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The Commonwealth Budget: Process and Presentation (April 2003)

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The Commonwealth Budget: Process and Presentation

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Glossary

The following is adapted from the Glossary prepared by the Budget Group of the Department of Finance and Administration.

Accrual accounting. The system which brings to account both monetary (for example, salary payments) and other activities (for example, depreciation of assets and increases in long service leave liabilities) in the period when they occur. Differs from cash accounting, which recognises only monetary transactions and only when such a transaction takes place. Accrual accounting shows information about revenues, expenses, assets and liabilities that cannot be obtained by cash accounting.

Accrual Budget. A comprehensive Budget incorporating assets, liabilities, expenses and revenues, not just monetary receipts and payments. Accrual Budgeting extends cash Budgeting by incorporating all resource implications such as depreciation and increases in liabilities.

Additional estimates. Changed circumstances after the Budget may lead agencies to ask the Government for additional funds. Approved funding increases are normally incorporated into Appropriation Bills 3 and 4 and the Appropriation (Parliamentary Departments) Bill (No. 2), and does not become available until after Parliament has passed the Bills and they have received royal assent.

Administered items. Revenues, expenses, assets and liabilities that the government controls, but which an agency manages on the government's behalf. Examples include subsidies, grants and benefit payments; taxes, fees, fines and excises; and public debt and related interest.

Advance to the Minister for Finance and Administration. A provision, authorised by the annual Appropriation Acts and made available to the Minister as a contingency fund, to provide urgent funding to agencies. Normally, the advance is made only if the need is urgent and was unforeseen or arose because of erroneous omission or understatement.

Agency. When used generally, encompasses departments, agencies, authorities and non-commercial companies. For the purposes of the *Financial Management and Accountability Act 1997,* agencies are Departments of State, Departments of Parliament and 'prescribed agencies'. Portfolios consist of a number of agencies.

Amortisation. The process of writing off, as an expense, initial expenditure on items such as research and development costs or lease payments over the over the period of the lease.

Appropriations. An amount of public moneys Parliament authorises for spending. An appropriation authorises the Commonwealth to withdraw moneys, but also restricts spending to the particular purpose specified by the appropriation. Parliament appropriates spending under annual Appropriation Bills and under Special (or Standing) appropriations. The annual appropriations Bills are Appropriation Bill (No. 1), Appropriation Bill (No. 2) and Appropriation (Parliamentary Departments) Bill. The annual Appropriation Bills account for about 25 per cent of agency expenses and Special (or Standing) appropriations for about 75 per cent.

Australian Accounting Standards (AAS). Specify accounting practices including how an entity should present financial information. AAS 31, *Financial Reporting by Governments*, is the main standard for government reporting.

Budget aggregates. Refers to totals of revenue, expenses and the Budget balance (surplus/deficit).

Budget balance. The term used to refer to a Budget outcome, whether a surplus or deficit. The 'fiscal balance' in accrual Budgets is the counterpart of 'underlying cash balance' in cash Budgets. The Budget Papers contain both the fiscal balance and the underlying cash balance.

Capital-use charge. A charge levied on agencies for the cost of capital they use. The charge is usually based on agencies' net assets at the end of the financial year. Funding for the charge is included in agencies' departmental appropriations. However, the capital use charge is to be discontinued from 1 July 2003.

Charter of Budget Honesty. The *Charter of Budget Honesty Act 1998* provides a legislative framework for the conduct and reporting of fiscal policy. The Act's aim is to improve fiscal policy by requiring fiscal strategy to be based on certain principles of fiscal management and by facilitating public scrutiny of fiscal policy and performance.

Consolidated Revenue Fund (CRF). Section 81 of the Constitution requires that all revenue raised or money received by the Executive Government has to form one consolidated revenue fund to be appropriated for Commonwealth purposes. The CRF is thus the principal operating fund where the transactions associated with the general activities of the government are recorded.

Cost. Expenses an agency incurs for the delivery of outputs.

Departmental items. Resources (assets, liabilities, revenues and expenses) that agencies control directly and use to produce outputs on behalf of government. Examples are computers and plant and equipment used in providing goods and services; accruing liabilities for employee entitlements; revenues from user charges and profits; and employee salaries and other administrative expenses incurred in providing goods and services.

Economic parameters. The values of economic variables—such as movements in prices, wages, employment, and interest and exchange rates—on which the Budget and forward years estimates are based. Parameters are based on the forecasts of the Joint Economic Forecasting Group.

Effectiveness. The extent to which outputs and/or administered items make positive contributions to the specified outcome. Effectiveness indicators are used to assess the degree of success in achieving outcomes.

Efficiency. The extent to which the use of inputs is minimised for a given level of outputs, or outputs are maximised for the given level of inputs.

Estimates. Expected expenses and revenue of the Commonwealth. Expense estimates are prepared for each item in the Budget in consultations between the Department of Finance and Administration and the agency responsible for program delivery. Treasury prepares tax revenue estimates.

Expenditure Review Committee (ERC). The sub-committee of Cabinet that meets over a period of months before the Budget to consider new policy and savings proposals, and which recommends to Cabinet proposals to be included in the Budget. The ERC usually includes the Prime Minister, Treasurer and Minister for Finance and Administration in addition to relevant portfolio Ministers.

Expense. Total value of all of the resources consumed in producing goods and services. Expenses include cash items such as salary payments as well as expenses that have been incurred—such as accruing employee entitlements—which will be paid in the future.

Final Budget outcome. The actual Budget result. The *Charter of Budget Honesty Act 1998* requires the Treasurer to release publicly and table a final Budget outcome report for each financial year no later than three months after the end of the financial year. The report contains Budget sector and general government sector fiscal outcomes including information on actual revenue, expenses, net capital investment, Federal financial relations and other information for the financial year.

Financial Management and Accountability Act 1997. The main Act governing the financial activities of agencies including the collection of public money, the maintenance of accounting records, control and management of public property, the responsibilities of chief executives, and the power of the Minister of Finance and Administration to make regulations and delegate powers.

Fiscal balance. In accrual Budgets, the difference between government saving and investment. Measures the government's net call on other sectors of the economy. A surplus, for example, indicates that the Commonwealth is lending to other sectors. The fiscal balance is thus an indicator of the financial impact of the Commonwealth's operations on the rest of the economy.

Fiscal policy. The use of government spending and taxation to influence the level of economic activity. 'Discretionary' fiscal policy seeks to counter cycles in the economy.

Fiscal risks. General developments or specific events that may affect the fiscal outlook. Examples are litigation before the courts and possible Senate rejection or amendment of Budget measures.

Forward estimates. Estimates of the revenues and costs of on-going Government policy after allowing for estimated movements in parameters. The forward estimates show the minimum cost of maintaining on-going Government policy because they do not include provision for new programs or expansion of existing programs that the Government has not agreed to or programs that are not expected to continue. Forward estimates are a system of rolling three-year financial estimates. After the Budget is passed, the first year of the forward estimates becomes the base for next year's Budget bid, and another out-year is added to the forward estimates.

General government sector. Encompasses agencies that provide public services that are mainly non-market in nature and are either for the collective consumption of the community or redistribute income such as social security payments, and are financed mainly through taxes.

General purpose payments (GPPs). Commonwealth payments to the States and Territories are divided into GPPs and specific purpose payments (SPPs). GPPs are distinguished from SPPs because GPPs are not subject to conditions regarding their use. GPPs comprise GST revenue, Budget balancing assistance, National Competition Policy payments and Special Revenue Assistance (paid to the Australian Capital Territory).

Government Finance Statistics (GFS). The GFS reporting framework is a specialised statistical system designed to support economic analysis of the public sector. The GFS used in Australia accord with the Australian Bureau of Statistics framework, which is consistent with international statistical standards (the *System of National Accounts 1993* and the draft accrual version of the International Monetary Fund's *A Manual on Government Finance Statistics*).

Inputs. Resources in the forms of people, materials, energy, facilities and funds that an agency uses to produce outputs.

Joint Economic Forecasting Group (JEFG). A group of officials from Treasury, Department of the Prime Minister and Cabinet, Department of Finance and Administration, Reserve Bank of Australia and Australian Bureau of Statistics. The group meets three or four times a year after the quarterly national accounts are released to review official economic forecasts. JEFG examines economic forecasts in light of the economic outlook for the remainder of the Budget year and the following year.

Mid-Year Economic and Fiscal Outlook (MYEFO). Essentially an update of the Budget estimates. The MYEFO takes account of actual spending and revenue in the year to date and decisions since the Budget. The MYEFO is published around November.

New policy proposals. Ministers' proposals to Cabinet recommending the adoption of a new initiative or change to existing programs. Such proposals are normally made in the context of the annual Budget process.

Outcomes (actual). The results or consequences of actions by the Commonwealth and other bodies on the community. Because actual outcomes reflect all influences, it is often difficult to disentangle those attributable to Commonwealth actions.

Outcomes (planned). The results or consequences for the community that the Government seeks to achieve.

Outputs. The goods and services that agencies produce to attain planned outcomes.

Performance. The proficiency of an agency in acquiring resources economically and using them efficiently and effectively in achieving planned outcomes.

Performance information. Evidence about performance that is collected and used systematically. Evidence may relate to appropriateness, effectiveness and efficiency. It may be about outcomes, factors that affect outcomes, and what can be done to improve them. Agencies specify in their Portfolio Budget Statements the performance information that they will collect, and use this information to report in their annual reports how well they have met planned outcomes.

Portfolio Budget Statements (PBS). Documents that portfolio departments develop and publish explaining each agency's source and use of funds by outcome. The PBS contain information on revenue authorised by the Appropriation Bills, revenue from other sources, information on special appropriations, other financial information, and performance information. The PBS consolidate information on all agencies within the portfolio.

Pre-Election Economic and Fiscal Outlook (PEFO). The *Charter of Budget Honesty Act 1998* requires the Secretaries of Treasury and the Department of Finance and Administration to produce a PEFO report within ten-days after an election is called. The purpose of the PEFO is to update information on the economic and fiscal outlook.

Price. The departmental price of outputs appropriations are the purchase price the government pays for agencies' outputs.

Purchaser/provider arrangements. Arrangements whereby an agency enters into an agreement with another agency to provide goods or services. For example, in 1999–2000 the Australian Taxation Office (ATO) entered into purchaser/provider arrangements with the Department of Family and Community Services and the Department of Health and Aged Care whereby the ATO undertook to provide services to both to enable them to achieve their outcomes. Agencies that receive the services pay the agencies that provide them.

Revenues from other sources. Include revenues from the sale of goods or provision of services to other entities (user charges) and profits from the sale of assets.

Savings measures. Measures that reduce the cost of programs. To satisfy Department of Finance and Administration guidelines, savings require either a Cabinet decision to alter existing policy or represent a discretionary reordering of priorities by a Minister, reduce expenses below what they would otherwise have been, and contribute to the achievement of the Government's fiscal targets.

Sensitivity analysis. Analysis of the extent to which expense and revenue estimates are subject to changes in economic parameters.

Special accounts. A mechanism for recording moneys set aside (hypothecated) for a particular purpose (for example, a levy collected from an industry and applied to making grants for the development of that industry) and for making payments for this purpose.

Special (or Standing) Appropriation. Money appropriated by a particular Act of Parliament (for example, the *Australian Land Transport Development Act 1988)* for a specific purpose, for example, the payment of grants to the States for roads. Special appropriations may be for a specific amount of money, level of benefit or period of time. Special appropriations do not require annual spending authorisation by Parliament, as they do not lapse at the end of each financial year. Special appropriations account for about 75 per cent of agency expenses.

Specific Purpose Payments (SPPs). Payments to the States and Territories for policy purposes that relate to particular functions, for example, health and education. SPPs are made under section 96 of the Constitution, which states that the Commonwealth Parliament may grant financial assistance to any State on such terms as it sees fit. Most SPPs are conditional on policy objectives that the Commonwealth sets or the achievement of policy objectives agreed between the Commonwealth and the States.

Tax expenditures. The financial benefits that individuals and businesses derive from tax concessions in the forms of exemptions, deductions, rebates or reduced rates. Concessions reduce or delay the collection of tax revenue. Governments can use concessions to allocate resources to different activities in much the same way that they can use direct spending programs.

