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The Commonwealth Budget: process and presentation (updated April 2010)

Richard Webb
Economics Section

Executive summary

- This Research Paper contains an overview of the Commonwealth budget process. It describes the main stages in the process, the system of appropriations, budget documents, reporting requirements, and key concepts and terms. It also describes how the content and presentation of the Budget have changed.

Contents

Acronyms

AAS	Australian Accounting Standards
AASB	Australian Accounting Standards Board
AEIFRS	Australian Equivalents to International Financial Reporting Standards
ABS	Australian Bureau of Statistics
ANAO	Australian National Audit Office
CFS	Consolidated Financial Statements
CRF	Consolidated Revenue Fund
ERC	Expenditure Review Committee
FBO	Final Budget Outcome
FMA Act	*Financial Management and Accountability Act 1997*
GAAP	Generally Accepted Accounting Principles
GFS	Government Finance Statistics
GST	Goods and Services Tax
IASB	International Accounting Standards Board
MYEFO	Mid-Year Economic and Fiscal Outlook
PBS	Portfolio Budget Statements
PEFO	Pre-Election Economic and Fiscal Outlook

Introduction

The annual Budget, which is brought down in May, is a major political, economic and social document. The sheer size of the Budget—spending is equivalent to about one quarter of gross domestic product—attests to its influence over 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 seeks to aid understanding of the budget process and reporting by describing the key features, beginning with the first steps around September in the year before the Budget is brought down through to the presentation and review of agency annual reports. The paper also explains key concepts, and the content and presentation of the budget papers and associated documents. The terms used are also explained. The paper does not purport to be a discussion or issues paper. A glossary at the end contains definitions of some commonly-used terms. This paper updates a 2007 paper.[1]

1. Overview of the budget process

The highlight of the process is budget night in May.[2] However, a 'typical' cycle begins in September in the year before budget night and ends four to five months after the budget year, taking into account the Senate estimates hearings on annual reports.

The preparation of a Budget involves a large number of bodies and participants. They include the Strategic Priorities and Budget Committee of Cabinet (formerly the Senior Ministers' Review), the Expenditure Review Committee, portfolio and agency ministers, and three central agencies—Treasury, the Department of Finance and Deregulation, and the Department of the Prime Minister and Cabinet. Very broadly, the Department of Finance and Deregulation coordinates the preparation of the Budget and prepares forward estimates, and is responsible for statements of expenses and non-tax revenue. Treasury is responsible for assessments of the economic and fiscal outlooks and estimates of tax revenues. Other agencies support the process by compiling data for inclusion in the budget estimates and documents, and by providing other information.

The following outlines the main steps in the annual budget cycle.[3]

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1. R Webb, *The Commonwealth Budget: process and presentation (updated January 2007)*, Research brief, no. 7, 2006–07, Parliamentary Library, Canberra, 2007, viewed 26 February 2010, http://www.aph.gov.au/library/pubs/rb/2006-07/07rb07.pdf

2. Budget night is the second Tuesday in May, which is the first night of the budget sittings of parliament. This sitting normally runs until late June.

1.1 Budget Process Operational Rules

In September before the Budget is brought down, the Treasurer and the Minister for Finance prepare a submission for Cabinet —the Budget Process Operational Rules—on the process and timetable for the Budget. The Department of Finance and Deregulation subsequently issues a circular that establishes, among other things, the process and timetable for the Expenditure Review Committee's consideration of budget bids for the following Budget.

1.2 Strategic Priorities and Budget Committee of Cabinet

In October, the Prime Minister writes to portfolio ministers asking them to submit new policy proposals. Officials from the Treasury, the Department of Finance and Deregulation, and the Department of the Prime Minister and Cabinet review these proposals and comment on them. The proposals and the comments are sent to the Strategic Priorities and Budget Committee. This is a formal Cabinet committee which establishes the government's fiscal strategy and policy priorities at the beginning of the each budget cycle. The Strategic Priorities and Budget Committee reviews the proposals to determine whether they conform to the government's priorities. Ministers are informed as to which proposals the Strategic Priorities and Budget Committee has approved and so can be further developed by ministers for consideration by the Expenditure Review Committee. This process seeks to ensure that all major spending proposals are subject to the annual budget process unless there are compelling reasons to the contrary. The Strategic Priorities and Budget Committee comprises the Prime Minister as chair, the Deputy Prime Minister, the Treasurer and the Minister for Finance and Deregulation. Other ministers are co-opted during discussion of new policy proposals relating to their portfolios.

1.3 Portfolio budget submissions

Following approval of new policy proposals by the Strategic Priorities and Budget Committee, agencies prepare portfolio budget submissions documents in January and February for consideration by the Expenditure Review Committee. The portfolio budget submissions outline all proposals and potential savings. Agencies cost the submissions and agree the costings with the Department of Finance and Deregulation. The submissions are circulated for coordination comment and lodged with the Cabinet secretariat, usually late in February. Summaries of cost-recovery statements that agencies prepare are attached to the portfolio budget submissions. The Department of Finance and Deregulation reviews all cost-recovery impact statements, and briefs the government about compliance with cost-recovery policy.

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3. For a fuller description of the budget process, see JR Blondal, D Bergvall, I Hawkesworth and R Deighton-Smith, 'Budgeting in Australia', *OECD Journal on Budgeting*, vol. 2008/2, 2008, pp. 133–196, viewed 26 February 2010, http://www.oecd.org/dataoecd/59/24/42007191.pdf

1.4 Estimates

A key component of the budget process is the preparation of estimates of spending and revenue. Estimates include decisions made since the previous Budget but exclude new programs, the proposed expansion of existing programs that the government has not agreed to, and programs that are expected to end. The estimates are thus the baseline on which spending and revenue proposals are built.

In addition to calculating estimates of spending and revenue for the budget year, estimates are also produced for the forward years. Forward estimates are rolling estimates of what would be appropriated based on the assumption that government policy is on-going. Forward estimates are for the three years beyond the Budget year. For example, in the 2009–10 Budget, the forward years were 2010–11, 2011–12 and 2012–13. Forward estimates are prepared on both cash and accrual bases. A recent review of the forward estimates process was highly complimentary.[4]

Estimates are updated three times a year: in February so that the Expenditure Review Committee can make decisions based on the most up-to-date information; in April for incorporation into the Budget; and finally, in October of the budget year for the Mid-Year Economic and Fiscal Outlook (see section 10.1.1). The Department of Finance and Deregulation consolidates agencies' estimates to construct the estimates for the general government sector (see section 2.1).

1.5 Expenditure Review Committee and the budget Cabinet

The Expenditure Review Committee (ERC)—which usually meets several times in March—is responsible for developing the Budget in line with the government's priorities. The ERC considers details of spending and revenue for the Budget and during the year after the Budget is bought down. The ERC is a Cabinet committee and is responsible, among other things, for recommending to Cabinet which new policy proposals should be funded and by how much. The ERC also examines savings proposals and on-going spending. The latter brings the system of special appropriations into the budget process (see section 7.4). In forming its recommendations, the ERC draws on the portfolio budget submissions and briefs that the Department of Finance and Deregulation and other agencies prepare. Whereas in the past, the ERC met over several weeks during the initial budget process, the Rudd Government decided that the ERC would meet throughout the year to ensure fiscal discipline, and be responsible for examining urgent spending measures.[5]

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4. Blondal, Bergvall, Hawkesworth and Deighton-Smith, op. cit., p. 162.

5. L Tanner (Minister for Finance and Deregulation), *National Press Club address*, media release, 6 February 2008, viewed 26 February 2010, http://www.financeminister.gov.au/speeches/2008/sp_20080206.html

In April, a meeting of the full Cabinet—the budget Cabinet—discusses all the ERC's decisions. The ERC's recommendations are made formally to the budget Cabinet.

The ERC currently comprises the Deputy Prime Minister, the Treasurer as chair, the Minister for Trade, the Minister for Financial Services, Superannuation and Corporate Law, the Minister for Families, Housing, Community Services and Indigenous Affairs, the Minister for Finance and Deregulation, and the Assistant Treasurer.[6] Other ministers are co-opted during discussion of new policy proposals relating to their portfolios.

1.6 Budget documents

Concurrent with the ERC process, agencies begin to prepare budget documents notably portfolio budget statements (see section 8.4) and the statement of risks.[7] Agencies may be called upon to help draft descriptions of the spending and revenue measures. Around March-April and after Cabinet has agreed to new policies, agencies update their estimates for the preparation of the budget documents and Appropriation Bills (section 7.3). The Departments of Finance and Deregulation and the Treasury prepare the budget papers (section 8.3).

Because the Budget is brought down in May, the financial outcomes of the Budget for the previous financial year can only be estimated. Actual spending and revenue data are not available until the Final Budget Outcome is released in September and agencies present their annual reports.

1.7 Budget presentation

The highlight of budget night is the Treasurer's budget speech which is traditionally presented at 7.30pm and lasts for about half an hour.[8] The Australian Broadcasting Corporation (ABC) broadcasts the speech and also broadcasts, at a later date, the 'address in reply' by the Leader of the Opposition. When it brings down the Budget, the government introduces Appropriation Bills No. 1 and No. 2 and the Appropriation (Parliamentary

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6. Australian Government, 'Expenditure review committee', Government online directory website, viewed 17 March 2010, http://www.directory.gov.au/osearch.php?ou%3DExpenditure%20Review%20Committee%2Cou%3DCabinet%20Committees%2Cou%3DCabinet%2Co%3DCommonwealth%20Parliament%2Co%3DCommonwealth%20of%20Australia%2Cc%3DAU&changebase

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

8. W Swan (Treasurer), *Budget speech: 2009–10*, Commonwealth of Australia, Canberra, 2009, viewed 11 January 2010, http://www.Budget.gov.au/2009-10/content/speech/html/index.htm

Departments) Bill, and presents the budget papers and related documents. They are on the Australian Government budget website.[9]

The practice of bringing down the Budget in May began with the 1993–94 Budget. Previously, the Budget was brought down in August.

1.8 Senate estimates committees

After the Budget is tabled, the Senate estimates committees scrutinise the Appropriation Bills and other budget documents—usually in the last week in May and the first week in June.[10] In particular, the committees scrutinise the portfolio budget statements (see section 8.4), which form the basis of their inquiries. The basic function of the committees is to require the presence of, and seek explanations from, ministers who formulate policy and from departmental officers who implement policy. The committees are portfolio-based—one such committee is the Foreign Affairs, Defence and Trade committee—and they review all agencies falling within the respective portfolios so that all spending and revenue measures are scrutinised. The estimates committee process is generally finished in time for parliament to pass the Appropriation Bills before the end of June. Although there is a delay in their release, the committee reports contain valuable information that agencies do not otherwise make publicly available. This information takes the forms of responses to questions on notice as well as verbal responses from senior public servants to questions from senators. Hansards of estimates proceedings are available on the Senate website.[11] Answers to questions on notice are published separately. The estimates committees also examine additional estimates (see section 7.3.3).

The Senate estimates committees also review agency annual reports. The reports are referred to the relevant committees for consideration. In practice, the committees review the annual reports in conjunction with additional estimates because most agencies have presented their annual reports by the end of October, that is, not long before the additional estimates hearings.

1.9 Additional estimates

Around November of the budget year, the process begins whereby additional funds are provided to agencies. This process is called additional estimates (section 7.3.3). The approved additional estimates are incorporated into Appropriation Bills No. 3 and No. 4 and Appropriation (Parliamentary Departments) Bill No. 2. In recent years, these Bills have been

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9. Australian Government, 'Budget 2009–10', Australian Government budget website, viewed 11 January 2010, http://www.Budget.gov.au/

10. Parliament of Australia, Senate, 'Senate estimates', Senate website, viewed 11 January 2010, http://www.aph.gov.au/Senate/estimates/index.htm

11. Parliament of Australia, Hansard, 'Senate Committees', Hansard website, viewed 26 February 2010, http://www.aph.gov.au/hansard/senate/commttee/comsen.htm

passed in the autumn sittings of parliament. As noted, the Senate estimates committees also review the additional estimates.

1.10 Final Budget Outcome

In September, the Final Budget Outcome (FBO) for the financial year just ended is tabled.[12] The *Charter of Budget Honesty Act 1998* requires the Treasurer to release publicly and table an FBO report for each financial year no later than three months after the end of the financial year. The report must contain Commonwealth general government sector (see section 2.1) fiscal outcomes for the financial year. The FBO is discussed in more detail in section 10.1.2.

1.11 Annual reports

In October, agencies present their annual reports for the past financial year. They include financial and other information including agency performance against agreed indicators. The Department of the Prime Minister and Cabinet publishes the requirements for annual reports to which agencies must adhere.[13]

The Senate Legal and Constitutional Committee publishes a report on the annual reports in March and September of each year.[14] Annual reports also referred to House of Representatives general purpose standing committees under Standing Order 215.

1.12 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.[15] The MYEFO updates the economic and fiscal outlooks and the general government sector financial statements. The MYEFO also incorporates decisions since the Budget was brought down that affect expenses

12. Australian Government, *Final budget outcome: 2008–09*, Commonwealth of Australia, Canberra, 2009, viewed 11 January 2010, http://www.budget.gov.au/2008-09/content/fbo/html/index.htm

13. Department of the Prime Minister and Cabinet (PM&C), *Requirements for annual reports for departments, executive agencies and FMA Act bodies*, Commonwealth of Australia, 17 June 2009, viewed 11 January 2010, http://www.pmc.gov.au/guidelines/docs/annual_report_requirements.pdf

14. Parliament of Australia, Senate, Senate Legal and Constitutional Affairs Committee, 'Reports on annual reports', Senate website, viewed 11 January 2010, http://www.aph.gov.au/Senate/committee/legcon_ctte/annual/index.htm

15. Australian Government, *Mid-year economic and fiscal outlook: 2009–10*, Commonwealth of Australia, Canberra, 2009, viewed 11 January 2010, http://www.budget.gov.au/2009-10/content/myefo/html/index.htm

and revenues, and so updates spending and revenue estimates. The MYEFO is discussed in more detail in section 10.1.1.

In practice, the MYEFO has been released as early as October and as late as December.

2. Public sector and budget focus

The public sector is classified into three sectors:

- the general government sector
- public financial corporations, and
- public non-financial corporations.

The focus of the Budget is the general government sector. This is discussed in section 2.1. The term 'whole of government' refers to all three sectors combined.

Public financial corporations provide various financial functions. Examples are the Reserve Bank of Australia, Medibank Private, and the Export Finance and Insurance Corporation.

Public non-financial corporations are bodies that the government owns or controls and which supply various services and undertake business activities. Examples are Australia Post which provides postal and parcel delivery services, and the Australian Rail Track Corporation which provides track services to interstate train operators and invests in rail infrastructure.

Statement 9 of Budget Paper No. 1 lists the entities in each sector.[16]

2.1 General government sector

The focus of the Budget is the general government sector.

The general government sector provides services that are mainly non-market in nature, mainly for the collective consumption of the community, and involve the redistribution of income. Examples of general government sector functions are defence, education, public order and safety, and the payment of 'transfer payments' such as disability pensions. The general government sector is financed mainly by taxes and other compulsory levies.

While the Budget focuses on the general government sector, the Budget incorporates some transactions between the general government sector and the other two sectors. For example, on the revenue side, the general government sector receives dividends from Australia Post

16. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2009–10*, Commonwealth of Australia, Canberra, 2009, pp. 9–36 to 9–40, viewed 11 January 2010, http://www.Budget.gov.au/2009-10/content/bp1/downloads/bp1_bst9.pdf

and the Reserve Bank of Australia. On the spending side, the general government sector provides capital grants to and injects equity into the Australian Rail Track Corporation to enable it to invest in rail infrastructure.

3. Budgeting and accounting

The systems of budgeting and accounting have changed over the years. The following describes these changes.

3.1 Cash and accrual accounting

Before 1999–2000, budgeting and accounting were on a cash basis. The 1999–2000 Budget formally adopted accrual accounting for budget financial statements although agencies had implemented accrual accounting several years earlier.[17] The following describes some differences between cash and accrual accounting.

Cash accounting recognises only cash transactions, and accounts for them only in the period when money changes hands. Cash accounting therefore does not take account of non-cash transactions. Accrual accounting, on the other hand, recognises both cash and non-cash transactions, and records them in the period when they occur. Accrual accounting thus gives a better picture of financial transactions in a given period. For example, in the case of public service superannuation, cash accounting recognises only payments to superannuants whereas accrual accounting recognises both these payments and the increase in liabilities for future payments. In the case of purchases of 'non-financial' assets such as buildings and plant, cash accounting recognises only the purchase and sale of the asset. Accrual accounting recognises that such assets yield services over several years. Accrual accounting records the purchase of such assets in the balance sheet and then writes them off, as an expense, over their lifetimes.

It can be argued that an overall view of the Budget takes account of both accrual and cash information:

- cash information is an easy way to communicate the amount to be spent on a particular program
- cash information informs the government's current and future borrowing requirements
- accrual information is less subject to distortions from large 'one-off' transactions such as the privatisation of assets and 'lumpy' large asset acquisitions, and
- accrual accounting statements give a broader picture of government assets and liabilities and in a more transparent way (only about one per cent of the government's assets is held as cash).

17. The former Department of Transport, for example, implemented accrual accounting in 1994–95.

Cash and accrual budget aggregates (see section 4) for the general government sector inevitably diverge but tend to be similar. The 2008–09 cash outcome—the 'underlying cash balance'—was a deficit of $27 billion while the accrual outcome—the 'fiscal balance'—was a deficit of $29.7 billion.[18]

The move to accrual accounting means that some data comparisons may not be possible because, strictly speaking, it is not valid to compare cash with accrual data.

Statement 9 of Budget Paper No. 1 and the Final Budget Outcome contain both accrual and cash financial statements for the general government sector.

3.2 Cash and accrual budgeting

The 1999–2000 Budget replaced cash budgeting with accrual budgeting. Under cash budgeting, agencies receive the net amount of cash—payments less receipts—they propose to spend each year. In contrast, under accrual budgeting, agencies are funded for both cash and non-cash items such as depreciation. Accrual budgeting thus appropriates to agencies the total resources they use to provide services.

Under accrual budgeting, agencies receive funds for some purposes even though the agencies will not spend the money in the year they receive it. For example, under accrual budgeting, agencies receive funds for their annual depreciation expense even if the agencies do not propose to replace assets until future years. In practice, this meant that agencies accumulated cash—assuming that agencies did not spend the funds for purposes other than asset replacement—until such time as they replaced assets. Under cash budgeting, agencies received money only in the year when they replaced assets.

Under *Operation Sunlight* (see section 14), the Rudd Government's policy is:

> …to cease funding for depreciation from 1 July 2009 for collecting institutions in relation to their heritage and cultural assets and from 2010–11 for all other agencies in the general government sector.[19]

3.2.1 Capital use charge

Although now of historical interest only, readers of earlier budget papers will encounter the capital use charge. As part of the accrual budgeting reforms, agency financial statements for 1999–2000 to 2002–03 contained a capital use charge. The charge was implemented:

18. Australian Government, *Final budget outcome: 2008–09*, op. cit., p. 1.

19. Australian Government, *Operation Sunlight - enhancing budget transparency*, December 2008, p. 18, viewed 18 March 2010, http://www.finance.gov.au/financial-framework/financial-management-policy-guidance/operation-sunlight/docs/operation-sunlight-enhancing-budget-transparency.pdf

> … to improve agency resource allocation, by ensuring that the full cost of competing activities are shown and the cost of capital is reflected in the pricing structures of equivalent outputs produced by the public or private sectors.[20]

The underlying concept is that the capital tied up in assets is not ‘free’. Rather, there is an implicit cost to using capital that is not reflected in the cost of running an agency. The capital use charge sought to make this cost explicit and so was included in each agency’s expenses. The charge was based on the agency’s net assets, and the rate was set annually.[21] Agencies had to meet the charge, which was offset by an appropriation. The government decided that the charge would cease on 30 June 2003.

