Guide to the 1998-99 Budget Papers

Presented by

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Treasurer of the State of Victoria

for the information of Honourable Members

Guide to the 1998-99 Budget Papers

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Treasurer's Foreword

Since the Kennett Government was first elected in October 1992, one of its highest priorities has been the restoration of Victoria's public finances to a sound and sustainable position.

This has required a coordinated and consistent reform program, comprising:

- establishing the Victorian Commission of Audit to determine the true financial position of the State;
- eliminating the State Budget's structural operating deficits;
- creating an ongoing capacity to provide essential public infrastructure;
- maintaining and improving the State's assets;
- reducing the State's liabilities, including repaying debt and reducing unfunded obligations;
- properly managing the State's risk; and
- ensuring that high-quality public services are provided at least cost, by introducing competitive discipline and contestability to services provision.

To be fully effective, all of these reforms require soundly-based budgeting and monitoring processes.

The *Report of the Victorian Commission of Audit* stated that Victoria needed to improve the quality of the information on which budgeting and assessment of service delivery is based. The inadequacies of the traditional cash- and input-based budgeting and monitoring systems were amply demonstrated by the unhealthy condition of the State's public finances in the early 1990s.

For several years, the Department of Treasury and Finance has been investigating and implementing reforms of the financial management of the State. This has been done in close cooperation with other departments, and with advice and assistance from financial experts. A number of reforms have already been implemented, most notably those incorporated in the *Financial Management Act* which was passed in 1994. This year's Budget introduces the next phase of the financial reforms.

The principal reforms implemented in this Budget include:

- the adoption of accrual accounting for budgeting purposes, both at the aggregate and departmental level; and
- the introduction, throughout the budget sector, of output management, where government revenue is distributed to departments based on outputs delivered in accordance with budgeted targets.

These reforms, supported by amendments to the *Financial Management Act,* will place Victoria at the forefront of global public sector management. By developing and extending reforms introduced elsewhere in Australia and overseas, we are ensuring that Victoria's financial management is as efficient and effective as that found anywhere in the world.

The reforms will:

- ensure that the public are fully informed about the government's financial position;
- give the clients of government departments better information about the quality of services;
- provide departments with greater incentives to improve their services; and
- enhance the government's accountability to Parliament and the public for performance and financial management of service delivery.

Victoria now becomes the first state, and the second Australian jurisdiction after the ACT, to present its Budget on an accrual output management basis. The introduction of fully accrual-based accounting and output management will ensure that future governments, financial markets, and the Victorian public are fully informed about the true condition of the State's finances, and the financial commitments that will require payment in the future.

At the same time, the Parliament, the government and the public will have access to information about the full costs and performance standards of government services. This information will increase the government's ability to improve the quality and quantity of service delivery without compromising efficiency or cost-effectiveness.

The greater transparency and accountability provided by these reforms will ensure that Victorians can assess whether or not the services that governments promise can be delivered at a cost that taxpayers can afford.

The move to best practice financial management means that this year's Budget Papers differ substantially in form and content from those of previous years. For example, non-cash expenses (such as depreciation) are included for the first time, which means that figures relating to expenses of service delivery cannot be directly compared with the cash costs shown in previous Budgets. To enable readers to reconcile this year's Budget numbers to those of previous years, appropriate tables have also been included.

This *Guide to the 1998-99 Budget Papers* will help readers of the Budget Papers to understand the initiatives that have been introduced and the impact that they will have on assessing Victoria's financial position and monitoring the delivery of public services.

I commend all readers who are interested in the delivery and funding of departmental services to read this *Guide* and extend their understanding of Victorian public finances.

Alan R Stockdale
Treasurer

Changes to the presentation of the Budget Estimates

Summary

- Traditional cash accounting and budgeting provide an incomplete picture of government finances.
- The 1998-99 Victorian Budget is presented on an accruals basis, and annual appropriations also change to an accruals format.
- Budget Paper No. 2 presents Government Finance Statistics on an accruals basis.
- Budget Paper No. 3 presents conventional accruals-based financial statements (operating statement, statement of financial position and cash flow statement) for each department.

Traditionally, the Victorian Budget, like those of most other governments, has been prepared on the basis of itemising the cash to be received and spent by the government for the year. Parliamentary authorisation of the Budget spending, through appropriations, has also been based solely on cash. However, cash accounting alone does not adequately reflect the complete state of public finances.

