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BUDGETING IN AUSTRALIA

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BUDGETING IN AUSTRALIA
BY
JÓN R. BLÖNDAL, DANIEL BERGVALL, IAN HAWKESWORTH AND REX DEIGHTON-
SMITH*

This review of budgeting in Australia concentrates on the national government only. The article first discusses Australia's recent economic and fiscal performance and then focuses on the budget formulation process. After a discussion of the role of the Parliament, the article reviews various aspects of budget implementation and management. The article concludes with a special section on Australia's efforts to eliminate "red tape" within government. This review was undertaken in September 2007; following the election of a new government in Australia in November 2007, some new policies are highlighted, encompassing budget formulation, processes, accounting and management.

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NOTE ON TERMINOLOGY

The term **Department of Finance** is used throughout this article. The department is now known formally as the Department of Finance and Deregulation and was previously known as the Department of Finance and Administration.

The term **national government** is used to refer to the Commonwealth or federal government.

The term **ministry** is used to generically describe departments.

All amounts are expressed in **Australian dollars**, unless otherwise mentioned.

The term **pension** is used rather than **superannuation**.

Unless otherwise noted, all fiscal references are to the **cash-basis** performance. Any references to **accrual-basis** performance are noted specifically.

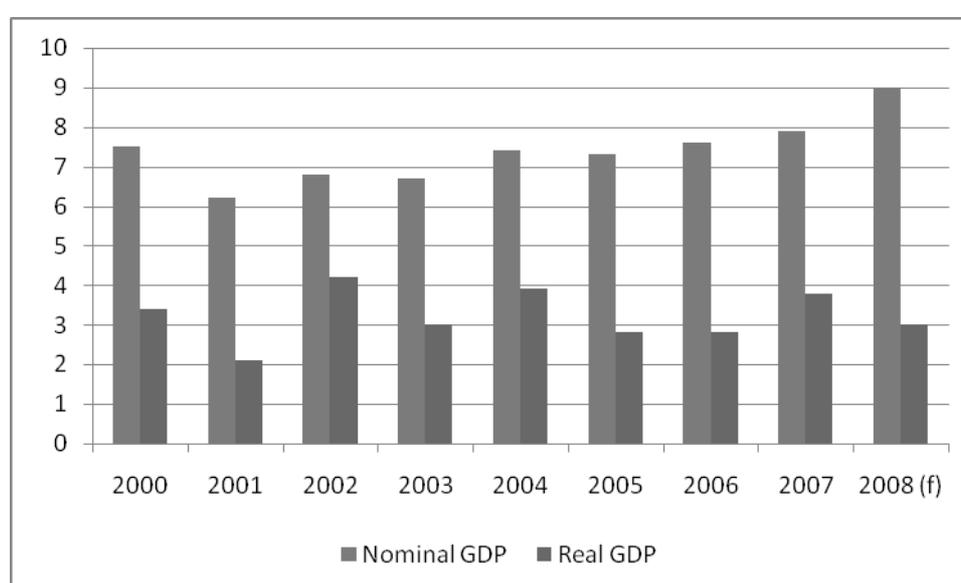
Australia has **two main political parties**: the Labor Party and the Coalition. The Coalition is in fact a “permanent” alliance of the Liberal Party and the National Party.

The terms **budget, estimates, and appropriation bills** can be viewed interchangeably for the purposes of this article.

1. INTRODUCTION

1. Australia's economic performance has been exceptional. It has enjoyed over 16 years of continuous economic growth. In the last decade, annual real GDP growth averaged about 3.5% (7.25% in nominal terms; see Figure 1). Output is at present estimated to be very close to potential.

Figure 1. GDP growth in Australia (per cent), 2000-08



f. Forecast.

Source: Australian Government, *Budget Paper No. 1*, 2008/09.

2. Australia's outstanding economic performance is attributed to two principal factors: first, structural reforms starting in the mid 1980s, and reinforced subsequently, which transformed the economy; second, a prolonged boom in commodity demand and prices since 2003 – led by China, India and other developing countries – which is currently a major driver of national income growth and investment.

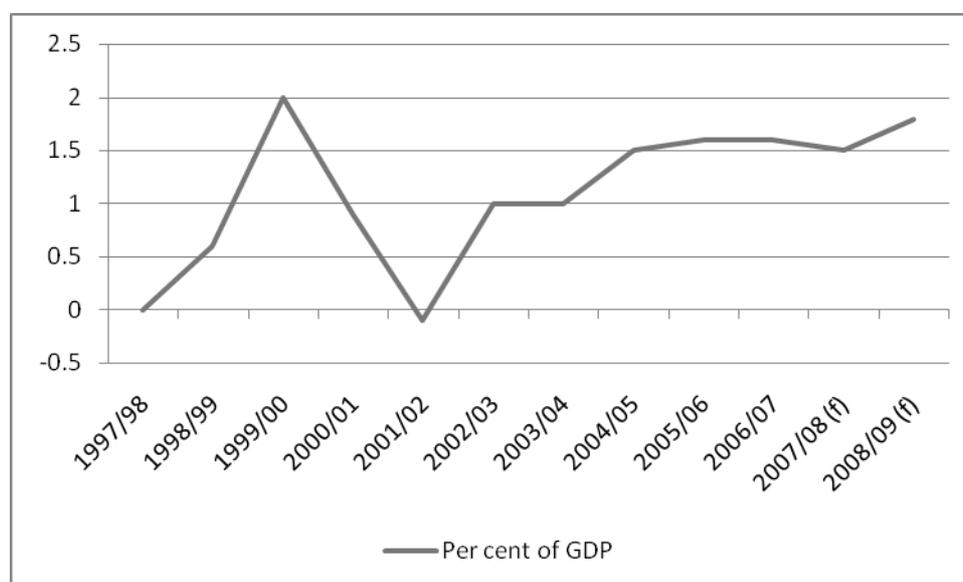
3. The early structural reforms included floating the Australian dollar, abolishing foreign exchange controls and interest rate controls, trade liberalisation – including unilateral reductions in tariffs – and deregulation of successive product markets and industries. Subsequent structural reforms included granting full independence to the Reserve Bank (the central bank) and the introduction of inflation targeting, a much more flexible labour market, tax reform aimed at widening the tax base, lowering marginal tax rates on both business and personal incomes and a greater focus on consumption taxes, and extensive privatisation of government business enterprises.¹

¹ For an excellent overview, see Banks, 2005.

4. Australia is a major commodity producer, including iron ore and metallurgical coal (both for steel), bauxite (for aluminium), thermal coal (for energy), uranium, lead, zinc, gold, silver, copper, crude oil and gas, and industrial diamonds. All together, commodities account for nearly two-thirds of all exports, and their export earnings are forecast to increase by 30% in 2008/09 (ABARE, 2008). The high commodity prices have naturally increased tax receipts.

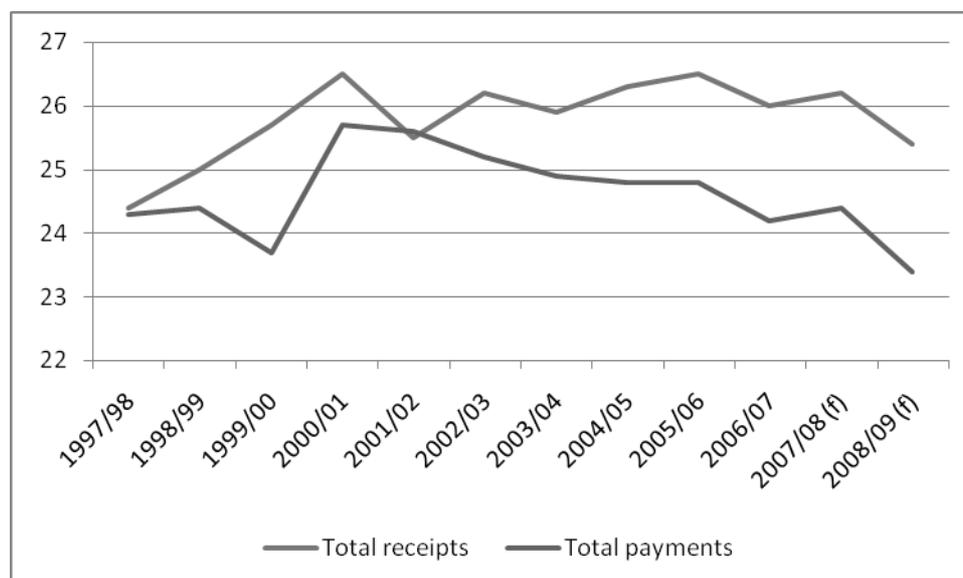
5. Hand in hand with Australia's overall economic performance, Australia's budget has been in surplus for nine of the past ten years. The exception was in 2001/02 when a modest deficit was recorded; that moment coincided with a major tax reform in Australia. Australia's budget balance as a percentage of GDP is shown in Figure 2. The development of receipts and payments over the same period is shown in Figure 3.

Figure 2. Budget balance (as a percentage of GDP), 1997-2009



f. Forecast.

Source: Australian Government, *Budget Paper No. 1*, 2008/09.

Figure 3. Total receipts and payments (as a percentage of GDP), 1997-2009

f. Forecast.