4. Budget aggregates, deficits and surpluses

Budget aggregates are total revenue, total expenses, and the Budget surplus or deficit. There are two measures of the Budget outcome for the general government sector.[22] The cash measure is the ‘underlying cash balance’. This is the ‘headline’ balance—the difference between total cash revenues and spending—adjusted for certain items (see section 4.1.2). The accrual measure is the ‘fiscal balance’ (see section 4.2).

Budget aggregates are shown both in dollar terms and as a proportion of gross domestic product in Statement 3 of Budget Paper No. 1 and the Final Budget Outcome.[23] Budget aggregates are based on the Australian Bureau of Statistics Government Finance Statistics framework (see section 11.2).[24]

4.1 Underlying cash balance

Most discussion of budget outcomes is of the underlying cash balance and not the fiscal balance. One reason economic commentators focus on the underlying cash balance and not the fiscal balance in discussions of fiscal policy is that, in economic terms, cash is generally considered to be more relevant in determining the effects of spending. Cash is also simpler to understand.

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20. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2002–03*, Commonwealth of Australia, Canberra, 2002, p. 12–30, viewed 11 January 2010, http://www.Budget.gov.au/2002-03/bp_index.html

21. In 1999–2000 and 2000–01 the rate was 12 per cent. The rate in 2001–02 was 11 per cent.

22. The word ‘balance’ is used for the outcome whether the Budget is in deficit or surplus. By convention, a negative sign indicates that the Budget is in deficit. The term balance is used because if, for example, the Budget is in deficit, the deficit is funded in some way and hence in balance. Conversely, a Budget surplus is utilised in some way leaving the Budget in balance.

23. See Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2009–10*, op. cit., p. 3–3.

24. Ibid., p. 9–29.

The following examines how the concept of the underlying cash balance has evolved.

4.1.1 Budget balance

Until 1995–96, the budget (cash) outcome was called the budget 'balance'. This was the difference between total cash receipts and outlays. A negative sign indicated a deficit and a positive sign a surplus.

4.1.2 Underlying balance

The concept of the 'underlying balance' first appeared in the 1996–97 Budget. In that budget, what was previously called the budget balance became the 'headline' balance. The reasons for adopting the concept of the underlying balance revolved to a large extent around the treatment of the proceeds of asset privatisations, which were sales of equity in government-owned enterprises. Until 1995–96, the proceeds of asset sales, including the proceeds of privatisations, were treated as negative outlays. The concept of the underlying balance was that including cash flows from privatisations—and some other disinvestment/investment in financial assets—disguised trends especially when the sums involved were substantial. In other words, including the proceeds of one-off privatisations—especially if the privatisations involved large sums—'distorted' or gave a misleading picture of trends. The underlying balance thus excluded certain items from the headline balance:

> The underlying Budget balance is measured as the headline Budget balance adjusted for net advances. The latter comprises transactions in financial assets undertaken for policy purposes. The category consists of net policy lending (new policy loans and advances less repayments) and net equity injections (injections/purchases of equity less equity sales). Because repayments of past advances are now greater in aggregate than new policy lending, and sales of equity outweigh purchase and injections, net advances are currently negative. For 1996-97, net advances are sufficiently negative to provide for an underlying deficit but a headline surplus.[25]

4.1.3 Underlying cash balance

In 1999–2000 when accrual accounting was introduced, the underlying balance became the 'underlying cash balance'. The latter term was used to distinguish it from the accrual 'fiscal balance' (section 4.2).

From 1999–2000 to 2004–05, the underlying cash balance was derived from the headline balance by deducting net cash flows from investments in financial assets for policy purposes. Examples of such flows are equity injections into the Commonwealth-owned Australian Rail Track Corporation to allow it to invest in rail infrastructure, and proceeds from the privatisations of government businesses.

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25. Australian Government, *Budget statements: Budget paper no. 1: 1996–97,* Commonwealth of Australia, Canberra, 1996, p. 1–21.

The measure of the underlying cash balance changed with the establishment of the Future Fund. Beginning in 2005–06, the underlying cash balance has been derived from the headline cash balance by deducting both net cash flows from investments in financial assets for policy purposes *and* Future Fund earnings (see section 15.1). The reason for also deducting Future Fund earnings is that the Future Fund—which was established in 2005–06—is, in principle, set aside to fund future superannuation payments and, as such, are ‘quarantined’ from other uses. The exclusion of Future Fund earnings from the underlying cash balance means that the current measure of the underlying cash balance is now smaller, by the amount of the earnings, than before the Future Fund was established. To obtain a time series of the underlying cash balance that is consistent with the data before the Future Fund was established, it is necessary to add Future Fund earnings to the current measure of the underlying cash balance (which excludes Future Fund earnings) for 2005–06 and later years.

The derivation of the underlying cash balance from the headline cash balance is shown in the general government sector cash flow statement in Statement 9 of Budget Paper No. 1. A time series of the underlying cash balance is in Statement 10 of Budget Paper No. 1.

4.2 Fiscal balance

The fiscal balance is the accrual counterpart of the underlying cash balance plus Future Fund earnings. The fiscal balance is the sum of two components: the net operating balance, and the net acquisition of non-financial assets.

In economic terms, the fiscal balance measures the government’s contribution—in accrual terms—to the savings-investment balance throughout the economy. A positive fiscal balance means that the government is not drawing on private savings to fund its activities but is actually contributing to national saving. Conversely, a negative fiscal balance means that the government is drawing on (borrowing) private savings to help fund its activities.

Statement 9 of Budget Paper No. 1 shows the derivation of the expected fiscal balance.

4.2.1 Net operating balance

The net operating balance for the general government sector measures the outcome of current operating—as distinct from capital—activities. It has two components: total revenue and total expenses. Total revenue is the sum of all forms of current income and includes taxation revenue, interest income, dividends and other forms of income. Expenses include employee expenses, interest, purchases of goods and services, and grants and transfer payments. The net operating balance is the difference between total revenue and total expenses. An excess of revenue over expenses means that the government is running a surplus on its current (operating) activities. Conversely, an excess of expenses over revenue means that the government is running a deficit on its current activities.

4.2.2 Net acquisition of non-financial assets

Governments buy and sell 'fixed' assets such as land, buildings, and plant and equipment. In financial statements, such assets are called 'non-financial' assets. The outcome of purchases and sales (and other transactions involving non-financial assets) is called the 'net acquisition' of non-financial assets.

It should be noted that Commonwealth funding of investment in non-financial assets by the states and territories—such as roads—is not treated as investment in the Commonwealth's books. Rather, such funding is treated as operating expenses (grants). The states and territories, however, treat the building of the roads as investment in their books and the Commonwealth grants as revenue. The Commonwealth's investment in non-financial assets is small compared to the amount of the grants provided to the states and territories

5. Outcomes, programs and outputs

The ways in which agencies have presented information have changed over time:

- before 1999–2000, agencies presented information on a running costs and programs basis
- from 1999–2000 to 2008–09, agencies presented information in their portfolio budget statements (see section 8.4) and annual reports in an outcomes and outputs framework, and
- starting with the 2009–10 Budget, general government sector agencies began reporting on an outcomes and programs basis.

The following examines the outcomes/outputs framework and the move to the outcomes/programs framework.

5.1 Outcomes and programs

Starting with the 2009–10 Budget, general government sector agencies began reporting on an outcomes and programs basis. The outcomes/programs framework is a hybrid in that it retains outcomes—as in the former outcomes/outputs framework—while drawing on the system of program budgeting that was used before 1999–2000. Planned outcomes are the results or consequences for the community that the government seeks to achieve. Programs are the means by which outcomes are attained. Examples of programs are employment services that the Department of Education, Employment and Workplace Relations administers, and the ethanol production subsidy that the Department of Resources, Energy and Tourism administers. Agencies may be appropriated on the basis of their nominated outcomes, but it is through programs that agencies pursue outcomes.

Concurrent with the adoption of outcomes/programs reporting in 2009–10, agencies revised their outcomes, in some cases substantially. Agencies showed the changes from outcomes/outputs to outcomes/programs and the changes in outcomes in a transition table in their 2009–10 portfolio budget statements. The move to the outcomes/programs framework and the changes in outcomes complicate data comparisons with earlier years.

The move to reporting at the program level is very welcome in that it has improved transparency considerably by providing information that was sometimes previously not available. On the other hand, the retention of outcomes means that their inherent deficiencies remain (see below). Although, the recasting of outcomes should help to reduce these deficiencies.

5.2 Outcomes and outputs

From 1999–2000 to 2008–09, agencies presented information in their portfolio budget statements and annual reports in an outcomes and outputs framework. The framework was introduced at the same time as accrual budgeting. However, accrual budgeting and the outcomes/outputs framework are independent, that is, it is possible to have accrual budgeting without the outcomes/outputs framework and vice versa.

The focus of the outcomes/output framework—and of the outcomes/program framework—is planned outcomes. Ministers approve the outcomes for their portfolios. An example of a planned outcome is the Department of Immigration and Citizenship's outcome one, namely, 'contributing to Australia's society and its economic advancement through the lawful and orderly entry and stay of people'.

Outputs were the goods and services that agencies produced that contributed to the attainment of outcomes. For example, the Department of Immigration and Citizenship formerly had seven outputs that contributed to outcome one, namely, 'migration and temporary entry', 'refugee and humanitarian entry and stay', 'border security', 'compliance', 'detention', 'offshore asylum seeker management', and 'systems for people'.

The objective of the outcomes/outputs framework was to encourage agencies to focus on ends and not means which, critics claimed, was a feature of the previous system. The system which preceded the outcomes/outputs framework grouped outlays into 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 the reasons for producing outputs and not enough on outcomes. For example, under program budgeting, there was a tendency to focus on the cost of information technology rather than on the uses to which it was put.

5.2.1 Issues and assessment

An objective of the outcomes/output framework was to hold agencies accountable for what they achieved (actual outcomes) rather than how they did it (inputs and outputs). However, the outcomes/outputs framework encountered conceptual and other difficulties.

The usefulness of the outcomes/output framework depended crucially on how well outcomes were specified—as does the outcomes/programs framework. One problem was the overlap of outcomes across agencies and portfolios. Outcomes reflected administrative arrangements. But these arrangements do not always 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 overlap with some Department of Defence outcomes. Another objective is to increase productivity including though infrastructure investment. But several agencies—not just the Department of Infrastructure, Transport, Regional Development and Local Government—fund infrastructure investment. Indeed there is no one place in the budget papers where total funding of infrastructure investment in any one year can be found.

A second problem was overlapping outcomes within a portfolio or agency. Overlapping outcomes lead to problems of accountability and reporting since agencies have discretion how to classify an activity. For example, the Department of Infrastructure, Transport, Regional Development and Local Government has three outcomes. One is ‘improved infrastructure across Australia through investment in and coordination of transport and other infrastructure’, the second is ‘an efficient, sustainable, competitive, safe and secure transport system for all transport users through regulation, financial assistance and safety investigations’, while the third is ‘coordinated community infrastructure and services in rural, regional and local government areas through financial assistance’. The Department funds roads in regional areas. Arguably, funding of roads in regional areas contributes to all three outcomes on the grounds that regional road funding enhances investment in infrastructure, the investment contributes to safer roads, and also aids regional development.

A third problem was the widely differing levels of specificity of outcomes. At first, agencies tended to consolidate outcomes but this trend has later reversed. The Department of Defence, for example, moved from one outcome to three. Another trend was for agencies to disaggregate outcomes into more outputs and even sub-outputs.

A fourth problem was instability in outcomes and outputs as agencies changed their outcomes and output structures, and as activities were reallocated among agencies. While it is unrealistic to expect stability in outcomes and outputs as agencies respond to new developments and as the government develops new policies, the instability of outcomes made data comparisons difficult.

Fifth, one of the most important losses associated with the adoption of the outcomes/outputs framework was information about individual programs. Some agencies continued to provide this information but, unfortunately, others did not. Given that members of parliament want to know the cost of and other information about individual programs, the lack of information about spending on programs was a major deficiency. As noted above, the move back to identifying spending on programs under the outcomes/programs framework is a very welcome move in that it provides information that often was not previously available.

Sixth, the emphasis in formulating the Budget and in the political process was, and is, on programs not outcomes:

> The extent to which outcomes are integrated into decision making during the Budget formulation stage and in daily agency operations has been very low. The overwhelming focus is on programmes. It should be noted that the term programme is used to refer to any discrete activity for which money is provided. It is as if there are two parallel systems in use ... The emphasis on programmes is not primarily due to the problems identified above with the outcomes and outputs framework. In fact, the emphasis has acted as a great catalyst for increasing the focus on results. The issue is mostly conceptual. Programmes are specific, can be defined concretely and are identifiable to the public, rather than aggregate outcome goals which are more conceptual in nature. For this reason, programmes will always be important politically. Similarly, day-to-day management is focused on programmes; outcomes are generally not reflected in any internal management documents. In this respect, it is important to note that in-year reporting from departments and agencies on their expenditures to the Department of Finance is done on the basis of major programmes.
>
> Consequently, if the Budgeting system is to serve the needs of the government, the Parliament and the public, it must take programmes increasingly into consideration.[26]

Finally, an issue was parliamentary control over how funds are spent. Appropriating against outcomes has positive and negative aspects. On the one hand, it gives agencies flexibility as to how they spend funds. On the other hand:

> The introduction of the outcome Budgeting framework promised to increase transparency and accountability and therefore strengthen Parliament's oversight role by providing enhanced information on the performance of government activities. However, this promise was not realised.[27]

Parliamentary control of appropriations was at the heart of the so-called Combet case in which the High Court ruled that only Appropriations Acts have legal status. The portfolio budget statements are supporting documents and information.[28] Portfolio budget statements are, however, a guide to the interpretation of appropriations (see section 8.4).

Overall, the extent to which the outcomes/outputs framework increased transparency and accountability was mixed. A review prepared for the Organisation for Economic Co-operation and Development of results-oriented financial management in Australia (and Britain) concluded:

26. Blondal, Bergvall, Hawkesworth and Deighton-Smith, op. cit., p. 24.

27. Ibid., p. 33.

28. Combet & Anor v Commonwealth of Australia & Ors (2005) 221 ALR 621.

> When the effects of the results-oriented financial management reforms are examined, it can be stated that the reforms are not a panacea which will solve all financial management problems, but do generate positive as well as negative effects.[29]

6. Classification of expenses

Expenses are classified in different ways:

- by function
- whether they are departmental or administered
- by outcomes, and programs within outcomes, and
- in accordance with accounting standards.

Expenses are classified by function in Statement 6 of Budget Paper No. 1 and in the Final Budget Outcome.

Expenses are classified as departmental or administered in several places including the Appropriation Acts, portfolio budget statements, and agency annual reports (see section 7.7).

Agencies classify expenses by outcome, and programs within outcomes, in their portfolio budget statements and annual reports (see section 5).

Expenses are classified in accordance with accounting standards in several places including Statement 9 of Budget Paper No. 1, the Final Budget Outcome, Consolidated Financial Statements, and agency annual reports (see section 11).

In addition to the above, the term Commonwealth own-purpose expenses (COPE) is sometimes used. COPE is general government sector payments less payments made to the states, territories and local governments, and payments to government enterprises such as the Australian Rail Track Corporation. COPE therefore includes payments which the Commonwealth cannot use for its own purposes such as defence and social security transfers.

The following examines the classification of expenses by function.

6.1 Functional classification of expenses

Proposed general government expenses are classified by function in Statement 6 of Budget Paper No. 1. Examples of functions are health, education, and defence. Some functions are

29. B Scheers, M Sterck and G Bouckaert, 'Lessons from Australian and British reforms in results-oriented financial management', *OECD Journal on Budgeting*, vol. 5, no. 2, p. 156, viewed 1 March 2010, http://www.oecd.org/dataoecd/61/24/37033986.pdf

classified into sub-functions. Education, for example, is divided into higher education, vocational and other education, schools (which are further divided into non-government schools and government schools), student assistance, general administration, and school education-specific funding.[30]

The functional classification is based on the Australian Bureau of Statistics Government Finance Statistics system.[31] This, in turn, is based upon the United Nation's *Classification of the Functions of Government*, which is also applied in the International Monetary Fund Government Finance Statistics system. The Final Budget Outcome contains the functional classification of actual spending.

The allocation of activities to functions has changed over time. Consequently, there are breaks in the series, and some data are therefore not strictly comparable. Two changes are particularly noteworthy.

First, the 2008–09 Budget included, for the first time, payments of goods and services tax (GST) revenue in general revenue assistance to the states and territories. Previous budgets treated the GST as if it were not a Commonwealth tax but as a state tax. Consequently, GST payments were wrongly omitted from payments of general revenue assistance to the states. Appendix A of the 2007–08 Final Budget Outcome included GST payments in general revenue assistance to the states for 2007–08 (and 2006–07). This means that general revenue assistance to the states is understated for 2000–01 to 2005–06 inclusive in the Final Budget Outcomes for those years. To obtain comparable data for 2000–01 to 2005–06 inclusive, it is necessary to add accrual GST payments to the amounts that were listed as general revenue assistance in the Final Budget Outcomes for 2000–01 to 2005–06. Given that GST revenue is about $40 billion annually, the exclusion of payments of GST to the states in 2000–01 to 2005–06 was a major omission.

Second, in the 2009–10 Budget, there was a major reclassification of expenses with almost $4.8 billion reclassified. The reasons given for the reclassification were:

> The transition to greater program reporting has provided the opportunity to review the functional classification of expenditure by program including, where appropriate, ensuring a one-for-one relationship between programs and sub-functions. This review has resulted in

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30. Australian Government, 'Statement 6: expenses and net capital investment', *Budget strategy and outlook: Budget paper no. 1: 2009–10,* Commonwealth of Australia, Canberra, 2009, pp. 6–1 to 6–51, viewed 1 March 2010, http://www.Budget.gov.au/2009-10/content/bp1/downloads/bp1_bst6.pdf

31. Australian Bureau of Statistics (ABS), *Australian system of government finance statistics. Concepts, sources and methods, 2005*, cat. no. 5514.0.55.01, ABS, Canberra, 2005, viewed 1 March 2010, http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/87520B9D70A82D47CA25706F00795A8D/$File/55140_2005.pdf

> an improved allocation of expenditure by function, improving the robustness of functional expenses data and the consistency of reporting across government.[32]

A consequence of these changes is that some data for 2009–10 are not strictly comparable with data for earlier years.

A very welcome practice is the 'boxes' that disaggregate some expenses in Budget Paper No. 1. For example, Budget Paper No. 1 for 2009–10 contained a table showing trends in the major components of the pharmaceutical benefits and services sub-function. These boxes contain very useful additional information, and their presentation is to be encouraged since they contain information often not readily available elsewhere.

6.1.1 Contingency reserve

Under 'other purposes', the functional classification of expenses includes an item called the contingency reserve (CR). The CR is principally a means of trying to ensure that the estimates of expenses in the Budget and forward estimates are sound. Major components of the CR for the Budget and forward estimates include:

- an allowance for the tendency for estimates of expenses for existing policies to be understated in the forward years
- an allowance for the tendency for estimates of some expenses to be overstated in the Budget year
- commercial-in-confidence and national security-in-confidence items which cannot be disclosed separately, and
- minor decisions made late in the budget process.