Underlying (cash) balance. The cash Budget counterpart of the fiscal balance in accrual Budgets. The underlying cash balance is a broad indicator of the Commonwealth's cash flow requirements. For example, an underlying cash surplus reflects the extent to which cash is available to the Commonwealth either to increase its financial assets or decrease its liabilities (assuming no revaluations and other changes occur). The underlying balance differs from the 'headline' balance—the actual cash outcome—by, for example, excluding proceeds from the privatisation of investments on the grounds that these are one-off or abnormal items.

Uniform Presentation Framework. An agreement between the Commonwealth, States and Territories whereby all jurisdictions are required to publish a common core of Government Finance Statistics and consistent financial information in their Budget papers.

Major Issues

The annual Budget, which is brought down in May, is perhaps the Government's most important political, economic and social document. The sheer size of the Budget—estimated outlays in the 2002–03 Budget were $167 billion dollars or the equivalent of 24 per cent of gross domestic product—attests to its influence over the size of as well as the allocation of resources within the economy. The Budget contains information on matters such as its economic consequences and the provision of goods and services. While the Budget process changes little, major changes have been made to the Budget's focus, content, format and reporting in recent years. These changes include:

- the move from cash accounting to accrual accounting and from cash budgeting to accrual budgeting
- the shift in the focus of agency reporting from program budgeting to planned outcomes
- the presentation of financial statements in accordance with two main accounting standards
- the presentation of information to allow assessment of agency performance, and
- the reporting and other requirements of the *Financial Management and Accountability Act 1997* and the *Charter of Budget Honesty Act 1998*.

The move to accrual accounting has positive features. In particular, non-cash expenses such as accruing long service entitlements and asset depreciation are now included in expenses along with cash expenses. Cost accounting methods are used to allocate all expenses to outputs and outcomes. While problems of cost attribution remain, the cost of providing goods and services is now measured more fully than under cash accounting.

Under cash budgeting, agencies' annual appropriations are based on their cash requirements. Under accrual budgeting, agencies' annual appropriations are based on their accrual expenses (and capital requirements). Hence agencies are resourced for all expenses as and when they arise and not just when they have to be paid. For example, agencies are funded for increasing long service leave liabilities and the depreciation of assets before the funds have to be spent on paying out the liabilities or replacing the asset. Agencies have to manage these unspent funds until they are needed.

Critics argue that appropriations should be cash-based with a parallel accrual accounting system on the grounds that cash budgeting and cash accounting are vital to the government's information needs. Another criticism of accrual budgeting is it does not seem sensible to appropriate in the current year funds that are not needed in that year but will be spent in future years.

Despite the move to accrual budgeting, most economic commentators continue to focus on the underlying cash balance and not the accrual fiscal balance in discussions of Budget aggregates. One reason is that cash balances have some advantages for tracking expenditures in a fiscal year and helping to identify the short-term effects of fiscal policy on the economy. Further, accrual fiscal balance data are available only from 1996–97, limiting their use for comparative purposes.

The move from program budgeting to the outcomes and output framework has been a major shift and, so far, a mixed one. The purpose of the framework is to encourage agencies to focus on planned outcomes—the results or consequences for the community that the government wants to achieve. Under the framework, expenses are allocated to outputs—the goods and services that agencies produce to attain outcomes—and thence to planned outcomes. However, the implementation of the framework has been difficult. Outcomes reflect administrative arrangements but these often do not coincide with broader community objectives. Some outcomes are so general that, as the Senate Finance and Public Administration Legislation Committee observed, it is hard to see how accountability is enhanced by reporting against them. It has been difficult to specify outcomes that do not overlap among and within agencies' activities.

The trend seems to be for agencies to consolidate outputs into fewer categories. The desirability of this trend is questionable on transparency and accountability grounds. The Senate Finance and Public Administration Legislation Committee's observation on the generality of outcomes could also be applied to the consolidation of outputs.

It will be some time before a proper assessment can be made of the framework's success in encouraging agencies to focus on outcomes: it has been in place for only three Budgets and remains under development. The recasting of outputs and outcomes will make difficult assessment of the framework and comparisons of data over time because of the lack of continuity in data series. However, the problem of comparability has to be balanced against the provision of better information and the issue of materiality.

In addition to showing expenses classified by outcomes, the Budget shows them classified by functions such as health, education, road transport and defence. While this classification system is not without problems—such as reclassifications of activities—many readers will find it more useful than allocations by outcomes.

Contrary to the rhetoric about how accrual budgeting and the outcomes and outputs framework would increase transparency and accountability, the availability of information in the Budget Papers and associated documents that Members of Parliament commonly seek has generally fallen, although this is truer of some agencies than others. This is particularly true of the Portfolio Budget Statements, which are the main source of information about proposed agency activity. The main complaint concerning these Statements is the high level of aggregation of financial data and the lack of detail about agency activities. Parliamentarians, through various committees, have been among the strongest critics of aggregation.

The Department of Finance and Administration, in an appearance before the Joint Committee of Public Accounts and Audit, has agreed that the aggregation of data in the Portfolio Budget Statements is an issue. The Department issues guidelines for the preparation of Portfolio Budget Statements. However, these are 'minimum' guidelines. Agencies have considerable discretion as to what they present in their Portfolio Budget Statements and in what format. Where Parliament identifies gaps in the information that agencies provide in their Portfolio Budget Statements, it can require them to provide that information, and agencies have responded to such requests from various Parliamentary committees. The trend, therefore, is for agencies to provide more information.

A particular issue is the reporting of special appropriations, which amount to around three-quarters of total spending. A welcome development is the reporting by some agencies of estimated expenses from individual special appropriations. For example, the Department of Family and Community Services Portfolio Budget Statement shows that in 2002–03, estimated spending under administered special appropriations is \$56 billion, being income support and family assistance. This spending is not predetermined but is driven by the number of people who qualify for payment and the amount of payment for which they are eligible. Almost \$43 billion will be spent under the Social Security (Administration) Act 1999. The Department even breaks down spending under this Act by category, for example, age pension, disability support pension, youth allowance and so on. However, the Portfolio Budget Statement does not show to which outcome(s) spending under this Act contributes. The Department administers 26 Acts and has three outcomes. The provision of such information would link the legislative authority for spending to planned outcomes.

Financial information in the Budget Papers is prepared in accordance with external reporting standards. The two main standards are the Government Finance Statistics and Australian Accounting Standard No. 31, *Financial Reporting by Governments* (AAS 31). The GFS is designed to allow economic analysis of the public sector, and major Budget aggregates are based on the GFS. AAS 31 is adapted from the accounting standards applying to business. The presentation of data under two standards is, however, a source of confusion especially since they can yield quite different results. Some critics argue that having two accounting systems is a retrograde step and for the use of only the GFS because it is designed for the public sector.

Agencies are required to prepare statements of financial performance (profit and loss), financial position (balance sheet), cash flows, and capital budget for their Portfolio Budget Statements and annual reports. This requirement has had the positive effect of increasing transparency and allows assessment of an agency's financial performance and status. However, the usefulness of the statements is limited because the concepts on which they are based are more applicable to business than to the public sector. Critics argue that business accounting systems should not be used in the public sector without modification to reflect the needs of government. For example, equity in a business is an indicator of its solvency. But the concept of equity has limited meaning for an agency whose main functions are to provide policy advice and administer appropriations. The concept has even less relevance to the government sector as a whole. Depending on the accounting standard used, general government net worth at 30 June 2002 was negative to the tune of between $42 billion and $50 billion. In the private sector, this would result in the business being made bankrupt. This is not to say that financial statements are valueless. Rather, it is to urge caution when interpreting them.

The *Charter of Budget Honesty Act 1998* has increased transparency of reporting. The Act requires, among other things, that the Government prepare an economic and fiscal outlook report with each Budget, a mid-year economic and fiscal outlook report, and a final budget outcome report. The Act thus imposes an obligation to provide information that has traditionally been made available. The Act also requires the public release of a pre-election economic and fiscal outlook (PEFO) report within 10 days of the issue of the writ for a general election. The publication of the PEFO has helped reduce dispute over the state of finances that usually surrounds election campaigns. Similarly, the *Financial Management and Accountability Act 1997* requires the Minister for Finance and Administration to publish monthly financial statements in a form consistent with the Budget estimates and annual consolidated financial statements.

Agencies report on how they have performed against planned outcomes in their annual reports. The usefulness of performance information is mixed. This is partly because it is often difficult if not impossible to measure the contribution of agencies to outcomes. For example, the States are primarily responsible for funding primary and secondary education. The Commonwealth also provides funds. Since both State and Commonwealth funds are lumped together to provide education services, it is not possible to disentangle the consequences of Commonwealth funding. The Auditor-General has observed that the development of indicators has some way to go.

Much attention is focused on the level of expenditure and revenue in the Budget. However, a large amount of revenue is foregone through tax concessions called 'tax expenditures'. The Government can use taxation concessions to allocate resources to different activities in much the same way that it can use direct expenditure. But tax expenditures are not reported like direct expenditure in that tax expenditures are not added to direct expenditure. This treatment may tempt governments to 'substitute' tax expenditures for direct expenditure to make public finances 'look good'. Not adding tax expenditures to direct expenditure has the effect of 'understating' the size of the government sector. For example, in 2001–02, if tax expenditures of around $30 billion were added to direct expenditure, total expenditure would rise from $167 billion to $197 billion, an increase of 18 per cent.

Another source of under-reporting of the size of the Commonwealth government sector is the treatment of the goods and services tax (GST). The Budget generally treats the GST as if it were not a Commonwealth tax. The Government argues that the Commonwealth collects the GST as an agent for the States. But the Australian Bureau of Statistics and the Auditor-General reject this argument on the grounds that the GST is imposed and administered under Commonwealth legislation. The consequences of not recognising the GST as a Commonwealth tax are to understate expenses and revenue and to overstate net liabilities. In 2001–02, revenues were understated by $27.6 billion and expenses by $27.4 billion, while net liabilities were overstated by $3.7 billion. The treatment of the GST inevitably gives rise to the suspicion that it is intended to reduce the apparent size of government.

Introduction

The annual May Budget is perhaps the Government's most important political, economic and social document. The sheer size of the Budget—estimated outlays in the 2002–03 Budget were $167170 billion dollars or the equivalent of 24 per cent of gross domestic product—attests to its influence over the size of as well as the allocation of resources within the economy. The Budget contains information on matters such as its economic consequences, the provision of goods and services, the Government's social and political priorities and information on how the Government intends to attain these priorities.

This paper describes the Budget process beginning with the first steps in the November before the Budget is brought down through to the presentation of agency annual reports. The paper also explains key concepts as well as the major changes to the content and presentation of the Budget Papers and associated documents that have been made in recent years. The paper further examines some issues such as the treatment of the goods and services tax and tax expenditures. This paper is the fourth in a series and updates a 1993 paper by Mr Denis James[1] to take account of a number of major changes in recent years. The changes include:

- the move from cash accounting to accrual accounting and from cash budgeting to accrual budgeting
- the shift in the focus of agency reporting from program budgeting to planned outcomes
- the presentation of financial statements in accordance with two main accounting standards
- the presentation of performance information to allow assessment of agency performance, and
- the reporting and other requirements of the *Financial Management and Accountability Act 1997* and the *Charter of Budget Honesty Act 1998*.

The following discusses these and other aspects of the Budget starting with an overview of the Budget process.

1. Overview of the Budget Process

The highlight of the process is Budget night in May.[2] However, a 'typical' cycle extends over 21 months, beginning about six months before Budget night and ending three months after the end of the Budget year on 30 June.

The preparation of a Budget involves a large number of participants. The Expenditure Review Committee, a Cabinet committee of senior Ministers chaired by the Prime Minister (see below) is primarily responsible for developing the Budget. However, a number of agencies—notably the Department of the Treasury (together with the Australian Taxation Office), the Department of Finance and Administration, the Department of the Prime Minister and Cabinet and line agencies—provide advice and support to the Expenditure Review Committee. Broadly, the Department of Finance and Administration coordinates the preparation of the Budget and forward estimates and is responsible for statements on expenses and non-tax revenue. Treasury is responsible for assessments of the economic and fiscal outlook and estimates of tax revenues.