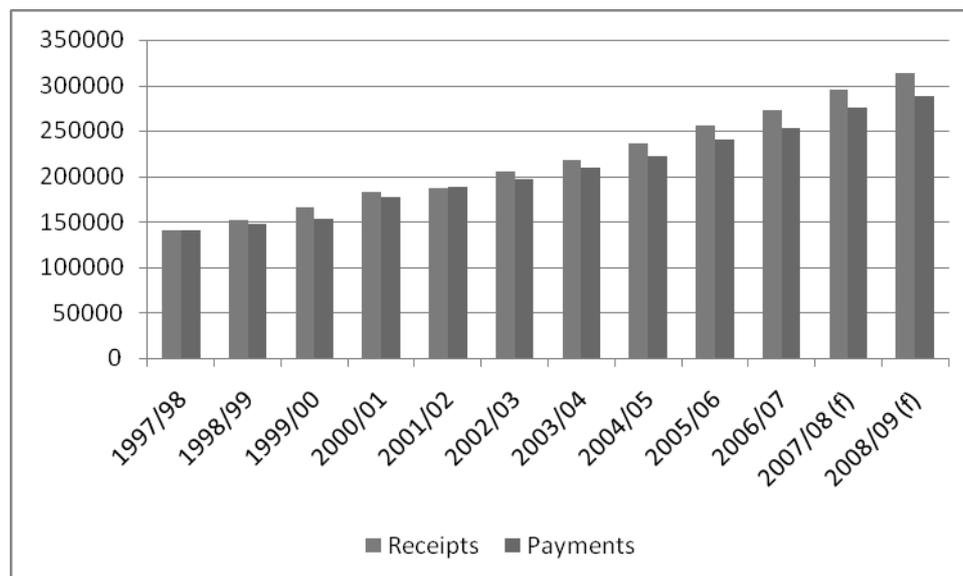
Source: Australian Government, *Budget Paper No. 1*, 2008/09.

6. Receipts as a share of GDP have remained relatively stable in recent years, while payments have declined as a proportion of GDP. Due to the strong growth in Australia's GDP, especially in nominal terms, annual government receipts grew significantly in real and nominal terms over the period but, as a share of GDP, this growth was offset by very substantial income tax cuts. Payments also grew significantly but, for most of the period, growth in receipts outpaced the growth in payments (see Figure 4).

7. This situation, however, does not reflect an important change in the composition of payments, arising from the elimination of net debt over the same period. The concomitant reduction in net interest payments, from over AUD 8 billion in 1997/98 to net interest receipts of around AUD 2.2 billion in 2008/09, allowed stronger growth in other payments than would otherwise have been the case. Tax expenditures – which reduce the level of reported revenue – grew rapidly as well. In just the five years from 2003/04 to 2007/08, tax expenditures grew by over AUD 20 billion.² This further highlights the underlying growth in government expenditure on both the spending and revenue sides of the budget.

² Source: 2007 Tax Expenditures Statement.

Figure 4. Annual growth in receipts and payments (in AUD millions), 1997-2009

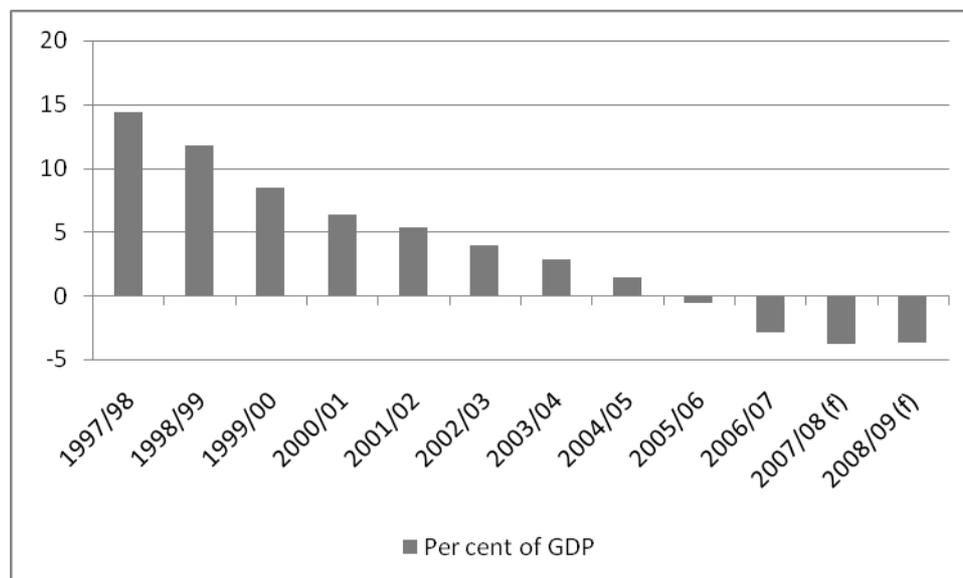


f. Forecast.

Source: Australian Government, *Budget Paper No. 1*, 2008/09.

8. The government used the budget surpluses and especially the proceeds of the sale of assets, including privatisation of government business enterprises, to pay down debt. As of 2005/06, Australia had no net debt (see Figure 5).

Figure 5. Net debt (as a percentage of GDP), 1997-2009



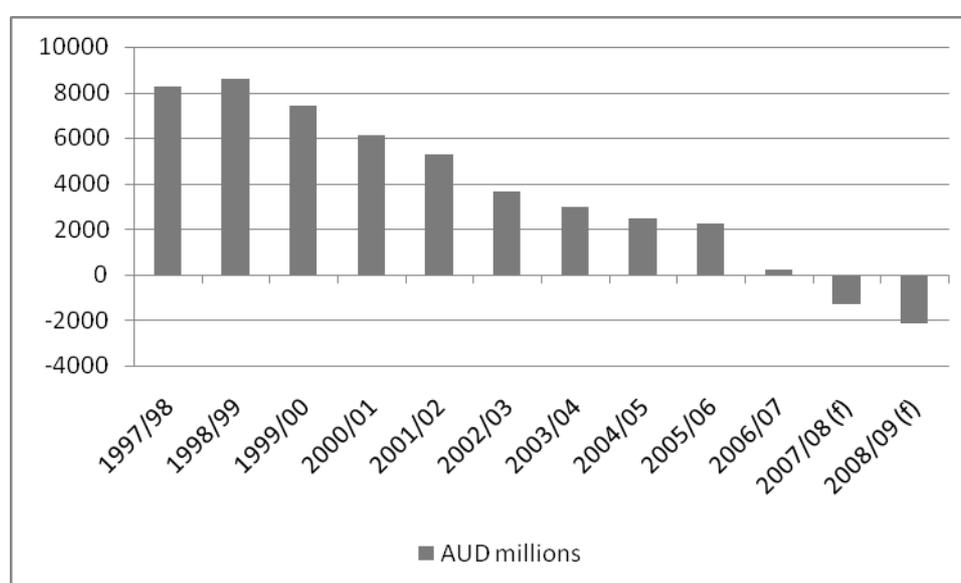
f. Forecast.

Source: Australian Government, *Budget Paper No. 1*, 2008/09.

9. Figure 5 shows a more rapid drop in net debt than the budget balances (Figure 2) in the respective years. This is due to the treatment of the proceeds of sales of assets. The government's privatisation programme commenced in earnest with the sale of the first tranche of Commonwealth Bank in 1991 and included the sale of Qantas Airways in 1995/96, the sale of the first tranche of Telstra (telecommunications company) starting in 1997/98 – the largest single sale – the sale of airports, culminating with the sale of Sydney Airport in 2002, and the sale of the final tranche of Telstra in 2006. The accounting treatment for the sale of assets changed over the period, which meant that significant amounts were treated “below the line” and therefore not reflected in the budget balance.

10. This reduction – and eventual elimination – of net debt created a virtuous impact on net interest payments, with the position turning to net receipts in 2007/08 (see Figure 6).

Figure 6. Net interest payments (in AUD millions), 1997-2009



f. Forecast.

Source: Australian Government, *Budget Paper No. 1, 2008/09*.

11. With net debt eliminated – and to ensure that the government meets its pension liabilities – the government announced the creation of the Future Fund in 2004, and established it in 2006, with budget surpluses being transferred to the Fund.³ The purpose of the Fund is to accumulate financial assets and invest them to address the government's unfunded civil service and military pension liability. This liability is not included in the concept of “net debt”. The Fund is fully quarantined from the budget, and its returns are explicitly excluded from the calculation of the budget balance.

12. As of May 2008, the unfunded civil service and military pension liability stood at around AUD 103 billion and is expected to grow to around AUD 150 billion by 2020. In response to these pressures, the Future Fund is to have sufficient assets in 2020 to offset the liability. As of June 2008, the Future Fund had AUD 65 billion in assets, and it is expected that the Fund will have sufficient assets to meet the 2020 target without further substantial injections of cash.

³ In addition, the government's residual shareholding in Telstra was transferred to the Future Fund. The proceeds of eventual sale will be retained by the Fund.

13. The creation of the Future Fund is commendable in its endeavour to pre-fund accrued pension liability and supports a shift from a pay-as-you-go pension system to a fully funded system. Further, the old defined benefit pension scheme for civil servants has been closed to new members.⁴

14. With net debt eliminated and the unfunded civil service and military pension liability covered, the government established the Higher Education Endowment Fund (HEEF) in 2007. Its objective is to support capital expenditure and research facilities in Australian universities. This support will be provided by the annual investment income earned on HEEF capital. In contrast, the annual investment income of the Future Fund accumulates. A total of AUD 6 billion in budget surpluses has been transferred to the HEEF.