To compensate for the tendency to underestimate the cost of existing programs in forward years, a 'conservative bias allowance' is built into the forward estimates. The allowance is one per cent of total expenditure in the first forward year, 1.5 per cent in the second year, and 2.5 per cent in the third year. This allowance is not used to fund new programs. Rather, its purpose is to ensure that the forward estimates better reflect likely spending levels.

An example of the use of the CR arose in the 2008–09 Budget. In this Budget, the Government undertook to provide up to $4.7 billion to build the national broadband network. At the time, the budget impact depended on the outcome of a 'request for proposals' process. A provision for the national broadband network was included in the CR pending the determination of the successful proponent.

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32. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2009–10*, op. cit., p. 6–9.

The amount in the CR can fluctuate considerably. In the 2005–06 Budget, for example, the amount for 2005–06 was $187 million whereas in the 2003–04 Budget, the amount for 2005–06 was $4 billion. In general, the amount in the CR increases the further the projections are into the future. This reflects increasing uncertainty about the cost of programs the further they are in the future.

The amounts and the movements in the CR need to be kept in context. Total expenses for 2008–09 were projected to be in the vicinity of $292 billion, so the $451 million in the CR was a small fraction of that total. Even the $12 billion for 2011–12 was less than four per cent of projected expenses ($339 billion) for that year.

6.2 Linking functions and programs

As noted above, general government expenses are classified by function in Statement 6 of Budget Paper No. 1 and in the Final Budget Outcome. In their portfolio budget statements, agencies classify spending by outcomes and programs. In the past, there was nothing to link outcomes with expenses by function. As noted in *Operation Sunlight*:

> There is insufficient mapping of spending by agencies on particular programs between Budget Papers and the P[ortfolio] B[udget] S[tatements]. Expenses are classified on two different bases. The PBS classify expenses by outcome. B[udget] P[aper] No.1 classifies by function or purpose. The two are not reconciled. Transparency is further reduced where responsibilities sit across portfolios.[33]

Starting with the 2009–10 Budget, government policy with respect to the lack of linkage is to:

> List programs in the Budget Papers that sit under sub functions including forward estimates. This program information would be cross-referenced to the P[ortfolio] B[udget] Statements. Individual PB Statements would contain a 'contra' reference back to the Budget Papers.
>
> The Government will introduce program reporting from the 2009–10 Budget in PB Statements. This will result in improved cross-referencing between sub-function reporting in Statement 6 of Budget Paper No.1 and PB Statements.[34]

7. Appropriations

7.1 Introduction

The ultimate authority for the receipt and spending of money is the *Australian Constitution*, notably sections 81 and 83. In practice, funds for the operation of Commonwealth entities come from four sources:

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33. Australian Government, *Operation Sunlight - enhancing budget transparency*, op. cit., p. 7.

34. Ibid., p. 8.

- annual appropriations (which account for less than 20 per cent of total appropriations)
- special appropriations (which account for more than 80 per cent of total appropriations)
- relevant agency receipts, and
- special accounts.

7.2 Consolidated Revenue Fund

Two sections of the *Australian Constitution* establish the framework for appropriations. Section 81 established the Consolidated Revenue Fund (CRF):

> All revenues or moneys raised or received by the Executive Government of the Commonwealth shall form one Consolidated Revenue Fund.

The CRF is deemed to be 'self-executing', that is, all money that the Commonwealth receives, whether it belongs to the Commonwealth or not, automatically forms part of the CRF on receipt.

All money expended from the CRF must be appropriated by law. Section 83 of the *Australian Constitution* states:

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

7.2.1 Drawing rights

Under the *Financial Management and Accountability Act 1997* (FMA Act), no money can be paid from the CRF without a valid drawing right. Drawing rights control payments from the CRF and the use of appropriations, and allow the Finance Minister (or the Finance Minister's delegate) to set conditions and limits relating to those activities. The FMA Act provides that an official or minister must not make a payment of money from the CRF, or debit an appropriation, unless authorised by a valid drawing right.

7.2.1.1 General drawing rights limits

General drawing rights limits are a mechanism for limiting spending under certain Acts. They do not appropriate money.

The *Nation-building Funds Act 2008* established three so-called nation-building funds—the Building Australia Fund, the Education Investment Fund, and the Health and Hospitals Fund—as well as special accounts for each of those funds (see section 15). The *COAG Reform Fund Act 2008* established the COAG Reform Fund as a special account. Its purpose is to make financial assistance grants to the states and territories. An amount in the Building

Australia Fund, the Education Investment Fund and the Health and Hospitals Fund may be transferred to the COAG Reform Fund special account.

The *Nation-building Funds Act 2008* and the *Federal Financial Relations Act 2009*—which is the special appropriation (see section 7.4) under which most payments to the states and territories are made—contain mechanisms to limit the amounts that can be paid annually under each of these two Acts. The maximum amounts are called the 'general drawing rights limits'.

Appropriation Act (No. 2) 2009–10 contained the general drawing rights limits for 2009–10. The Explanatory Memorandum for the Bill for *Appropriation Act (No. 2) 2009–10* provided the following reason for the general drawing rights limits:

> The general drawing rights limits provide Parliament with a mechanism by which it may review the maximum amounts that can be paid under each of these Acts in a financial year.[35]

7.3 Annual appropriations

Annual appropriations are contained in six (but sometimes more) Appropriation Acts.[36] The first three Acts are:

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

The Bills for the first three Acts are introduced on budget night. The other three Acts are called 'additional estimates' Acts (see section 7.3.3). The Acts authorise the payment of specific amounts for particular purposes.

7.3.1 Ordinary annual services

Section 54 of the *Australian Constitution* provides:

> The proposed law which appropriates revenue or moneys for the ordinary annual services of the Government shall deal only with such appropriation.

35. Explanatory Memorandum, Appropriation Bill (No. 2) 2009–10, p. 13, viewed 1 March 2010, http://parlinfo/parlInfo/download/legislation/ems/r4111_ems_87928089-bf66-48ac-952e-c035a1a5b31a/upload_pdf/329139.pdf

36. In 2008–09, Explanatory Memorandums were issued to accompany the annual Appropriation Bills.

Appropriation Act (No. 1) provides for the appropriation of money for ordinary annual services. Appropriation Act (No. 2) provides for the appropriation of money for services other than ordinary annual services ('other' services). The parliamentary departments have a separate Appropriation Act because the services of these departments are not services of the government as such.

The distinction between ordinary and other services is blurred. The distinction was agreed between the Senate and the government in 1965, and the division of items between the two Acts accords with the 1965 'compact' between the House of Representatives and the Senate.[37] The compact defines ordinary services as continuing expenditure for existing policies. This begs the question of what constitutes an existing policy. The allocation of items between Appropriation Acts 1 and 2 is sometimes negotiated between the House of Representatives and the Senate. In practice, when the government introduces administered funding for a program under a new outcome that is not funded under a special appropriation, the program is initially funded under Appropriation Act (No. 2). Thereafter, the program is considered to be an ordinary service and is funded under Appropriation Act (No. 1).

Appropriation Act (No. 1) sets out agency appropriations by outcome and distinguishes between administered and departmental expenses (see section 7.7). The majority of spending under Appropriation Act (No. 1) is for departmental expenses. Administered expenses include some programs, and payments to bodies established under the *Commonwealth Authorities and Companies Act 1997* (CAC Act) (see section 7.8). Examples of CAC Act bodies are the Australian War Memorial, the Australian Film Commission, and the Australian Broadcasting Corporation.

Payments to CAC Act bodies used to be made 'directly' to the bodies. Since 2008–09, payments to CAC Act bodies have been made 'indirectly' through portfolio departments. For example, funding for the Australian Broadcasting Corporation and the Special Broadcasting Service Corporation is made through the Department of Broadband, Communications and the Digital Economy, this being the relevant portfolio department. The Department passes the funds to the CAC Act bodies.

The data in Appropriation Act (No. 1) are highly aggregated but additional information is contained in agencies' portfolio budget statements.[38]

Section 53 of the *Australian Constitution* limits the powers of the Senate in relation to ordinary annual services bills. Under section 53, the Senate may not amend proposed laws appropriating revenue or moneys for the ordinary annual services of the government. The

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37. Parliament of Australia, Senate, *Odgers' Australian Senate Practice*, chapter 13, Commonwealth of Australia, viewed 17 March 2010, http://www.aph.gov.au/Senate/pubs/odgers/contents.htm

38. The Appropriation Acts state that the portfolio budget statements are to be read in conjunction with the Acts.

Senate may, however, return to the House of Representatives any such proposed laws requesting, by message, the omission or amendment of any items or provisions therein. The Senate can also reject the legislation outright.

7.3.2 Other services

As noted above, payments for ‘other’ services—that is, services that are not ordinary annual services—are made under Appropriation Act (No. 2). Other services fall into the following categories.

7.3.2.1 Payments to the states, territories and local governments

These payments are administered expenses in the form of only some payments to the states, territories and local governments. These payments are made under section 96 of the *Australian Constitution*.

As discussed below, most payments to the states, territories and local governments are now made under the *Federal Financial Relations Act 2009* and not under Appropriation Act (No. 2) as before.

7.3.2.2 New administered expenses

This category is payments for administered expenses for new outcomes. Once approved by parliament, such outcomes are considered to be ordinary annual services and so are funded under Appropriation Act (No. 1) in future years.

7.3.2.3 Non-operating appropriations

Non-operating appropriations fall into two categories: departmental and administered.

Departmental non-operating appropriations in turn fall into three categories:

- equity injections: these are provided to agencies to fund, for example, substantial investment in new assets
- loans: they are provided when an investment is expected to yield a return such as productivity gains, and
- prior year departmental appropriations: they replenish funds spent on departmental expenses in the previous year. This can occur, for example, when the government decides to introduce a new program but the decision comes too late for the program to be funded through the additional estimates Appropriation Acts. In such cases, the program is initially funded from existing appropriations.

Administered non-operating costs fall into two categories:

- payments for 'administered assets and liabilities' which fund, for example, the purchase of new administered assets and the reduction of administered liabilities, and
- payments to CAC Act bodies for non-operating costs. These are bodies established under the *Commonwealth Authorities and Companies Act 1997* (see section 7.8).

7.3.2.4 Payments to the states, territories and local governments

There was a major change to payments under Appropriation Act (No. 2) beginning 1 January 2009. This resulted from the agreement by the Council of Australian Governments to new arrangements for federal-state financial relations. Under the new arrangements, Treasury makes specific purposes payments to the states monthly. These payments are for National Specific Purpose Payments, National Partnership payments and general revenue assistance. These payments are made under the *Federal Financial Relations Act 2009* and account for the great bulk of payments to the states and territories. Previously, these payments were made under Appropriation Act (No. 2). There are two exceptions to these arrangements: payments made directly to local governments, and some payments made 'through' the states for non-government schools that are not paid under the *Schools Assistance Act 2008* or the COAG Reform Fund. The new arrangements are supposed to improve transparency.

A consequence of transferring the bulk of payments to the states from Appropriation Act (No. 2) to the *Federal Financial Relations Act 2009* is to convert annual appropriations into special appropriations. Before this change, the annual Appropriation Acts accounted for about 20 per cent of total spending. This figure is now less than 20 per cent.

7.3.3 Additional estimates

Funding requirements usually change after the Budget is brought down in May. Governments make new policy commitments that need 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 three Appropriation Acts introduced with the Budget are inadequate. The government has to seek parliamentary approval for proposed additional spending. The process whereby additional funds are provided is called 'additional estimates' and begins around November of the budget year. The approved additional estimates are incorporated into Appropriation Bills 3 and 4 and Appropriation (Parliamentary Departments) Bill No. 2. These Bills are the counterparts of Appropriation Bills No. 1 and 2 and Appropriation (Parliamentary Departments) Bill No. 1 respectively.

Portfolio additional estimates statements are the additional estimates counterparts of portfolio budget statements, and contain explanations of the items to be funded under Appropriation Bills 3 and 4 and Appropriations (Parliamentary Departments) Bill No. 2. The Senate estimates committees also scrutinise the additional estimates bills. Parliament usually passes the additional estimates Bills around April.

7.3.4 Supplementary additional estimates

The government can introduce as many Appropriation Bills as it believes necessary. In 2004–05, for example, the government introduced the Appropriation (Tsunami Financial Assistance) Bill 2004–05, the Appropriation (Tsunami Financial Assistance and Australia-Indonesia Partnership) Bill 2004–05, Appropriation Bill (No. 5) 2004–05 and Appropriation Bill (No. 6) 2004–05. These Bills were supplementary to the usual three additional estimates Bills and brought the total number of annual Appropriation Bills to 10. The government introduced additional Bills in 2003–04 and 2005–06. Such Bills are called supplementary additional estimates Bills.

A third series of bills occurs occasionally. On average, there has been an Appropriation Bill No. 5 every fourth year over the past 30-odd years, although the 2003–04 Bill was the first for about a decade.

7.3.5 Advance to the Finance Minister

The Advance to the Finance Minister (AFM) provides flexibility by allowing the spending of money for unforseen and urgent events. The AFM is authorised by the annual Appropriation Acts and made available to the Finance Minister as a contingency fund.

AFM funding is available to an agency only if there is an urgent need for expenditure, and the additional expenditure is not provided for (or is insufficiently provided for) because of an erroneous omission or understatement, or because the additional expenditure was unforeseen and it was not practicable to provide for the expenditure in Bills before those Bills were introduced into the House of Representatives. The Department of Finance and Deregulation website discusses the criteria for determining whether an AFM payment is justified.[39]

A determination to spend from the AFM is a legislative instrument and so is registered on the Federal register of legislative instruments in accordance with the *Legislative Instruments Act 2003*.[40] All legislative instruments are tabled in the House of Representatives and the Senate within six sitting days after registration.

As to information on how the AFM is spent, in 2009, the government issued, for the first time, a publication titled *Issues from the advances under the annual Appropriations Act: Annual report 2008–09*.[41] This contained details of the items for which money was expended

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39. Australian Government, 'Advance to the Finance Minister (AFM)', Department of Finance and Deregulation website, viewed 1 March 2010, http://www.finance.gov.au/Budget/Budget-process/advance-to-finance-minister.html

40. The term 'legislative instrument' is defined in section 5 of the *Legislative Instruments Act 2003*.

41. Australian Government, *Issues from the advances under the annual Appropriations Acts: Annual Report 2008–09*, Commonwealth of Australia, Canberra, 2009, viewed 1 March 2010,

in 2008–09 under the AFM and the reasons therefore. This new publication replaced the former annual *Issues from the advance to the Finance Minister as a final charge* which contained very little information.[42] The new publication is, therefore, a considerable improvement over the former document. The publication of *Issues from the advances under the annual Appropriations Acts: Annual report 2008–09* was an undertaking under *Operation Sunlight*, which pledged to introduce a new and more comprehensive report than the previous *Issues from the Advance to the Finance Minister as a Final Charge.*

Appropriation Act (No. 3) 2008–09 and *Appropriation Act (No. 4) 2008–09* changed previous practice for the AFM. In essence, the change automatically restored the AFM amount to its original value after a payment had been made from the AFM. The Minister for Finance and Deregulation, in the second reading speech for Appropriation Bill (No. 3) 2008–09, gave the following reasons for the change:

> Based on current indications, we expect demand for issues from the advance to be greater than the $295 million provided in Appropriation Act (No. 1) and the $380 million provided in Appropriation Act (No. 2). It is important that the government can maintain its ability to issue amounts from the advance in the event that there is an urgent need for expenditure. Accordingly, clause 13 of Appropriation Bill (No. 3) provides that, irrespective of the amounts issued from the advance, at the commencement of Appropriation Act (No. 3), the amount available to be issued will be restored to the original limit of $295 million. A similar clause has been added to Appropriation Bill (No. 4) which will restore the limit to $380 million.[43]

7.4 Special (standing) appropriations

Annual appropriations account for less than 20 per cent of government expenses. In excess of 80 per cent of spending is funded under special (or standing) appropriations—the terms tend to be used interchangeably.[44] A special appropriation is an appropriation in an Act, other than an annual Appropriation Act, which appropriates money from the Consolidated Revenue Fund for a particular purpose. For example, payments for the age pension, the disability support pension, and other social security payments are made under the *Social Security (Administration) Act 1999*. Virtually all special appropriations are for administered expenses.

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http://www.finance.gov.au/publications/advance_to_the_finance_minister/docs/AFM_Annual_Report_2008-09.pdf

42. More information on advances made before 2008–09 can be found in the explanatory statements to the legislative instruments.

43. L Tanner (Minister for Finance and Deregulation), ‘Second reading speech: Appropriation Bill (No. 3) 2008–09’, House of Representatives, *Debates*, 4 December 2008, p. 7, viewed 1 March 2010, http://parlinfo.aph.gov.au/parlInfo/genpdf/chamber/hansardr/2008-12-04/0008/hansard_frag.pdf

44. In practice, either term is used to refer to appropriations not made under the annual Appropriation Bills.

Special appropriations fall into three categories. First, most special appropriations are open-ended in that the amount appropriated for a particular purpose is determined by the eligibility and other provisions of the relevant Acts. Appropriations dependent on beneficiaries meeting certain criteria and/or being entitled to receive payments are often called 'standing' appropriations. An example of a standing appropriation is the eligibility conditions for the age pension prescribed by the *Social Security (Administration) Act 1999*.

Second, some special appropriations are for a specific amount. In this case, the special appropriation is said to be 'limited by amount'. An example is section 66 of the *Commonwealth of Australia Constitution Act* under which salaries of ministers are paid.

The Department of Finance and Deregulation's portfolio budget statements show a third category of special appropriation described as 'special appropriations limited by capital'. This appropriation pays the unfunded component of superannuation benefits payable under the PSS and CSS superannuation schemes.

There are several differences between annual and special appropriations. First, whereas the Appropriation Acts specify amounts, the amounts in the Budget for special appropriations are mostly estimates. Second, whereas spending under the Appropriation Acts is subject to annual review and approval by parliament, special appropriations are approved by parliament when the legislation is passed, and can only be removed or amended by repealing or amending that legislation, which also requires parliamentary approval. However, as discussed in section 1.5, the Expenditure Review Committee scrutinises spending under special appropriations.

The portfolio budget statements show estimated spending under special appropriations, and link this spending to the relevant outcomes. For example, in 2009–10, the Department of Infrastructure, Transport, Regional Development and Local Government listed five Acts, and the estimated spending under each Act. Budget paper no. 4 contains a consolidated list of special appropriations and estimated payments under each Act.

From the perspective of transparency and accountability, no mechanisms exist for the periodic review of special appropriations. The Senate Standing Committee on Finance and Public Administration in its report titled *Transparency and accountability of Commonwealth public funding and expenditure*, recommended the implementation of a system of review of standing appropriations to ensure that access to the Consolidated Revenue Fund is withdrawn when no longer required, and to ensure that standing appropriations are subject to periodic government and parliamentary review.[45] In its response, the government agreed that standing appropriations should be reviewed regularly, and stated that it is considering including formal

45. Senate Standing Committee on Finance and Public Administration, *Transparency and accountability of Commonwealth public funding and expenditure*, The Senate, Canberra, March 2007, viewed 17 March 2010, http://www.aph.gov.au/Senate/committee/fapa_ctte/completed_inquiries/2004-07/funding_expenditure_06/index.htm

review clauses in special appropriations legislation requiring governments to review and report to parliament, on a periodic basis, on the continuing need for the legislation and whether the existing focus of the legislation remains valid.[46]

7.5 Relevant agency receipts

Some agencies generate revenue, for example, from the sale of goods and services. However, agencies cannot spend this money without an appropriation. Section 31 of the *Financial Management and Accountability Act 1997* (FMA Act) contains the mechanism—relevant agency receipts—whereby agencies can spend this money on departmental expenses. Section 31 provides that an agency's departmental appropriation can be increased by the kinds of receipts prescribed by FMA Regulations 15 and 16. The system of relevant agency receipts was introduced on 1 July 2008 by the *Financial Framework Legislation Amendment Act (No. 1) 2007*.