The following outlines the key stages of a typical Budget process. Definitions of the terms used are in the Glossary and are explained in more detail throughout this Paper and by the use of e-links, which are underlined.

1. 1 Forward Estimates Update

A typical Budget process begins around November when the forward estimates are updated. Forward estimates are rolling three-year estimates of what would be appropriated assuming that government policy is on-going. The estimates include decisions made since the Budget. An example is the decision to send troops to East Timor. Forward estimates exclude new programs, the expansion of existing programs that the Government has not agreed to, and programs that are expected to end. The forward estimates are thus the base on which current and future year spending estimates are built. The estimates are updated so that the Expenditure Review Committee can consider new policy bids based on the most up-to-date information.

1.2 Senior Ministers' Review

In November or December, a Senior Ministers' Review[3] is held. This is a meeting of the Prime Minister, the Treasurer and the Minister for Finance and Administration, who establish priorities for the coming Budget, set timetables and deal with other issues. The review considers Ministers' proposals, new policies and lapsing programs, and expected major pressures on agency budgets. The Prime Minister advises agencies of the Government's priorities and targets after the review.

1.3 Portfolio Budget Submissions

To seek additional funding for new policy proposals, agencies have to prepare portfolio budget submissions based on the outcome of the Senior Ministers' Review. The submissions outline all major proposals and potential savings. Agencies also send a letter to the Minister for Finance and Administration outlining all minor proposals, and a letter to the Secretary of the Department of Finance and Administration outlining achievements against previous savings measures. Agencies cost the submissions and agree the costings with the Department of Finance and Administration. The submissions are circulated for coordination comments and lodged with the Cabinet Office, usually by late February.[4]

1.4 Expenditure Review Committee

As noted, the Expenditure Review Committee (ERC) is primarily responsible for developing the Budget against the background of the Government's political, social and economic priorities. The ERC is a Cabinet committee consisting of senior Ministers. On 13 December 2001, the Prime Minister announced that the ERC would include himself (Chair), the Treasurer, and the Ministers for Trade, Environment and Heritage, Finance and Administration, and Revenue.[5] The ERC is responsible, among other things, for framing the spending side of the Budget. The ERC first meets around March and reviews new policy proposals and on-going spending as well as savings proposals. The ERC recommends to Cabinet proposals for inclusion in the Budget. When examining new policy proposals and savings options, the Committee draws on the Portfolio Budget Submissions and briefs that the Department of Finance and Administration prepares.

1.5 Revenue Committee

After the Expenditure Review Committee process, the Revenue Committee—also a Cabinet Committee—meets to decide the revenue components of the Budget, which are based on proposals and options generally formulated or reviewed by Treasury.

1.6 Pre-Budget Review of Estimates

Around March and after Cabinet has agreed to new policies, agencies update their estimates for the preparation of the Budget documents and Appropriation Bills.

1.7 Budget Documents

Also around March and concurrent with the Expenditure Review Committee process, agencies begin to prepare Budget documents. Agencies prepare three components: the

Portfolio Budget Statements, the Statement of Risks[6] (which was included in Statement 9 of Budget Paper No. 1 in 2002–03) and the 'measures' descriptions in Budget Paper No. 2.

1.8 Budget Presentation

The Budget is usually brought down in May. A consequence is that the outcome of the Budget for the financial year before the Budget year can only be estimated. The Government introduces Appropriation Bills 1 and 2 and the Appropriation (Parliamentary Departments) Bill when it brings down the Budget, and presents the Budget Papers and related documents. The Budget itself is summarised by the Treasurer in his Budget Speech which is traditionally presented at 7.30 pm and lasts for half an hour. The speech is broadcast by the ABC in place of its usual current affairs programs. Following the Budget the ABC also provides time to broadcast the Address in Reply by the Leader of the Opposition.

1.9 Senate Estimates Committees

After the Budget is tabled, the Senate Estimates Committees scrutinise the Appropriation Bills and other Budget documentation. In particular, the Committees scrutinise the Portfolio Budget Statements, which form the basis for their inquiries. The basic function of the Committees is to require the presence of, and seek explanations from Ministers of State who formulate policy and Departmental officers who implement policy, regarding proposed spending and revenue. Each of the Estimates Committees takes responsibility for a number of agencies so that all spending is scrutinised. For example, one such Committee is the Employment, Workplace Relations, Small Business and Education Legislation Committee. The Estimates Committee process is generally finished in time for Parliament to pass the Appropriation Bills before the end of June.

1.10 Mid-Year Economic and Fiscal Outlook

The *Charter of Budget Honesty Act 1998* requires the Treasurer to release publicly and table a Mid-Year Economic and Fiscal Outlook (MYEFO) report by the end of January in each year or within six months after the last Budget, whichever is later. In practice, the MYEFO has been released in November. The MYEFO updates the economic and fiscal outlook and the budgetary position. In particular, the MYEFO takes account of decisions since the Budget was brought down that affect expenses and revenues, and so updates the Budget spending and revenue aggregates.

1.11 Final Budget Outcome

The final stage in the Budget process is in September when the Final Budget Outcome for the financial year just ended is tabled. The *Charter of Budget Honesty Act 1998* requires the Treasurer to release publicly and table a Final Budget Outcome report for each financial year no later than three months after the end of the financial year. The report must contain Commonwealth budget sector and Commonwealth general government sector fiscal outcomes for the financial year.

2. Accrual Accounting and Accrual Budgeting

2.1 Accrual Accounting and Accrual Budgeting: What are They?

The move from cash accounting and cash budgeting to accrual accounting and accrual budgeting in 1999–2000 has been a major change. The rationale for this move derives from the logic behind accrual accounting as opposed to cash accounting. Cash accounting recognises only monetary transactions and only in the period when money changes hands. Accrual accounting, on the other hand, recognises financial commitments as well as monetary transactions and records them in the period when they take place. For example, under cash accounting, a credit sale is brought to account only when the purchaser pays the debt. Under accrual accounting, the sale and the payment are treated as two transactions. In the case of Public Service superannuation, cash accounting recognises only payments to superannuants whereas accrual accounting also brings to account the increase in liabilities for future payments.[7] In the case of purchases of assets such as land and buildings, cash accounting recognises only the purchase. Accrual accounting recognises the purchase by bringing the asset into the balance sheet and then depreciates it (as an expense) over its life.

Because cash accounting is a subset of accrual accounting, it can yield quite different results. This is illustrated by the Mid-Year Economic and Fiscal Outlook (MYEFO) for 2002–03. The MYEFO reports the forecast Budget balance in both cash ('underlying cash balance') and accrual ('fiscal balance') terms. The MYEFO shows the underlying cash balance to be in surplus at $2.1 billion but the fiscal balance in deficit, -$0.5 billion, in 2002–03.

Under cash budgeting, agencies' annual appropriations are based on their cash requirements. Under accrual budgeting, agencies' annual appropriations are based on their accrual expenses (and capital requirements). Hence agencies are resourced for all expenses as and when they arise and not just when they have to be paid. For example, agencies are funded for increasing long service leave liabilities and the depreciation of assets before the funds have to be spent on reducing the liabilities or replacing the asset. Agencies have to manage these unspent funds until they are needed.

The move to accrual accounting means that some data comparisons may not be possible. In particular, it may not be possible to compare data up to and including 1998–99 with data for subsequent years. Further, agencies presented financial statements in their annual reports on an accrual basis for a number of years in the run up to the introduction of accrual budgeting.

2.2 Issues

Some argue that instead of being accrual-based, appropriations should be cash-based with a parallel accrual accounting system. In a submission to the Joint Committee of Public Accounts and Audit, Emeritus Professor Alan Barton, formerly Professor of Accounting at the Australian National University, argued that cash budgeting and cash accounting are vital to the government's information needs, and that cash budgets can be run in parallel with accrual accounting reports.

Another strand of argument relates to the fact that agencies receive, in a given Budget year, funds that they will spend in future years and have to manage these funds until such time as they are spent. In a submission to the same Committee, Professor Harris, formerly Auditor-General in NSW, questioned the wisdom of this system of appropriating funds.[8]

Despite the move to accrual budgeting, most economic commentators continue to focus on the underlying cash balance and not the accrual fiscal balance in discussions of Budget aggregates. One reason commentators focus on cash balances is that they have some advantages for tracking expenditures in a fiscal year and in helping to identify the short-term effects of fiscal policy on the economy.[9] Another reason is that accrual fiscal balance data are available only from 1996–97, limiting their use for comparative purposes.

3. Outcomes and Outputs

3.1 The Outcomes and Outputs Framework

Since 1999–2000, budgets have been presented in an outcomes and outputs framework. The framework was introduced at the same time as accrual budgeting. However, it should be noted that accrual budgeting and the framework are independent, that is, it is possible to have accrual budgeting without the framework and vice versa. The outcomes and outputs framework forms part of a broader framework of reform of the Public Service and financial management and reporting. Other reform elements were the devolution of responsibility to agencies, the repeal of the *Audit Act 1901*, and the passage of the *Financial Management and Accountability Act 1997*. The devolution of responsibility to agencies has, among other things, given them greater discretion as to how they report their activities within the outcomes and outputs framework.

The focus of the framework is planned outcomes. They are the results or consequences for the community that the Government seeks to achieve. Ministers approve the outcomes for their portfolios. An example of a planned outcome is the Department of Immigration and Multicultural and Indigenous Affairs outcome 1, namely, the 'lawful and orderly entry and stay of people' in Australia. Outputs are the goods and services that agencies produce that contribute to the attainment of outcomes. The Department of Immigration and Multicultural and Indigenous Affairs has four outputs which contribute to outcome 1, namely, 'non-humanitarian entry and stay', 'refugee and humanitarian entry and stay', 'enforcement of immigration law', and 'safe haven'. The Department of the Parliamentary Library has one outcome, namely, 'To contribute to a more informed Parliament and, through it, to the Australian community'. The two outputs that contribute to this outcome are 'the provision of commissioned information services and policy advice and analysis to Senators, Members, Parliamentary committees and Parliamentary departments' and the 'provision of self-help information services for Senators, Members, Parliamentary committees and Parliamentary departments'.

The framework was introduced to encourage agencies to focus on ends and not means. Program budgeting, which preceded the outcomes and output framework, grouped outlays into identifiable programs. For example, the Attorney-General's portfolio had six programs in 1998–99. One was 'administration of justice' which encompassed the activities of the courts and tribunals. Another program was 'maintenance of law, order and safety'. A criticism of program budgeting was that it focused too much on inputs and outputs and not enough on the reasons for producing outputs. For example, under program budgeting, there was a tendency to focus on the cost of information technology rather than on its uses to which it was put.

3.2 Issues

The outcomes and outputs framework has encountered conceptual and implementation difficulties. The framework's success depends crucially on how well outcomes are specified. One issue is the overlapping of outcomes across agencies and portfolios. Outcomes reflect administrative arrangements. But these arrangements often do not coincide with broader objectives. For example, it could be argued that some functions of the Department of Foreign Affairs and Trade contribute indirectly to Australia's defence and therefore to the Department of Defence outcome: 'the defence of Australia and its national interests'. The Department of Transport and Regional Services has one outcome: 'a better transport system for Australia and greater recognition and opportunities for local, regional and territory communities'. But the Department provides only some regional services. Equitable access to services in regional areas involves agencies funding health, education and other services. The need for effective coordination between departments and across all levels of government and the social support network was a theme of the Reference Group on Welfare Reform.[10]

Another issue is overlapping outcomes within a portfolio or agency. The framework implicitly assumes that outcomes can be specified discretely. Professor Harris cites as examples of what he believes to be overlapping outcomes those of the Commonwealth Department of Health and Ageing portfolio and the NSW Police Service. He notes that overlapping outcomes create problems of accountability since agencies have discretion as to how they classify an activity.[11] This, in turn, raises issues of agencies' reporting on their contributions to outcomes. Reporting of performance is discussed in section nine of this paper.

Another issue is the level of specificity of outcomes: some are highly abstract while others are more specific. An example of a general outcome is outcome one of the Environment and Heritage portfolio. This is 'the environment, especially those aspects that are matters of national environmental significance, is protected and conserved'. The Senate Finance and Public Administration Legislation Committee, in its 1999 report The Format of the Portfolio Budget Statements-Second Report, expressed concern over the widely differing levels of specificity. The Committee stated that some outcomes are so general that it is hard to see how accountability can be enhanced in reporting against them.