15. In the 2008/09 budget, the new government announced the establishment of three new funds to put its own stamp on their organisation and to take the projected 2007/08 and 2008/09 budget surpluses. The first fund, the Building Australia Fund, will finance investment in priority transport and communications infrastructure such as roads, rail, ports and broadband. The government has committed AUD 20 billion to this fund. Second, the Education Investment Fund will replace the HEEF. The new fund has a broader mandate than the HEEF, as it will encompass capital expenditure in vocational education and training facilities as well as higher education. The government has committed around AUD 11 billion to this fund. Third, the Health and Hospitals Fund will finance capital expenditure of hospital physical plants and new medical technology equipment. The government has committed AUD 10 billion to the Health and Hospitals Fund. The three funds will be established by 1 January 2009 and will be managed by the Future Fund (see Box 1).

16. These three new funds differ significantly from the funds established by the previous government. The Future Fund reinvested all investment income and will disburse none prior to offsetting the unfunded pension liabilities of the Australian government which fall due in future generations. The HEEF only disbursed annual investment income. The new funds will have available for disbursement both the capital and the investment earnings of these funds. Therefore, they cannot be described as endowment funds. In budgeting terms, there is no difference between the government simply retaining the surpluses and subsequently dedicating them to the above policy areas rather than creating these separate funds. Indeed, the new government has announced that disbursements from them will be made as part of the annual budget process. And the capital of the previously “lock-boxed” HEEF will be fully available as well.

⁴ The defined benefit scheme for the military, however, remains open to new members.

Box 1. Managing the Future Fund

The Future Fund's Board of Guardians is collectively responsible for the investment decisions of the Fund and is accountable to the government for the safekeeping and performance of the assets of the Fund. The Fund invests in financial assets only, both domestically and internationally.

The Board consists of a chair and up to six other members. Board members are appointed jointly by the Treasurer and the Minister for Finance. Appointees must have substantial experience or expertise and professional credibility in investing financial assets, managing financial investments or corporate governance. Each guardian is appointed on a part-time basis for a term of up to five years.

The Board's primary role is to set the strategic direction of the investment activities consistent with its investment mandate. The legislated general objective is to maximise the return on assets over the long term consistent with international best practice for institutional investment. The investment mandate issued jointly by the Treasurer and the Minister for Finance is more specific: it states that the Board is to adopt an average return of at least the consumer price index plus 4.5% to 5.5% per annum over the long term as the benchmark return.

In targeting this benchmark return, the Board is required to determine an acceptable but not excessive level of risk for the portfolio. The Fund is not permitted to take a controlling stake in companies. Furthermore, the Board is required to avoid impacting the normal volatility and efficiency of Australian financial markets.

The Board is supported in its functions by the Future Fund Management Agency. The Agency is responsible for making the necessary arrangements to give effect to the decisions of the Board, and for providing advice and information to the Board in support of the Board's investment duties. All administrative and operational functions associated with the management of the funds are undertaken by the Agency.

2. BUDGET FORMULATION

2.1. Introduction

17. The budget process in Australia has undergone profound reforms during the past quarter of a century and can be said to have been in a state of continual change/reform since the launch of a White Paper entitled Budget Reform in 1984 which set the process in motion. Early reforms focused on reducing central input controls and granting more flexibility to spending ministries and agencies. Line items were systematically merged through the running costs arrangements; subsequently, centralised manpower controls were abolished, and the budget was the only constraint on staffing levels. There was a complementary system of carry-overs of unused running cost appropriations to the next fiscal year. These constituted the principal elements of the Financial Management Improvement Programme. A medium-term expenditure framework (the forward estimates) and a more effective cabinet committee process for identifying priorities and promoting fiscal discipline were launched. The reforms aimed to increase the focus on performance and results, originally starting with programme budgeting and a formal system of programme evaluations. This focus was the *quid pro quo* for increased flexibility.

18. The reforms were very much associated with changes in governments and were often preceded by extensive reviews and high-level commissions as well as drawing on the experiences of the states and territories. The early reforms described above were launched by the Labor Party upon assuming office in 1983. Labor remained in office until 1996 when the conservative Coalition came to power. The Coalition largely built on the previous reforms while expanding the reform focus to include a greater emphasis on commercialisation and use of market-type mechanisms. This period coincides with the introduction of accrual budgeting and the outcomes and outputs framework.⁵ It also saw the introduction of the Charter of Budget Honesty Act 1998 which legislates a high level of budget transparency and specific disclosures. Most recently, the Labor Party returned to power at the end of 2007. The new government has a strong policy platform of increasing the openness and transparency across all areas of government operations. In the area of the budget, it has a specific policy platform – “Operation Sunlight” (see Box 2). This section outlines past practices and, where appropriate, comments on the changes instituted by the new government.

Box 2. Operation Sunlight

On 16 April 2006, the current Minister for Finance and Deregulation (then as the Shadow Minister for Finance) released a discussion paper entitled “Operation Sunlight”. Operation Sunlight sets out the new Australian government’s policy to enhance budget transparency and accountability. These initiatives are discussed in the relevant sections of this article and are summarised in Annex 1.

19. Another characteristic is the adaptability of the budget formulation process to different circumstances. The process varies from year to year at the margins, and more substantially from times of fiscal stress to times of fiscal abundance. It is consequently difficult to talk about “the” budget process. This section – and this article – aim to give a flavour to this variability.

⁵ Accrual budgeting and the outcomes and outputs framework were introduced in the 1999/2000 budget.

20. This section is divided into two parts. The first highlights various special features of the Australian budget process; the second outlines the key steps in the annual budget formulation process.

2.2. Special features

21. This section reviews five innovative and often distinctive features of the Australian budget formulation system:

- Unique organisational arrangements, including the strong role of Cabinet committees, multiple central agencies, and the limited role of spending ministries *vis-à-vis* their agencies;
- Fiscal rules based on “principles” rather than specific targets;
- Rolling multi-year forward estimates that form the basis of the annual budget system;
- The use of accrual budgeting;
- The use of the outcomes and outputs framework.

Box 3. Federalism and the structure of government expenditures

Australia is a federation consisting of six states – New South Wales (Sydney), Queensland (Brisbane), South Australia (Adelaide), Tasmania (Hobart), Victoria (Melbourne), and Western Australia (Perth) – and two federal territories with self-government – the Australian Capital Territory (Canberra) and the Northern Territory (Darwin). Most public services are the primary responsibility of states and territories, including education, health, welfare and community services, public order and safety, and infrastructure. Aside from defence, nearly all capital spending takes place in the states and territories. In short, the national government’s activities would appear to be relatively constrained. However, the national government is responsible for social transfer payments to individuals based on common national criteria.

The national government does collect most taxes in Australia, including on behalf of the states and territories, and is the main funder of the states and territories. The Commonwealth Grants Commission annually recommends to the national government the allocation to individual states and territories to achieve fiscal equalisation. Under the Uniform Presentation Framework, all states and territories have agreed to publish budget information in a standard format to facilitate comparisons of each government’s budget results and projections.

The concomitant nature of the national government’s expenditures results in 80% of its annual expenditure being authorised by “special” (permanent) legislation. Only 20% of its total expenditure is approved through the annual budget. This situation is discussed further in section 3 regarding the role of the legislature.

2.2.1. Unique organisational arrangements

22. There are three notable features of the organisational arrangements for budgeting in Australia. First, various Cabinet committees have a powerful role in the budget process. Second, there are three separate central agencies that have strong roles in the budget process. Third, spending ministries have a limited role in the budget process, *vis-à-vis* their agencies.

Cabinet committees

23. Under the Coalition government, there were two long-established Cabinet committees and a less formal group of senior ministers – operating in the same way as a Cabinet committee – that played an important role in the budget process:

- Senior Ministers' Review (SMR);
- Expenditure Review Committee (ERC);
- *Ad Hoc* Committee on Revenue.

24. The Senior Ministers' Review (SMR) consisted of the Prime Minister, the Deputy Prime Minister, the Treasurer and the Minister for Finance. In addition to the respective ministers and their senior political advisors, the secretaries and senior officials from the three central agencies generally attended the SMR as well. The Department of the Prime Minister and Cabinet acted as the secretariat for the SMR.

25. In formal terms, the SMR typically met once at the onset of the budget process. Its role was to act as a "fiscal guardian" and to unify the senior ministers in that capacity. It set the strategic direction for the forthcoming budget, established the agenda and advised on the means to achieve identified fiscal objectives. In times of fiscal stress, the SMR would set the overall targets for expenditure reductions. In good times, the SMR would focus mainly on culling the many proposals for new initiatives.

26. The new government replaced the SMR with a Strategic Budget Committee (SBC), which is a formal Cabinet committee. While retaining the same membership as the SMR, the SBC is designed to have a stronger strategic focus and has met throughout the 2008/09 budget formulation process. It establishes the fiscal strategy and policy priorities for the next financial year. Decisions of the SBC are formally recorded in the Cabinet minutes; these decisions outline the proposals that can be considered in the budget.