Relevant agency receipts replaced the system of 'net appropriation agreements' made under section 31 of the FMA Act, prior to 2008–09. Net appropriation agreements were made between the Finance Minister and an agency minister to identify the type of receipts that could increase an appropriation. The *Financial Framework Legislation Amendment Act (No. 1) 2007* amended section 31 to remove the requirement for ministerial agreements for each FMA Act agency and instead introduced—via FMA regulations 15 and 16—a standard set of receipts applicable of all FMA Act agencies.

7.6 Special accounts

A special account is essentially a mechanism used to manage money that is designated for a particular purpose. A special account is an appropriation mechanism that notionally sets aside an amount within the Consolidated Revenue Fund to be expended for that purpose. The appropriation authority is section 20 or 21 of the *Financial Management and Accountability Act 1997* (FMA Act). The type of appropriation provided by a special account is a special appropriation. The appropriation amount is limited up to the balance of the special account and this remains available until the special account is abolished. An example of a special account is that established for the Future Fund.

A special account can be established by:

- a legislative instrument made by the Finance Minister, under section 20 of the FMA Act or
- an enabling Act, under section 21 of the FMA Act.

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46. Australian Government, *Government response to Senate report "Transparency and accountability of Commonwealth public funding and expenditure"*, 11 August 2009, p. 3, viewed 17 March 2010, http://www.aph.gov.au/Senate/committee/fapa_ctte/completed_inquiries/2004-07/funding_expenditure_06/responses/govt_response.pdf

The statutory crediting clauses specify the amounts that may be credited to a particular special account, and also the appropriation purposes for which amounts may be legally debited from the balance of that special account. Depending on the appropriation purpose, a special account may be credited with amounts from annual or special appropriations or from other sources.

The Australian National Audit Office (ANAO) has described the reasons for setting up special accounts:

> [Special Accounts] provide a useful method of delivering some government programs, particularly ones funded by, say, indirect taxes or other compulsory imposts, contributions by other governments or discretionary contributions by members of the community. Special Accounts allow money in the CRF to be set aside for particular spending purposes, and moneys in a Special Account can only be spent for the purposes nominated.
>
> … Special Accounts may be used for proper trustee type moneys, where the Commonwealth is holding money on behalf of other parties, so genuine trustees' moneys can fit into the Special Account definition. Also, where we are holding moneys on behalf of the States and for other similar uses, Special Accounts are an appropriate vehicle as well.[47]

In 2004, the ANAO examined the use of special accounts in a report titled *Agency Management of Special Accounts*.[48] The ANAO found that many agencies needed to improve management of special accounts, and had not complied with a number of legislative requirements. ANAO concluded that its audit demonstrated that there was significant scope for agencies to improve their financial management and reporting practices, and made 13 recommendations to improve management and accountability. The Department of Finance and Deregulation subsequently reviewed special accounts and has prepared an introduction to and other information about special accounts.[49]

Movements in special accounts are reported at the agency level, in Budget paper no. 4, and in the Consolidated Financial Statements. At the agency level, for each special account it manages, the agency presents in its portfolio budget statement information in two tables—the 'agency resource statement' and 'estimates of cash flows and balances'. The agency resource statement summarises estimated expenditure from special accounts. Since the estimated expenditure includes amounts appropriated from annual and special appropriations, these

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47. Joint Committee of Public Accounts and Audit, *Inquiry into the Draft Financial Framework Legislation Amendment Bill*, report 395, Joint Committee, Canberra, 2003, p. 29, viewed 17 March 2010, http://www.aph.gov.au/house/committee/jpaa/financial_bill/contents.htm

48. Australian National Audit Office (ANAO), *Agency Management of Special Accounts*, Audit report no. 24, ANAO, Canberra, 2004, viewed 17 March 2010, http://www.anao.gov.au/uploads/documents/2003-04_Audit_Report_24.pdf

49. Australian Government, 'Finance Circular 2009/01: An introduction to special accounts', Department of Finance and Deregulation website, viewed 17 March 2010, http://www.finance.gov.au/publications/finance-circulars/2009/01.html

amounts are deducted at the end of the agency resources statement table to avoid double counting. The estimates of cash flows and balances are more detailed than the agency resource statement. In its annual report, the agency shows actual movements in special accounts in notes to the financial statements.

Budget paper no. 4 shows estimated cash flows and balances of special accounts. The annual Consolidated Financial Statements also report, for each special account, the purpose for which it was established, actual payments and receipts, and opening and closing balances.

7.7 Departmental and administered expenses

7.7.1 Departmental expenses

Agencies' expenses are classified as either departmental or administered. Departmental expenses are expenses associated with the day-to-day operations and program-support activities of agencies. Examples are salaries, property operating costs, and the cost of operating assets for the entity's own use. Departmental expenses are appropriated as a single amount for each agency. Departmental expenses account for around 17 per cent of general government expenses.[50]

Agencies have some flexibility as to how they spend departmental expenses appropriations. While an agency's portfolio budget statements show the amount of departmental expenses allocated to each outcome and programs within that outcome, an agency can reallocate departmental expenses appropriations among outcomes and programs as needed.

Agencies sometimes do not spend all the amounts they are appropriated for departmental expenses. In such cases, departmental expenses may be subject to a reduction process, which is specified in the Appropriation Acts. Under this process, which was introduced in the additional estimates Appropriation Acts for 2003–04, the relevant minister can ask the Finance Minister to issue a determination to reduce the surplus funds.

7.7.1.1 Efficiency dividend

Departmental expenses are subject to an annual reduction process known as the 'efficiency dividend'. According to the Department of Finance and Deregulation, the benefit of the efficiency dividend is that it:

> … provides an incentive for agencies to continually seek efficiencies, delivering benefits to taxpayers and allowing the Government to re-direct efficiency gains to new or higher priority areas.

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50. Department of Finance and Deregulation, *Finance submission to the Joint Committee of Public Accounts and Audit Inquiry into the effects of the ongoing efficiency dividend on smaller public sector agencies*, July 2008, p. 3, viewed 17 March 2010, http://www.aph.gov.au/house/committee/jpaa/efficdiv/subs/sub25.pdf

> In the absence of the efficiency dividend, the identification and redirection of efficiency gains to other priorities would require a more interventionist approach by Finance to assess whether agencies were operating efficiently and to seek savings where this was not the case. Such an approach would be resource intensive, potentially more arbitrary, and would reduce the incentive for agencies to pursue efficiency gains themselves.
>
> The efficiency dividend operates as a means of facilitating a change in priorities. It provides a return to the Budget from ongoing gains in efficiency which can be redirected through the Budget process to areas that the Government has identified for additional funding.[51]

The efficiency dividend applies to all general government sector agencies unless they are specifically exempted. In general, the base on which the efficiency dividend is levied is departmental expenses (although it applies to only a portion of some agencies' departmental expenses). Administered expenses are usually not subject to the efficiency dividend unless the government determines otherwise, and it does not apply to capital acquisitions. The efficiency dividend is applied before any price adjustments (that is, before indexation in accordance with the relevant index) are made to estimates. The efficiency dividend is implemented through a reduction in appropriations revenue.

Whatever its rationale, the application of the efficiency dividend has been arbitrary, and governments have used it as a device to cut or reallocate spending. The rate has varied. Starting from 0.5 per cent in 1986–87, the rate was increased to 1.25 per cent from 1987–88. In the 1994–95 Budget, the rate was reduced to one per cent. In the 2005–06 Budget, the government announced that the rate would revert to 1.25 per cent from 2005–06 to 2007–08.[52] In the 2007–08 Mid-Year Economic and Fiscal Outlook, the Howard Government proposed to extend the 1.25 per cent rate for another three years from 2008–09 to 2010–11.[53] The Rudd Government continued the Howard Government's policy. In addition, the Rudd Government applied—with exceptions—a one-off, two per cent efficiency dividend starting in 2007–08. The Rudd Government applied a pro-rata adjustment for 2007–08 to take account of the fact that its policy was implemented part way through 2007–08, with the full-year effect of the two per cent starting in 2008–09. The two per cent was calculated on the same base as that used for the ongoing 1.25 per cent. Rate changes are summarised in the following table.

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51. Ibid., p. 2.

52. Australian Government, *Budget measures: Budget paper no. 2: 2005–06*, Commonwealth of Australia, Canberra, 2005, p. 118, viewed 1 March 2010, http://www.Budget.gov.au/2005-06/bp2/download/bp2.pdf

53. Australian Government, *Mid-year economic and fiscal outlook: 2007–08*, Commonwealth of Australia, Canberra, 2007, p. 121, viewed 1 March 2010, http://www.Budget.gov.au/2007-08/myefo/html/index.htm

Table: Efficiency dividend rates

Period	**Rate (per cent)**
1986–87 to 1986–87	0.5
1987–88 to 1993–94	1.25
1994–95 to 2004–05	1.0
2005–06 to 2006–07	1.25
2007–08	1.25 plus *pro-rata* of 2.0 on the same base as the 1.25
2008–09	1.25 plus 2.0 of the same base as the 1.25
2009–10	1.25
2010–11	1.25

Source: Department of Finance and Deregulation, Submission to the Joint Committee of Public Accounts and Audit Inquiry into the Effects of the Ongoing Efficiency Dividend on Smaller Public Sector Agencies, July 2008, p. 2, viewed 17 March 2010,
http://www.aph.gov.au/house/committee/jpaa/efficdiv/subs/sub25.pdf

In December 2008, the Joint Committee of Public Accounts and Audit released a report that examined the effects of the efficiency dividend on small agencies. This Committee found, amongst other things, that the efficiency dividend weighed particularly heavily on small agencies. Among the Committee's recommendations was recommendation 8 that the government either:

> · exempt the first $50 million of all agencies' appropriations from the efficiency dividend, excluding departments of state (the preferred option); or
>
> · exempt the first $50 million of the appropriations of all agencies that have departmental expenses of less than $150 million, excluding departments of state.
>
> These benchmarks to be indexed over time. [54]

On 4 February 2010, the government responded to this report.[55] The response rejected most of the Committee's findings. In particular, it rejected recommendation 8.

7.7.2 Administered expenses

Administered expenses are typically the cost of programs that agencies manage on the government's behalf. Examples are subsidies, grants, benefit payments, and the financial

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54. Joint Committee of Public Accounts and Audit, *The efficiency dividend and small agencies: size does matter*, Commonwealth of Australia, Canberra, December 2008, p. xvii, viewed 17 March 2010, http://www.aph.gov.au/House/committee/jpaa/efficdiv/report/front.pdf

55. Australian Government, *Government response to JCPAA report 413 'The efficiency dividend and small agencies: size does matter'*, viewed 17 March 2010, http://www.finance.gov.au/Publications/efficiency-dividend/docs/GovernmentResponse_JCPAA_413.pdf

assistance grants the Commonwealth makes to local governments. Administered expenses account for about 83 per cent of total agency expenses. Most administered expenses are paid under special appropriations. Most of the remainder—for example, payments under the Bass Strait passenger vehicle equalisation scheme and the LPG vehicle scheme—are paid under Appropriation Act No. 1.

Administered expenses, like departmental expenses, can be subject to a reduction process which is specified in the Appropriation Acts. The process changed in the 2008–09 Budget. Previously, the Finance Minister issued, after the end of the financial year, a determination of the amounts for administered expenses. This had the effect of preventing the appropriation of an amount that had not been expensed in that financial year. From 2008–09, the amounts that agencies show in their financial statements as having been spent on administered expenses determine how much of unspent administered expenses appropriations will be extinguished. In short, the difference between the amount appropriated and the amount expended, as shown in the financial statements, will be extinguished.

7.8 Commonwealth Authorities and Companies Act 1997 bodies

Agencies subject to the *Financial Management and Accountability Act 1997* are financially part of the Commonwealth. Bodies subject to the *Commonwealth Authorities and Companies Act 1997* (CAC Act) are legally and financially separate from the Commonwealth. Examples of CAC Act bodies are the Australian War Memorial, Screen Australia, and the Australian Broadcasting Corporation.[56]

Matters the CAC Act covers include:

- the corporate governance, financial management and reporting of Commonwealth authorities, which are additional to the requirements of their enabling legislation
- the corporate governance and reporting of Commonwealth companies, which are additional to the requirements of the *Corporations Act 2001*
- reporting by an authority or a company to a minister and, through a minister, to parliament
- contents of the annual report of operations of an authority or a company, and
- the audit of financial statements of an authority or a company by the Auditor-General.

Before 2008–09, CAC Act bodies were funded ‘directly’ through the annual Appropriation Acts and special appropriations. But in recognition of the fact that CAC Act bodies are

56. For a list of CAC Act bodies see: Australian Government, ‘List of bodies subject to the *Commonwealth Authorities and Companies Act 1997* (CAC Act), Department of Finance and Deregulation website, viewed 1 March 2010, http://www.finance.gov.au/financial-framework/cac-legislation/docs/CAC-body-list.pdf,

legally and financially separate from the Commonwealth, the 2008–09 Budget changed the system of payments to CAC Act bodies. The Explanatory Memorandum for Appropriation Bill No. 1 2008–09 contained the following explanation for the change:

> A CAC Act body is defined in clause 3 to be a Commonwealth authority or Commonwealth company within the meaning of the CAC Act. Many CAC Act bodies receive funding directly from appropriations. However, these bodies are legally separate from the Commonwealth and as a result, do not debit appropriations or make payments from the Consolidated Revenue Fund. The Bill is the first annual appropriation bill since 1999 to clearly recognise CAC Act bodies with a separate item.[57]

FMA Act agencies are now specifically appropriated amounts for the purposes of making payments to CAC Act bodies. The agencies are then required to pay those amounts to the CAC Act body upon request by that body. For example, funding for the Australian Broadcasting Corporation and the Special Broadcasting Corporation appeared as a 'payment to CAC Act bodies' in the statement of administered income and expenses of the Department of Broadband, Communications and the Digital Economy.

The change complicates comparisons of time series data. A consequence of the change is that the Department of Broadband, Communications and the Digital Economy's administered revenue and expenses, for example, were both 'inflated' in 2008–09 by the amount it received for and then paid to CAC bodies compared with previous years. To obtain comparable data, it is necessary either to add the revenue for and payments to CAC bodies to the previous year's data, or subtract the CAC body revenue and payments from the data for 2008–09 and future years.

7.9 Administered income

The portfolio budget statements also show estimated administered income. This is income that agencies manage on the government's behalf. An example is the passport fees that the Department of Foreign Affairs and Trade collects.

7.10 Issues relating to appropriations

The distinction between departmental and administered expenses is based on the concept of control:

> Administered expenses are expenses that agencies do not have control over and are normally made pursuant to eligibility rules and conditions established by the Government such as grants, subsidies and benefit payments. Annual appropriations for administered

57. Explanatory Memorandum, Appropriation Bill (No. 1) 2008–09, p. 9, viewed 17 March 2010, http://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r2973_ems_b2a52566-472b-4af6-855b-a9309d7ce3a5/upload_pdf/317130.pdf

> expenses are appropriated on the basis of agency outcomes, making it clear what the funding is intended to achieve rather than the programme it is being spent on.[58]

The distinction between administered and departmental items is not, however, always clear. The Senate Finance and Public Administration Legislation Committee, in its third report on the format of the portfolio budget statements 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.[59]

Several points are noteworthy. First, it is not a simple process to transfer items from one classification to the other. Second, even if an item is transferred from administered to departmental, funding for departmental items is contained in appropriation Bills, which parliament has to pass. As noted, classifying an item as departmental does, however, give agencies greater spending discretion.

8. Budget documents

Budget documents can be classified into two broad categories: those that report proposed spending and revenue, and those that report actual spending and revenue. The budget papers and agency portfolio budget statements are the main sources of information on the former.

The government releases the budget papers and related documents on Budget night. Ministers also issue media releases and information kits. The number of budget papers and related documents differs little from year to year. The 2009–10 budget documents comprised:

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58. Australian Government, 'Appropriation Bills', Department of Finance and Deregulation website, viewed 17 March 2010, http://www.finance.gov.au/budget/budget-process/appropriation-bills.html

59. Senate Finance and Public Administration Legislation Committee, *The format of the portfolio budget statements, third report*, The Senate, Canberra, November 2000, pp. 18–19, viewed 17 March 2010, http://www.aph.gov.au/senate/committee/fapa_ctte/completed_inquiries/1999-02/pbs3/report/report.pdf

- the budget speech
- budget at a glance
- budget overview
- four budget papers
- portfolio budget statements covering each general government sector agency, and
- ministerial statements.

8.1 Budget speech

The budget speech is the printed version of the speech that the treasurer delivers on budget night.[60] The speech contains highlights and details of the government's priorities. The budget speech and the budget papers are loaded onto the parliamentary website on budget night or soon thereafter, and on to the Australian Government budget website.[61]

8.2 Budget overview

As its name suggests, the budget overview (sometimes called budget highlights) summarises key features of the Budget.[62] The contents and length of the document vary from year to year. Its main use is as a quick reference to the main features of the Budget as the government sees them.

8.3 Budget papers

There are four budget papers. The following outlines the budget papers for 2009–10.

8.3.1 Budget paper no. 1: budget strategy and outlook 2009–10

Budget paper no. 1 is the main budget paper.[63] Budget paper no. 1 for 2009–10 contained 10 statements dealing, among other things, with fiscal policy, the outlook for the economy, the assumptions underlying the projections of growth, unemployment, revenue and expenses, and other matters. Part of Budget paper no. 1 accords with the *Charter of Budget Honesty Act 1998* which requires that the government provide, among other things, a statement of its

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60. W Swan, *Budget speech: 2009–10*, op. cit.

61. Australian Government, 'Budget website', op. cit.

62. Australian Government, *Budget overview: 2009–10*, Commonwealth of Australia, Canberra, 2009, viewed 17 March 2010, http://www.Budget.gov.au/2009-10/content/overview/download/Budget_Overview.pdf

63. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2009–10*, op. cit.

fiscal strategy and a report on the economic and fiscal outlooks as well as risks to the outlooks (see section 10.1).

Statement 1: budget overview. This contained sections dealing with the fiscal and economic outlooks, fiscal strategy and the government's priorities. Statement 1 contained a table showing budget aggregates.

Statement 2: economic outlook. This discussed developments in the domestic and international economies, and uncertainties in both.

Statement 3: fiscal strategy and outlook. This statement contained sections dealing with fiscal strategy, an assessment of the fiscal outlook against that strategy, and the medium-term fiscal outlook.

Statement 4: assessing the sustainability of the Budget. This statement is one of a series that have discussed various aspects of the economy. Statement 4 dealt with topics such as tax reform, productivity, unemployment, and the terms of trade.

Statement 5: revenue. This contained revenue estimates for the budget and forward years. For example, revenue from taxes such as excise on petrol and diesel can be found here. More information on the goods and services tax can be found in Budget paper no. 3. The appendices contained much useful information. For example, appendix C contained revenue and receipts history going back to 2000–01, and forecasts of revenue and receipts for the budget and forward years.

Statement 6: expenses and net capital investment. This statement contained information on the spending side of the Budget. Most of statement 6 is devoted to details of expenses which are classified on a functional basis, for example, defence, education, health, and social security and welfare. Another part of this statement dealt with general government net capital investment. Appendix A contained estimates of expenses by function and sub-function for the past two years, and the budget and forward years. Appendix C contained tables showing expenses, net capital investment, and average staffing levels by agency.