From 1998-99, the Victorian State Budget will provide a much more complete picture of the State's financial plans by:

- presenting the budget on an accrual accounting basis; and
- implementing accruals-based appropriations.

The Budget now provides important additional information in relation to:

- the ***assets*** owned by government, including: financial assets such as cash and bonds; physical assets such as land, buildings and equipment; investments such as Public Trading Enterprises; and intangible assets such as copyrights;

- the ***liabilities*** owed by government, including: debts; leases; employee entitlements; creditors; and contingencies such as guarantees and indemnities;
- ***revenue*** earned for services delivered but not yet received in cash (debtors); and
- ***expenses***, such as depreciation, that do not require payment in cash but instead recognise that some physical assets, such as equipment, have a finite working life and that their value reduces as they are used, or over time.

Including these items ensures that the Budget, and the management systems which implement the budget strategy, accurately reflect the full financial impact of all decisions made during the period.

Government departments and agencies need sound and complete financial information in order to make fully-informed decisions about operations and investments, and the government needs it to account properly to the Parliament for its use of all State resources.

For example, a department may have a choice between a capital-intensive and a labour-intensive method of service delivery. Ignoring depreciation (as cash accounting does) will bias the choice in favour of the capital-intensive method, at potentially great cost to clients and taxpayers.

Similarly, payments for services delivered can occur well after the obligation is incurred. If the government must seek Parliamentary approval when the obligation is incurred, Parliament’s control over government finances is enhanced, and Parliament and the public are better informed of the State’s actual financial position.

Accrual accounting is at the core of internationally-recognised generally accepted accounting principles (GAAP).

Under GAAP, the main focus of accounting is the “matching concept”, whereby the timing of the recognition of revenue and expenses is matched to production or delivery of products and services, not to when cash is exchanged.

In the 1998-99 Victorian Budget, GAAP-based financial estimates will be provided for the first time for each department in Budget Paper No. 3 *Budget Estimates*.

In government, financial management behaviour is strongly influenced by accountability for appropriations by Parliament. Although accrual reporting is already in place in Victoria, government has been operating on a cash appropriations system, which has meant that management attention has not been directed to ‘non-cash’ aspects of business (i.e. assets, liabilities, and many revenues and expenses). For this reason, the move to appropriation of accrual-based resources by Parliament, in conjunction with the accruals-based presentation of the Budget, represents a fundamental improvement.

For some years, Victoria’s cash-based budget estimates (at both an aggregate and departmental level) have been presented in the Government Finance Statistics (GFS) format. Because this format is intended to show the impact of government finances on the economy, it eliminates from both the government revenue and expenses figures some items which are transfers within government. An example of this is payroll tax which is an operating expense paid by Victorian government departments.

Except for the ACT in recent years, all Australian governments have to date presented Budget estimates on a cash basis in the GFS format.

From 1999-00, it is likely that all governments will adopt the GFS accrual format, and Victoria has adopted this format one year earlier. The aggregate Budget estimates will be presented in GFS accruals format for the first time in the 1998-99 Budget Paper No. 2 *Budget Statement*.

To enable comparison with other Australian governments, an appendix to Budget Paper No. 2 contains a cash-based GFS presentation of the estimates.

Impact of the inclusion of non-cash costs on the reported cost of outputs

Summary

- Accrual accounting includes non-cash costs which, while they were always incurred, were previously omitted from cash cost totals.
- Examples of these costs are depreciation and employee entitlements.
- Including these costs means that total costs will appear higher than they were under cash accounting.

The introduction of accrual accounting to financial reporting of government output provision requires the inclusion of non-cash expenses (which have previously been omitted from financial statements), and the recognition that revenue may be earned and expenses incurred before or after the time at which cash is exchanged.

Examples of non-cash operating expenses that will now be included are:

- employee entitlements, such as long-service leave (LSL), that build up steadily during the term of employment, but do not require any cash payments until the employee takes LSL or retires, possibly many years later;
- increases in unfunded superannuation; and
- depreciation, charged as an expense to reflect the fact that some fixed assets wear out as they are used, and will gradually become less productive and less valuable.