The Committee also criticised the absorption of agencies and functions into broader frameworks so that these agencies were no longer separately identifiable in terms of their funding and performance. For example, in 1999–2000, the Office of the Status of Women and the Australian Geological Survey Organisation (AGSO) were absorbed into broader frameworks. Possibly in response to such criticism, the subsequent trend has been to show agencies separately. For example, AGSO is now shown separately in the Portfolio Budget Statements of the Industry, Tourism and Resources portfolio. The Committee also noted that the amounts allocated to outcomes ranged from $271 000 to more than $17.5 billion.

A major problem associated with the framework to which the Committee drew attention is the paucity of information especially in the Portfolio Budget Statements. Contrary to the rhetoric about how accrual budgeting and the outcomes and output framework would increase transparency and accountability, the availability of information in the Budget Papers and documentation, especially the Portfolio Budget Statements, has fallen sharply. The main complaint is excessive aggregation of financial data and the lack of detail about agency activities. The extent of aggregation can be seen by comparing the 1995–96 Portfolio Budget Statement for the Department of Employment, Education and Training with that of the Department of Employment and Workplace Relations for 2002–03. The latter refers to just two outcomes. This issue is discussed in section 5.5, which deals with the Portfolio Budget Statements.

It will be some time before a proper assessment can be made of whether the benefits of the outcomes and outputs framework justify its cost. Agencies have, at considerable expense, restructured their accounting and costing systems to conform to the framework. The framework has been in place for three Budgets and is still being developed. Some recasting of outcomes and outputs has already occurred with the trend apparently towards fewer of both. For example, in 2001–02, the Department of Environment and Heritage changed its outputs structure substantially. Further recasting is likely.

The recasting of outcomes and outputs will make assessment of the success or otherwise of the framework difficult. Recasting will also make time series comparisons of expenses difficult because of the lack of continuity in data series. However, the problem of comparability has to be balanced against the provision of better information and the issue of materiality.

The trend seems to be for agencies to consolidate outputs into fewer categories. The desirability of this is questionable on transparency and accountability grounds. The Senate Finance and Public Administration Legislation Committee's observation about the generality of some outcomes and accountability, could also be applied to the consolidation of outputs.

3.3 Costing of Outcomes and Outputs

Outcomes and outputs are costed by attributing all costs to outputs and thence to outcomes. The objective is to measure as accurately as possible the cost of producing outputs and outcomes. The trend is for improved costing of activities.

Still, problems remain. For example, it is difficult to allocate some costs—for example, 'overheads' such as electricity and rent—which cannot be attributed directly to a particular output or which contribute to more than one output. The Auditor-General has noted:

> During the 2000–2001 financial statement audit process, the attribution issue was considered. At this time, not all entities are able to attribute accurately all costs to relevant outcomes/output groups … There is scope for many entities to develop comprehensive allocation models which are able to attribute more reliably expenses to outputs.[12]

The Productivity Commission's inquiry into cost recovery arrangements by Commonwealth regulatory, administrative and information agencies should result in further improvement in costing of activities.[13]

3.4 Functional Classification of Expenses

Under the outcomes and output framework, it is usually not possible to determine how much is spent on functions such as health, education, road transport and defence[14]. However, expenses are classified by function in Statement 6 of Budget Paper No. 1 for 2002–03 and in other documents such as the Final Budget Outcome. The Department of Finance and Administration notes:

> The function classification is a code used to classify expense transactions by the purpose they serve (e.g. health, education). It is based upon the Australian Bureau of Statistics GPC (government purpose classification) which in turn is based upon the United Nation's *Classification of the Functions of Government* (COFOG), which is also applied in the IMF Government Finance Statistics system.
>
> The function allows trends in government expenditure on particular functions to be analysed over time. This is helpful in forecasting future expenditures. It can also be used to isolate government expenditures on functions of interest for specific economic or social studies. [15]

For example, the 'education' function covers:

- expenses on the provision, management and support of all levels of educational services at the preschool, school and tertiary level (through both the higher and technical and further education systems)
- expenses relating to allowances to students at all levels, educational programs designed specifically for the benefit of special groups, expenses on non-vocational adult education courses, regulation and some research activities (with other research funding being classified to General Research), and general administration relating to education but
- excludes expenses on military colleges classified to Defence. [16]

Note that the classification of activities to functions can change. The changes are noted at the end of the tables. For example, expenses for assistance to the aged were reclassified from 'health' to 'social security and welfare' in Table 3 of Statement 6 in Budget Paper No. 1 for 2001–02.

4. Appropriations

Section 83 of the Constitution states:

> No money shall be drawn from the Treasury of the Commonwealth except under appropriation made by law.

There are two broad categories of appropriations:

- annual appropriations and
- special (or standing) appropriations.

4.1 Annual Appropriation Bills

Annual appropriations are contained in the three Appropriation Bills:

- Appropriation Bill (No. 1)
- Appropriation Bill (No. 2), and
- Appropriation (Parliamentary Departments) Bill.

These Bills are contained in Budget Paper No. 4.

The Bills authorise the payment of specified amounts for particular purposes. Appropriation Bill (No. 1) provides for the appropriation of money from the Consolidated Revenue Fund for the ordinary annual services of government. Appropriation Bill (No. 2) provides for the appropriation of money from the Consolidated Revenue Fund for purposes other than the ordinary services of government. The division of items between the two Bills accords with the 1965 'compact' between the House of Representatives and the Senate.[17]

Appropriation Bill (No. 1) sets out agency appropriations by outcome and distinguishes between administered and departmental expenses. The data in Appropriation Bill (No. 1) are highly aggregated and additional information is contained in Portfolio Budget Statements. Items in Appropriation Bill (No. 2) include:

- expenses in relation to grants to the States under section 96 of the Constitution (Specific Purpose Payments) and for payments to the Northern Territory and the Australian Capital Territory
- administered expenses for new agency outcomes, and
- departmental capital—in the forms of equity injections, loans and carryovers—and administered capital.

The Parliamentary Departments have a separate Appropriation Bill because Parliament is constitutionally separate and independent of the Executive and because the Departments are administered under their own legislation separate from the *Public Service Act 1999.*

4.2 Special (or Standing) Appropriations

Annual appropriations account for around only 25 per cent of agency expenses. The remaining 75 per cent are funded under special (or standing) appropriations—the terms are often used interchangeably—and receipts from independent sources.[18] Authority for special appropriations (the term generally used to refer to either special or standing appropriations) derives from various Acts. For example, the authority for spending on roads is three Acts: the *Australian Land Transport Development Act 1988*, the *Roads to Recovery Act 2000*, and the *Local Government (Financial Assistance) Act 1995*. Standing appropriations are 'open-ended' in that the amount appropriated for a particular purpose is determined by the eligibility and other provisions in the relevant Act. An example is age pensions paid under the *Social Security (Administration) Act 1999*. Special appropriations are payments of a specific amount over a specific period of time.

This highlights a number of differences between the annual and special appropriations. Whereas the Appropriation Bills are for specific amounts, the amounts in the Budget for special appropriations are estimated spending under the various Acts. Further, whereas spending under the Appropriation Bills is subject to annual review and approval by Parliament, this is not the case for special appropriations in the sense that Parliament does not legislate annually for special appropriations. Information on the estimated payments under special appropriations can be found in Portfolio Budget Statements.

Revenues from independent sources include proceeds from the sale of goods and charges for the provision of services, and profits from the sale of assets. The amount that Parliament appropriates for an outcome is the difference between the 'price of outputs' (the full cost of the good or service) and revenue from other sources. For example, in 2002–03, the Department of Finance and Administration outcome 1 (sustainable government finances) has a price of outputs of $37.43 million, which will be funded by $36.17 million in Appropriation Bill (No. 1) and $1.26 million in revenue from other sources. To the Department's credit, receipts from independent sources are listed in some detail in an appendix.

A welcome development is the reporting by some agencies of estimated expenses from individual special appropriations in their Portfolio Budget Statements. For example, in 2002–03, the Department of Family and Community Services and the Department of Finance and Administration reported such information in an appendix. In the case of the Department of Family and Community Services, it can be seen that estimated spending under administered (see section 4.3) special appropriations is $56 billion. Of this, almost $43 billion will be spent under the *Social Security (Administration) Act 1999*. The Department of Family and Community Services goes even further and breaks down spending under this Act by category, for example, age pension, disability support pension, youth allowance and so on.

4.3 Administered and Departmental Items

Appropriations are classified as either administered or departmental. The distinction is based on the concept of 'control' as outlined in Australian Accounting Standard (AAS) 29 'Financial Reporting by Departments'.

Departmental items are the resources that agencies control and use to produce outputs. Examples are equipment, liabilities for employee entitlements, revenues from user charges, and employee and other administrative expenses. Administered items are revenues, expenses, assets and liabilities that the government controls and which an agency manages on the government's behalf. Administered items include expenses such as subsidies, grants and benefit payments; revenues from taxes, fees, and fines; liabilities relating to public debt and employee superannuation; and assets relating to tax amounts receivable, loans to other governments and investments in controlled entities. An example of an administered expense is the road grants the Commonwealth makes to the States under the *Australian Land Transport Development Act 1988*. Spending by some Departments, for example, Family and Community Services, is overwhelmingly administered because most of its spending is authorised by various legislative enactments such as those pertaining to pensions, family assistance and various allowances.

The distinction between administered and departmental items is not clear cut. The Senate Finance and Public Administration Legislation Committee, in its third report on the format of the PBS observed:

> 3.22 It became evident, during the 2000–01 budget estimates hearings, that a number of activities had been reclassified from 'administered' to 'departmental' and hence their funding could be varied at agency discretion. For example, a range of programs in the Department of Environment and Heritage, including grant schemes, became 'departmental' and were listed as such in the PBS. The distinction, and its implications, was not the subject of particular questioning on this occasion.
>
> 3.23 The committee could find no examples of reclassifications in the other direction. The committee concedes that the concept of 'control' is at times a matter of judgement; it also notes that reclassifications cannot be done unilaterally by agencies but the approval of DOFA must be sought. Representatives of a number of agencies stressed that funding flexibility was needed to meet changing priorities and to deal with the unexpected. While accepting this argument, the committee is nevertheless concerned that any such reclassifications not be used to thwart accountability.

4.4 Additional Estimates

Funding requirements often change after the Budget is brought down. Governments make new policy commitments which have to be funded. Agencies reassess their requirements and, if necessary, submit requests for additional funding. The Government may agree to additional funding if the amounts in the Appropriation Acts are inadequate. The process whereby additional funds are provided is called additional estimates, and begins around November. The approved additional estimates are normally incorporated into Appropriation Bills 3 and 4 and Appropriations (Parliamentary Departments) Bill No. 2. These Bills are the counterparts of Appropriation Bills No. 1 and 2 and Appropriations (Parliamentary Departments) Bill No. 1 respectively.

Portfolio Additional Estimates Statements are the additional estimates counterparts of Portfolio Budget Statements and contain explanations of Appropriation Bills 3 and 4 and Appropriations (Parliamentary Departments) Bill No 2. The Senate Estimates Committees also scrutinise Appropriation Bills 3 and 4. Parliament usually passes the additional estimates Bills around April.

4.5 Advance to the Finance Minister

The Advance to the Finance Minister (AFM) provides flexibility to the system of appropriating funds. The AFM is a contingency fund from which the Minister for Finance and Administration can spend for emergency or unforeseen circumstances. Authority for payments derives from section 11 of the annual Appropriation Acts. According to Department of Finance and Administration guidelines, funding is available only if agencies meet two tests:

- the need for funding must be urgent, and
- the need was unforeseen or arose because of erroneous omission or understatement.

Section 11 of the Appropriation Acts also requires the Minister to account to Parliament for spending from the AFM, which the Minister does by tabling monthly and annual statements. These reports are, however, not terribly enlightening since they allocate payments by outcome and do not provide details of what the payments were for.

5. Budget Documents

As noted, the Government releases the Budget Papers and Documentation on Budget night. Ministers also issue media releases and hard copy information kits. The Budget Papers and documents consist of:

- the Budget Speech
- Budget Overview
- five Budget Papers
- Portfolio Budget Statements, and
- Ministerial Statements.