Statement 7: asset and liability management. This contained two sections. The first contained information on the government's major assets and liabilities. The second section 'managing changes in the Government's borrowing needs', dealt with government borrowing notably treasury bonds and treasury notes.

Statement 8: **statement of risks.** This statement dealt with risks to the assumptions underlying the Budget. Risks included changes to economic parameters, the possibility that contingent liabilities would become actual liabilities, and the risk that the government might have to meet its guarantee of deposits in authorised deposit-taking institutions. The statement divided contingent liabilities between those that were quantifiable and those that were not.

Statement 9: budget financial statements. This statement contains financial statements for all three government sectors: general government, public non-financial corporations, and public financial corporations. The financial statements were presented in accordance with the standard for financial reporting by government, namely, Australian Accounting Standards Board 1049 *Whole of Government and General Government Sector Financial Reporting*.

Statement 10: historical Australian Government data. This statement contained, among other things, aggregate data on receipts, payments, the budget outcome, and net debt. In some cases, the data went back to the early 1970s. Statement 10 contained major data revisions. They included adjustments for accounting classification changes, the inclusion of the goods and services tax as a Commonwealth revenue and expense, the use of the consumer price index to deflate nominal spending data, and treating defence weapons platforms as capital investment rather than as expenses.

8.3.2 Budget paper no. 2: budget measures 2009–10

Budget paper no. 2: budget measures 2009–10 described all the measures that the government proposed in the Budget such as changes to taxes and new programs.[64] The merit of Budget paper no. 2 is that it consolidated all measures into one document. (The portfolio budget statements summarised in a table, the measures shown in Budget paper no. 2). The measures were grouped by portfolio, with the individual measures listed by agency. There were three parts to Budget paper no. 2: revenue measures, expense measures, and capital measures. Each part had a summary table at the beginning. They were an aid to finding information quickly. The measures listed were those since the last Mid-Year Economic and Fiscal Outlook as well as those announced in the Budget. Measures introduced between the previous Budget and the Mid-Year Economic and Fiscal Outlook can be found in the latter.

The figures in Budget paper no. 2 are *changes* to expenses, revenues and capital items resulting from the measures. Data on *levels* of expenditure on programs can be found in the portfolio budget statements.

8.3.3 Budget paper no. 3: Australia's federal relations 2009–10

Budget paper no. 3 dealt with Commonwealth payments to the states, territories, and local governments.[65] Budget paper no. 3 contained, among other things, cash and accrual estimates of goods and services tax payments by state and territory, and specific purpose payments (SPPs) classified by function such as education, health, and infrastructure. Given that much Commonwealth spending takes the form of SPPs, Budget paper no. 3 contained much useful

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64. Australian Government, *Budget measures: Budget paper no. 2: 2009–10*, Commonwealth of Australia, Canberra, 2009, viewed 17 March 2010, http://www.Budget.gov.au/2009-10/content/bp2/download/bp2_Consolidated.pdf

65. Australian Government, *Australia's federal relations: Budget paper no. 3: 2009–10*, Commonwealth of Australia, Canberra, 2009, viewed 17 March 2010, http://www.Budget.gov.au/2009-10/content/bp3/download/bp3.pdf

information. Budget paper no. 3 was substantially revised in 2008–09 to take account of the new framework for federal-state financial relations, which came into effect on 1 January 2009.

8.3.4 Budget paper no. 4: agency resourcing 2009–10

Budget paper no. 4 for 2009–10 contained information on agency resourcing.[66] It showed the total resources available to each agency for the budget year, and contained tables that summarised special appropriations and special accounts.

The introduction to Budget paper no. 4 contained a brief (13 pages) but extremely useful overview of the appropriations system, and is recommended reading for anyone wanting to understand the fundamentals of the system.

Before 2008–09, Budget paper no. 4 reproduced Appropriation Bills No. 1 and No. 2 and the Appropriation Bill for the parliamentary departments. Note that in 1998–99 and earlier years, Budget paper no. 4 was titled ‘The Commonwealth Public Account’. It reproduced the three annual Appropriation Bills and contained, among other things, details of appropriations under special appropriations.

8.4 Portfolio budget statements

The portfolio budget statements (PBS) are the main source of information on proposed agency funding and activities. Information in the PBS includes agency resourcing, budget measures affecting the agency, information the agency will collect in order to assess its performance, and budgeted financial statements. Senate estimates committees use the PBS extensively. Agencies release hard copies of their PBS on budget night and make them available online soon after.

The PBS are a guide to the interpretation of appropriations. The Appropriation Acts contain a provision whereby the PBS are designated as ‘relevant documents’ for the purposes of section 15AB of the *Acts Interpretation Act 1901*. This means that the PBS can be used to help interpret an Act.

The amount of information in the PBS has improved considerably since the 1990–2000 Budget. Two major improvements to the PBS were first, the inclusion of program level information starting with the 2009–10 Budget; previously, only some agencies presented information at the program level. Second, data were provided for the three forward years and not just the budget year as in the past. Both changes were made under *Operation Sunlight* (see section 14). The agency resource statement is also an improvement because it summarises an agency’s entire budget in one table.

66. Australian Government, *Agency resourcing: Budget paper no. 4: 2009–10*, Commonwealth of Australia, Canberra, 2009, viewed 17 March 2010, http://www.Budget.gov.au/2009-10/content/bp4/download/BP4.pdf

In addition to moving from the outcomes/output framework to the outcomes/programs framework in 2009–10, some outcomes were revised. The 2009–10 PBS contained a 'transition table' which showed the relationship between the previous outcomes/output framework and the outcomes/programs framework.

An example of a PBS is that of the Department of Finance and Deregulation for 2009–10.[67] The following describes its contents.

Section 1: Agency overview and resources

- **1.1 Strategic direction.** This section outlines the Department's functions and objectives and the means it proposes to use to fulfil those objectives.
- **1.2 Agency resource statement.** This summarises all sources of revenue and proposed spending and has four components:
  - 'ordinary annual services'. They are services funded under Appropriation Bill No. 1 (see section 7.3.1)
  - 'other services'. They are services funded under Appropriation Bill No. 2 (see section 7.3.2)
  - special appropriations (see section 7.4). This component contains the names of the Acts under which expenditure is appropriated, and the estimated amount payable under each Act, and
  - expenditure from special accounts (see section 7.6). Since the amounts credited to special accounts are appropriated by annual and special appropriations, the amounts credited are deducted at the end of the agency resource tale to avoid double counting.
- **1.3 Budget measures.** This sub-section summarises the measures announced in the Budget for which the Department is responsible, and includes budget year and forward estimates of the financial consequences of the measures. A fuller description of budget measures is contained in Budget paper no. 2 (see section 8.3.2).
- **1.4 Transition from outcomes and outputs to outcomes and programs**. This table appeared in 2009–10 only in order to take account of the revisions to outcomes and the adoption of the outcomes/programs framework (see section 5.1).

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67. Australian Government, *Portfolio budget statements 2009–10: budget related paper no. 1.8: Finance and Deregulation portfolio*, Commonwealth of Australia, Canberra, 2009, viewed 17 March 2010, http://www.finance.gov.au/publications/portfolio-Budget-statements/09-10/docs/2009-10_PBS_finance.pdf

Section 2: Outcomes and planned performance. This contains financial and performance information for each outcome. The financial tables contain information as described above under sub-section 1.2 but additionally show information at the program level. Performance information lists key performance indicators and, where applicable, the targets the Department seeks to achieve.

Section 3: **Explanatory tables and budgeted financial statements**

- **3.1 Explanatory tables**. The explanatory tables contain information such as movements of administered funds between years, special account flows and balances, and indigenous spending.

- **3.2 Budgeted financial statements**. This sub-section contains the budgeted financial statements against which the Department will report in its annual reports. There are separate statements for departmental items and for administered items.

8.5 Ministerial statements and media kits

Some ministers issue ministerial budget statements (otherwise known as the 'blue books') on budget night.[68] These can be 'one-off' or regular. A regular blue book is the one the Minister for Foreign Affairs and Trade issues titled *Australia's Overseas Aid Program*. Ministerial budget statements sometimes contain information not available elsewhere.

Ministers also release media kits. They can be useful supplements to the budget papers in that they sometimes contain information not available elsewhere. The press releases in the media kits replicate the releases available on ministerial web sites soon after the Budget is brought down.

It should be remembered that ministerial budget statements, media kits and press releases are political documents which often 'stretch' their content in the sense that the same item of spending is often mentioned under several headings. In short, the reader should be aware of 'multiple counting' of appropriations.

9. Financial statements

9.1 Introduction

Financial statements are prepared for all three sectors of government (see section 2) and for agencies. The following describes these statements.

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68. Australian Government, *Ministerial statements: 2009–10*, Commonwealth of Australia, Canberra, May 2009, Australian Government budget website, viewed 17 March 2010, http://www.Budget.gov.au/2009-10/content/ministerial_statements/html/index.htm

The budget papers contain financial statements for all three sectors of government—the general government sector, the public non-financial corporations sector, and the public financial corporations sector—and for all three sectors combined. However, as discussed in section 2, the main focus of the Budget is the general government sector and the discussion below focuses on this sector.

Agencies are also required to prepare financial statements. These statements appear in their portfolio budget statements and annual reports.

Financial statements can be divided between those which show proposed outcomes, and those that report actual outcomes. The latter can be subdivided into statements produced during the financial year and those produced at the end of the financial year.

Proposed financial outcomes for the general government sector are in statement 9 of Budget paper no. 1. Agencies' proposed financial outcomes are located at the end of their portfolio budget statements under the heading 'budgeted financial statements'. Agencies produce separate statements for departmental items and administered items.

As to actual outcomes during the year, the Department of Finance and Deregulation produces monthly financial statements for the general government sector. They are on Department of Finance and Deregulation website.

Actual outcomes for the financial year for the general government sector (and the other two sectors of government) are reported in the Final Budget Outcome and in the Consolidated Financial Statements. As the title of the latter suggests, it contains consolidated data for all three government sectors (although it also contains data for each sector). Agencies report actual outcomes in their annual reports.

There are three main financial statements for the general government sector and agencies: the operating/income statement, the balance sheet, and the cash flow statement. Other statements are essentially subsidiary or supplementary to these three statements. The following outlines these three statements.

9.2 Operating/income statement

The operating/income statement shows sources of revenue/income and expenses. The term 'operating statement' is used for the general government sector while agencies use 'income' statement.

A key distinction in the general government sector operating statement is between 'operating' revenues and expenses and 'non-operating' gains and losses. Operating revenues include taxation and dividends, while operating expenses include transfers to individuals through the social security system and grants to the states and territories. The net result of operating revenues and operating expenses is called the 'net operating balance'. Non-operating gains and losses are mostly valuation changes such as asset revaluations and bad debt write-offs.

The net result of non-operating gains and losses is called 'other economic flows'. The distinction between operating and non-operating items serves to highlight what might be called the results of on-going or 'normal' activities as distinct from events that are essentially incidental to operating activities. The net operating balance forms part of the 'fiscal balance' measure of the budget outcome (see section 4.2).

As noted above, agencies produce separate income statements for departmental and administered items. In the case of departmental items, total income falls into two categories: own-source income and appropriation revenues. The former consists of revenue, and gains, for example, from the sale of assets. Annual appropriations are the main source of income for agencies to pay for departmental expenses. The latter include payments to employees and suppliers, and depreciation. The main item of departmental revenue is usually proceeds from the sale of goods and services.

The format of the agency departmental income statement changed in the 2009–10 Budget. The new format is designed to emphasise the cost of running agencies that is met from appropriations. As stated in *Operation Sunlight*:

> The Government will introduce a Net Cost of Services presentation of income statements from the 2009–10 financial year. This recognises the nature of public sector activity and the emphasis on the net cost of services to Government.[69]

The new format deducts own-source income from expenses to show the 'net cost of services', that is, the amount that has to be funded from appropriations. In other words, the net cost of services indicates the extent to which agencies are self-sufficient, and the extent to which appropriations cover the net cost.

Agencies' administered income statements show income and expenses administered on behalf of government. Administered income is divided between tax and non-taxation sources. An example of administered income is the income tax revenue the Australian Taxation Office collects. Administered expenses include grants, subsidies, and income transfers.

9.3 Balance sheet

The balance sheet sets out assets, liabilities and the difference between the two at a point in time. In the case of the general government sector, the difference is called 'net worth', while in the case of agencies, the difference in the departmental items balance sheet is called 'net assets'.

In both the general government sector and agency balance sheets, assets are divided between financial assets such as cash, and non-financial assets such as land and buildings.

69. Australian Government, *Operation Sunlight: enhancing budget transparency*, op. cit., p. 18.

Liabilities are divided between interest-bearing liabilities, and provisions and payables. In the case of the general government sector, the largest item is 'government securities'; they are the amounts that the government has borrowed to finance budget deficits and day-to-day activities. Agencies' interest-bearing liabilities include loans and leases. The largest provision for the general government sector is the superannuation liability. Agency provisions include accrued employee benefits, while payables include amounts owed to suppliers. For an agency, its equity—which is, by definition, equal to its net assets—consists of government-contributed equity, reserves, and retained surpluses.

The balance sheet assists assessment of the government's and agencies' financial positions. Statement 7 of Budget paper no. 1 analyses the government's major assets and liabilities.

9.3.1 Net debt

Discussions of budget policy frequently include net debt, which is an indicator of the government's financial position. As shown in the general government sector balance sheet, net debt is interest-bearing liabilities less certain financial assets. The interest-bearing liabilities are deposits held, advances received, government securities, loans and other borrowing. The sum of cash and deposits, advances paid, and investments, loans and placements is deducted from the total of interest-bearing liabilities to yield net debt. The following table shows net debt as at 30 June 2009.

Table: Net debt 30 June 2009 ($ million)

Interest bearing liabilities	
Deposits held	230
Advances received	0
Government securities	107,290
Loans	6,026
Other borrowing	893
Subtotal	*114,440*
Less:	
Financial assets	
Cash and deposits	1,654
Advances paid	21,807
Investments, loans and placements	107,127
Subtotal	*130,588*
Net debt	**-16,148**

Source: Australian Government, *Final budget outcome: 2008–09*, p. 15, viewed 17 March 2010, http://www.budget.gov.au/2008-09/content/fbo/download/2008_09_FBO.pdf

Net debt is often expressed as a percentage of gross domestic product (GDP). A time series of net debt as a share of GDP can be found in statement 10 of Budget paper no. 1, the Mid-Year Economic and Fiscal Outlook, and in the Final Budget Outcome.

The amount of net debt can be affected by changes in the composition of Future Fund investments. That's because Future Fund holdings of cash and fixed interest securities are included in the calculation of net debt but holdings of equities are excluded.

In 2005–06, the Commonwealth effectively eliminated net debt (although the government decided to keep some debt on issue to support the bond futures market). The elimination of net debt was achieved mainly by privatising government business enterprises and selling other assets and by running budget surpluses.

9.4 Cash flow statements

9.4.1 General government sector

The cash flow statement for the general government sector incorporates cash flows from operating activities, investments in non-financial assets, investments in financial assets for policy purposes, investments in financial assets for liquidity purposes, and financing activities. The cash flow statement also shows the derivation of the underlying cash balance from the headline balance.

Operating activities include the receipts of taxes and the payment of grants and subsidies. Non-financial assets are assets such as plant, land and buildings. Net investment in non-financial assets for policy purposes includes equity injections into government business enterprises such as the Australian Rail Track Corporation, and proceeds from the sale of such enterprises. Investments in non-financial assets for liquidity purposes include investments held to cover superannuation and other employee entitlements payments. Cash flows from financing activities include flows from the issue and redemption of government securities such as Treasury bonds.

9.4.2 Agencies

Agencies prepare cash flow statements for departmental and administered items.

The departmental cash flows statement distinguishes between operating, investing, and financing activities. Operating activities include cash received from appropriations and payments to employees. Investment flows include proceeds from asset sales and asset purchases. Financing activities include equity contributions received from government and the use of cash to repay debt.

Like the departmental cash flows statement, the administered cash flows statement distinguishes between operating, investing, and financing activities. Depending on the agency, operating activities may include cash received from the sale of goods and services, taxes, fees and fines, while cash used may be used for grants, subsidies and payments to suppliers. Investment receipts include repayments of advances while cash used may include the purchase of investments. Financing activities include cash received from the repayment of loans while cash used may include payments to the official public account.

9.5 Other financial statements

Other financial statements are produced in addition to the operating/income statement, the balance sheet, and the cash flow statement. An example is the 'statement of changes in equity'. This resulted from the adoption of the Australian Equivalents to International Financial Reporting Standards' (section 11.3.2). The statement shows items such as equity injections and distributions and net operating profits and losses.

The financial statements appear in various reports which are discussed below.

10. Financial reports

The *Charter of Budget Honesty Act 1998* contains requirements for regular financial reporting. Other reporting requirements—such as monthly financial statements—are required by the *Financial Management and Accountability Act 1997*. The following discusses the requirements of the *Charter of Budget Honesty Act 1998*.

10.1 Charter of budget honesty

The *Charter of Budget Honesty Act 1998* (the Act) is a framework for the conduct and reporting of fiscal policy.[70] It 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.

With respect to fiscal policy objectives, Part 3 of the Act contains 'principles of sound fiscal management'. These are broken down into principles governing the 'formulation of government fiscal policy' and the 'principles of sound fiscal management'. The approach that the Act adopts has been described as follows:

> The most noteworthy aspect of this approach to setting fiscal objectives is that the Principles of Sound Fiscal Management are stated in general terms in the legislation and do not mandate any specific fiscal targets, but rather refer to "prudent levels" and "reasonable degrees". It is left to the government of the day to specify its interpretation of the relevant fiscal terms in the Fiscal Strategy Statement …
>
> The Charter specifically allows the government to temporarily depart from the general principles of responsible fiscal management. In doing so, the government must indicate the process for the reversal of such measures.
>
> In cases of non-compliance, the Charter does not call for legal penalties. It does, however, mandate the production of a comprehensive set of reports in order to monitor the

70. *Charter of Budget Honesty Act 1998* (Cth), viewed 17 March 2010, http://www.comlaw.gov.au/comlaw/Legislation/ActCompilation1.nsf/0/D02952355D8A9906CA256F710051FA5E?OpenDocument

> consistency of the government's fiscal actions against its stated fiscal objectives. The objective is to ensure that the "court of public opinion", not a law court, is able to make the necessary judgments on the government's fiscal management.[71]

With respect to reporting, the Act obliges the government to present:

- a 'fiscal strategy statement' (Part 4 of the Act). This is to be released publicly and tabled by the treasurer with each Budget
- a 'Budget economic and fiscal outlook report' (sections 10 to 13 of the Act)
- a 'mid-year economic and fiscal outlook report' (sections 14 to 17 of the Act), and
- a 'final Budget outcome report' (sections 18 and 19 of the Act).

The Act also requires the preparation of:

- intergenerational reports
- pre-election reports, and
- general elections policy costings.

10.1.1 Mid-Year Economic and Fiscal Outlook

As noted above, the Act requires the treasurer to release publicly, and table, a Mid-Year Economic and Fiscal Outlook (MYEFO) report. This must be presented 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.[72]

Section 16 of the Act specifies the contents of the MYEFO. The main requirement is an update of the economic and fiscal outlooks. The MYEFO also updates the budgetary position, including budget aggregates, by incorporating all decisions affecting expenses and revenues and changes to parameters. An appendix summarises all policy decisions taken since the Budget was brought down, including their estimated financial consequences. This appendix is the MYEFO counterpart of Budget paper no. 2. A second appendix updates the financial statements for the general government sector, the public non-financial corporations sector, and the total non-financial public sectors. A third appendix updates the statement of risks, while a fourth appendix contains historical financial data.