By including non-cash expenses in 1998-99, operating expenses for departments will appear greater than the corresponding cash expenditure shown in the 1997-98 Budget Papers. This is because the operating expenses reflect all costs, rather than only some of the costs, of service delivery to the community.

Cash Expenses

In previous years, funding and budgeting were based on cash costs only. In 1998-99 output costs will appear higher due to inclusion - for the first time - of non cash items.

Cash Expenses

Non cash items are reported in:

- the operating statement as expenses incurred in the provision of outputs
- the statement of financial position as financial assets and liabilities.

+

Capital and non cash expenses

Capital Assets Charge *(CAC)* - recognises the imputed cost of the investment in departmental assets. Recorded in the operating statement as an expense. For 1998-99, departments will pay an average of 8% on the 'written down value' of non-current physical assets within their control.

Capital Assets Charge

+

Depreciation - allocation of the cost or value of a physical asset over its useful life. The revenue amounts equivalent to depreciation are held centrally as deposits and, subject to government approval, may be drawn upon to maintain a department's asset base.

Depreciation

+

Employee Entitlements - costs accrued for staff entitlements such as long service leave and annual leave. Recorded in the statement of financial position as a financial asset and liability, to be drawn upon at a future date as obligations crystallise (for example, when employees take leave).

Employee Entitlements

+

Purchases on Credit - are expenses incurred in the current period requiring payment at a future date. Recorded in the operating statement as an expense and the statement of financial position as a financial asset and liability until actual payment is made.

Purchases on Credit

=

Full Costs

Accounting for accrued costs ensures that the consequences of decisions taken by governments of the day will be made transparent through conventional financial reporting practice.

Full Costs

Other increases in departmental operating expenses since 1997-98 are the result of:

- the introduction of the Capital Assets Charge (CAC) on departmental fixed assets, to reflect the cost of the capital represented by departments' investment in physical assets. The CAC replaces the interim capital charge, which has been imposed for several years on new capital outlays by departments. Because the CAC, like the interim capital charge, is paid by departments to the government, it does not represent a net increase in costs to taxpayers;
- wage increases and changes in other input costs (such as the price of materials and supplies); and
- changes in government policy.

A table reconciling the 1997-98 published cash budget to the 1997-98 accrual equivalent is provided in an appendix to Budget Paper No. 2.

What information do the Budget documents provide?

Summary

- The Budget Papers include: the Treasurer's Speech; Budget Statement; Budget Estimates.
- Budget Paper No. 2 outlines the government's financial and economic policy and provides the consolidated financial estimates for the budget sector.
- Budget Paper No. 3 details the service provision plans and performance targets of departments and provides their financial estimates.
- This year, for the first time, the financial information in Budget Paper No. 2 and Budget Paper No. 3 will be in accrual accounting format.
- Budget Information Paper No. 1 details the government's major asset construction and purchase plans, and will be published as usual in October.

Budget Paper No. 1

Budget Paper No. 1 is the Treasurer's Budget Speech, which is technically the Second Reading speech on the annual *Appropriation Bill*. It provides the Treasurer with the opportunity to set out the Government's economic and financial program.

The Speech provides a broad overview of:

- major features of the Budget;
- the Government's economic, financial and social objectives and strategies;
- details of new developments or initiatives; and
- the formal details of the appropriations sought by the government.

It is of particular relevance to people who are interested in the above issues but not the technical details of public finances.

Budget Paper No. 2 *Budget Statement*

Budget Paper No. 2 details the Government's aggregate resource plans for the budget sector. This year, the Budget is presented using the accruals GFS format, which gives a true and complete indication of the economic impact of the Budget.

The *Budget Statement* provides details of the items outlined in the Treasurer's Speech, and also sets out estimates of government revenue and expenses for the three financial years after the Budget year. It also provides details of:

- economic forecasts on which the Budget estimates are based;
- the State's budget sector assets and liabilities;
- financial arrangements between Victoria and the Commonwealth;
- expected financial results for the non-budget sector;
- transactions for the general government and public trading enterprises sectors; and
- changes from the previous year's estimates.

Budget Paper No. 2 is particularly useful for readers interested in the government's broad fiscal strategies.

Budget Paper No. 3 *Budget Estimates*

Budget Paper No. 3 sets out in detail the operating resource plans of each department, and is the primary source of information regarding the delivery of government services. It provides a detailed explanation, at a departmental level, of service delivery plans and revenue and expense estimates.