27. The Expenditure Review Committee (ERC) is a very long-standing institutional mechanism in the Cabinet, focused on expenditure restraint and fiscal responsibility. Compared to the SBC, its focus is more operational and it meets on numerous occasions. It has seven members: the Prime Minister, the Treasurer, the Minister for Finance, the Assistant Treasurer, the Deputy Prime Minister (concurrently the Minister for Education, Employment and Workplace Relations), the Minister for Trade, and the Minister for Families, Housing, Community Services and Indigenous Affairs. The composition can change over time. The Prime Minister typically chairs only the first meeting where the overall budget strategy is discussed based on the conclusions of the SMR/SBC. Subsequent meetings are usually chaired by the Treasurer or the Deputy Prime Minister. The Department of Finance provides substantive input to the ERC (the "Greens" – see below) while the Department of the Prime Minister and Cabinet provides the formal secretariat for the Committee.

28. In times of fiscal stress, the ERC would elaborate further on the targets for expenditure reduction and ensure that all ministers were in line with their targets. The ERC will reject some proposals as unrealistic and, where necessary, ask the respective minister to come back with revised proposals. In times of fiscal abundance, the ERC will further cull the various new policy proposals. The conclusions of the ERC are made as formal recommendations to the full Budget Cabinet.

29. Under the new government, the role of the ERC has also been expanded in two important areas. First, it has been charged with undertaking an expenditure review examining all the programmes of the previous government. Second, it will not only meet during the budget formulation process but will meet regularly throughout the year. This frequency is to reinforce the importance of close examination of "between budgets" proposals, further enhancing fiscal scrutiny.

30. The *Ad Hoc* Committee on Revenue – despite its name – was a reasonably regular and ongoing Cabinet committee under the Coalition. It generally met after the Cabinet had considered the recommendations of the ERC. In its final incarnation, it consisted of the Prime Minister, the Deputy Prime Minister, the Treasurer, the Assistant Treasurer, and the Minister for Finance. At that meeting, the Treasurer discussed the latest economic assumptions and revenue estimates. The Committee also decided

on substantive taxation measures. There has traditionally been a desire that the Cabinet discuss expenditures and revenues separately. The new government has decided that revenue measures will be handled by the ERC.

31. Under the previous government, the Budget Cabinet authorised the SMR to make changes (fix “loose ends”) to the expenditure side of the budget in view of the conclusions of the *Ad Hoc* Committee on Revenue/ERC. In times of fiscal stress, this would mean that further expenditure cuts would often be necessary. This time period in the budget calendar is known as the “hunting licence” in Australia as a result. More recently, it dealt more often with what to do with “unexpected” revenue windfalls.

32. The role of the committees is further discussed in section 2.3 which outlines each step in the annual budget formulation cycle.

Box 4. The National Security Committee

The National Security Committee (NSC) oversees the development of Australia’s foreign and defence policy, ensuring that Australia maintains a co-ordinated policy approach on national security issues. The NSC is responsible for taking budgetary decisions relating to these issues. The Prime Minister chairs the NSC and its decisions are final – *i.e.* they are not subject to review by Cabinet.

Central agencies

33. The three central agencies are the Department of Finance, the Department of the Treasury (the Treasury), and the Department of the Prime Minister and Cabinet.

34. The Treasury and the Department of Finance were the same ministry until being separated in the year 1976. Commentators generally interpreted that decision as intended to reduce the Treasury’s influence. Their separation was also due to great and growing dissatisfaction by the then Prime Minister with the Treasury in terms of economic advice. The separation enabled the Treasury to focus on economic and taxation issues while the Department of Finance was able to focus on enhancing the expenditure side of the budget.

35. The Department of Finance is focused on the expenditure side of the budget and is organised along the same lines and performs the same functions as generally associated with a central budget office. It co-ordinates the preparation of the expenditure side of the budget and oversees the budget accounting and the financial framework. It analyses the government’s expenditures and has traditionally provided options for reallocation or reductions in outlays. It provides substantive input for the deliberations of the Expenditure Review Committee (ERC) of Cabinet.

36. The Department of Finance underwent a “traumatic” period in the late 1990s and at the beginning of the 2000s. This is the time associated with the introduction of major budgeting reforms. As part of these reforms, the Department withdrew from many of its traditional functions, as it effectively devolved those functions to spending ministries. The devolution went beyond getting budget examiners to focus on broader expenditure policy and effectiveness issues rather than input details – such reforms had begun in the early 1980s. The then Department of Finance wanted agencies to assume still greater responsibility and saw its role then as akin to an investment bank that only needed the broadest of overviews.⁶ This is discussed further below. The number of analytical budget branches – the ones mirroring spending

⁶ For a further discussion, see Andrews, Helgeby and Wanna, 1998.

ministries – was reduced from 13 to 4, creating a vacuum at the centre. The Department lost much of its corporate knowledge of expenditure policy issues, such that it became difficult for it to exercise an effective budget “challenge” function *vis-à-vis* spending ministries and agencies. This situation has been reversed and, for the past several years, the Department has been rebuilding its capacity, with staffing now back to its original levels (albeit in the case of much larger overall budgets).

37. The Treasury is focused on economic and taxation issues. However, it is also involved with the expenditure side as well. As the Department of Finance was withdrawing from its many functions, the Treasury started building up its capacity in this area. That build-up remains largely in place today despite the Department of Finance being back to near its original strength.

38. The Budget Policy Group of the Treasury is organised to shadow each line ministry, just as a budget office would typically do. It provides a “strategic structural focus” whereby it looks at those aspects of the government’s expenditure that contribute to, or detract from, necessary structural adjustment to enhance economic performance. It has been described as a “think tank” in relation to government expenditures.

39. The Treasury is also directly responsible for fiscal relations with the states and territories. Intergovernmental fiscal relations are a major – and sensitive – issue in Australia.

40. The Department of the Prime Minister and Cabinet (PM&C) has a natural role in supporting the Prime Minister as head of government and in managing the extensive Cabinet processes that underlie government decisions in this area. As part of the secretariat for the SBC and the ERC, it has a key role in setting the strategic agenda for the budget. The PM&C has always had a structure with desk officers following each ministry – again, just as a budget office would typically be organised. The role of these desk officers is to provide advice to the Prime Minister on expenditure and revenue proposals from a whole-of-government perspective by bringing together the government’s policy objectives, the economic and fiscal strategy, and the policy objectives of the portfolio ministers.

41. The relationship between the central agencies is complex, but they do appear to complement each other for the most part, with each focusing largely on its special “niche” in the budget process – general expenditure review, structural adjustment policies, and the broad policy overview, respectively. The definition of responsibility could however be clearer, especially between the Treasury and the Department of Finance. There is also a cost – in both time and money – in managing the relationship and achieving consensus among the three central agencies on the various issues.

Spending ministries and agencies (portfolios)

42. The limited role of spending ministries *vis-à-vis* their agencies in the budget process is very apparent.

43. All budget discussions are structured around ministerial portfolios, each headed by a Cabinet minister. There are 17 such portfolios currently. (There were 16 under the previous government.) The portfolios can be quite large and can encompass a large number of organisations – including the core ministry and a multitude of agencies of various size and shape (see the discussion in section 4.1 on organisational structure). The minister is responsible for all entities in his/her portfolio.

44. In budgeting terms, however, the portfolios are only a group of loosely related entities, all reporting directly to the respective minister. The core portfolio ministries often have a weak co-ordinating role within the portfolio. Indeed, the Department of Finance maintains direct relations with each large agency within the portfolio, rather than focusing on the core portfolio ministry which in turn would maintain relations with each of its respective agencies. This is an unusual practice. The Department of

Finance focuses especially on the largest 50 agencies which are responsible for 99% of all expenditure; these are known as material agencies.

45. There are several reasons for this situation. Most important is the fact that legal responsibility – accountability – rests with the minister and the head of each agency. The core ministry has a limited legal basis for any co-ordinating role. The heads of agencies are also keen to have a direct relationship with their ministers rather than operating through the core ministry.

46. In today's fiscal environment, each large agency is essentially a self-contained unit on "auto pilot" in regards to the budget process through the forward estimates process (see below). Only incremental bids for increased appropriations will see an agency interact with its ministry or engage in the SBC/ERC process. Agencies have wide discretion to reallocate their resources, as is discussed subsequently in this article.

47. This should not be interpreted as a criticism of the greater flexibility that has been granted to agencies. Australia was a pioneer in this area and the experience is overwhelmingly positive. The observation being made here relates to the interaction between agencies and their core ministries within each portfolio.

48. During the most pronounced expenditure reduction rounds – in the 1980s and mid 1990s – portfolios were often given specific numerical savings targets by the ERC. The portfolio minister was responsible for achieving these targets. He/she could identify savings and reallocations anywhere in the portfolio. However, the core ministry did not provide the detailed options for reallocation or reductions in outlays in the portfolio. These options were provided by the Department of Finance. During the budget reforms of the late 1990s and early 2000s when the Department of Finance devolved responsibility to agencies, as discussed above, it would have been natural – and desirable – for each portfolio to develop a strong central budget capacity in its respective core ministry. This did not happen.

49. It would appear reasonable to assume that, if the need arose in the future for an expenditure reduction round, the options for reductions and reallocations would come primarily from the now-reconstructed Department of Finance and the Treasury, rather than the core portfolio ministries. This was the case with the 2008/09 budget.