71. Blondal, Bergvall, Hawkesworth and Deighton-Smith, op. cit., p. 146.

72. Australian Government, *Mid-year economic and fiscal outlook: 2009–10*, op. cit.

In February 2009, the Rudd Government released the *Updated Economic and Fiscal Outlook* when it announced its national building and jobs plan fiscal stimulus package.[73] This was the first such document and was in the nature of a supplementary MYEFO.

10.1.2 Final Budget Outcome

Section 18 of the Act 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.[74] Section 19 specifies the contents of the FBO:

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

In addition to budget outcomes—which are in parts 1 and 2 of the FBO—the FBO in part 3 contains payments to state and local governments including the goods and services tax (GST). An appendix contains expenses analysed by function and sub-function, and a second appendix contains historical fiscal data.

Care needs to be exercised when using FBO data particularly with respect to the treatment of the GST and the use of different accounting standards. Until 2006–07, part 1 of the FBO covered the general government sector on a Government Finance Statistics (GFS) basis but excluded the GST. Part 3 also covered the general government sector on the Australian Accounting Standards basis but also excluded the GST. The exclusion of the GST means that the statements in parts 1 and 3 were misleading because the GST is a Commonwealth tax. Part 2 covered all three government sectors on a GFS basis and included the GST.

Two changes were introduced into the 2007–08 FBO. First, part 1—which, as before, covered the general government sector—changed the accounting standard to the *Whole of Government and General Government Sector Financial Reporting* (AASB 1049) standard (section 11.3.1). Second, the GST was included in statements for the general government sector. Part 2 in the 2007–08 FBO was on the same basis as in previous years and so provides a consistent time series.

It should be noted that some of the ‘final’ data in the FBOs have turned out to be not so final because of data revisions. The functional classification of expenses is an example. Users wishing to construct a time series of the functional classification of expenses are advised to start with the most recent version of the FBO and work backwards. Second, the figures in the FBO have differed from more up-to-date figures in statement 6 of Budget paper no. 1which is prepared after the FBO for the past financial year. Hence it is wise to check to see whether the FBO figures have been superseded by those in statement 6.

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73. Australian Government, *Updated economic and fiscal outlook*, Commonwealth of Australia, Canberra, 2009, viewed 17 March 2010, http://www.Budget.gov.au/2008-09/content/uefo/html/index.htm

74. Australian Government, *Final Budget outcome: 2008*–09, op. cit.

The FBO is not audited. The reason given is that auditing the FBO would compromise its timeliness and end-of-year usefulness. Still, the Joint Committee of Public Accounts and Audit recommended that the Australian National Audit Office audit the FBO.[75]

No FBO was published for 1995–96. This was before the publication of FBOs was required under the charter of budget honesty (see section 10.1). The estimated outturn data for 1995–96 can be found in the budget papers for 1996–97.

10.1.3 Intergenerational reports

Part 6 of the Act requires the government to produce, at least once every five years, an intergenerational report. The Act specifies that the report is to assess the long-term sustainability of current government policies over the 40 years following the release of the report, including by taking account of the financial implications of demographic change. The first report was released with the 2002–03 Budget. The most recent report was released on 1 February 2010.[76] Under *Operation Sunlight* (see section 14), government policy is to have the report produced every three years with greater disaggregation at the program level, and to produce the report at least once every parliamentary term.[77]

10.1.4 Pre-Election Economic and Fiscal Outlook report

Part 7 (sections 22 to 28) of the Act deals with the preparation of the Pre-Election Economic and Fiscal Outlook Report (PEFO). The purpose of the PEFO is to update information on the economic and fiscal outlooks 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. The secretary to the Department of the Treasury is responsible for revenue estimates and tax expenditures, and the secretary to the Department of Finance and Deregulation is responsible for expense estimates. Four PEFOs have been prepared, namely, before the 1998, 2001, 2004 and 2007 elections.

The financial position that an incoming government is likely to face is often an election issue. The PEFO is prepared during the caretaker period after an election is called. The requirement that a PEFO be prepared is a positive contribution to transparency in that it shows the prospective state of finances. The fact that the secretaries are responsible for preparing the

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75. Joint Committee of Public Accounts and Audit, *Review of the accrual budget documentation*, Report no. 388, Parliament of Australia, 19 June 2002, viewed 17 March 2010, http://www.aph.gov.au/House/committee/jpaa/accrualBudget/contents.htm

76. Department of the Treasury, *Intergenerational report 2010*, Commonwealth of Australia, Canberra, 2010, viewed 17 March 2010, http://www.treasury.gov.au/igr/igr2010/

77. Australian Government, *Operation Sunlight: enhancing Budget transparency*, op. cit., p. 17.

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 state of finances.

10.1.5 General elections policy costings

Part 8 (sections 29 to 32) of the Act deals with the costing of general elections policy commitments.[78] The main purpose of Part 8, although not stated in the Act, is to provide public confidence in costings by having the secretaries of the Treasury and the Department of Finance and Deregulation undertake them.

Section 29 deals with requests, during the caretaker period before a general election, for costings of election commitments. Under this section, the prime minister may request the secretaries of the Treasury and the Department of Finance and Deregulation to prepare costings of publicly-announced government policies. Similarly, the leader of the opposition may request the secretaries to cost publicly-announced opposition policies. In the latter case, the request has to be given to the prime minister, who may then agree to refer it to the secretaries. The secretaries are not obliged or authorised to take any action in relation to the request from the leader of the opposition, unless the prime minister has referred the request to them. A request from either the prime minister or the leader of the opposition must be in writing, outline fully the policy to be costed, give relevant details, and state the purpose or intent of the policy. Section 29 also allows the prime minister or the leader of the opposition to withdraw a request.

Section 30 deals with how policy costings are to be prepared. It allows the secretaries to issue guidelines for the preparation of costings, and allocates to the secretary of the Treasury responsibility for revenue costings and, to the secretary of the Department of Finance and Deregulation, responsibility for costing spending. Under section 30, the secretaries have issued guidelines outlining the general methodology that is to be applied and what information will be needed when requesting a policy costing, and what will be produced.[79] Section 30 also provides that if the secretaries need more information, they can ask the prime minister or the leader of the opposition (as the case requires) for that information.

Section 31 of the Act deals with public release and timing. Unlike the PEFO, the legislation has no specific timing provision, with section 31 merely providing for the public release of costings ‘as soon as practicable’ after a costing request has been made and before polling day.

78. The Department of Finance and Deregulation maintains the costings on its website. See: Australian Government, ‘Election commitment costing: federal election 2007’, Department of Finance and Administration website, viewed 12 March 2010, http://www.electioncostings.gov.au/

79. Department of Finance and Deregulation, *Charter of budget honesty: costing election commitments*, Commonwealth of Australia, 2007, viewed 17 March 2010, http://www.finance.gov.au/publications/charter-of-Budget-honesty/docs/charter_of_Budget_honesty_2007.pdf

If a secretary does not have enough information or time to prepare and release publicly a policy costing before polling day, the secretary is to release publicly a statement to that effect before polling day. As with the PEFO, under section 32, the secretaries can call on other agencies to help prepare the costings and the agencies must comply.

The costing process has been criticised on the grounds that it is biased in favour of the government of the day:

> First, the government can release its own document (*e.g.* the MYEFO) prepared by the public service, up to and even after the election is called. This access to the resources of the public service provides some advantage and limits the opportunity for independent scrutiny. Second, access to costing resources for the Opposition is only available after an election has been called, whereas the government has access year-round.
>
> In Operation Sunlight, it is proposed to amend the Charter to allow the government or the Opposition to request the Secretaries to the Treasury and to the Department of Finance to prepare a costing of any policies within 12 months of a scheduled election (the last day for issue of writs for a general election). The government will address this issue later in 2008.[80]

An alternative to the general elections policy costings model would be to have a body similar to the Congressional Budget Office in the United States undertake the costings.

10.2 Other financial reports

The *Financial Management and Accountability Act 1997* (FMA Act) requires the preparation of financial reports. The following discusses these reports.

10.2.1 Monthly financial statements

The FMA Act requires the Finance Minister to publish monthly financial statements, in a form consistent with the budget estimates, as soon as practicable after the end of each month. The statements contain monthly and cumulative data, including the underlying cash balance and the fiscal balance, and three financial statements: the income statement, the balance sheet, and the cash flow statement for the general government sector. Monthly financial statements are on the Department of Finance and Deregulation's web site.[81]

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80. Blondal, Bergvall, Hawkesworth and Deighton-Smith, op. cit., p. 148.

81. Australian Government, 'Commonwealth monthly financial statements', Department of Finance and Deregulation website, viewed 17 March 2010, http://www.finance.gov.au/publications/commonwealth-monthly-financial-statements/index.html

10.2.2 Consolidated Financial Statements

Section 55 of the FMA Act requires the Finance Minister to prepare annually consolidated financial statements for the Commonwealth.[82] Consolidated means the three sectors of government: general government, public non-financial corporations, and public financial corporations. The Consolidated Financial Statements (CFS) are a general purpose financial report, and contain a consolidated income statement, balance sheet and cash flows statement. However, the CFS also contains sectoral statements, comprising a consolidated income statement by sector, a consolidated balance sheet by sector, and a consolidated statement of cash flows by sector. Statements are prepared in accordance with Australian Accounting Standards.

The Australian National Audit Office audits the CFS. Before 2006–07, the CFS did not treat the goods and services tax (GST) as Commonwealth revenue received and paid to the states and territories. Consequently the Australian National Audit Office qualified the CFS. The 2006–07 CFS included the GST for the first time.

The adoption of the accounting standard for the public sector *Whole of Government and General Government Sector Financial Reporting* (AAS1049) (see section 11.3.1) resulted in the 2008–09 CFS being presented in a different format from previous years.

10.3 Agency annual reports

Agencies' planned financial outcomes are at the end of their portfolio budget statements under the heading 'budgeted financial statements'. Agencies report their actual financial year outcomes in their annual reports. Agencies prepare financial statements for both departmental and administered items. 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.

Annual reports contain a wide range of non-financial and financial information including how agencies performed against planned outcomes using the performance measures in the portfolio budget statements. This information is often quite detailed. The notes to the financial statements, for example, often contain information which is not available elsewhere. The main drawback to annual reports is that the information is necessarily historical.

The Senate estimates committees review agency annual reports, with the reports referred to the appropriate committees for consideration. In practice, the committees review the annual reports in conjunction with additional estimates because most agencies have presented their

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82. Australian Government, 'Commonwealth consolidated financial statements', Department of Finance and Deregulation website, viewed 17 March 2010, http://www.finance.gov.au/publications/commonwealth-consolidated-financial-statements/index.html

annual reports by the end of October, that is, not long before the additional estimates hearings.

The Department of the Prime Minister and Cabinet publishes annual report requirements on its website.[83] The requirements are prepared pursuant to subsections 63(2) and 70(2) of the *Public Service Act 1999* and were approved by the Joint Committee of Public Accounts and Audit on 17 June 2009. As a matter of policy, the requirements also apply to prescribed agencies under section 5 of the FMA Act.

11. Financial reporting standards

11.1 Introduction

Until 1998–99, financial statements in Budget paper no. 1 and the Final Budget Outcome were prepared on a cash basis. Under section 49 of the *Financial Management and Accountability Act 1997* (FMA Act), agencies prepared financial statements in accordance with financial management and accountability orders which required, among other things, that financial statements comply with Australian Accounting Standards. The statements required under section 49 were in the nature of a general purpose financial report.

The advent of accrual accounting introduced major changes to financial statements. From 1999–2000 to 2007–08, financial statements in Budget paper no. 1 and the Final Budget Outcome were presented in accordance with two standards. One was the Australian Bureau of Statistics (ABS) Government Finance Statistics (GFS) standard. Four statements for the general government sector were prepared under the GFS standard: operating statement, balance sheet, a reconciliation statement of stocks and flows, and a cash flow statement. Budget aggregates—the fiscal balance and the underlying cash balance—are based on the GFS framework.

The other standard was Australian Accounting Standards (AAS). Under the AAS, *Financial Reporting by Government* (AAS 31) was the standard for government reporting. AAS31 required the preparation of an operating statement (sometimes called a profit or loss statement or statement of revenue and expenses), a statement of financial position (often called a balance sheet) and a statement of cash flows. When the Australian Equivalents to International Financial Reporting Standards (AEIFRS) were introduced (see section 11.3.2), the AAS reporting framework for Budget paper no. 1 and the Final Budget Outcome was the AEIFRS and AAS31.

83. Department of the Prime Minister and Cabinet (PM&C), *Requirements for annual reports: for departments, executive agencies and FMA Act bodies*, op. cit. Separate annual report requirements for bodies under the *Commonwealth Authorities and Companies Act 1997* are made through Finance Minister's Orders, made under that Act.

The GFS and AAS were generally consistent in their treatment of the concepts underlying financial statements. However, they differed in some respects. Some of these differences were described in statement 8 of Budget paper no. 1 for 2007–08.[84]

With the formal adoption of accrual accounting in 1999–2000, agencies continued to produce financial statements under section 49 of the FMA Act. These statements were produced in accordance with Schedule 2 to the Financial Management and Accountability Orders, and AAS. Agencies subsequently also had to adopt the AEIFRS.

The 2008–09 Budget applied a third (accrual) standard: Australian Accounting Standard 1049 *Whole of Government and General Government Sector Financial Reporting* (AASB 1049) for Budget paper No. 1. AASB 1049 seeks to 'harmonise' the GFS and the AAS. AASB 1049 thus replaced two sets of financial statements—one based on the GFS standard and the other on AAS—with one set. There are, however, still some differences between the GFS and AASB1049. Key differences are summarised in statement 9 of Budget paper no. 1.

Agencies prepare their financial statements in accordance with AAS (and Finance Minister's Orders) (see section 11.6).

The following describes the accounting standards.

11.2 Government Finance Statistics

The Government Finance Statistics (GFS) framework is a specialised statistical system designed to assist economic analysis of the public sector, especially the effects of government spending and revenue on the economy. The GFS standard is based on the Australian Bureau of Statistics accrual GFS framework. This framework is consistent with international statistical standards (the United Nations *System of National Accounts 2008* and the International Monetary Fund's *A Manual on Government Finance Statistics 2001*).[85]

Government accounting policy is based on the GFS except where AAS provide a sounder basis for presenting information. For example, in addition to the GFS fiscal aggregates, AASB1049 requires the disclosure of the net operating balance and the fiscal balance.

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84. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2007–08*, Commonwealth of Australia, Canberra, 2007, p. 8–8, viewed 17 March 2010, http://www.Budget.gov.au/2007-08/bp1/download/bp1_bst8.pdf

85. United Nations Statistics Division, *System of national accounts 2008*, viewed 17 March 2010, http://unstats.un.org/unsd/nationalaccount/sna2008.asp; International Monetary Fund, *Government Finance Statistics Manual 2001*, IMF, 2001, viewed 17 March 2010, http://www.imf.org/external/pubs/ft/gfs/manual/index.htm

11.3 Australian Accounting Standards

The Australian Accounting Standards Board (AASB) is an independent Australian Government agency in the Treasury portfolio that is responsible for developing accounting standards for the private and public sectors. The AASB's Generally Accepted Accounting Principles (GAAP) are comprehensive standards that specify a range of accounting practices and how financial information should be reported. GAAP have two components so far as government reporting is concerned. The first is the relevant AAS for government reporting. As noted above, this is now AASB 1049 for consolidated and sectoral statements. The second component is the Australian Equivalents to International Financial Reporting Standards (see section 11.3.2). While the latter are designed principally for the private sector, they also apply to government financial reporting.

11.3.1 Australian Accounting Standard 1049

Following criticism that the preparation of financial statements based on two standards—GFS and AAS31—was confusing, the Financial Reporting Council—the government body responsible, among other things, for overseeing accounting standards—directed the AASB to 'harmonise' the AAS and the GFS standards into a single set of financial statements.[86] In October 2007, the AASB released the new accounting standard for the public sector: *Whole of Government and General Government Sector Financial Reporting* (AASB 1049), replacing AAS31 as the standard for government reporting for consolidated and sectoral statements.[87] AASB 1049 applied from 1 July 2008.

Key differences between the GFS and AASB 1049 were described in Statement 9 of Budget Paper No. 1 for 2009–10 and also in the April 2008 version of the Uniform Presentation Framework (see section 11.4).[88]

11.3.2 Australian Equivalents to International Financial Reporting Standards

AAS statements for the general government sector incorporated the Australian Equivalents to International Financial Reporting Standards (AEIFRS) for the first time in Statement 10 of Budget paper no. 1 2006–07. This followed the decision that Australia would adopt

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86. See Australian Capital Territory Treasury, *Harmonisation of Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics, (GFS)*, ACT Government, Canberra, March 2004, viewed 15 March 2010, http://www.treasury.act.gov.au/accounting/download/IAS_02.pdf#search=%22Generally%20Accepted%20Accounting%20principles%20%20define%22

87. Australian Accounting Standards Board (AASB), *Financial Reporting of General Government Sectors by Governments: Accounting Standard AASB1049*, AASB, September 2006, viewed 15 March 2010, http://www.aasb.com.au/admin/file/content105/c9/AASB1049_09-06.pdf

88. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2009–10*, op. cit., p. 9–41.

international accounting standards. On 3 July 2002, the Financial Reporting Council directed the AASB to adopt the standards of the International Accounting Standards Board (IASB) into Australian Accounting Standards.[89] The IASB is an independent London-based organisation responsible for developing international accounting standards. The AASB is responsible for harmonising IASB standards with Australian legislation and regulations. The AASB has issued a full set of AEIFRS, which came into effect for reporting periods beginning on or after 1 January 2005.

The adoption of the AEIFRS resulted in several changes to the financial statements in Budget paper no. 1. First, there were changes to terminology. For example, what was the 'statement of financial performance' became the 'income statement' (the statement includes expenses as well as income), while the 'statement of financial position' became the 'balance sheet'. In the income statement, what was 'total revenue' became 'income'. Second, some changes were presentational. For example, some items—such as net foreign exchange gains—which were previously included in 'non-taxation revenue' were shown under a separate heading titled 'gains'. Third, the adoption of AEIFRS introduced a new financial statement, the 'Statement of Changes in Equity'. Finally, some items previously included with other items were shown separately. For example, 'investment property', 'biological assets' and 'assets held for sale' were new categories in the balance sheet. Note that, under liabilities, what was previously 'employees and superannuation' became 'employees', which includes accrued superannuation entitlements.

While some of these changes may appear superficial, there was good reason for them. For example, the reason for having a separate category 'assets held for sale' is to distinguish them from assets that are being used in the normal course of operations. In a business—and reflecting the fact that the AEIFRS are essentially designed for business—assets held for sale do not generate income, are best valued at market selling price, and are therefore shown separately.

The consequences of adopting AEIFRS were anything but superficial. They included an 'increase' in equity of the general government sector of about $23 billion.[90] This mainly reflected changes to the way some investments were valued:

> Consistent with the market basis of valuation of assets adopted elsewhere in this document, the basis of valuation of the Government's investment in Telstra Corporation Limited and

89. Australian Government, Financial Reporting Council website, viewed 17 March 2010, http://www.frc.gov.au/. See also International Accounting Standards Board website, viewed 17 March 2010, http://www.iasb.org/Home.htm

90. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2006–07*, Commonwealth of Australia, Canberra, 2006, p. 10–5, viewed 17 March 2010, http://www.Budget.gov.au/2006-07/bp1/html/index.htm

> other Commonwealth entities under AAS, has changed from cost to fair value. The financial effect of this change is recognised in the Statement of Changes in Equity.[91]

Agencies also had to comply with the AEIFRS. To provide comparative data with 2005–06 data, agencies recast their 2004–05 accounts to accord with the AEIFRS, and provided reconciliations in their 2005–06 annual reports of the accounts under the former standard and the AEIFRS.