Budget Estimates consists of four statements:

- *Statement 1* contains a summary of departmental estimates;
- *Statement 2* contains departmental statements which are a compilation of service delivery and financial information for each department. This information includes broad strategic direction; description of major outputs and performance measures; and budgeted financial statements (operating statement; statement of financial position; and cash flow statement);
- *Statement 3* contains an explanation of State revenue from all sources, including taxes, fees, fines and Commonwealth tied and untied grants, and a summary of tax rates and tax bases; and

- *Statement 4* contains details of all transactions on the Public Account[1].

The format of *Statements 1* & *2* in Budget Paper No. 3 has been extensively revised since 1997-98, so that they now contain accrual based estimates which provide a more comprehensive view of departmental finances. In this way they provide a "total resources" view of each department, showing:

- the full financial resources available to the department from all sources;
- the way these resources are used; and
- the basis of the authority of the department to obtain and use these resources.

Budget Paper No. 3 is the primary source of information for readers who are interested in the detailed output delivery plans of individual departments.

Budget Information Paper No. 1

Budget Information Paper No. 1 provides extensive details of investment in public infrastructure assets. It is tabled during the Spring Session of Parliament, and contains the following information:

- full details of total end costs and cashflows relating to new major fixed asset investments of departments;
- progressive expenditure to the end of the previous financial year on major fixed asset investments approved in previous years;
- information on the sources of funding for asset investment;
- minor asset investments of departments;
- investment undertaken by non-budget sector entities; and
- private investment in public infrastructure.

[1] The Public Account is the government's principal bank account, established under the *Financial Management Act* 1994. It comprises the Consolidated Fund and the Trust Fund.

Locating information in the Budget Papers

Each Budget Paper has a table of contents which provides an outline of the chapters, tables and charts in that Paper. The table below sets out where readers can find different types of information. Where information is included in Budget Paper 3, the relevant statement is also indicated (for example, BP3(S1) indicates Budget Paper No. 3, Statement 1).

	Budget Paper		
Information	*Whole of budget sector*	*Whole of department*	*Output group*
Financial plans and strategies	BP1, BP2	BP3(S2)	BP3(S2)
Operating Revenue	BP2, BP3(S1), BP3(S3)	BP3(S2)	BP3(S2)
Operating Expenses	BP2, BP3(S1)	BP3(S2)	BP3(S2)
Assets and Investment (including new projects)	BP2, BP3(S1)	BP3(S2)	BP3(S2), BIP1
Liabilities	BP2, BP3(S1)	BP3(S2)	BP3(S2)
Cash transactions	BP3(S1)	BP3(S2)	BP3(S2), BP3(S4)
Service provision (outputs)	BP2	BP2, BP3(S2)	BP3(S2)

The economic and accounting presentations of the Budget

Summary

- The financial information in both Budget Paper No. 2 and Budget Paper No. 3 is in accrual accounting format.
- Budget Paper No. 2 is based on GFS format, which indicates net economic impact of government finances.
- Budget Paper No. 3 is based on a standard accounting format, which indicates full revenue and costs from departmental operations.
- Tables are included in the Budget Papers reconciling the two accruals formats, and reconciling accrual accounting estimates with last year's cash-based estimates.

Focus of each presentation

Two accrual accounting formats are used in this year's budget papers: the internationally recognised Government Finance Statistics (GFS) format in Budget Paper No. 2, and the standard accounting format in Budget Paper No. 3.

The GFS format, as the name suggests, is designed for government entities. Because the GFS format is intended to indicate the economic impact of the financial activities of government, it eliminates from the consolidated figures transactions that are internal to government. In Victoria, these include the Capital Assets Charge and payroll tax paid by departments and agencies.

The standard accounting format is based on generally accepted accounting principles (GAAP), and is similar to the format in which commercial corporations must present their accounts.

Both of these formats are consistent with the government's view that public presentation of the Budget should:

- be based on modern accounting practice;
- show the true cost of running Government operations;
- show the impact of Budget decisions on net assets; and
- facilitate efficient resource allocation and management decision-making.