50. Australia's system of Cabinet committees also serves to foster joint ministerial responsibility rather than the "each minister is his/her own finance minister" model.

2.2.2. Charter of Budget Honesty Act 1998

51. The Charter of Budget Honesty (the Charter) was enacted into law in 1998 shortly following a change of government. The Charter was intended to help entrench sound and transparent fiscal policies and make it difficult for future governments to deviate from them.

52. The Charter provides a comprehensive legal framework for the formulation and conduct of fiscal policy in general. The provisions of the Charter can be divided into two groups: a regime for setting fiscal objectives, and an extensive system of fiscal reporting to monitor the consistency of the government's fiscal actions with its stated fiscal objectives.

53. Setting fiscal objectives is a two-step process involving certain legislated "Principles of Sound Fiscal Management" and an annual "Fiscal Strategy Statement" prepared by the government.

54. The legislated “Principles of Sound Fiscal Management” require the government:⁷

- To manage financial risks faced by the Commonwealth prudently, having regard to economic circumstances, including by maintaining Commonwealth general government debt at prudent levels;
- To ensure that its fiscal policy contributes to achieving adequate national savings and to moderating cyclical fluctuations in economic activity, as appropriate, taking account of the economic risks facing the nation and the impact of those risks on the government’s fiscal position;
- To pursue spending and taxing policies that are consistent with a reasonable degree of stability and predictability in the level of the tax burden;
- To maintain the integrity of the tax system;
- To ensure that its policy decisions have regard to their financial effects on future generations.

55. These Principles of Sound Fiscal Management are translated into specific government objectives through an annual “Fiscal Strategy Statement”. The Statement in turn provides a benchmark for evaluating the government’s fiscal policy performance. This Statement is published as part of the budget documentation.

56. In the Fiscal Strategy Statement, the government is required by the Charter to, *inter alia*:

- specify the government’s long-term fiscal objectives within which shorter-term fiscal policy will be framed;
- specify the key fiscal measures that the government considers important and against which fiscal policy will be set and assessed;
- specify, for the budget year and the following three financial years, the government’s fiscal objectives and targets and the expected outcomes for the specified key fiscal measures;
- explain how the fiscal objectives and strategic priorities specified relate to the principles of sound fiscal management;
- specify fiscal policy actions taken or to be taken by the government that are temporary in nature, adopted for the purpose of moderating cyclical fluctuations in economic activity, and indicate the process for their reversal.

57. 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 (see Box 5).

⁷ Source: Charter of Budget Honesty Act 1998, Part 3: Principles of Sound Fiscal Management.

Box 5. The Fiscal Strategy Statement

The new Labor government's "medium-term fiscal strategy involves: achieving budget surpluses, on average, over the medium term; keeping taxation as a share of GDP on average below the level for 2007/08; and improving the government's net financial worth over the medium term" (2008/09 *Budget Papers*).

The previous Coalition government's "medium-term fiscal strategy [was] to maintain budget balance, on average, over the course of the economic cycle... The [then] government's medium-term fiscal strategy [had] a number of supplementary objectives, including: maintaining budget surpluses over the forward estimates period while growth prospects are sound; not increasing the overall tax burden from 1996/97 levels; and improving the Australian government's net worth position over the medium to longer term..." (2008/09 *Budget Papers*).

There is great similarity between the two and neither can be described as especially challenging given Australia's current economic and fiscal environment.

It is also noteworthy that both the new and the previous government made public commitments separate from the Fiscal Strategy Statement that are more ambitious. The previous government made a public commitment to achieve a 1% of GDP budget surplus. The new government has made a stronger public commitment to achieve a 1.5% of GDP budget surplus in the 2008/09 budget, as well as committing any revenue windfalls during the year to increasing the surplus – *i.e.* not to spend them.

Although the Fiscal Strategy Statement implicitly and explicitly refers to the cycle, scepticism about the practical usefulness of both the output gap and the cyclically-adjusted fiscal balances means that such measures are not published by the government.

58. 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.

59. 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 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.

60. The reports are the *Economic and Fiscal Outlook* released at the time of the budget, the *Mid-Year Economic and Fiscal Outlook* released approximately six months after the budget, and the *Final Budget Outcome Report* released three months after the end of the fiscal year. In addition, the Charter requires a *Pre-Election Economic and Fiscal Outlook* to be presented within ten days of an election being called (see Box 6). An *Intergenerational Report*, designed to assess the long-term sustainability of current government policies, must be produced at least every five years (see Box 7).

61. This "principles-based" (or discretionary) approach contrasts with the more common "rules-based" approach in other OECD countries where specific fiscal targets are set in legal documents. Australia opted against this approach principally due to its perceived rigidity and the difficulty of attempting to anticipate all future events. A fiscal rule is never stronger than the political commitment to actually adhere to it, and Australia chose an approach that allows for policy flexibility while relying on a high degree of transparency to discipline the government's actions. New Zealand had adopted a similar approach with its Fiscal Responsibility Act several years earlier, and the experience with legislated fiscal targets in the European Union and the United States was also viewed by Australian officials as disappointing and easily subject to manipulation.

62. It is too soon to assess the effectiveness of the Australian principles-based approach. The economic environment has been most favourable during the time since its introduction, making it possible

to decrease taxes, increase expenditure and reduce debt – all at the same time. Keeping expenditures from growing in good times is arguably the greatest task for any budgeting system. Whether this principles-based approach is the best institutional mechanism for achieving that goal is open to question, as expenditure has grown rapidly in Australia in the 2000s to date. A greater emphasis on setting limits on expenditures can assist the government in resisting popular demands for increased expenditures, and several examples of positive experiences with fiscal rules based on expenditure ceilings exist among OECD countries (see Anderson and Minarik, 2006).

Box 6. Pre-Election Economic and Fiscal Outlook report and costing of election commitments

The Charter of Budget Honesty requires that a *Pre-Election Economic and Fiscal Outlook* (PEFO) be published no later than ten days after the election campaign has formally begun. The purpose of the report is to provide updated information on the economic and fiscal outlook and to prevent the government from withholding any adverse information on the true state of government finances in the run up to an election. The report contains a forecast of all key economic and fiscal variables for the current budget year and the three subsequent years. It also lists each and every revenue and expenditure measure that has been taken since the last *Economic and Fiscal Outlook* (or the *Mid-Year Economic and Fiscal Outlook*, MYEFO), and their budgetary impact.

The PEFO contains two statements of responsibility, one by the Treasurer and the Minister for Finance, and one by the Secretary to the Treasury and the Secretary of the Department of Finance (civil servants). The ministers must state that all policy decisions with material economic or fiscal implications have been communicated to the secretaries. The secretaries must state that, on the basis of the economic and fiscal information available, the Treasury and the Department of Finance have used their best professional judgment in producing the reports. These statements of responsibility aim to clarify the roles of politicians and civil servants in producing the report and to give a greater role to civil servants in this case. This responsibility framework has served to enhance the overall credibility of the report. The PEFO provides the political parties with a much more comprehensive and agreed economic and budgetary basis upon which to fight an election campaign than the documents released by the government prior to the first PEFO in 1998.

In addition, the major political parties can request the Secretary to the Treasury and the Secretary of the Department of Finance to cost their parties' individual election commitments. These requests can be made only after an election is called. Typically, the parties do this in order to highlight their fiscal responsibility credentials. The secretaries prepare manuals specifying the format and information needed in order for them to be able to accurately cost commitments.^a A dedicated team of civil servants develops the costings. A system of firewalls is in place to ensure the integrity of (Opposition) costings, and the independence of the costings has not been raised as an issue. The secretaries aim to provide costings within five days of receiving the request. For the 2007 elections, a total of 47 (then) government commitments and 167 Opposition commitments were costed.

However, some have criticised this mechanism as still being 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.

a. Australian Government (2007), *Charter of Budget Honesty – Costing Election Commitments. Guidelines Issued Jointly by the Secretaries to the Departments of the Treasury and of Finance and Administration*, Canberra.

Box 7. Intergenerational Report

The Charter of Budget Honesty requires that an *Intergenerational Report* be presented at least once every five years. The report focuses on the implications of demographic changes for economic growth and assesses the financial implications of continuing current policies and trends over the next four decades (two generations).

The report outlines the government's fiscal sustainability objectives and its approach to achieving them, and gives details on Australia's long-term demographic and economic projections. Based on the projections, the report provides detailed estimates for future revenue and spending projections and the resulting budget balance. The report contains sensitivity analysis of the projections and goes into detail on the methodology and assumptions used.

A report is published every five years. It attracts much public and media attention. The five-year interval allows a narrative to be written of policy changes in the intervening period and of their impact on fiscal sustainability. This time-frame also coincides with Australia's five-yearly population census. Although demographics may change slowly, annual fiscal policy decisions can and frequently do affect the long-term outlook every year. A more frequent release of the report may serve to enhance its usefulness. Indeed, the new government is considering greater frequency as part of its Operation Sunlight.

2.2.3. Forward estimates

63. The forward estimates are rolling baseline projections for all revenues and expenditures for three years beyond the next budget. After the budget is passed, the first year of the forward estimates becomes the base for next year's budget, and another out-year is added to the forward estimates. The forward estimates are an integral part of the budget process – in fact, the whole budget process is built around them – and they are generally viewed as the single most significant and successful budgeting reform in Australia.