11.4 Uniform Presentation Framework

The Uniform Presentation Framework (UPF) is an agreement among the Commonwealth and the states and territories whereby all jurisdictions publish common core financial information. The primary objective of the UPF is:

> … to ensure that Commonwealth Government, State and Territory governments provide a common 'core' of financial information in their Budget papers. It was recognised that a more uniform approach to the presentation of financial data would facilitate a better understanding of individual governments' Budget papers and provide for more meaningful comparisons of each government's financial results and projections.[92]

Examples of information presented under the UPF are the operating statement, the balance sheet, the cash flow statement, and net debt. The UPF apply to all three government sectors: the general government sector, the public non-financial corporations sector, and the public financial corporations sector. The UPF was revised in April 2008 to take account of the introduction of AASB 1049. All jurisdictions were required to implement the revised UPF before their 2009–10 Budgets.

11.5 Accounting treatment of specific items

11.5.1 Defence weapons platforms/ specialist military equipment

One noteworthy difference in accounting standards is the treatment of the acquisition of defence weapons platforms in the general government sector financial statements. The GFS write off such spending as expenses in the year in which it is incurred. However, the financial statements treat defence weapons platforms as capital investment:

> This is consistent with AAS, and also represents an early adoption of the ABS' proposed revisions to GFS from September 2009 in line with revised international standards (refer

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91. Ibid., p. 10–10.

92. Department of the Treasury, *Uniform presentation framework: for the presentation of uniform financial information by Commonwealth, state and territory governments,* Commonwealth of Australia, Canberra, April 2008, p. 1, viewed 17 March 2010, http://www.treasury.gov.au/documents/1371/PDF/2008_UPF.pdf

ABS cat. no. 5310.0.55.001 *Information Paper: Introduction of revised international standards in ABS economic statistics in 2009*).[93]

The AASB 1049 treats defence platforms as capital in nature and so brings acquisitions into the balance sheet and depreciates them. The initial effect of AASB 1049, compared with the GFS, was to increase net worth because what had been written off as an expense under the GFS was brought into the balance sheet as an asset under AASB 1049. In the 2009–10 Budget, this change was back-cast in historical statistics to 1999–2000.

The Department of Defence has been recording 'specialist military equipment' as a separate item in the balance sheet since 1999–2000.

11.5.2 Goods and services tax

Before 2008–09, the AAS statements in the budget papers treated the goods and services tax (GST) as if it were not a Commonwealth tax. In contrast, the GFS financial statements in Budget paper no. 1 treated the GST as taxation revenue and payments to the states. The argument for not treating the GST as a Commonwealth tax—the 'agency' argument—was that the intent of the *Intergovernmental Agreement on Commonwealth-State Financial Relations*—which governed Commonwealth-state financial relations—was that the GST is collected by the Commonwealth as an agent for the states and territories and appropriated to them. The alternative 'constitutional' argument was that whatever the intent of the *Intergovernmental Agreement*, constitutionally, the GST is a Commonwealth tax because it is imposed under Commonwealth legislation.

The ABS, correctly, rejected the agency argument and classified GST revenue as a Commonwealth tax.[94] The Auditor-General also rejected the agency argument. The Consolidated Financial Statements (see section 10.2.2) treated the GST as a tax that the Commonwealth collected in an agency capacity. Consequently, the Auditor-General, in successive years, qualified the Consolidated Financial Statements with respect to the treatment of the GST. However, the 2007–08 Consolidated Financial Statements included the GST for the first time and so were not qualified. Budget paper no.1 for 2008–09 also treated the GST as a Commonwealth tax and its payment to the states as an expense. The GST was probably excluded to reduce the apparent size of the Commonwealth government sector.

11.5.3 Other items

It is important to note that non-cash items that affect the general government sector operating statement also affect the accrual measure of the budget outcome, that is, the fiscal balance. In

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93. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2009–10*, op. cit., p. 9–19.

94. Australian Bureau of Statistics (ABS), *Accrual-based Government Finance Statistics*, Information paper 5517.0, ABS, 13 March 2000, viewed 17 March 2010, http://www.abs.gov.au/ausstats/abs@.nsf/mf/5517.0

contrast, only cash items affect the cash surplus or deficit. The accrual and cash surpluses or deficits can differ because the financial year in which an item is reflected in the accrual surplus or deficit may differ from the financial year in which the item is reflected on a cash basis.

It is also important to understand that items that affect only the general government sector balance sheet do not affect the budget surplus or deficit. For example, asset sales—such as the sale of the Commonwealth's equity in Telstra—were mostly reflected in the balance sheet. This is because the sale was a change in the type of asset 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 a reduction in assets. However, asset sales and the use of the proceeds of these sales to reduce debt, also affect the general government sector operating statement through changes to dividends received and public debt interest paid and hence the budget surplus or deficit.

11.6 Agency financial statements

Agencies present financial statements for their portfolio budget statements and annual reports. Section 49 of the FMA Act requires agencies to produce financial statements. Agencies prepare their statements in accordance with Australian Accounting Standards and Interpretations and Finance Minister's Orders (FMOs). FMOs specify, for example, which alternative agencies must adopt where AAS allow alternative ways to report. FMOs also require additional reporting that AAS do not require.

While agencies report on the basis of AAS, the Department of Finance and Deregulation converts them to the GFS basis for other reporting purposes.

The main statements that agencies prepare are the income statement, the balance sheet, and statement of cash flows (see section 9). Agencies produce separate statements for departmental and administered items (see section 7.7).

12. Tax expenditures

Most attention is focused on the level of spending and revenue shown in the Budget. But a large amount of revenue is forgone through tax concessions. 'Tax expenditures' are 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 reach the required amount of taxation revenue.

Statement 5 in Budget paper no. 1 lists the main tax expenditures.[95] Treasury publishes a much more comprehensive document titled *Tax Expenditures Statement*, which sets out in detail the value of concessions.[96] Given the magnitude and importance of tax expenditures, an issue is their transparency and parliamentary scrutiny. Treasury's publication is a major contributor towards helping ensure transparency.

The Treasury document published in January 2010 shows the aggregate cost of measured tax expenditures for which estimates were prepared was almost $ 115 billion in 2007–08. This was equivalent to 10.2 percent of gross domestic product.

Tax expenditures are not added to direct expenditures in the budget papers. Not adding tax expenditures to direct expenditure has the effect of 'understating' the size of government. For example, in 2007–08, if estimated tax expenditures of around $115 billion were added to general government sector expenses of $280 billion, total spending would be almost 41 per cent higher.

In May 2004, the Organisation for Economic Co-operation and Development (OECD) published best practice guidelines for off-Budget and tax expenditures.[97] With respect to tax expenditures, the guidelines are:

- Guideline 10: Tax expenditures should be identified by use of a benchmark tax. The benchmark does not necessarily need to represent the normative tax base. The benchmark should be comprehensive and unique.

- Guideline 11: All tax expenditures should be estimated and integrated in the expenditure documentation that is presented to the budgetary authorities for all significant taxes. Regular expenditures and tax expenditures should be shown in this documentation side-by-side for the same number of years.

- Guideline 12: Under nominal or structural deficit or operating/current balance rules, tax expenditures should either be included in the total expenditure cap that is set every year during Budget preparation or in a special tax expenditure cap. Under medium term rules with multi-annual expenditure caps, tax expenditures should either be included in the total expenditure cap of each year or in a special tax expenditure cap of each year.

95. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2009–10*, op. cit., p. 5–57.

96. The Treasury, *Tax Expenditures Statement 2009*, Commonwealth of Australia, Canberra, January 2010, viewed 17 March 2010, http://www.treasury.gov.au/documents/1719/PDF/TES_2009_Consolidated.pdf

97. Organisation for Economic Co-operation and Development, *Best practice guidelines – off budget and tax expenditures*, OECD, June 2004, viewed 17 March 2010, http://appli1.oecd.org/olis/2004doc.nsf/43bb6130e5e86e5fc12569fa005d004c/e0ecb0e1073e2677c1256e99003a75f2/$FILE/JT00164525.PDF

Overspending on tax expenditures should be fully compensated, at least in so far as it originates in policy change. If a special tax expenditure cap is used, compensation can take place within that cap or through reduction of the regular expenditure cap.

- Guideline 13: All tax expenditures should be reviewed in the same way as regular expenditures in the annual Budget process. They should be reviewed by the financial staff of spending ministers and the Budget bureau in the same way as regular expenditures. Special evaluation procedures, including program review, should be applied to tax expenditures in the same way as to regular expenditures

- Guideline 14: Tax expenditures should be assigned to individual ministries. Objections of the Minister of Finance against change of tax expenditures can never be used as an argument against adjustment of other (tax-) expenditures if a ministry is required to diminish its expenditures or find compensation for overspending.

- Guideline 15: Tax expenditures should be estimated by revenue forgone, corrected by an equivalent tax margin, if equivalent expenditure transfers are taxed (or by outlay equivalence).

- Guideline 16: The responsibility for tax expenditure estimates should remain with the Ministry of Finance.

Australia complies with guidelines 10, 11, 15 and 16.

Guidelines 12 and 14 are related. Guideline 12 proposes that 'the Budget' should be broadly defined to encompass both direct and tax expenditures, thus identifying the total cost of government activities. Assigning to each agency its broadly-defined budget, as proposed in Guideline 14, would identify the total cost of that agency's activities. As noted, in Australia, the two components are not combined. Combining the components would be a way of controlling spending, for example, by ensuring that agencies do not exceed their budgets by substituting tax expenditures for direct expenditure while remaining within the cap on direct expenditures). In both the Treasury tax expenditures statements and statement 5 of Budget paper no. 1, spending is classified by function rather than by agency.

With respect to Guideline 13, tax expenditures are not separately reviewed annually as part of the Budget process. However, under *Operation Sunlight*, the Rudd Government proposed:

> … an independent up-front audit and assessment of existing concessions and ... processes for their periodic review.[98]

98. Australian Government, *Operation Sunlight: enhancing Budget transparency*, op. cit., p. 13.

13. Performance information

In their portfolio budget statements, agencies set out the information they will collect to assess their performance against planned outcomes. Agencies report against performance indicators such as effectiveness, quantity, and quality. Effectiveness, for example, indicates how well an agency has performed overall in achieving an outcome, while agencies use quality and quantity indicators to evaluate performance in delivering programs. Agencies report their performance in their annual reports.

An issue is how well the performance information actually measures performance. Problems exist with performance measurement. A review of Australian and UK experience found that these problems included lack of stability in the indicators, the value of the indicators is questionable because there is no independent validation of performance reporting, and the causal relationship between outputs and outcomes is difficult to define.[99] A 2003–04 report on annual performance reporting by the Australian National Audit Office (ANAO) was similarly critical of performance measurement.[100] In August 2004, the Joint Committee of Public Accounts and Audit examined the ANAO report. Among the issues the Committee commented on were:

- the need for agencies to have measurable outputs and performance indicators that allow assessment of whether outcomes have been achieved
- the tendency for agencies not to report on or under-report unmet targets
- the low use of cost-benefit analysis in performance reporting, and
- the need for agencies to identify their contribution to a shared outcome and to report on that contribution.[101]

There are numerous reasons it is difficult to measure performance as a means of improving outcomes. First, many indicators are partial at best. Second, it is inherently difficult to measure the success or otherwise of policy contributions. Third, the states undertake some functions using both their own and Commonwealth funds. While the Commonwealth has some control over the use of its funds through the conditions it attaches to the payments it makes to the states, its control is limited. An example is education. While the states are

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99. B Scheers, M Sterck and G Bouckaert, op. cit.

100. Australian National Audit Office (ANAO), *Annual performance reporting*, Audit report no. 11, 2003–04, ANAO, 2003, viewed 17 March 2010, http://www.anao.gov.au/uploads/documents/2003-04_Audit_Report_11.pdf

101. Joint Committee of Public Accounts and Audit, *Report 402. Review of Auditor-Generals' reports 2003–04: first and second quarters*, Joint Committee, August 2004, p. 53, viewed 17 March 2010, http://www.aph.gov.au/house/committee/jpaa/agfirst-sec03_04/Report.htm#fullreport

primarily responsible for funding primary and secondary education, the Commonwealth also provides funds. Since the states combine both their own-source revenue and Commonwealth funds to provide education, it is nigh impossible to disentangle the consequences of Commonwealth funding.

In April 2004, ANAO issued a better practice guide for performance reporting.[102] Prepared jointly by ANAO and the Department of Finance and Deregulation, the guide aims to be a practical tool to help agencies improve the quality of their performance reporting in annual reports.

Under *Operation Sunlight* (see section 14), the Rudd Government introduced:

> … program reporting from the 2009–10 Budget requiring agencies to set targets for their results and performance for the Budget and forward years. Finance will provide guidance to agencies to assist in improving the quality of reporting, noting that the ANAO sets its own audit schedule.[103]

14. Operation Sunlight

Some of the changes to the presentation of the Budget are contained in the Rudd Government's *Operation Sunlight*.[104] This has six main objectives:

- tightening the outcomes and outputs framework
- changing the Budget Papers to improve their readability and usefulness
- improving the transparency of estimates
- expanding the reach of Budget reporting
- improving inter-generational reporting, and
- improving the financial framework.

The objectives are based, in part, on the recommendations in a report prepared by former Senator, Mr Andrew Murray.[105] In June 2008, the Government responded to the Murray

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102. Australian National Audit Office (ANAO), *Better practice guide: better practice in annual performance reporting*, ANAO, Canberra, April 2004, viewed 15 March 2010, http://www.anao.gov.au/uploads/documents/Better_Practice_in_Annual_Performance_Reporting.pdf.

103. Australian Government, *Operation Sunlight: enhancing budget transparency*, op. cit., p. 5.

104. Ibid.

report. The following examines some of proposals in *Operation Sunlight*. The Government has adopted some proposals but others are work-in-progress.

14.1 Tightening the outcomes and outputs framework

Operation Sunlight states that while the outcomes and outputs framework was intended to shift the focus of financial reporting from inputs to outcomes, it has not worked for several reasons. Agencies reviewed their outcomes for the 2009-10 Budget and reported the changes in their portfolio budget statements (see section 8.4). Also starting in 2009–10, the Government implemented program level reporting. The period covered by the programs included the forward years as well as the budget year in the 2009–10 portfolio budget statements.

The move to program reporting is a vast improvement since only some agencies used to report at the program level. The inclusion of the forward years' estimates for programs is also a great improvement because these data were generally not available previously.

14.2 Changing the budget papers to improve their readability and usefulness

Among the matters *Operation Sunlight* addressed is that of accounting standards. Before 2008–09, in addition to cash statements, general government sector financial statements in Budget paper no. 1 were produced under two accounting standards: Government Finance Statistics and Australian Accounting Standards (AAS) under which AAS 31 *Financial Reporting by Governments* was the standard for reporting by government (see section 11). The presentation of two sets of statements was confusing. In the 2008–09 Budget, this problem was 'resolved' when general government sector statements were presented, for the first time, under one standard, namely, Australian Accounting Standard *Whole of Government and General Government Sector Financial Reporting* (AASB 1049). AASB 1049 'harmonises' the GFS and the AAS (see section 11.3.1).

The government decided to make Government Finance Statistics the accounting standard in the budget papers except where AAS provide a better basis for presenting information.[106] Given that Budget aggregates (see section 4) are now reported under the Government Finance Statistics standard, this decision will help ensure consistency in reporting. AASB 1049 is now the standard for whole-of-government reporting, for example, in the Final Budget Outcome.[107]

The Consolidated Financial Statements were first published using AASB 1049 in 2008–09.

105. A Murray, *Review of Operation Sunlight: overhauling Budgetary transparency*, June 2008, viewed 15 March 2010, http://www.finance.gov.au/financial-framework/financial-management-policy-guidance/operation-sunlight/docs/Budget-transparency-report.pdf

106. Australian Government, *Operation Sunlight: enhancing budget transparency*, op. cit., p. 8.

107. Ibid., p. 9.

14.3 Improving the transparency of estimates

Operation Sunlight states that some of what are classified as 'parameter variations' are in fact material estimation errors.[108] Further, revenue and expenses can fluctuate considerably. The government proposes that Treasury and the Department of Finance and Deregulation publish on their web sites material changes in revenue and expenses and, every three months, fiscal and cash balances. This had not been implemented at the time of writing.

14.4 Expanding the reach of budget reporting

Operation Sunlight proposes, amongst other things, changes to the examination of tax expenditures (see section 12). Tax expenditures are among the least reviewed areas of activity. Government policy is to require an independent audit and assessment of existing concessions, establish processes for periodic review of tax expenditures, and allocate tax expenditures to functions and sub-functions in the way spending is now classified. According to *Operation Sunlight*, Treasury and relevant agencies are progressively reviewing all tax expenditures.[109] The 2009 tax expenditures statement projected that tax expenditures will progressively fall as a percentage of gross domestic product.[110]

14.5 Improving intergenerational reporting

Under *Operation Sunlight*, government policy is to have the Intergenerational Report produced every three years (rather than five as is now the case) with greater disaggregation at the program level, and to produce the report at least once every parliamentary term.[111] The first report was issued on 4 May 2002, the second in April 2007, and the third on 1 February 2010.

14.6 Improving the financial framework

Under accrual budgeting, agencies receive cash for depreciation expenses. Under *Operation Sunlight*, the Rudd Government proposed ceasing funding for depreciation from 1 July 2009 for collecting institutions in relation to their heritage and cultural assets, and from 2010–11 for all other agencies in the general government sector.

The Rudd Government also introduced a 'net cost of services' presentation of income statements from 2009–10. This first appeared in the portfolio budget statements for 2009–10.

108. Ibid., p. 10.

109. Ibid., p. 13.

110. The Treasury, *Tax expenditures statement 2009*, op. cit.

111. Australian Government, *Operation Sunlight: enhancing budget transparency*, op. cit., p. 17.

15. Funds

The Howard and Rudd Governments established several funds. The following describes some of these funds.