In addition, the major review of outputs undertaken during 1997-98 has resulted in significant changes to published outputs and performance targets. These changes, combined with the move to accrual-based financial statements mean that it is difficult to directly compare the information in the 1998-99 Budget Paper No. 3 with that presented in 1997-98.

For this reason, the appendices to *Statement 1* and to each department's section in *Statement 2* of Budget Paper No. 3, and Budget Paper No. 2 include tables which reconcile:

- the GAAP-based departmental estimates with the GFS departmental estimates shown in Budget Paper No. 2, and
- the 1997-98 GFS accrual-based budget estimates with the published 1997-98 GFS cash-based budget estimates.

Major differences between the two are:

- GFS presentation in Budget Paper No. 2 presents aggregate information with intergovernmental transactions eliminated; whereas
- GAAP reports in Budget Paper No. 3 present data on a gross transaction basis (i.e. No. eliminations) for each department.

Departmental expenses shown in Budget Paper No. 3 will therefore be greater than the equivalent totals shown in Budget Paper No. 2.

How will the community be better off?

Summary

- Accrual output based budgeting will provide tangible benefits for the community.
- Contestability and competition are fostered, and will deliver:
  - — cheaper and/or higher quality services
  - — more innovative services
  - — greater consumer choice.
- The risk of a financial crisis developing un-noticed in the future is practically eliminated.

A new financial management framework, reflected in changes to budgeting processes, will provide the following benefits to Victorians.

Delivery of government services and management of public assets are made more efficient

Victorians will benefit from more efficient production of government services and better management of public assets. This means that lower taxes and charges will be required to fund given quantities and standards of services and assets.

The impact of government decisions is transparent

Under an accrual budgeting system, the full cost of Government decisions, including the future impacts which will be reflected in the Government's financial statements, will be readily apparent.

Consumers have greater choice in accessing high-quality, least-cost government services

The reforms will result in increased contestability of government services, and more complete information on the quality and cost of those services. This will provide departmental management with the opportunity and the incentives to strive for continuous improvements to services.

As a result, consumers will be better off because services will be improved and there will be greater transparency regarding the value for money that each service provides.

Government can make informed decisions about whether a particular service can best be provided at the required quality and quantity, and at least cost to users and taxpayers by government, private, or non-profit sector organisations.

The true financial position of the State is presented

By moving to an accrual-based budget, the Budget papers disclose the true and complete extent to which the State's finances are committed. As a result, Victorians are less likely to be required by a government to make financial sacrifices to restore the State's financial position to a sustainable level.

Similarly, future generations are less likely to be required to meet an unreasonable financial burden arising from a failure of governments to disclose and budget for financial liabilities and obligations.

Parliament can exercise wider control over public finances

Because the government now needs to seek Parliamentary authority for accruing expenses and obligations, as well as cash expenses, Victorians will benefit from an increased level of Parliamentary scrutiny over public finances.

This increased scrutiny strengthens existing checks and balances that are inherent in the Parliamentary process, resulting in a more open, honest, and accountable government. It will also help ensure that departments provide services more efficiently and at a lower cost, resulting in lower taxes for Victorians.

Outline of the Financial Management Reform Program

Summary

- Significant reforms have been already implemented.
- The 1998-99 Budget takes these reforms further by defining more clearly the roles and responsibilities of funder; owner; purchaser; and provider.
- Accountability for achievement of outcomes is improved.

Since the first stages of financial management reforms were implemented in 1993, there have been significant achievements, including:

- the adoption of accrual accounting and reporting across the Victorian public sector;
- introduction of the annual State Budget before the start of the financial year;
- inclusion of planned outputs for all departments in Budget Paper No. 3 with performance measures and related targets provided for a selection of key outputs; and
- movement by a number of departments towards output management in various forms. Examples include: the *Schools of the Future* initiative, devolving authority to school Councils; output management in the provision of TAFE vocational education and training; and casemix funding for all public hospitals, whether owned by government or other bodies.

To continue to improve the State's financial position that has been achieved through these reforms, and to ensure that the full benefits are preserved, we need to implement further reforms that introduce and secure more efficient management practice in the Budget sector. This is the best way of achieving significant improvement in the State's operating result and net asset position, and consequently being able to improve services in the medium- and long-term.