5.1 Budget Speech

The Budget Speech is the printed version of the speech that the Treasurer delivers on Budget night. The speech contains Budget highlights and details of the Government's priorities. As is the case with the other Budget Papers, the Speech is loaded onto the Parliamentary computing network on Budget night or very soon thereafter.

5.2 Budget Overview

As its name suggests, the Budget Overview is a document of about 30 pages that summarises key features of the Budget with an emphasis on graphical and tabular presentation. In 2002–03, the Overview contained a Budget overview, a review of the Australian economy, and appendices containing Budget aggregates, spending initiatives, economic forecasts and historical data going back to 1975–76.

5.3 Budget Papers

There are five Budget Papers. Each is discussed in turn.

5.3.1 Budget Paper No. 1, Budget Strategy and Outlook 2002–03

Budget Paper No. 1 is the most important explanatory document. Budget Paper No. 1 for 2001–02 contained eleven Statements dealing, among other things, with fiscal policy, the outlook for the economy, assumptions underlying the projections of growth, unemployment, revenue and expenses and other matters. Budget Paper No. 1 is prepared in accordance with the *Charter of Budget Honesty Act 1998*, which requires that the government provide, among other things, a statement of its fiscal strategy and a report on the economic and fiscal outlook as well as risks to the outlook. It should be noted that the precise content and statement number can vary from year to year. The following is based on the 2001–02 Budget.

Statement 1 — Fiscal Strategy and Budget Priorities. This contains sections dealing with the fiscal and economic outlooks, fiscal strategy and the Government's priorities in areas such as welfare, health, education and transport.

Statement 2 — Fiscal Outlook. This statement contains sections dealing with the fiscal aggregates, variations to expense and revenue estimates and their consequences for the fiscal balance, the Commonwealth's net debt and worth positions, and cash flows. An appendix deals with the sensitivity of fiscal aggregates to economic developments.

Statement 3 — Economic Outlook. This Statement discusses developments in the domestic and international economies, and uncertainties in the outlooks for both.

Statement 4 — A Australian Terms of Trade – Stronger and Less Volatile. This Statement is one of a series in recent Budgets, which discuss various aspects of the economy. In the 2000–01 and 2001–02 Budgets, the topics were tax reform and productivity issues respectively.

Statement 5 — Revenue. This contains an overview and discussion of Budget and forward year revenue estimates. The Appendices contain useful information including details of revenue measures and revenue statistics going back to 1990–91.

Statement 6 — Expenses and Net Capital Investment. This contains information on the spending side of the Budget including on expenses, which are often the focus of Budget discussions. Expenses are divided on a functional basis, for example, defence, education, health, and social security and welfare. Part II deals with general government net capital investment. The appendices contain useful data including expense measures by agency, and expenses statistics by function for the Budget and out years.

Statement 7 — Budget Funding. This contains details of the Commonwealth's recent and prospective net funding requirements and borrowing programs.

Statement 8 — Trends in Public Sector Finances. This contains and discusses data on trends in public sector finances including fiscal balance and net debt and net worth. The Appendices contain data on the size of the public sector and other information.

Statement 9 — Risks to the Budget. This statement attempts to disclose the range of factors that may influence the budget outcome in future years. They include economic parameters reflecting the state of the economy, possible events that are not forecast, but not ruled out either, and the Commonwealth's exposure to contingent liabilities.

Statement 10 — External Reporting Standards and Budget Concepts. This Statement explains and discusses key Budget concepts such as fiscal balance, the underlying cash balance and the headline cash balance, and the Government Finance Statistics (GFS) and Australian Accounting Standard No. 31. Statement 11 also contains a reconciliation of these two standards.

Statement 11 — Government Finance Statistics Statements. As discussed later, accrual financial data are presented in two ways. One is known as Government Finance Statistics (GFS). Statement 11 presents data on a GFS basis for 2001–02, 2002–03 and the three following ('out') years. The financial statements include the general government operating statement, balance sheet, cash flow statement, and statement of taxation revenue by source.

Statement 12 — Australian Accounting Standard No. 31 Budget Financial Statements. The second way of presenting financial data is in accordance with Australian Accounting Standard No. 31. The data in Statement 10 accord with this Standard. Statement 10 contains data on general government sector revenue and expenses, balance sheet, and cash flows, as well as Notes containing information, for example, on interest and dividends and income tax.

Statement 13 —Historical Commonweatlh Data. This Statement is one of the most important—but often overlooked—sources of historical data. For example, Part II contains data on revenues, outlays, surplus/deficit, and net debt on a cash basis going back to the early 1970s.

5.3.2 Budget Paper No. 2, Budget Measures 2002–03

Budget Paper No. 2 titled 'Budget Measures' summarises the various measures the Government is proposing, such as changes to tax rates and new spending initiatives. Budget Paper No. 2 brings together in the one document all the intended measures involving individual agencies and so is a quick way of finding information. It contains details of the *changes* to expenses, revenues and capital items by portfolio, and summarises revenue and expense measures since and up to the Mid-Year Economic and Fiscal Outlook. Each measure is described briefly.

5.3.3 Budget Paper No. 3, Federal Financial Relations 2002–03

Budget Paper No. 3 deals with Commonwealth payments to the States and Territories and local government. Budget Paper No. 3 contains estimates of GST payments and Specific Purpose Payments (SPPs) to the States and Territories classified by function such as education, health, and transport and communications. Given that so much of Commonwealth spending takes the form of SPPs, which are authorised by specific Acts, Budget Paper No. 3 contains much useful information.

5.3.4 Budget Paper No. 4, Agency Resourcing 2002–03

Budget Paper No. 4 contains information on resourcing in Commonwealth agencies and includes Appropriation Bills No. 1 and No. 2 and the Appropriation Bill for the Parliamentary departments. The introduction to Budget Paper No. 4 contains a useful overview of the annual appropriations system.

5.3.5 Budget Paper No. 5, Intergenerational Report 2002–03 This statement attempts to give an assessment of the long-term trends in government finances through to the year 2041–42. In particular the implications of an aging population are discussed with projections made on the assumption of unchanged government policy.

5.4 Ministerial Statements and Media Kits

Some Ministers issue Ministerial Statements (otherwise known as the 'blue books') on Budget night. For example, when the 2001–02 Budget was brought down, the Minister for Agriculture, Fisheries and Forestry issued a Statement titled 'Safeguarding Our Rural Resources'. Another Statement dealt with regional Australia. These Statements often contain information not readily obtainable elsewhere. Ministers usually release media kits and press releases. However, it should be remembered that Ministerial Statements, media kits and press releases are political documents which sometimes 'stretch' the definition of what their titles suggest they contain. Media releases are usually available on Ministers' web sites soon after the Budget is brought down.

5.5 Portfolio Budget Statements

The Portfolio Budget Statements (PBS) are one of the most important Budget documents. They are the main source of information on proposed agency activities and contain information in support of spending proposed by the Appropriation Bills. Ministers prepare the PBS for the Senate Estimates Committees' examination of proposed appropriations. The PBS are made available with the Budget or soon after on-line.

5.5.1 Content and Format

The information in the PBS falls into two broad categories: agency resourcing and performance assessment. The former contains information on how agencies will be funded, the use to which the funds will be put as defined by planned outcomes, and budgeted financial statements. The PBS also contain details of performance information that agencies will collect to assess their performance against planned outcomes. The assessments are presented in their annual reports. Performance information is discussed in section 9.

The Department of Finance and Administration has guidelines for the format of the PBS. As a result, the structure of the PBS is broadly similar across agencies. However, agencies have discretion to present their PBS in a format that presents information clearly so that the format differs somewhat across agencies. An example of a structure is the following taken from the Department of Finance and Administration PBS for 2002–03.

- Part A: User Guide: provides an introduction explaining the purpose of the PBS as well as information in relation to the styles and conventions used.

- Part B: Portfolio Overview: provides an overview of the portfolio. The structure of the portfolio outcomes is depicted in a chart that outlines the structure of the outcomes to which the portfolio contributes.

- Part C: Agency Budget Statements: for each agency within the portfolio, statements are presented under the agency's name.

  – Section 1: Agency overview, appropriations, and budget measures summary. This section details the link between the resources appropriated and their application to the outputs which contribute to the achievement of outcomes.

  – Section 2: Outcomes and outputs information. This section details planned outcomes and the contributing administered items and agency outputs.

  – Section 3: Budgeted Financial Statements. This section contains the four budgeted financial statements in accrual format covering the Budget year, previous year and the three out-years for each agency.

  - Section 4: Purchaser/provider arrangements. This section is presented for those agencies that have entered into purchaser/provider arrangements with other agencies.

- Styles and conventions used.

The appropriations and revenue summary distinguishes between departmental and administered spending, and allocates spending in these two categories across outcomes. The summary also shows the amounts appropriated under Appropriation Bills 1 and 2, special appropriations, and total appropriations.

5.6 Issues

There has been considerable criticism of the format and content of the Budget Papers and associated documents since the introduction of accrual accounting and the outcomes and outputs framework. The 1999–2000 Budget marked a low point in that it was one of the least informative ever.

Subsequent Budgets have progressively provided more information. But much of the information that Members of Parliament frequently require, and which was available before 1999–2000, is still not available. The paucity of information has also meant that it is now necessary to contact agencies more frequently than before to obtain information. That is certainly the experience of staff in the Department of the Parliamentary Library, whom Members of Parliament call upon to find information in Budget documents. The lack of information has probably increased the importance of the Senate Estimates Committees process as a means of obtaining information and releasing it into the public domain.

The PBS have come under particular criticism. A major complaint is excessive aggregation and the lack of detail about agency activities. The amount of detail that agencies provide varies considerably. Some agencies such as the Department of Transport and Regional Services continue to provide a considerable amount of detailed information.

Aggregation in the PBS has been at two levels. First, compared with the program budgeting format, the number of items has been compressed into fewer outputs and even fewer outcomes. The result is a loss of information about individual programs. Second, agency budgeted financial statements are also highly aggregated. For example, the Department of the Environment and Heritage's administered expenses are broken down into four categories (suppliers, grants, cash to official public account and other). The figure of $223.794 million for grants in 2002–03 (and $297.018 million in 2001–02) is not broken down.

The Senate Finance and Public Administration Legislation Committee in its report titled The Format of the Portfolio Budget Statements - Second Report, criticised the aggregation of financial information. The Committee stated:

> The committee notes a clear preference on the part of senators for a more detailed breakdown of financial information. The committee is mindful of the tight timeframes in which the PBS are finalised, a fact attested to by the numerous and extensive corrigenda tabled to the 1999–2000 PBS. It makes the following recommendations cautiously, and would be prepared to accept the later provision of the disaggregated information, if agencies required additional time to provide it accurately. With the above provisos, the committee **recommends (2)** the disaggregation of appropriations to output level; it **recommends (3)** the itemising of administered items; and it further **recommends (4)** the inclusion of forward estimates for outcomes and outputs. It expects that [the Department of Finance and Administration] and agencies will monitor the accuracy of the disaggregated information and if after a reasonable period of time it becomes apparent that the figures are so imprecise as to be meaningless, the committee will review its recommendation. [19]

In its response, the Government agreed to the majority of the Committee's recommendations but rejected the recommendation that forward estimates for outcomes and outputs should be itemised on the grounds that Budget Paper No. 1 already provides adequate information. However, the Committee, in its third report on the format of the PBS, rejected the Government's response based partly on the fact that some agencies have done what the Committee recommended. Concern with aggregation is also a major theme in the hearings of the Joint Committee of Public Accounts and Audit's Review of the Accrual Budget Documentation held on 22 June 2001.

Mr Bartos, a senior executive in the Department of Finance and Administration has acknowledged that the level of aggregation is a problem.[20] The Department of Finance and Administration issues Guidelines for the Preparation of Portfolio Budget Statements. However, these are 'minimum' guidelines. Agencies have considerable discretion as to what they present in their PBS and in what format. Where Parliament identifies gaps in the information the PBS, it can require agencies to provide that information. Agencies have responded to requests from various Parliamentary committees by including additional information in PBS. The trend, therefore, is for agencies to provide more information.