15.1 Future Fund

In 2006, the Howard Government established the Future Fund.[112] The purpose of the Future Fund is to accumulate assets to meet the Commonwealth's unfunded superannuation liability.[113] Current Commonwealth superannuation benefits are paid from each year's Budget. Until the Future Fund was established, no specific provision was made to accumulate investments to cover these unfunded superannuation payments. The Future Fund thus constitutes a move towards fully-financed Commonwealth superannuation arrangements. The Rudd Government pledged to continue the Future Fund.[114]

With the establishment of the Future Fund in 2005–06, the definition of the underlying cash balance changed. The revised definition excludes Future Fund earnings from the underlying cash balance. This raises the question of why Future Fund earnings are treated this way. Earnings from investments are normally included in the underlying cash balance. This suggests that Future Fund earnings should be treated similarly. The rationale for excluding Future Fund earnings from the underlying cash balance is that they are 'quarantined', that is, not available for current spending. Instead, earnings are accumulated to help fund the superannuation liability:

> The Government is reporting the underlying cash balance net of Future Fund earnings from 2005–06 onwards because the earnings will be reinvested to meet future superannuation payments and are therefore not available for current spending.[115]

From a reporting perspective, excluding Future Fund earnings from revenues has the effect of reducing the underlying cash balance. This should be borne in mind when measuring the size of the general government sector as a proportion of gross domestic product. A footnote to

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112. The balance in the Future Fund can be found at the Future Fund website, viewed 17 March 2010, http://www.futurefund.gov.au/

113. The estimated liability at the end of June 2009 was $118 billion. See: Australian Government, *Budget strategy and outlook: Budget paper no. 1, 2009–10*, Commonwealth of Australia, Canberra, 2009, p. 9–4, viewed 17 March 2010, http://www.Budget.gov.au/2009-10/content/bp1/downloads/bp1_bst9.pdf

114. W Swan (Treasurer), *Budget speech: 2008–09*, Commonwealth of Australia, Canberra, 2008, p. 12, viewed 17 March 2010, http://www.Budget.gov.au/2008-09/content/speech/download/speech.pdf

115. Australian Government, *Budget strategy and outlook: Budget paper no. 1: 2008–09*, Commonwealth of Australia, Canberra, 2008, pp. 9–32 and 9–33, viewed 17 March 2010, http://www.Budget.gov.au/2008-09/content/bp1/downloads/bp1.pdf

Table 1 in statement 10 in Budget paper no. 1 for 2009–10 acknowledges this by noting that for the purposes of consistent comparison with years before 2005–06, Future Fund earnings should be added to the underlying cash balance.[116]

15.2 Nation-building funds

The Rudd Government established three so-called nation-building funds: the Building Australia Fund, the Education Investment Fund, and the Health and Hospitals Fund.

The Building Australia Fund was established to fund investment in transport infrastructure (such as roads, rail, urban transport and ports), communications infrastructure (such as broadband), energy infrastructure and water infrastructure. The Building Australia Fund was funded from the remaining proceeds of the Telstra 3 sale, the assets of the closed Communications Fund and $7.5 billion from the 2007–08 Budget surplus.

The Education Investment Fund was established to fund investment in higher education infrastructure, research infrastructure and vocational education and training infrastructure. The Education Investment Fund was funded from the assets of the closed Higher Education Endowment Fund, which the Howard Government established.

The Health and Hospitals Fund was established to fund investments in health infrastructure. The Health and Hospitals Fund was funded from $5 billion from the 2007–08 Budget surplus.

The Future Fund Board of Guardians invests the assets of the Building Australia Fund, the Education Investment Fund and the Health and Hospitals Fund as well as the Future Fund. The amounts in the nation-building funds can be found on the Future Fund internet site.

The nation-building funds differ in several respects from the Future Fund and the closed Higher Education Endowment Fund and closed Communications Fund. As noted, the Future Fund is quarantined from the Budget in that its assets and income are not available until the superannuation liability is fully met or from 1 July 2020 (whichever is earlier), and all income until that point is reinvested. Further, only the income from the Higher Education Endowment Fund and the Communications Fund was available for spending. In contrast, both the capital and income from the three nation-building funds can be spent. All projects financed from the nation-building funds, other than the National Broadband Network, must satisfy evaluation criteria assessed by the relevant advisory board.

The merits of establishing funds are questionable. The rationale for establishing them was purely political: governments have for years funded infrastructure, education, health and so without the need for funds. Tracing the sources and use of money flowing through the funds has added unnecessary complexity.

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116. Australian Government, *Budget strategy and outlook: Budget paper no. 1, 2009–10*, Commonwealth of Australia, Canberra, 2009, p. 10–6, viewed 17 March 2010, http://www.Budget.gov.au/2009-10/content/bp1/downloads/bp1_bst9.pdf

Details of movements on the three nation-building funds can be found in the Department of Finance and Deregulation's portfolio budget statements.

16. Conclusions

The Budget is the foremost statement of a Commonwealth government's priorities. With spending and revenue equivalent to more than a quarter of gross domestic product, the Budget is also a major influence on the economy generally and on particular activities.

This paper has sought to address some of the key issues from the perspective of Members of Parliament and their experience as users of the budget papers and related documentation. A theme of earlier versions of this paper was that Members of Parliament wanted information about programs. The adoption of program level reporting for the Budget year and forward years in the 2009–10 portfolio budget statements is, in the author's opinion, the single best step in improving budget information that has been made in recent years.

17. Glossary

The following is adapted from a glossary prepared by the Department of Finance and Deregulation.

AASB 1049. The Australian Accounting Standard for reporting by government of information in financial statements. Its full title is *Whole of Government and General Government Sector Financial Reporting*. AASB 1049 replaced the previous standard for government reporting Australian Accounting Standard 31 *Financial Reporting by Governments* as the main reference point for consolidated and sectoral financial statements. AASB 1049 'harmonises' the Government Finance Statistics and Australian Accounting Standards reporting frameworks.

Accrual accounting. The system that brings to account both monetary payments and receipts (for example, salary payments) and non-cash transactions (for example, depreciation of assets and increases in employee long service leave liabilities) in the period when they are incurred. Accrual accounting differs from cash accounting, which recognises only monetary transactions, and only when such a transaction takes place (for example, payment of a debt) even though the monetary transaction may relate to an earlier period (for example, a credit sale in a previous year).

Accrual budgeting. Accrual budgeting extends cash budgeting by incorporating funding to agencies for non-cash resource usage and revenues such as increases in long service leave liabilities and depreciation. Under *Operation Sunlight*, the Rudd Government proposed ceasing funding for depreciation from 1 July 2009 for collecting institutions in relation to their heritage and cultural assets, and from 2010–11 for all other agencies in the general government sector.

Additional estimates. Agencies often seek funds additional to those appropriated in the Budget. Approved funding increases are normally incorporated into Appropriation Acts 3 and 4 and the Appropriation (Parliamentary Departments) Act (No. 2). The funding in these three Acts is collectively known as additional estimates. Agencies produce portfolio additional estimates statements that contain details of the additional spending. The Bills for additional estimates are normally introduced in February. Senate estimates committees enquire into additional estimates, usually in February.

Administered items. Revenues, expenses, assets and liabilities that agencies manage on the government's behalf. Examples include subsidies, grants and benefit payments, and taxes, fees, fines and excises. An example is the age pension paid under the *Social Security (Administration) Act 1999*. The total amount paid as aged pensions is beyond agency control because this is determined by the eligibility criteria, the pension rates, and the number of eligible persons.

Advance to the Finance Minister. A provision, authorised by the annual Appropriation Acts and made available to the Finance Minister, to provide urgent funding to agencies. Advances are made only if the need is urgent and was unforeseen or arose because of erroneous omission or understatement. The Finance Minister has to account to parliament for spending from the advance.

Agency. When used in a general sense, the term encompasses departments, agencies, and authorities. Agencies are classified as Departments of State (for example, the Attorney-General's Department), Departments of the Parliament (for example, the Department of the House of Representatives) and 'prescribed agencies' (for example, the Administrative Appeals Tribunal) for the purposes of the *Financial Management and Accountability Act 1997*.

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

Appropriations. An amount of public money that parliament authorises for spending. When the government wishes to undertake spending, legislation must be brought before parliament seeking approval for such spending. Parliament appropriates spending under annual Appropriation Acts and under special appropriations. The annual Appropriations Acts are Appropriation Act (No. 1), Appropriation Act (No. 2) and Appropriation (Parliamentary Departments) Act. These three Acts are usually supplemented by additional Appropriation Acts called 'additional' estimates. The annual Appropriation Acts account for less than 20 per cent of government spending, and special appropriations for more than 80 per cent.

Australian Accounting Standards (AAS). A general set of standards for financial reporting for the private and public sectors. The current standard for reporting by government of information at a consolidated and sectoral level in financial statements is AASB 1049 *Whole of Government and General Government Sector Financial Reporting.* Australian Accounting Standard 31 (AAS 31) *Financial Reporting by Governments* was, until 2007–08, the AAS general framework for financial reporting by governments. Detailed requirements for specific transactions and balances are contained in the other accounting standards.

Budget aggregates. Comprise total receipts and total spending and the Budget outcome (surplus or deficit). There are two measures of the outcome. The cash measure is the 'underlying cash balance'. The accrual measure is the 'fiscal balance'. Budget aggregates are shown both in dollar terms and as a proportion of gross domestic product

Budget balance. The term used to refer to a budget outcome, whether a surplus or deficit. There are two measures of the balance. The 'fiscal balance' is the accrual budget outcome. Its cash counterpart is the 'underlying cash balance'.

Capital requirements. The amount an agency needs to fund its purchases of non-current assets such as plant and equipment. Agencies capital requirements are met from several sources including retained earnings, and equity injections and loans appropriation**s.**

Charter of budget honesty. The *Charter of Budget Honesty Act 1998* is a legislative framework for the conduct and reporting of fiscal policy. The Act aims is to improve the conduct of 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. The Act obliges the government to present three reports annually: a Budget Economic and Fiscal Outlook Report, a Mid-Year Economic and Fiscal Outlook report, and a Final Budget Outcome report.

Consolidated Financial Statements. Section 55 of the *Financial Management and Accountability Act 1997* requires the Finance Minister to prepare annually consolidated financial statements (CFS) for the Commonwealth. The statements contain consolidated results for all Commonwealth-controlled entities, and disaggregated information for all three sectors: general government, public non-financial corporations, and public financial corporations. The CFS are prepared on the basis of Australian Accounting Standards including Australian Accounting Standard 1049.

Consolidated Revenue Fund (CRF). Section 81 of the *Australian 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 deemed to be 'self-executing', that is, money that the Executive Government raises or receives automatically forms part of the CRF regardless of whether the amount has been credited to a ledger account designated CRF or paid into a bank account so designated.

Contingency r**eserve**. The contingency reserve (CR) is the means of trying to ensure that the aggregate estimates for the budget and forward years are robust and based on the best information available at the time of publication. Major components of the CR include an allowance for the tendency for estimates of expenses for existing policies to be revised upwards in the forward years; an allowance for the tendency for estimates of some expenses to be overstated in the budget year; commercial-in-confidence and national security-in-confidence items which cannot be disclosed separately; and minor decisions made late in the budget process.

Departmental items. Resources (assets, liabilities, revenues and expenses) that agencies control and use to produce outcomes on behalf of government. Departmental expenses are mostly operating expenses. Examples are purchases of supplies used in providing goods and services; accruing liabilities for employee entitlements; revenues from user charges; and employee salaries and other administrative expenses incurred in providing goods and services. Appropriations for departmental expenses can be subject to a reduction process whereby, on request from an agency minister, the Finance Minister may issue a determination which causes unspent departmental appropriations to lapse.

Economic parameters. The values of economic variables—such as price changes, 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.

Efficiency dividend. Agencies are expected to improve their efficiency, and the efficiency dividend is an incentive for agencies to improve efficiency. The efficiency dividend is a deduction from agencies' departmental expenses. The dividend also applies to some administered items. The dividend is calculated and deducted with the creation of the forward years estimates. Most agencies pay the dividend the main exception being Defence.

Equity, net assets, net worth. All terms mean the difference between total assets and total liabilities.

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 Deregulation and the agency responsible for program delivery. Treasury prepares tax revenue estimates. Estimates are prepared for on-going and new programs. Budget paper no. 2 contains estimates of the expected revenues and expenses resulting from the measures announced in the Budget.

Expenditure Review Committee (ERC). The sub-committee of Cabinet that meets to consider new policy and savings proposals. The ERC examines proposed major spending in the context of the government's overall Budget strategy, recommends to Cabinet proposals to be included in the Budget, and initiates spending reviews of on-going programs. The ERC comprises the Deputy Prime Minister, the Treasurer as chair, the Minister for Trade, the Minister for Families, Housing, Community Services and Indigenous Affairs, the Minister for Finance and Deregulation, and the Assistant Treasurer.

Expenses. The value of total resources consumed in producing goods and services. Expenses include cash items such as salary payments and non-cash expenses that are incurred—such as accruing employee entitlements—but which will be paid in the future.

Final Budget Outcome. Contains 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 that financial year. The report contains general government sector financial outcomes including information on revenue, expenses, net capital investment, federal financial relations, and other information.

Financial Management and Accountability Act 1997 (FMA Act). 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 Finance Minister to make regulations and delegate powers.

Fiscal balance. The Budget outcome measured in accrual (as distinct from cash) terms. The fiscal balance is the net operating balance of the general government sector less net capital investment. The net operating balance is the difference between revenues and expenses, while net capital investment is additions to non-financial assets (such as buildings and equipment) less depreciation of non-financial assets. A fiscal surplus indicates that the Commonwealth is reducing its net debt to other sectors of the economy and 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—such as increased spending or tax cuts—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 yet agreed to or programs that are not expected to continue. Forward estimates are a system of rolling three-year financial estimates. For example, in the 2009–10 Budget, the forward estimates were for the three years 2010–11, 2011–12 and 2012–13. After the Budget is passed, the first year of the forward estimates becomes the base for next year's budget, and another year is added to the forward estimates. The three forward estimates years are sometimes referred to as the 'out' years.

General government sector. The Budget focuses on the general government sector. This encompasses agencies that provide public services that are mainly non-market in nature and are either for collective consumption by the community (for example, defence and law and order) or redistribute income (for example, social security payments), and are financed mainly by taxes. The other two sectors of government are the public non-financial corporations, such as Australia Post, and public financial corporations such as the Export Finance and Insurance Corporation.

General purpose payments (GPPs). Commonwealth payments to the states and territories are divided into GPPs and specific purpose payments (SPPs). GPPs differ from SPPs because GPPs are not subject to conditions regarding their use. The main component of GPPs is GST revenue.

Government Finance Statistics (GFS). One of two reporting frameworks used to present Budget financial statements (the other is Australian Accounting Standards). The GFS reporting framework is a specialised statistical system designed to support economic analysis of the public sector. The GFS standard used in the Budget is based on the Australian Bureau of Statistics (ABS) accrual GFS framework, which is consistent with international statistical standards. Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting* 'harmonises' the GFS and Australian Accounting Standards frameworks.

Headline (cash) balance. The actual Budget outcome measured in cash terms. The headline balance differs from the 'underlying' balance by, for example, including proceeds from the sale of assets that the underlying balance excludes on the grounds that they are one-off or abnormal items, so their inclusion would give a 'distorted' view of the Budget outcome.

Joint Economic Forecasting Group (JEFG). The group responsible for official economic forecasts. The JEFG comprises the Department of Treasury as chair, the Department of the Prime Minister and Cabinet, the Department of Finance and Deregulation, the Australian Bureau of Statistics, and the Reserve Bank of Australia. The JEFG makes forecasts twice a year, at budget time and for the Mid-Year Economic and Fiscal Outlook.

Mid-Year Economic and Fiscal Outlook (MYEFO). Essentially a Budget update. The MYEFO takes account of trends in spending and revenue in the financial year to date, revenue and expense decisions taken since the Budget, and revisions to economic parameters such as the projected economic growth rate. The MYEFO is published around November.

Net capital investment. Net capital investment is gross investment in fixed capital (such as buildings and structures and machinery and equipment) less the consumption of fixed capital, that is, the reduction in the value of fixed assets resulting from physical deterioration, obsolescence and accidental damage.

Net debt. A measure of the strength of the government's financial position. Net debt is the difference between certain financial liabilities (deposits held, advances received, government securities, loans and other borrowings) and certain financial assets (cash and deposits, advances paid, and investments, loans and placements). Net debt is commonly used as an indicator of the soundness of the government's financial position because high levels of net debt indicate that servicing that debt will be an imposition on future revenue flows. Net debt is a narrow measure of public debt in that it excludes some assets and liabilities, notably, public service superannuation liabilities. A more broadly defined measure of the government's financial position is net worth, which is the value of all assets minus the value of all liabilities.

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.

Non-operating resources. Non-operating costs include (1) equity injections, for example, to finance investment in new capacity, (2) loans which are provided when an investment is expected to result in a direct return such as savings, (3) 'previous years outputs' appropriations to replenish cash reserves used to deliver outputs in a previous year (the latter can occur, for example, when a decision is made to implement a new activity after the cut-off date for inclusion in the additional estimates Bills), and (4) administered assets and liabilities appropriations, which fund acquisitions of new administered assets, enhancement of existing administered assets, and the discharge of administered liabilities relating to activities that agencies administer. Non-operating costs are appropriated through Appropriation Act (No. 2). In an appropriation context, non-operating costs are sometimes called 'capital' costs.

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.

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. Performance information can be quantitative or qualitative but must be verifiable. Performance measures are quantified representation of indicators, and are used when there is a clear causal link between an action and its measurable consequence. 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. A group of several, loosely-related agencies which all report to the same minister.

Portfolio budget statements (PBS). The main source of information on agency proposed activities. The PBS are documents that portfolio departments coordinate (they are tabled by ministers) and publish explaining each agency's source and use of funds by outcome. The PBS contain information on revenue authorised by the Appropriation Acts, revenue from other sources, special appropriations, other financial information, performance information and budgeted financial statements. The PBS contain information on all general government sector agencies within the portfolio.

Pre-Election Economic and Fiscal Outlook (PEFO). The *Charter of Budget Honesty Act* 1998 provides for the secretaries of the Departments of the Treasury and of Finance and Deregulation to release publicly a PEFO report within ten days of the issue of the writ for a general election. The purpose of the PEFO is to provide updated information on the economic and fiscal outlook. The information in the report takes into account, to the fullest extent possible, all government decisions made before the issue of the writ and all other circumstances that may have a material effect on the fiscal and economic outlook.

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 then Department of Family and Community Services and the Department of Health and Aged Care whereby the ATO undertook to provide services to both to assist 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 offset the cost of programs. To satisfy Department of Finance and Deregulation 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 respond to changes in economic parameters.

Special accounts. A special account is an appropriation mechanism that notionally sets aside an amount within the Consolidated Revenue Fund to be expended for specific purposes. An example is the national cattle disease eradication account; all revenues and expenses associated with that activity flow though that special account. The appropriation authority for special accounts is section 20 or 21 of the *Financial Management and Accountability Act 1997*.

Special (or standing) appropriation. Money appropriated by a particular Act (for example, the *Veterans' Entitlements Act 1986)* for a specific purpose (in this example, pensions, medical treatment and other matters for veterans, war widows and others covered by that Act) 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 more than 80 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 or education. SPPs are made under section 96 of the *Australian Constitution*, which states that the Commonwealth

Parliament may grant financial assistance to any state on such terms as it sees fit. Many SPPs are conditional on policy objectives that the Commonwealth sets or the achievement of policy objectives that the Commonwealth and states agree.

Spending. As used in this paper, the term encompasses all forms of general government expenditure, whether for current or capital purposes. This term was adopted because the terms used for expenditure have changed over the years and have had different meanings. Thus**,** until 1998–99, under cash budgeting, spending was termed ‘outlays’. Since 1999–2000, under accrual budgeting, the main form of spending has been ‘expenses’. However, there are other forms of spending such as injections of capital into agencies.

Standing appropriation. A form of special appropriation that does not state an amount to be appropriated but where the amount payable is determined by the conditions and criteria set out in the legislation. Such appropriations are sometimes referred to as ‘unlimited by amount’.

Strategic Priorities and Budget Committee (SPBC). A formal Cabinet committee which establishes the government’s fiscal strategy and policy priorities at the beginning of the each budget cycle and throughout the year. The SPBC reviews the proposals to ensure that they conform to the government’s priorities. The SPBC comprises the Prime Minister as chair, the Deputy Prime Minister, the Treasurer, and the Minister for Finance and Deregulation.

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 (for example, the deferral of a tax liability) 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 measure of the budget outcome (proposed or actual). 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). The underlying balance differs from the ‘headline’ balance—the actual cash outcome—by, for example, excluding Future Fund earnings.

Uniform Presentation Framework. An agreement between the Commonwealth, states and territories whereby all jurisdictions are required to publish a common set of government financial statistics.