The Financial Management Reform program aims to:

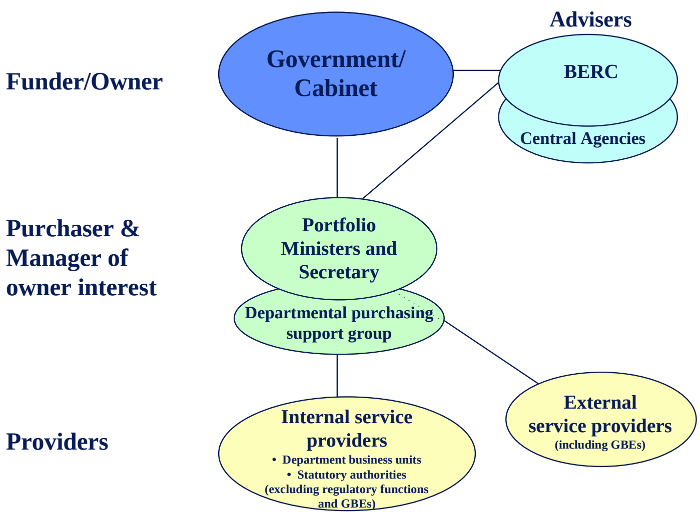
- improve and entrench departmental accountability for output provision and management of assets and liabilities; and
- strengthen government strategic control over fiscal aggregates.

Critical to achieving these results is aligning output provision with clients' needs and the Government's desired outcomes, and building in incentives for better management of available resources.

The reform program is based on a clear delineation of the roles and accountabilities of:

- Government as **owner** of the State's "businesses";
- departments as **managers** of these businesses;
- Government as the **funder** of departmental purchases and investments;
- departments as **purchasers** of services, with responsibility for overseeing service provision but not necessarily undertaking the actual delivery; and
- service **providers**, whether internal or external to the purchasing department (external service providers are either government entities outside the department or private sector organisations).

Management Reform Program - Proposed Framework



Within this model:

- Government is accountable to voters for the achievement of outcomes;
- Departments, through Ministers and CEOs, are accountable to Government for the provision of outputs, at specified levels of quantity, quality, timeliness, and cost, which will achieve the outcomes sought by the government;
- the central agencies of Department of Premier and Cabinet, and Department of Treasury and Finance provide advice to Government on:
  - which outcomes should be sought by government;
  - whether departments' outputs will achieve these outcomes; and
  - ways in which departments can achieve greater efficiency in service delivery and thus better value for taxpayers' money; and
- departmental CEOs are accountable to Ministers and the Government for their department's operating result and for management of assets.

Changes to structure of the Budget and Appropriation Bills

Summary

- Financial Management Reform Program principles implemented in the 1998-99 Budget:
  - — entrench outputs as the building blocks of the Budget; and
  - — introduce accrual concepts for budgeting and appropriations.
- Appropriation purposes have been changed to reflect output management and accrual accounting.

1998-99 Budget

The 1998-99 Budget reflects reforms which include:

- strengthening the concept of outputs (identifiable products and services) as the building blocks for the Budget;
- making significant progress towards establishing an environment which will encourage greater contestability in service delivery;
- identifying the full cost of outputs so that the government can determine whether the amounts it is paying for outputs are acceptable in a contestable environment;
- changing the purpose of appropriations to reflect explicit payment for the provision of outputs;
- improving the specification of performance measures to allow the government, as funder, to be satisfied that the outputs it has funded have in fact been provided (each output being measured against targets for quantity, quality, timeliness, and cost);

- highlighting the management of all resources employed in service delivery, through the publication of budgeted operating statements and statements of financial position;
- providing tangible incentives for the improved management of total resources and for continuous efforts to improve value for money through:
  - bringing all expenses to account in determining each department's financial performance, through its operating statement;
  - recognising the costs of both using capital and holding capital through reporting in the operating statement both depreciation expense and a capital assets charge;
  - establishing a new capacity for departments, subject to approval of investment plans, to retain the proceeds of the sale of underperforming physical assets for re-investment; and
  - establishing a new capacity for departments to retain and apply any operating surplus generated by initiatives to improve efficiency.
- providing appropriations explicitly for investment in departmental businesses, through a new appropriation purpose for additions to the net asset base of departments; and
- establishing a new capacity, through accrual appropriations, for departments to retain spending authority in order to meet liabilities incurred in the Budget year but not requiring cash payment until future years.