64. The fact that 80% of annual expenditure is authorised by “special” (permanent) legislation with only 20% of expenditure being approved through the annual budget reinforces the importance of the forward estimates, as they incorporate both types of expenditures. By bringing forward the consideration of their enduring costs, the forward estimates in fact form the primary vehicle for monitoring and overseeing the “special” (permanent) appropriations.

65. The forward estimates represent a provisional government decision on future expenditures. In the absence of any new decision, and of other adjustments for new price or volume indexes where applicable, the out-year expenditures become the budgets in the respective years. The forward estimates record the cost of all ongoing programmes but they do not include any allowance for the introduction of new programmes in future years or the expansion of existing programmes due to policy measures; such measures would involve new government decisions.⁸ Thus, the Australian budget system is designed to ensure that incremental budget decisions are strategic, rather than to overcome incrementalism.

66. The 1987/88 budget was the first to be firmly and publicly based on the previous year's forward estimates figures. The Finance Minister at the time noted: “By providing a consistent and continuing basis for budget deliberations, and minimising unproductive contention over baseline estimates, these new

⁸ A conservative bias allowance is included in the out-years. The conservative bias allowance is 1% of total expenditures in the first forward year, 1.5% in the second forward year and 2.5% in the third forward year. However, this allowance is only to compensate for a historical tendency to underestimate the cost of existing programmes. It cannot be used to fund new programmes, nor for the expansion of existing programmes.

procedures improved outlays control and enhanced the government's capacity to focus on substantive issues in the budget context."⁹

67. The forward estimates are prepared at the same level of detail as the budget. Each year's budget contains reconciliation between its own figures and the first out-year in the previous year's forward estimates. Differences are explained and categorised as being due to new government policy decisions (*i.e.* new programmes or expansion of existing programmes), changes in non-economic parameters (*i.e.* number of people claiming benefits from a certain programme, such as the old-age pension), adjustments to macroeconomic parameters and "other variations".¹⁰ Some programmes are affected by both macroeconomic and non-economic parameter changes.

68. The forward estimates are published twice a year: in the budget and in the *Mid-Year Economic and Fiscal Outlook*. A further but unpublished update is made available for ministers prior to the launch of the ERC process. Originally, all forward estimates remained internal documents and were not published. It should be noted that the forward estimates themselves are not enacted into law.

69. The process for the forward estimates is managed actively throughout the year, and considerable care goes into ensuring that any new decisions, or changes in assumptions underlying expenditure projections, are included in the forward estimates so that, at any given time, they are accurate and up-to-date.

70. The Department of Finance is responsible for the forward estimates of expenditure and non-tax revenue and the Treasury for the forward estimates of tax revenue. In relation to expenditure, while individual agencies will do the initial costings of new initiatives, Finance's role is to validate these costings to ensure their accuracy and reasonableness. This costing process is discussed further in section 2.3.3. In addition, the Department of Finance will work with individual agencies to update the agreed methodology for ongoing costings as the needs arise. For example, the methodology for forecasting various means-tested social programmes has been repeatedly re-examined in recent years, as actual expenditure is consistently lower than forecast. Again, the Department of Finance has the last word on the new agreed methodology.

71. The forward estimates are prepared in unchanged nominal terms. The appropriations are inflated centrally by the use of various wage-cost indexes formulated by the Department of Finance. It is important to note that the Department of Finance extracts a 1.25% efficiency dividend each year on all running (operating) costs as part of this process.¹¹ The new Labor government has applied a one-off efficiency dividend of 2% to the running costs of most agencies.

72. The forward estimates are prepared on both a cash basis and an accrual basis. It is also noteworthy in the context of Australia's outcomes and outputs framework that the forward estimates do not contain any performance and results information.

73. The use of the forward estimates has succeeded in encouraging and sometimes forcing the government to lengthen the time frame for budgetary decisions from one year to four years. All new proposals are discussed in terms of their four-year impact. Further, the forward estimates are extended beyond a three-year time horizon for certain types of expenditures, notably defence capital expenditures

⁹ Department of Finance (1987), *Report on the Forward Estimates on Budget Outlays*, Canberra (as quoted in Kelly and Wanna, 2004).

¹⁰ Budget Paper No. 1, Table 2 of Statement 6 reconciles expense estimates (policy decisions, economic parameter and programme-specific parameter variations, and "other variations").

¹¹ There are some exemptions to the efficiency dividend, including some agencies and specific types of expenditure in the area of defence.

and programmes that grow rapidly beyond the forward estimates period. This practice has contributed to the control of the growth in outlays by ensuring that the estimates reflect the ongoing cost of programmes and not just the first year's impact, or even the first "few years". The estimates have also incorporated the "special" (permanent) appropriations into the regular budget discussions.

74. As noted earlier, the forward estimates are viewed very positively in Australia – and justifiably so. They have brought stability and discipline to the budgeting process by providing appropriate benchmarks for necessary fiscal action. They have greatly eased the annual budget process by allowing all parties to concentrate on substantive policy and implementation issues.

75. The forward estimates have worked well in times of fiscal stress and in times of fiscal abundance. In the former, they were used to develop targets for necessary expenditure cuts. They are the pre-requisite for such a top-down exercise to be effective.

76. The forward estimates, however, do serve to lock in expenditures for future years – especially in times of fiscal abundance. This aspect is being partly addressed by the new "strategic review" initiative (see Box 8).

Box 8. Strategic reviews

Australia has been grappling with the optimal manner in which to systematically review existing programmes. The most common over the last decade were so-called "lapsing reviews" whereby programmes would sunset if not renewed by a decision of the government. While this ensured that a review was done, such reviews became a mechanical and ineffective exercise which rarely resulted in any significant changes to the programmes, despite an abundance of reviews – there were 149 lapsing reviews between the 2004/05 and 2006/07 budgets.

A new system of strategic reviews was launched in 2007 as the lapsing reviews were being abolished. The strategic reviews aim to take a holistic look at major clusters of programmes. The objectives are programme appropriateness, efficiency and effectiveness, and making sure that the programmes are aligned with government priorities. The focus is not to achieve savings. The reviews are commissioned by the SBC and/or ERC based on recommendations of the three central agencies. Areas to be reviewed are decided on the basis of criteria such as priority to government, growth rate of the programmes, and the time elapsed since they were last reviewed.

It is envisaged that up to seven large and seven smaller reviews will take place each year. The reviews generally originate in January or February and take 3-6 months to complete – *i.e.* so that their results will be known prior to the following year's budget formulation.

The review teams are based in the Department of Finance, and the reviews are undertaken independently of the agencies responsible for the programmes; outside expertise is often used. The reviews can be led by academics, business leaders, former senior public servants, or current senior public servants seconded for the purpose. Agencies being reviewed and related bodies are encouraged to second staff to work on the reviews. A special unit in the Department of Finance has been set up to co-ordinate and contribute to the reviews. Importantly, the desk officers in the Department of Finance that handle daily contact with the agencies are not directly involved, reducing the likelihood that agencies perceive the reviews as savings exercises.

In 2007, two pilot reviews were conducted. In 2008, the government commissioned four reviews. In addition, the government is undertaking a more comprehensive expenditure review under the strategic reviews framework. It is too early to assess the new framework but results so far have been good. The fact that they are not designed as savings exercises and the role of external parties in the exercise are viewed as critical in this regard.

2.2.4. *Accrual budgeting*

77. Australia introduced full accrual budgeting with the 1999/2000 budget.

78. The accrual budgeting framework was driven by two very different actors: first, a Coalition government that viewed accrual budgeting as heralding a new “businesslike” era in government. For the Coalition, it was not a mere technical change. Second, the professional accounting community viewed accruals as indeed a technical change in order to achieve superior financial reporting and as an obvious step once accrual accounting was in place.

79. For the Coalition government, accrual budgeting would show the full cost of all programmes, not just the immediate cash outlays, and therefore make it easier to price and compare them with alternative private sector provision. The introduction of accrual budgeting was accompanied by the introduction of the outcomes and outputs framework. The combination of the two was designed to replace the remaining bureaucratic controls with market-like disciplines. Value for money would be secured by exposing public services to contestability. The “price” of outcomes quoted by agencies would now be contested by the price available in the market.

80. This approach was strongly driven by officials of the Department of Finance, partly explaining why the Department of Finance withdrew from the details of the budget process, as described earlier. It was believed that the market would replace many of its functions. In addition, accrual budgeting was being introduced at the same time as a major tax reform. Key ministers and the other central agencies were distracted by the tax reform, and the field was largely left to the Department of Finance to introduce accrual budgeting, with limited understanding by the other central agencies (or indeed the government) of what was being undertaken in practical terms.

81. The actual move to accrual budgeting was arduous but was accomplished in a very short period of time (less than two years). It soon became apparent that the public sector did not possess the requisite accountancy skills to introduce accruals. As a result, extensive use was made of private sector accountants who had little or no experience in the public sector context. In working out the technicalities of the accrual budgeting framework, they tended to apply what has been described as an “orthodox” accounting philosophy – one not always as suitable for the public sector as for the private sector.