Another criticism of the PBS is that it is not possible to see how much is to be spent under individual special appropriations. As noted in section 4.2, a welcome development is the reporting by some agencies of estimated expenses from individual special appropriations in their PBS. The example cited is estimated spending by the Department of Family and Community Services under the *Social Security (Administration) Act 1999*. The present PBS now shows the links between spending under special appropriations and outputs and outcomes. The Department of Family and Community Services administers five Acts that contribute to its three outcomes. Three Acts: *A New Tax System (Family Assistance)(Administration) Act 1999*, *Childcare Rebate Act 1993*, and *Child Support (Registration and Collection) Act 1988* contribute to outcome 1, namely, “Stronger Families.” The *Social Security (Administration) Act 1999* also contributes to outcome 1 as well as outcome 3, “Economic and Social Participation.” The latter includes all the major personal benefits from the age pension to the youth allowance. Finally there are payments under the *State Grants (Housing) Act 1971* that contribute to outcome 2, "Stronger Communities."

Given that 75 per cent of expenses are funded from special appropriations and that authority for special appropriations is the Acts that Parliament has passed, it seems appropriate that agencies should show estimated spending under each Act and the outcome(s) which the Act contributes. The provision of this information links the legislative authority for spending to planned outcomes. The Department of Family and Community Services now appears to be the outstanding example of how that should be done.

6. Reporting Standards

Information in the Budget papers is prepared in accordance with a number of requirements. One is the Uniform Presentation Framework, which is an agreement among the Commonwealth, States and Territories whereby all jurisdictions must publish common core aggregate budgetary and fiscal information for external purposes.

The *Charter of Budget Honesty Act 1998* requires that the Budget be presented on the basis of external reporting standards. There are two main standards: the Government Finance Statistics framework of the Australian Bureau of Statistics, and the public sector accounting standards developed by the Public Sector Accounting Standards Board (PSASB). The PSASB standard for government is Australian Accounting Standard No. 31, *Financial Reporting by Governments* (AAS 31).[21]

6.2 Government Finance Statistics

The Government Finance Statistics (GFS) reporting framework is a statistical system designed to allow economic analysis of the public sector, especially of the effects of government spending and revenue on the economy. Major Budget aggregates (including the fiscal and underlying cash balances) are based on the GFS framework. The data required under the *Uniform Presentation Framework* are also on a GFS basis.

6.3 Australian Accounting Standard 31

AAS 31 is a comprehensive standard that specifies a range of accounting practices and how agencies should present financial information. Reporting under AAS 31 is intended to provide an overview of the government's financial performance and position, including financing and investing activities. AAS 31 is adapted from the accounting standards developed for the private sector.

6.4 Accounting Standards Issues

GFS and AAS 31 standards can yield quite different results. For example, in 2001–02, the general government sector operating deficit was $3.0 billion on a GFS basis while the operating deficit was $3.7 billion on the AAS 31 basis. At 30 June 2002, general government sector net worth was minus $42.3 billion on a GFS basis but minus $49.9 billion on the AAS 31 basis.[22] The differences between the two systems are described in the Budget Papers.[23] By way of illustration, AAS 31 includes profits from the sale of assets in the operating statement; GFS treats such profits as revaluations and excludes them from the operating statement. Under AAS 31, the Department of Defence brings specialist capital equipment into the balance sheet and depreciates it. The GFS treat all defence spending as if it were an expense.

The use of the two standards is a source of confusion. This raises the issue of what accounting standards should apply to the Budget documents. In particular, it raises the issue of the usefulness of accounting standards developed for the private sector in a public sector context.

The usefulness of AAS 31 in a public sector context is limited. This is especially true of non-commercial government agencies. For example, whereas equity in a business is an indicator of its solvency, creditworthiness, and net worth, these concepts have limited meaning for an agency whose main functions are to provide policy advice and administer appropriations.[24] Similarly, an agency statement of financial performance does not have the same purpose or meaning as that of a company operating for profit. The purpose of business is to earn profits for its owners. The function of many government agencies is to provide goods and services for the non-market sector (public goods) and to redistribute income through transfer payments such as old age pensions, which do not entail any reciprocal provision of goods and services. None of this is to say that financial statements using private sector concepts are valueless and should not be prepared. Rather, it is to note that caution should be used when interpreting statements.

One commentator, critical of the decision to use AAS 31 in Budget documents, said:

> Merely having two accounting systems is a serious retrograde step in Australia. Prior to the introduction of accrual accounting in Australia, there has been huge progress towards the standardisation of government budget accounting, based upon the cash accounting version of GFS. Why two systems? AAS 31 is driven by the idea that government accounting should operate just like private sector accounting, whereas GFS is tailor-made for public sector policy purposes. This means that AAS 31 incorporates accounting policies which do not necessarily make a great deal of sense in a government context.[25]

Professor Barton, in evidence to the Joint Committee of Public Accounts and Audit, argued that private sector accounting standards should be modified for public sector purposes:

> … I argue strongly that the accrual accounting system appropriate for the government is not the accrual accounting system used by business. The accrual accounting systems used by business are designed to suit the specific market environment of business operations…When we move to the public sector…the government is concerned with providing those goods and services which the market cannot conveniently provide… I believe the accrual accounting systems developed for business are not readily transportable to the public sector without significant modifications for some areas of activity. These include the provision of all these types of public goods, the accounting for the cultural and heritage assets such as the National Gallery, the National Library and the Australian War Memorial; all of the land under public roads, a lot of our infrastructure and so on. The present business accounting standards do not readily cover these types of situations because they were never intended for application to them, so we need accrual accounting—but it has to be modified.[26]

6.5 Treatment of the Goods and Services Tax

The Budget Papers generally treat the goods and services tax (GST) as if it were not a Commonwealth tax. With one exception (noted below), the GST is not shown as Commonwealth revenue or spending in Budget Paper No. 1. The Government's argument for this treatment—the 'agency' argument—is that the intent of the *Intergovernmental Agreement on Commonwealth-State Financial Arrangement*—which governs Commonwealth-State financial relations—is that the GST is collected by the Commonwealth as an agent for the States and Territories and appropriated to them.

The alternative 'constitutional' argument is that whatever the intent of the *Intergovernmental Agreement*, constitutionally, the GST is a Commonwealth tax because the GST is imposed and administered under Commonwealth legislation. The Australian Bureau of Statistics (ABS) has rejected the agency argument and classifies GST revenue as a Commonwealth tax in the Government Finance Statistics.[27] The Auditor-General also rejects the agency argument (see discussion under Consolidated Financial Statements). Against the argument that the GST is a State tax collected by the Commonwealth in an agency capacity the Auditor-General makes the following finding:

> From an accounting perspective, the GST is a Commonwealth revenue. It is imposed under Commonwealth legislation and the Commonwealth Government therefore controls the revenue raised. The Government's decision to enter into an agreement to pass the GST revenue collected to the States is a separate transaction conducted to meet its particular objectives.
>
> The Commonwealth Government's control of the GST revenue is also illustrated by the fact that the distribution of GST revenue is based on population share adjusted by a relativity factor embodying per capita financial needs. The relativity factor is determined by the Commonwealth Treasurer based on advice given by the Commonwealth Grants Commission and following consultation with the States and Territories. Thus, the actual distribution will only coincidentally reflect the amount of tax collected within the jurisdictions of the beneficiary governments, so that there is no direct connection

> between the tax revenue arising in, and the tax revenue returned to, a particular State or Territory.[28]

The tables in Statement 9 of Budget Paper No. 1 for 2001–02 are consistent with ABS standards on the *Uniform Presentation Framework* reporting basis, and show GST as revenue in and expenses out.

A consequence of not recognising the GST as a Commonwealth tax is to understate expenses and revenue. In 2001–02, revenues were understated by $27.6 billion and expenses by $27.4 billion. The suspicion inevitably arises that the 'agency' treatment of the GST is intended to show the Commonwealth government sector as smaller than it really is.[29]

7. Agency Financial Statements

The move to accrual accounting has entailed wide-reaching changes to the presentation of financial information. The requirement that agencies produce financial statements has had the positive effect of increasing transparency. For example, under cash accounting, receipts include diverse items such as taxation revenue and proceeds from the privatisation of assets while cash outlays include purchases of assets such as plant and equipment and current expenses such as advertising. Accrual accounting, on the other hand, brings assets into the balance sheet and treats advertising as an expense. Accrual accounting thus distinguishes between the activities that affect operating activities and those that affect the balance sheet.

Agencies are required to prepare four financial statements for their Portfolio Budget Statements and annual reports. They are statements of financial performance, financial position, cash flows, and capital budget. The statements show departmental and administered items separately.

7.1 Statement of Financial Performance

The statement of financial performance can be thought of as the counterpart of what used to be called a business profit and loss statement, albeit with obvious differences in the functions of government agencies and their sources of revenue compared to businesses. The statement allows assessment of agencies' financial performance. Typically, the statement shows revenues from ordinary activities, the total cost (expenses) of these activities, borrowing cost expense (discussed in section 7.1.1), and the net surplus or deficit from ordinary activities. Revenues include revenue from government, sales of goods and services, interest and dividends, net gains from sales of assets and other revenue. Expenses include payments to employees, suppliers, grants, write-down of assets, and depreciation and amortisation.

It is important to understand that items that affect the statement of financial performance also affect the Budget surplus or deficit.

7.1.1 Capital Use Charge

A particular item in the statement of financial performance that requires explanation is the capital use charge (CUC). As its name suggests, it is a charge that agencies pay for their use of capital. The argument for the CUC is that capital is not a free resource. Agencies do not, however, pay explicitly for the capital they use so that the cost of their activities is understated. Agencies should therefore bear a charge for the implicit cost of capital used. Funding for the CUC is included in agencies' departmental appropriations. In practice the CUC has been a problem and the Government decided to abolish it as of 1 July 2003. For example, Auditor-General, Mr Pat Barrett, recently explained:

> in the ANAO's opinion, the major impact of the charge has been to provide public sector managers with an incentive to manage financial results so as to minimise the charge payable. Whether, in practice, this has resulted in improved management at the program level or resulted in other benefits, is not clear.[30]

A few comments are in order to assist in understanding the present arrangements. Agencies pay the CUC on their estimated departmental equity (assets less liabilities) at the end of the financial year; in some cases, funding is based on opening equity. The CUC does not apply to administered equity. The CUC rate is set annually. In 2001–02, the rate was 11 per cent.

The CUC is shown in the statement of financial performance. The CUC appears 'below the line', that is, after net operating profit (revenues less expenses) along with abnormal and extraordinary items. How the CUC operates is illustrated in the Department of Defence Portfolio Budget Statement for 2001–02. This shows that the Department is projected to run a net operating surplus of $4.8 billion in 2002–03. The CUC is projected to offset the surplus exactly.

7.1.2 Agency Banking

In a related change the Government has decided to discontinue the Agency Banking Incentive Scheme (ABIS) from 1 July 2003. Under ABIS the government’s banking functions were devolved to agencies that were able to invest surplus cash balances in term deposits and retain the interest earned on those funds. Agency appropriations were reduced by an amount equal to the forecast interest earnings that were to be retained by agencies. The intention was to produce a budget neutral result but, as with the CUC, the intention was also to provide an incentive for agencies to better manage their resources. For example, agencies now receive funding to cover all of their expenses, including depreciation of their capital items, even though there may be no intention of replacing those assets. In this way agencies can build up substantial funds.

The Auditor-General has remarked:

> There has been a temptation for individuals both within and outside the agency to see these funds as an available resource and to redirect them to other, perhaps more immediate, priorities. Agencies would require discipline and effective financial management practices to prevent this diminution in their capital base if this practice were to continue.
>
> Again, Finance has recognised such concerns, recommending that the Agency Banking Incentive Scheme be discontinued and that specific cash management rules for the cash draw-down and reporting requirements be developed. Finance had previously issued guidance suggesting that depreciation funding provided for long lived assets (defined as those with a useful life in excess of 50 years) be set aside and only accessed when required to meet planned expenditure on long lived assets as set out in a capital plan endorsed by a management board. However, as noted earlier, Finance has now recommended, by way of the Budget Estimates and Framework review, that 'a just in time' draw-down model be implemented whereby cash is released from the Official Public Account to agencies for departmental and administered expenses as needed.[31]

Depending on how it is managed the 'just in time' draw-down model could represent a serious challenge to the philosophy behind accrual budgeting. Finance is now required to develop specific rules for the cash draw-down and reporting requirements. If those rules and their administration represent a check on agency behaviour, then they will imply a departure from the devolution of management of assets allowed under the ABIS. The implications could well be a significant return to the centralised control of government by central agencies.