The Budget Papers continue to provide comparisons on a "budget-to-budget" basis to maintain a focus on the year ahead. Actual results for departments, including achievement against performance targets, will be produced in each department's annual report, enabling Parliament and the public to monitor and compare over time each department's performance in service delivery.

Changes to purposes of appropriations

From the 1998-99 Budget onwards, departments will receive appropriations for three purposes:

- provision of outputs;
- additions to the net asset base; and
- payments made on behalf of the State.

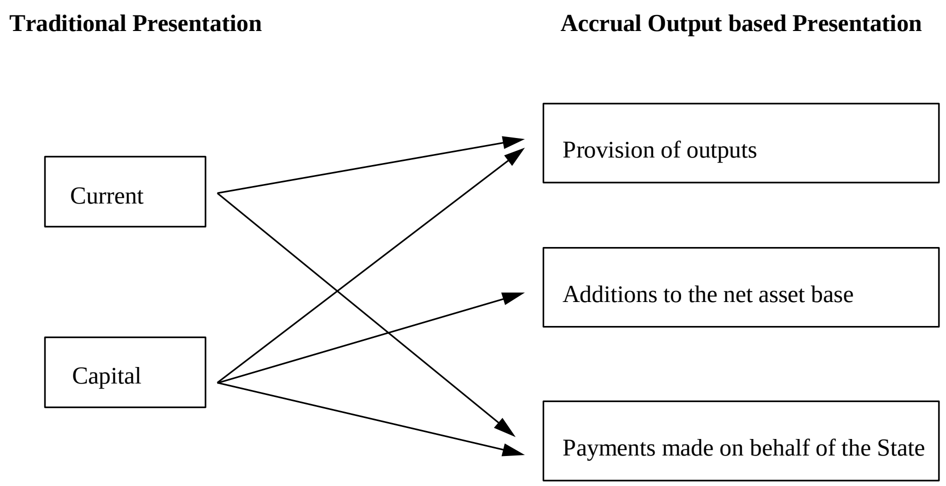
Appropriations for the ***provision of outputs*** provide authority to incur operating expenses relating to a department's provision of outputs.

An appropriation for ***additions to the net asset base*** of a department provides authority for contributions by government to strengthen the department's financial position.

This category of appropriation will usually be provided for the construction or purchase of new physical assets for the department, but may also be provided to meet a range of business needs including expansion of the department's role in providing outputs, or major strategic refocussing of the department.

Appropriations for ***payments made on behalf of the State*** allow departments to make payments for purposes which are a government responsibility as a whole, not part of the department's own services.

These three appropriation purposes do not directly correspond to the previous cash-based purposes of 'current' and 'capital'.



As illustrated in the diagram above:

- 'Provision of outputs' incorporates most of the traditional 'current' appropriations, as well as elements, such as depreciation, from the traditional 'capital' appropriation;
- 'Additions to the net asset base' represent a subset of appropriations previously classified as 'capital'; and

- ‘Payments made on behalf of the State’ represent payments on-passed or administered by the State which traditionally were included in ‘current’ or ‘capital’, or excluded altogether.

Appropriations now cover all expenses

Departments have access to four major sources of legally authorised budget funding:

- annual appropriations, under the *Appropriation Act*;
- special appropriations, under other legislation;
- trust accounts within the Trust Fund in the Public Account; and
- funds obtained and held outside the Public Account by budget sector agencies.

Together, these sources enable departments to incur expenses and make payments, and Government to control expenditure.

Under amendments to the *Financial Management Act* 1994, appropriations now comprise authority to incur expenses and obligations during the financial year, and authority to draw cash from the Consolidated Fund to make payments whenever those expenses or obligations mature. Under cash budgeting, appropriations represented Parliamentary authority to pay cash from the Consolidated Fund during a financial year.

In the 1998-99 Budget, additional appropriations will be provided to cover the transition from a cash-based to an accrual-based Budget. These transitional appropriations authorise the cash costs relating to expenses incurred in previous financial years which do not fall payable until 1998-99 or later. These amounts are represented in the State’s statement of financial position by opening balances for liabilities, including employee entitlements and creditors.