82. When the first accrual budgeting documents were presented to the Expenditure Review Committee (ERC), they met with great resistance. Ministers were not ready to depart from the traditional cash basis of making budget decisions. They did not accept the accrual basis. The technical differences between the two were not readily understood and the absence of comparable data for previous years compounded the problem. Clearly, insufficient resources were spent on engaging with ministers at the outset.

83. It should be noted that the Australian government undertakes very little capital investment. The military accounts for over 70% of all capital outlays in the budget. Most other capital-intensive services, including infrastructure, are developed and operated by lower levels of government. This situation, coupled with the facts that Australia has virtually no interest expenditure and its civil service pension plan is now fully funded – the three major differences, generally, between cash and accruals – means that there is relatively little material difference between cash-basis and accrual-basis numbers.

84. The issue remains unresolved. Australia’s budget is officially presented to Parliament on both an accruals basis and a cash basis. Decision making at budget formulation time and all deliberations in the Parliament continue to be almost exclusively on a cash basis, as are the public statements on the government’s surplus/deficit. However, appropriations are made on an accrual basis only, and the accrual

basis is very much the standard employed for budget implementation and reporting (detailed further in section 4.3 on financial management).

85. The major impact of accruals has been in improving the management of assets and liabilities, *i.e.* the government's balance sheet. Perhaps the greatest achievement to date has been the focus that accruals helped to bring on civil service pensions. Previously, the pension system was a pay-as-you-go plan. After the adoption of accruals, the plan was closed and a new fully-funded civil service pension scheme was adopted. The Future Fund was subsequently created to finance the accumulated liabilities of the old plan. It should be highlighted that the adoption of accruals only disclosed the liability; the action to reform civil service pensions was a separate decision. Whether it was accrual accounting or accrual budgeting – or indeed the budget surpluses themselves – that brought about the Future Fund is open to debate. However, it is clearly acknowledged in Australia that the management of balance sheet items has greatly improved as the result of accruals.

86. There is one aspect of accrual appropriations which is of special note: appropriating cash for non-cash items. This applies principally to depreciation and to a lesser extent to employee entitlements. Agencies now receive a cash appropriation in this regard. They have great flexibility in how this appropriation is used. They should build up cash balances until the need for this money arises. However, some agencies have used this money for bridging expenditure (which is not unreasonable, as it may not be needed in the near term) or for their general running (operating) expenses. The fact that no appropriations were given for accumulated depreciation on the day of the switch to accruals, meaning that agencies would almost always need to have a separate appropriation to replace assets, has exacerbated this problem.

87. An extreme example of orthodoxy in accrual appropriations comes from the National Archives. Its contents are valued at AUD 1 per metre of stock, resulting in total Archives assets of AUD 800 million. The assets are depreciated over 100 years (maximum depreciation time according to relevant accounting standards). In order for the Archives not to show a “loss” of AUD 20 million on their accrual financial statements, they receive an equivalent cash appropriation, although there is no apparent need to refinance the investment.

88. The perceived lack of transparency regarding the appropriation and use of these funds has led to criticism that the provision of cash in excess of immediate needs provides a pool of funds which can be used for other purposes. A standing committee of the Australian Senate has expressed concern that accrual-based appropriations have led to a loss of transparency in the management and use of funds appropriated for accrual expenses (Parliament of Australia, 2007b). As part of Operation Sunlight, the new government is considering options for resolving these issues.

2.2.5. Outcomes and outputs framework

89. Australia introduced the outcomes and outputs framework with the 1999/2000 budget. Its introduction was meant to focus the budget process on ends rather than means. It was therefore a continuation – or culmination – of the move away from inputs launched by the Department of Finance in the 1980s. Coupled with the introduction of accruals, it was also meant to foster market testing with the private sector for the provision of public services.

90. Under this framework, every agency is required to identify comprehensive and explicit outcomes, thus forming the legal basis for appropriations approved by the Parliament. In their “Portfolio Budget Statements”, which are the supporting explanatory documents to the budget, agencies need to identify the outputs to be produced and the administered items to be delivered on behalf of the government¹² which

¹² Administered items refer principally to transfer programmes, further described in section 4.4.

will contribute to the achievements of the outcomes. It should be emphasised, however, that the Portfolio Budget Statements are indicative only and do not bind the government in any way. The legal focus of appropriations is exclusively on the outcomes.¹³

91. Agencies are expected to measure performance at two levels: first, the effectiveness of the contribution of agency outputs and administered items to the achievement of outcomes; second, the efficiency of agency outputs in terms of quantity, quality and price. In their respective annual reports, which are published shortly after the end of each fiscal year, agencies are to report on their achievements *vis-à-vis* the Portfolio Budget Statements.

92. Prior to the introduction of the outcomes and outputs framework, Australia budgeted on the basis of running costs and programmes. Agencies received one lump-sum appropriation to cover all of their running costs, which included salaries and other operating costs. A separate appropriation was made for each programme which largely consisted of transfer payments.

93. The outcomes and outputs framework was introduced concurrently with the accrual budgeting framework. It too was driven by the Department of Finance, and similar dynamics were at work. Implementing outcomes has proved to be a significant challenge, especially in terms of its usefulness for decision-making purposes. Many of these challenges are common to other countries in moving to a results-oriented budgeting framework.

94. Agencies generally have between one and five outcomes each, with a majority having only one outcome. There is greater dispersion in the number of outputs, but most agencies have one to ten outputs, although there are outliers with a significantly greater number of outputs.

95. Some observations on the design and implementation of the Australian outcomes and outputs framework can be made. First, outcomes are defined solely in terms of existing administrative arrangements. The organisational entity – ministries and agencies – is the basis of the outcomes system, with each defining its own outcomes. There are no shared outcomes between entities, although the framework does enable two or more agencies to share the same outcome. However, in practice agencies have opted to follow their own outcomes for which they are wholly and solely accountable. This administrative focus appears to be the case inside agencies as well, with outputs often reflecting the internal organisational structure of the agency. The alignment of the organisational structure with outcomes/outputs is certainly desirable; the observation being made here is that outcomes and outputs were defined in terms of existing organisational structures. These arrangements may or may not coincide with broader objectives.

96. Second, outcomes are defined very briefly and very broadly. In fact, being as short and as general and far-reaching as possible would appear to be the guiding principle behind most definitions of outcomes. They are generally one sentence in length. The definitions have been described as vision statements, often aspirational and value-laden in nature, rather than attempting to concretely define the desired impact of activities on society.

97. This level of definition is quite understandable from the point of view of the agencies themselves, since outcomes are the basis of appropriations: the more general the outcome, the more flexibility the budget holder has.

¹³ Departmental appropriations, principally salaries and other administrative costs, can be used across outcomes within each respective ministry and agency. See section 4.4.

Box 9. Examples of outcomes

A recent review of outcomes^a identified the following as “some of the more incomprehensible examples”:

- The then Department of Family and Community Services had the following outcome: “Families and children have choices and opportunities – Services and assistance that: help children have the best possible start to life; promote healthy family relationships; and help families adapt to changing economic and social circumstances and take an active part in the community.”
- The then Department of Employment and Workplace Relations had the following outcome: “Higher pay, higher productivity.”
- The then Department of Transport and Regional Services had the following outcome: “Assisting regions to manage their own futures.”

(Note that each of these departments has more than one outcome.)

At the launch of the outcome budgeting framework, the Department of Defence had just one outcome: “To defend Australia and Australia’s interests.” It received one lump-sum appropriation for all of its operations which was completely fungible. After several years of criticism, the Department of Defence moved from one to seven outcomes – with the bulk of the appropriations now accounted for by three outcomes respectively (the Army, the Navy and the Air Force).

Outcomes can be so broad as to overlap within agencies, *i.e.* agencies in effect have discretion on where to classify an activity. An example is the then Department of Transport and Regional Services. Among others, it had the following two outcomes: “A better transport system for Australia” and “Greater recognition and development opportunities for local, regional and territory communities.” A report by the Australian National Audit Office found that an activity had simply been shifted from one outcome to the other.^b There was no need to shift funding between outcomes; the underlying programme was shifted from one outcome to the other.

A further example concerns overlaps between agencies.^c A parliamentary committee noted that some outcomes of the Department of Foreign Affairs and Trade overlapped with some outcomes of the Department of Defence. Their respective outcomes were so general that, in effect, the outcomes were shared, with no agency having overall responsibility for an individual outcome.

a. Australian Labor Party (2007), *Operation Sunlight*, Canberra.

b. Audit Report No. 31, 2006.

c. Joint Committee of Public Accounts and Audit, June 2002.

98. Third, outcomes and outputs vary widely between agencies in terms of their nature and specificity. This is a direct consequence of the Department of Finance’s explicit policy at the time of devolving responsibility for identifying and defining outcomes to the agencies themselves. The Department issued guidance to agencies but did not challenge agencies in this regard. The requirement that the Minister for Finance must officially agree to the outcomes was only a formality. (Recall, from the previous section, that the Department of Finance was withdrawing from many of the “details” of budgeting at this point.)

99. Fourth, there is instability in outcomes and – especially – outputs, as agencies make substantial changes to them over time. It is to be expected to have some “teething” issues in the first few years, as agencies become more experienced in specifying outcomes and output, but the “teething” has continued. It cannot reasonably be explained by factors such as new policies being put in place over time. This instability makes data comparisons over time difficult.