7.2 Statement of Financial Position

The statement of financial position sets out the agency's assets, liabilities and equity (assets less liabilities) at a point in time (stock). The statement is the counterpart of a business balance sheet and allows assessment of an agency's financial position over time. Assets are divided between financial assets such as cash, receivables and investments, and non-financial assets such as plant and equipment and inventories. Liabilities are divided between debt such as loans and leases, and provisions and payables such as amounts owed to employees and suppliers. Equity is divided among capital contributions, reserves and accumulated surpluses or deficits.

Items that affect the statement of financial position *only* do not affect the budget surplus or deficit. For example, asset sales such as the sale of the Commonwealth's equity in Telstra are generally reflected only in the statement of financial position. In this case, the sale is a change in the type of asset (from financial investment to cash) with no change in the Commonwealth's net equity position. Similarly, using the proceeds of asset sales to reduce debt does not change the Commonwealth's net equity position since the reduction in debt is matched by an equal reduction in cash.

Such a transaction will, however, also usually also affect the statement of financial performance—through changes to dividends and public debt interest—and hence the Budget surplus or deficit.

Under Australian Accounting Standard 31, any profit or loss on the sale of an asset has to be brought into the operating statement and hence would affect the Budget deficit or surplus. However, in practice, it seems that some assets are revalued (reflected in an increase in equity) to the sale price so that no profit is recognised in the statement of financial performance.

7.3 Cash Flows Statement

The cash flows statement shows the sources and uses of cash (flows) including the cash balance at the end of the year (stock). The statement distinguishes among cash received and used in operating, investing and financing activities. Operating activities include, for example, cash received from appropriations and payments to employees. Investing activities include proceeds from sales of property and repayments of loans, and cash used to make loans and buy property. Financing activities include equity contributions and proceeds from loans and cash used to repay debt.

7.4 Capital Budget Statement

The capital budget statement shows how agencies fund capital activities and how they use those funds. Agencies fund capital activities from their own resources and from additional capital that the government provides in the forms of loans and equity injections. The capital statement also shows how the capital is used, that is, to buy new assets or reduce liabilities.

8. Other Financial Information

In addition to the documents presented on Budget night, there are other documents containing Budget-related financial information. In particular, the *Charter of Budget Honesty Act 1998* and the *Financial Management and Accountability Act 1997* require the preparation of a number of reports.

8.1 Charter of Budget Honesty

The *Charter of Budget Honesty Act 1998* is a framework for the conduct and reporting of fiscal policy. The Act has two broad purposes: to improve fiscal policy by requiring policy to be based on principles of sound fiscal management, and to require the government to explain and account for its actions. The Act obliges the government to present three reports annually. They are:

- a Budget Economic and Fiscal Outlook Report (sections 10 to 13 inclusive)
- a Mid-Year Economic and Fiscal Outlook report (sections 14 to 17 inclusive), and
- a Final Budget Outcome report (sections 18 and 19).

The Budget report is contained in Budget Paper No. 1.

8.1.1 Mid-Year Economic and Fiscal Outlook

Section 14 of the *Charter of Budget Honesty Act 1998* requires the Treasurer is to release publicly and table a Mid-Year Economic and Fiscal Outlook (MYEFO) report by the end of January in each year, or within six months after the last Budget, whichever is later. In practice, the MYEFO has been brought down in October or November in recent years. The required contents of the MYEFO are set out in section 16. The main requirement is an update (the 'budget report') of the economic and fiscal outlook.

The MYEFO updates the economic and fiscal outlooks and the budgetary position. In particular, the MYEFO takes account of all decisions affecting expenses and revenues and so revises Budget aggregates.

8.1.2 Final Budget Outcome

Section 18 of the *Charter of Budget Honesty Act 1998* requires the Treasurer to release publicly and table a Final Budget Outcome (FBO) report for each financial year no later than three months after the end of the financial year. Section 19 deals with the contents of the FBO and states:

> A final budget outcome report is to contain Commonwealth budget sector and Commonwealth general government sector fiscal outcomes for the financial year.

Much of the data in the FBO are aggregated and so are of limited use. However, the FBO contains a comprehensive section dealing with payments to the States and Territories.

As noted, one problem associated with the presentation of Budgets in May is that financial outcomes for the year preceding the Budget year can only be estimated. However, information on actual outcomes for the financial year just ended can sometimes be found in the Portfolio Additional Estimates Statements.

8.1.3 Pre-Election Economic and Fiscal Outlook Report

Part 7 (sections 22 to 28) of the *Charter of Budget Honesty Act 1998* deals with the preparation of the Pre-Election Economic and Fiscal Outlook Report (PEFO).[32] The purpose of the PEFO is to update information on the economic and fiscal outlook before an election. Section 22 requires that the PEFO be released publicly within 10 days of the issue of the writ for a general election. The PEFO must contain spending and revenue estimates for the current and following three financial years, the assumptions underlying the estimates, the sensitivity of the estimates to changes in the assumptions, and risks that might change the fiscal outlook materially. Only two PEFOs have been prepared: one before the 1998 election and the other before the 2001 election. In 2001, the Government published the MYEFO and the PEFO within a day of each other and the two documents were virtually identical.

The financial position that an incoming government is likely to face is usually an election issue. The requirement that a PEFO be prepared is a positive step towards transparency in that it shows the likely state of finances. The fact that the Secretaries of the Treasury and the Department of Finance and Administration are responsible for preparing the PEFO—albeit on the basis of information that Ministers provide—adds to its credibility. The PEFO has therefore taken some of the heat out of election campaigns, which were often typified by claims and counter-claims about the true state of finances.

8.2 Financial Management and Accountability Act 1997

8.2.1 Monthly Reports

The *Financial Management and Accountability Act 1997* requires the Minister for Finance and Administration to publish monthly financial statements in a form consistent with the Budget estimates, as soon as practicable after the end of each month. Monthly financial statements can be found on the Department's web site. These show, among other things, monthly and cumulative data including the fiscal balance, the underlying cash balance and the net operating result for the Commonwealth general government sector.

8.2.2 Consolidated Financial Statements

Section 55 of the *Financial Management and Accountability Act 1997* requires the Minister for Finance and Administration to prepare annually consolidated financial statements (CFS) for the Commonwealth. The statements contain consolidated results for all Commonwealth-controlled entities, and disaggregated information on all three Commonwealth sectors: general government, public non-financial corporations and public financial corporations. It is not possible to compare the CFS directly with the Final Budget Outcome because the the CFS are prepared on the basis of Australian Accounting

Standards including AAS31 whereas data in the Final Budget Outcome are on a GFS basis.

8.2.2.1 Issues

The Auditor-General has qualified the CFS in respect of their treatment of taxation revenue and the GST. The CFS treat the GST as a tax that the Commonwealth collects in an agency capacity on behalf of the States. For the year ended 30 June 2001, in respect of the treatment of the GST, the Auditor-General found:

The financial effects of not recognising the GST as a Commonwealth revenue are to understate the net result for the period and to overstate net liabilities as at period end. The financial effects of not recognising the GST, calculated by reference to the amounts that would have been recognised had all other tax revenue been recognised on an accrual basis, are as follows:

• The consolidated statement of financial performance for the 2001–2002 year involves an understatement of revenues by $27.6 billion (2000–2001: $27.5 billion), expenses by $26.9 billion (2000–2001: $23.8 billion) and hence the net result by $0.7 billion (2000–2001: $3.7 billion).

• The consolidated statement of financial position as at 30 June 2002 involves an understatement of accrued revenues by $4.7 billion (2000–2001:

$3.8 billion) and liabilities by $0.3 billion (2000–2001: $0.1 billion), and hence an overstatement of net liabilities by $4.4 billion (2000–2001: $3.7 billion).

• The consolidated statement of cash flows, total operating cash inflows and outflows are each understated by $23.1 billion (2000–2001: $19.2 billion) (that is a difference which takes account of GST-related cash flows within the Commonwealth Government).

This treatment of GST in the CFS is contrary to the treatment adopted in the financial statements of the administering agencies. The ATO has reported the GST as a Commonwealth tax and the associated payments to the states and territories are recognised by the Department of the Treasury as grant expenses. In addition, the Australian Bureau of Statistics treats GST as a tax of the Commonwealth Government for statistical purposes.

For the reasons set out above, the GST should be recognised as revenue of the Commonwealth Government in the CFS. The CFS audit opinion includes a qualification in relation to the omission of GST from the CFS. [33]

8.3 Senate Estimates

As discussed, the eight Senate Estimates Committees such as the Rural and Regional Affairs and Transport Legislation Committee and the Employment, Workplace Relations and Education Legislation Committee, examine agency estimates after the Budget is presented. The Committees also examine additional estimates. The Committees require the presence of Ministers (although not always the portfolio Minister) and agency officers, and provide Senators with the opportunity to question them about programs and policy implementation. Although there is a delay in their release, the Committee reports contain valuable information not available elsewhere. Hansards of Estimates proceedings are available on the Senate website and Parlinfo.

8.4 Annual Reports

Most agencies table their annual reports by the end of October in the year after the Budget is introduced, that is, 18 months after the Budget to which they relate is introduced. Agencies provide a wide range of non-financial and financial information in their annual reports.

A feature of the changes that were introduced in the 1999–2000 Budget is greater consistency between Portfolio Budget Statements and annual reports. Annual reports contain information on how agencies performed against planned outcomes using the performance information measures set out in the Portfolio Budget Statements. The presentation of financial statements in annual reports is on the same basis as the budgeted financial statements in the Portfolio Budget Statements, allowing comparisons of budgeted and actual financial outcomes. Unfortunately, like the Portfolio Budget Statements, annual reports have also dispensed with some of the financial data they used to contain.

8.5 Tax Expenditures

Much attention is focused on the level of spending and revenue shown in the Budget. But a large amount of revenue is foregone through tax concessions. 'Tax expenditures' are estimates of the financial benefits derived by the recipients of these concessions. Concessions take the forms of tax exemptions, deductions and rebates, and reduced tax rates. Concessions lower the tax burden on the beneficiary by either reducing the amount of, or delaying the collection of, taxation revenue. The concessions raise the burden of taxation on non-beneficiaries who have to pay more to raise the amount of taxation revenue the government wants.

Appendix D of Statement 5 in Budget Paper No. 1 in the 2002–03 Budget contains a statement of tax expenditures. Treasury publishes a more comprehensive 'Tax Expenditures Statement'. The statement issued in January 2003 shows that the single largest tax expenditure is related to the concessional treatment of superannuation contributions, fund income and benefits paid. The total benefit of this concession is estimated at $9.8 billion in 2001–02. The aggregate cost of tax expenditures for which estimates were prepared is around $29.3 billion in 2001–02. This compares with taxation revenue (on a Government Finance Statistics basis) of $148.8 billion and total receipts of $164 billion.[34]

8.5.1 Issues

Tax expenditures are not reported like direct expenditure in that tax expenditures are not added to direct expenditure. This treatment may tempt governments to 'substitute' tax expenditures for direct expenditure to make public finances 'look good'. Not adding tax expenditures to direct expenditure has the effect of 'understating' the size of the government sector. For example, in 2001–02, if tax expenditures of around $30 billion were added to direct expenditure, total expenditure would rise from $167 billion to $197 billion, an increase of 18 per cent.

9. Performance Information

In their Portfolio Budget Statements, agencies set out the performance indicators they will use to assess their performance in terms of efficiency and effectiveness against planned outcomes. Using the information collected under the indicators, agencies report on how well they actually performed against the planned outcomes in their annual reports. Agencies report against indicators such as quantity, quality and timeliness. The purpose in requiring performance assessments is to increase agency accountability.

