outputs together with a return to the owner (capital use charge). We understand that a similar approach used in some parts of the ACT government.

In summary therefore, a market pricing model is only one of a number of ways in which pricing structures can be set. The absence of an active market can make it difficult to determine market prices : it does not, in itself, mean that market prices cannot be estimated or that other pricing models are not appropriate.

The more significant issue in employing pricing models for the funding of the delivery of general government services is the question of how to deal with the difference between prices and costs. Given government agencies are established, not in their own right, but for the sole purpose of delivering services on behalf of the government, in the longer term, these variations have to be funded by, or returned to, the government. This raises the question as to what benefit is there in differentiating between price and cost.

A key argument in favour of such differentiation and thereby funding agencies for the ‘market price’ of services delivered is that this will drive efficiencies and lead to lower cost outcomes. In this sense, the market price can be a valuable, independent benchmark of public sector cost levels. That is, if market prices are below existing government cost levels, then efficiencies will follow when agencies are funded at these lower levels.

This presupposes that the agency has the capacity to reduce its cost levels and/or, there is an alternate source of supply (and outsourcing occurs). If neither of these conditions exist, then the funding reductions are likely to result in a lower level or quality of service delivery by the agency.

In summary, the concept of price has been adopted as part of the new resource management framework to draw a distinction between the provision of funding of the basis of market prices or benchmarked costs. It is intended to signal to Commonwealth agencies that funding will not necessarily be given on the basis of costs. This is an important message. That said, in terms of presentation of the PBS, if there was concern with reference to ‘price’, this term could be replaced with ‘funding’ or a similar term which Senators and Members would be more familiar with. The resource management framework could still continue to draw the distinction between price and costs.

Q2. Appropriation Act No. 1 2001-2002 authorises the Minister for Finance to issue out of the Consolidated Revenue Fund the sum of $41,425,224,000 in accordance with the Schedule which forms part of the Act.

It has been suggested that the Appropriation Act No. 1 could alternatively authorise each Portfolio Minister to issue out of Consolidated Revenue Fund the amount for each entity in the Minister’s Portfolio.

- Would you care to comment?

Such a change would result in the loss of some central control over the release of, and accounting for, appropriations. This loss of control would need to be offset by identified benefits. It is unclear as to what these benefits may be.

In addition, you should note that section 27 of the *Financial Management and Accountability Act 1997* (FMA Act) provides the Finance Minister with the authority to issue drawing rights for Commonwealth expenditure. It could be that the proposed change to the Appropriation Act would be ineffective without consequential changes to the FMA Act. You may wish to seek legal advice on this issue.