The revenue that departments receive from the government for each output provided is set at a level that covers all budgeted expenses incurred in producing a given quantity and quality of that output. For this reason, budgeted departmental revenue will be sufficient to cover both budgeted cash expenses and non-cash expenses. The difference between the revenue earned from the output provision and the cash expenses incurred by a department will be held as a deposit with the government, which can be drawn on to meet cash costs of non-cash expenses when they become payable.

Impacts of the Financial Management Reform Program on departmental management

Improved presentation of government financial plans

By including in the Budget the full costs of providing government services, government and departments have the information they need to make effective comparisons and choices between alternative methods of service delivery.

Full departmental financial statements are provided in Budget Paper No. 3 for the first time, and these indicate explicitly the impact of Budget decisions on departmental operating revenues and expenses, assets and liabilities, and cashflows.

Departmental financial statements will allow better comparison of the efficiency of service delivery between departments, alternative service providers, and other jurisdictions. In addition, this information will promote more effective stewardship of the State's assets and its capacity to continue providing services. The full cash flow statements provide better information regarding budget sector cash management than has been possible in the past.

Greater scrutiny of service provision through output performance targets

The outputs and performance measures presented in Budget Paper No. 3 for 1997-98, were useful, but varied in quality and displayed a mix of outputs, objectives, functions and activities. Output statements should enable Parliament and the public to scrutinise departmental purchasing decisions and Government funding determinations. Therefore, they must provide sets of genuine outputs, accompanied by, for each output group, performance measures which address the quantity to be delivered and the levels of quality expected. The statements included in the 1998-99 Budget Papers represent a significant improvement over 1997-98, and will continue to be refined in future years.

Output management requires a more rigorous budget monitoring regime in order to reinforce the behaviours it sets out to achieve. Under previous budget arrangements, the global budget for departments, once passed by Parliament, was viewed by management as an entitlement and it was only budget aggregates that were closely monitored by Department of Treasury and Finance on behalf of Government.

The change of focus to outputs requires that internal and external budget monitoring is based on departments' performance in delivering specified outputs, in addition to aggregate fiscal performance.

As a provider/producer of outputs, each department accepts responsibility for reporting its performance to the government and demonstrating that outputs have been delivered. As a responsible funder, the Government needs to link the ongoing recognition of departmental revenue and continued allocation of resources to satisfactory progress in delivering outputs.

Performance measures are designed so that the government can:

- determine a department's standards of output provision, and hence establish its entitlement or otherwise to funding; and
- compare output performance over time and, where possible, with other jurisdictions in Australia and overseas.

In order to make departments publicly accountable for the services they provide, major performance targets are published in the Budget Papers and each department's annual report.

More effective management of Budget plans throughout the year

As both owner and funder, the government has a responsibility to keep its finger on the pulse of departmental operations. Each department will be required to provide monthly financial reports to government in order to demonstrate the effect of its operations on the financial condition of the department.

Each department will also supply a more comprehensive quarterly assessment of its business performance, focussing on the department's outputs. As output management becomes more embedded in departmental operations over time, these reports will increasingly enable government to review in detail not only the quantity of outputs provided but also their quality, timeliness and cost.

External reporting of the budget result (financial and output provision) will contribute to the improvement in the performance of departmental managers because of increased accountability. The State's financial position and performance, at a whole-of-government level, is annually presented in the *Financial Statements for the State of Victoria* (known informally as the Annual Financial Statements, or AFS).

The Minister for Finance has directed each department to include in its annual report data and discussion of their performance against the targets published in Budget Paper No. 3. This will result in improved accountability at departmental level.

Improved management of departmental assets

Under the cash budget system, capital spending and the holding and use of assets have not impacted directly on the operating resources of departments or their measured performance. Four significant elements of the reforms change this:

- using the statement of financial position as a key tool for allocating resources and monitoring performance brings all resources of the departments into consideration;
- reflecting the cost of ***using*** assets through depreciation expense will focus management attention on the impact of physical assets on the department's operating performance, as indicated by its reported surplus or deficit;
- introducing the Capital Assets Charge (levied at an average 8 per cent on the written-down value of the department's non-current physical assets) will highlight, through the operating statement, the opportunity cost of tying up State resources in a particular type of asset; and
- creating the capacity for departments to retain the proceeds of the sale of assets.

These factors together provide a powerful incentive for managers to actively review and monitor their use of capital assets and to ensure that all assets are optimally employed in the business of the department.