9.1 Issues

The usefulness of performance information has been criticised as limited. This is partly because it is often difficult if not impossible to measure the contribution of agencies to outcomes. Actual outcomes are the consequences of Commonwealth government actions and those of other agents in the community. As a result, the consequences of Commonwealth actions cannot be disentangled, qualitatively or quantitatively, from other influences. For example, the States are primarily responsible for funding primary and secondary education. The Commonwealth also provides funds but this is at the margin. Since both State and Commonwealth funds are lumped together to provide education services, it is not possible to disentangle the consequences of Commonwealth funding.

The Senate Finance and Public Administration Legislation Committee, in its third report on the format of the PBS concluded:

> Reporting on progress towards outcomes is at present a weakness of the new system. Few of the narrative 'effectiveness indicators' proffered to date are particularly robust and many agencies have indicated that they have work to do in this area. Given that funding is now directed to outcomes, the importance of assessing progress towards outcomes is of paramount importance. When and if this is done well, senators may indeed begin to scrutinise outcomes.[35]

Such criticism suggests that scope exists for Parliament to give agencies feedback and require them to provide more useful information. The Senate Finance and Public

Administration References Committee, in its Second Report on the Format of the Portfolio Budget Statements, was mildly critical of Senate Standing Committees in this regard:

> Performance reporting per se is not new, but its presence in annual reports has not attracted a great deal of systematic scrutiny from senators. As the committee has noted in its previous reports on the PBS and their predecessors, to make sense of specific performance information, an adequate knowledge base is required and the vagaries of political life frequently work against the acquisition of such knowledge. While individual senators may develop expertise in a given subject area, it is a random process.[36]

The Australian National Audit Office (ANAO) has undertaken a performance audit of how well agencies are reporting performance information. The ANAO concluded that :

> … overall, performance information in the PBS should be improved to enable agencies to establish and demonstrate the links between outcomes, outputs and performance indicators. Agencies had placed considerable emphasis on developing useful performance information. The latter remains a priority given the importance of using performance information for target setting, performance measurement and for accountability purposes.
>
> A common limitation in the performance information in all 10 audited agencies' PBS and annual reports related to effectiveness indicators which did not actually measure outcome performance. In particular, outcome effectiveness indicators were often influenced by factors beyond the agencies' control to a degree that may mask any direct effect that agency performance had on actual achievements. In this context it is important to track overall outcomes achieved across the layers of government and through various partnerships with other agencies, including non-government bodies, as well as the particular contribution made by the specific Commonwealth agency to the outcome to the most practicable extent possible.
>
> The ANAO also concluded that it would be difficult for Parliament and other stakeholders to assess agency performance with reasonable assurance. This was because the PBS performance information did not always include targets, or the targets that were provided were often vague and/or ambiguous.
>
> As well as these general themes, the ANAO identified and informed agencies of agency-specific issues early in the audit. The latter were dealt with by the relevant agencies during the audit fieldwork. For example, this included Department of Transport and Regional Services making extensive revisions to its outcome and outputs and performance information for the 2001–02 PBS. As well, Defence was advancing the development of new agency-wide performance information arrangements for the 2002–03 Defence PBS.
>
> All 10 agencies audited complied with PM&C requirements for annual reports in that the performance information identified in their PBS was reported in their annual report. However, problems with the performance information in the 1999–2000 PBS, identified by this audit, made it difficult for agencies to reach an informed judgement in relation to their performance in the related annual report.

> Agencies generally had adequate organisational arrangements to support the PBS performance information and reporting. Quality assurance for PBS data (for example, relating to data validity, reliability and accuracy) relied on operational areas that, typically, had embedded procedural arrangements such as range and consistency checks. However, in many cases, the current performance information arrangements were developed for internal operational purposes without consideration of the higher accountability PBS requirements. Therefore, minimum PBS data quality standards should be established and monitored to ensure the data supplied to Parliament are valid, reliable and accurate.[37]

As noted, agencies table their annual reports 18 months after the Budget to which they relate. The Senate Finance and Public Administration Legislation Committee noted that a major defect of this arrangement is the 18-month time lapse between the setting of the indicators and reporting against them. The Committee suggested that agencies provide in their PBS part-year performance information for quantifiable indicators or which information is readily available. Performance information would also benefit from disaggregation of indicators. This point is related to the trend for agencies to consolidate the number of outputs.

10. Conclusions

The Budget is the foremost statement of the Government's priorities, which are reflected in the resources allocated to particular activities. With outlays equivalent to almost a quarter of gross domestic product, the Budget is also a major influence over the economy generally and particular activities.

Given this, it is desirable that the Government should be accountable to voters through their representatives in the Parliament, not least because voters' taxes fund spending. Recent changes to the format and content of the Budget Papers and related document are aimed at enhancing accountability. These changes include the move from cash to accrual accounting; from cash budgeting to accrual budgeting; agency reporting in terms of planned outcomes; the presentation of financial statements in accordance with two main accounting standards; the presentation of information to allow assessment of agency performance; and the reporting and other requirements of the *Financial Management and Accountability Act 1997* and the *Charter of Budget Honesty Act 1998*.

The move from cash to accrual accounting has improved accountability because all costs are now taken into account and allocated to outcomes. However, caution should be used when interpreting accrual financial statements because their usefulness in a public sector context is limited. For example, general government net worth is negative to the tune of more than $40 billion. A business valued at this amount would immediately be made bankrupt. The desirability of the move from cash to accrual budgeting is subject to debate, with some arguing that it would be preferable to retain cash budgeting along with accrual accounting. Most economic commentators continue to focus on cash rather than accrual outcomes.

It is difficult to assess the success or otherwise of the outcomes and outputs framework in encouraging agencies to focus on ends and not means. Implementing the framework has encountered conceptual and practical difficulties. Moreover, the associated sharp decline in information in Portfolio Budget Statements has been a source of frustration to users including Members of Parliament. In response to criticism, more information is now being provided in the Budget Papers and Portfolio Budget Statements but room for improvement remains. The lack of information in the Portfolio Budget Statements has probably increased the importance of Senate Estimates Committees in ferreting out information.

The use of two accounting standards to present financial data is a source of confusion to non-specialist readers. While the Budget Papers explain the differences between the two main standards, critics have argued that it would be sensible to use the Government Finance Statistics system that is designed specifically for the public sector. However, a case can also be made for aspects of Australian Accounting Standard 31.

The Budget generally treats the GST as if it were not a Commonwealth tax. This has the effect of understating expenses and revenues. The rationale for this treatment is questionable and both the Australian Bureau of Statistics and the Auditor-General have rejected it. The treatment of the GST inevitably gives rise to the suspicion that it is intended to show the Commonwealth government sector as smaller than it really is. Similarly, the treatment of 'tax expenditures' which are not added to direct Budget expenditure also has the effect of 'understating' the size of government.

Endnotes

1. Denis James, 'An Overview of the Commonwealth Budgetary Process (Third Edition)', Department of the Parliamentary Library, *Background Paper* No. 30, 18 November 1993.

2. Budget night typically occurs around mid-May and on the first night of the Budget sittings of Parliament. This sitting normally runs until late June when Parliament adjourns.

3. An underlined word or phrase indicates an electronic link exists for this reference. See the online version at http://www.aph.gov.au/library/pubs/rp/2001-02/02RP10.htm

4. For a description of Cabinet processes, see Department of the Prime Minister and Cabinet, 'Cabinet Handbook' at http://www.dpmc.gov.au/docs/cabinet_index.cfm#pubs

5. Hon. John Howard, MP, 'Cabinet Committees', *Media Release*, 13 December 2001, at http://www.pm.gov.au/news/media_releases/2001/media_release1462.htm

6. The statement of risks discusses matters such as changes to economic parameters and contingent liabilities that can affect the forward estimates of expenses and revenues.

7. Payments are recognised as an expense (debit in accounting terms) and in the balance sheet as a reduction in money balances (credit). The increase in the liability is recognised as an expense (debit) and in the balance sheet as an increase in liabilities (credit).
8. Official Committee Hansard, Joint Committee of Public Accounts and Audit, 'Review of the accrual budget documentation', 22 June 2001, pp. 14–15 at http://www.aph.gov.au/hansard/joint/commttee/j4854.pdf
9. Budget Paper No. 1, 1999–2000, p. 1–5.
10. For background to the report and the Government's response, see http://www.facs.gov.au/internet/facsinternet.nsf/whatsnew/welfare_reform_background.htm.
11. Official Committee Hansard, op. cit., pp. 15 and 16.
12. Australian National Audit Office, 'Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2001', *Audit Report* No. 29, 2001–02, 21 December 2001, p. 16.
13. See draft report at http://www.pc.gov.au/inquiry/costrecovery/index.html
14. National security considerations limit scrutiny of the defence budget including in Budget Cabinet.
15. Department of Finance and Administration website at http://www.finance.gov.au/budgetgroup/other%5Fguidance%5Fnotes/functions.html
16. Department of Finance and Administration website at http://www.finance.gov.au/budgetgroup/other%5Fguidance%5Fnotes/functions.html
17. See Chapter 13 of *Senate Practice*, which deals with financial legislation, at http://search.aph.gov.au/search/ParlInfo.ASP?action=view&item=18&resultsID=1rLMQg
18. In practice, either term is used to refer to appropriations not made under the annual Appropriation Bills. To confuse matters further, the terms are used interchangeably. This paper uses special appropriations to mean either special or standing appropriations.
19. Official Committee Hansard, Joint Committee of Public Accounts and Audit, 22 June 2001, pp. 14 and 15
20. ibid., p. 9.
21. AAS 31 is a general framework for accrual budgeting and financial reporting for governments. However, compliance with all other applicable accounting standards is required. Exceptions to this rule are explicitly stated in AAS 31.
22. *Final Budget Outcome 2000–01*, pp. 16–17 and 32–33.
23. A summary of selected differences and a reconciliation of GFS and AAS 31 data can be found in 2002–03 Budget Paper No.1, Statement 10: External Reporting Standards and Budget Concepts, pp.10-1 to 10-15.
24. Marc Robinson, 'Public Sector Net Worth: Is It Worth Measuring?', *Research Paper* No. 26, 1995–96, Department of the Parliamentary Library.

25. Marc Robinson, 'Accrual Accounting and the Public Sector', *Economic Papers*, volume 20 No. 2, June 2001, pp. 57–66.

26. Official Committee Hansard, Joint Committee of Public Accounts and Audit, 'Review of the accrual budget documentation', 22 June 2001, pp. 13–14.

27. Australian Bureau of Statistics, *Accruals-based Government Finance Statistics*, Information Paper 5517.0, 13 March 2000.

28. Australian National Audit Office, Audits of the Financial Statements of Commonwealth Entitites for the Period Ended 30 June 2002, Audit Report No. 25, 2002–03 at http://www.anao.gov.au/WebSite.nsf/Publications/218CCBDFF179AE3E4A256C98000880B9

29. It is interesting to note that when the States handed their income tax powers to the Commonwealth, the Commonwealth treated the revenue as if it were its own revenue even though, in a sense, the Commonwealth was acting as an agent for the States. For a time, the Commonwealth used to describe money it gave to the States as 'tax reimbursements to the States'.

30. P Barrett, ‘Accountability and governance in a changing APS,’ Address to Department of Finance and Administration’s Learning Centre, 3 December 2002 p. 12 at http://www.anao.gov.au/WebSite.nsf/Publications/B439D5E6F27556C84A256C860020CE0D.

31. ibid, p. 12.

32. For a fuller description of the provisions relating to the PEFO, see 'Charter of Budget Honesty: Pre-election Provisions', *Research Note no. 10*, Department of the Parliamentary Library, 28 September 2001 at http://www.aph.gov.au/library/pubs/rn/2001-02/02RN10.htm

33. Australian National Audit Office, Audits of the Financial Statements of Commonwealth Entities for the Period Ended 30 June 2002', *Audit Report* No. 25, 2002–03, p. 14.

34. *Final Budget Outcome 1999–2000*, p. 34.

35. Senate Finance and Public Administration Legislative Committee, 'The Format of the Portfolio Budget Statements: Third Report', November 2000, p. 41.

36. Senate Finance and Public Administration Legislative Committee, 'The Format of the Portfolio Budget Statements: Second Report', October 1999, chapter 5.

37. Australian National Audit Office, 'Performance Information in Portfolio Budget Statements', *Audit Report* No. 18, 2001–02, 1 November 2001, pp. 14–15.