100. Fifth, concerns have been raised about the overall quality of information in the outcomes and outputs framework. The high-level outcome statements by their very nature make it difficult to demonstrate the linkages between the individual outputs and administered items, and the outcomes. Furthermore, performance information is often lacking. Some agencies do not even attempt to develop performance indicators for outcome effectiveness. Others note that some of their outcome indicators are

not measurable. Agencies tend to focus more on indicators of the efficiency of their outputs and use them as proxy outcome indicators, although there are exceptions to this as well. It is also noteworthy that, in a majority of cases, output indicators do not employ any targets or benchmarks.

101. Under Operation Sunlight, the new government has made a commitment to improve the specificity of outcomes and to ensure greater consistency across government. The Department of Finance has begun a review of all outcomes, to be completed by the end of 2008, with a view that the improvements will be implemented in time for the 2009/10 budget.

102. 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.¹⁴ It is as if there are two parallel systems in use. This is especially problematic in terms of transparency and accountability, as the legal basis of appropriations is outcomes.

103. 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.

104. 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.

105. The new government has recognised that these issues need to be resolved and is considering the introduction of programme reporting in agency Portfolio Budget Statements from the 2009/10 budget. A significant aspect is the new government's commitment to improving performance measurement, including introducing targets and tracking performance over time.

¹⁴ Previously, programmes tended to refer only to transfer payments in Australia and not to any running costs (salaries and other administrative expenses).

Box 10. The limited role of the national government

The development of performance information is particularly challenging due to Australia's federalism and the structure of national government expenditures, as most of the direct service delivery functions take place at the state and territory level.

On the one hand, many national government functions can be described as policy-oriented and thus notoriously difficult for meaningful measurement of results.

On the other hand, the Australian government does not control the use of resources and has limited influence on the performance of states and territories. Some transfers, however, require performance reporting and the achievement of targets or performance conditions. For example, specific performance benchmarks are set for literacy, numeracy and participation in schools, the quantity and quality of housing for disadvantaged people, and a range of health services delivered through cross-jurisdictional agreements by state and territory governments.

The new government has begun a reform programme in relation to "specific purpose payments", *i.e.* payments to the states and territories such as for health and hospitals, in co-operation with the states and territories. This process aims to reduce significantly the number of different payments while at the same time aiming to significantly improve the reporting of performance by the states and territories in the use of the funds.

2.3. Annual budget cycle

106. Australia's fiscal year starts on 1 July. The budget formulation cycle begins the previous September, or ten months prior to the start of the fiscal year.

Box 11. Budget formulation calendar

Fiscal year: 1 July – 30 June

September	Cabinet submission and resulting budget circular.
October	The Prime Minister seeks proposals for new initiatives from ministers.
November	Senior Ministers' Review (SMR) / Strategic Budget Committee (SBC).
January-February	Costing of new policy proposals.
March	Expenditure Review Committee (ERC).
April	Budget Cabinet.
April-May	"Hunting licence".
May	Budget submitted to Parliament.

2.3.1. Budget Cabinet submission and resulting budget circular

107. The first step in the cycle comes with the Treasurer and the Minister for Finance providing a submission to the Cabinet on the process and timetable for the forthcoming budget. Following the Cabinet's consideration of the submission, the Department of Finance issues a budget circular detailing the timetable and operational rules for the forthcoming budget formulation process. The document is largely technical in nature, setting timelines for the various milestones of the budget process and establishing thresholds for the varying treatment of different proposals – such as what will be considered by the Cabinet's Expenditure Review Committee (ERC) and what will be considered in the "minors" process (see Box 13). The budget circular is broadly similar from one year to another, although changes may be made following a "post-mortem" evaluation of the previous year's process. The new government has streamlined the budget circular, formally known as the "Budget Process Operational Rules", by introducing the

“Finance Minister’s Instructions” (FMIs). FMIs are a new set of guidance to supplement the circular, providing more detailed information about the budget and related processes.

108. The budget circular does not outline any fiscal policy goals for the forthcoming budget and does not contain any assessment of the overall macroeconomic situation.

2.3.2. *Strategic Budget Committee*

109. In October, the Prime Minister traditionally writes to portfolio ministers asking them to outline their proposals for new initiatives. No indicative monetary levels were set for new policy priorities in these letters, and no indication of overall policy priorities. The new government has yet to determine how this phase of the budget process will operate, but used a modified form in the 2008/09 budget.

110. It is also around this time that various lobby groups and community organisations send letters to their respective portfolio minister trying to promote their areas, perhaps most actively in the social welfare field.

111. Ministers deliver their budget proposals by late October in letters to the Prime Minister. Their submissions must conform to a standard template for new policy proposals in order to provide minimum common information, including their rationale and preliminary costings.

112. These proposals will first be reviewed by officials from the three central agencies, namely the Department of the Prime Minister and Cabinet (PM&C), the Treasury, and the Department of Finance – referred to as the “trilateral review” – before being vetted by the Senior Ministers’ Review (SMR), formerly, and now the Strategic Budget Committee (SBC). The SMR/SBC consists of the Prime Minister, the Deputy Prime Minister, the Treasurer and the Minister for Finance.

113. Each of the three central agencies will offer its views on whether an individual submission should be approved for further development and the consideration of the ERC or rejected and not further developed. The central agencies themselves endeavour to reach consensus to the greatest extent possible in order to simplify ministers’ consideration. The SMR/SBC meetings generally last for several hours. In the last two years, more than half of all new policy proposals have been dropped at this stage.

114. After the SBC, ministers are notified – via formal Cabinet minutes – which proposals were approved at SBC and can be developed further and submitted to the ERC for consideration. Ministers can appeal; this would generally take the form of the Prime Minister allowing a minister to bring an amended new policy proposal for consideration by the ERC. In the past, ministers had been allowed to bring new proposals to the Cabinet outside of the SMR process and even outside the budget process itself: new “in-year” spending stemming from windfall revenues from “prudent” revenue estimates had become most pronounced during the last government. This reduced the ERC in importance and weakened comprehensive budget examination, as competing proposals were not considered together.

115. The new Labor government has announced that any windfalls will go directly to increasing the surplus in 2008/09. It has also sent most of the relatively few bids for funds that have come directly to the Cabinet since December 2007 to the ERC for consideration.

Box 12. No expenditure targets

In the past, under the Coalition government, it was noteworthy that no explicit expenditure targets, either for the government as a whole or for individual portfolios, were set to guide the SMR process. According to the then government's "Fiscal Strategy Statement" and supplementary statements by the Prime Minister, the government should run a surplus of 1% of GDP and the government's expenditure share of GDP should not increase. As the Treasury and the Department of Finance provide an updated economic and fiscal outlook at this time that shows the amount of revenue available and baseline expenditures, an "informal" expenditure target can be said to exist.

The main reasons for the lack of discussion of an overall expenditure target are the surplus environment in general and the fact that there have been dramatic and "unexpected" increases in the revenue estimates from the beginning to the end of the budget preparation phase. Previously, the SMR had been known to set portfolio savings targets that were implemented during the following budget preparation stage.

2.3.3. Expenditure Review Committee

116. Following the SMR/SBC, portfolio ministers prepare their respective "Portfolio Budget Submissions" document. These submissions are usually long background documents which contain the portfolio minister's "business case" for their proposal. In principle, there should be one submission per portfolio. In reality, there are more, as ministers – with the approval of senior ministers (the Prime Minister, and/or the Treasurer, and/or the Minister for Finance in consultation with the Prime Minister) – may bring forward separate submissions for specific proposals to highlight them, or for large and complex cross-portfolio proposals.

117. The submissions must contain complete costings of the proposals, and the costings must be agreed with the Department of Finance. This stage takes place in January and February. Disagreements may emerge on volume issues in relation to formula-based programmes. More serious disagreements generally occur on the needed running (operating) costs in order to manage the respective programme. The initial bids are – on average – reduced by 30% before the Department of Finance approves the costing. As in other areas of co-operation, there is an escalation of disputes from more junior to more senior officials, culminating with meetings at the level of budget director. If a disagreement is judged to be of a highly political nature, and this is very rare, the proposal is costed on the basis of the Department of Finance's numbers, but is brought forward as an issue for the ERC.

Box 13. "The minors process"

A separate process applies to spending proposals below a certain threshold which go through the so-called "minors process". The threshold has recently been increased from AUD 5 million to AUD 10 million in one year. In aggregate, this amounts to AUD 1 billion. The minors process involves a minister's proposal being considered bilaterally with the Minister for Finance, rather than it being brought forward to the ERC directly. Some ministries have targeted this process since they perceive that such proposals will be scrutinised less than through the normal SMR/SBC-ERC process. All approved minors proposals are submitted as a package by the Minister for Finance to the ERC and ultimately the Budget Cabinet.

118. For each submission, the Department of Finance prepares a so-called "Green Brief", named for the colour of the paper on which it is printed. The "Greens" summarise the proposals and bring together all available information, as well as stating the Department of Finance perspective on policy issues. A total of 78 Greens were produced in for the 2007/08 budget compared to 44 for the 2006/07 budget. Departments are able to see their respective Green before the relevant ERC meeting in order to prepare their own briefs

for their ministers. Greens reflect the Department of Finance's professional civil servant view, not necessarily the view of the Minister for Finance. Ministers may lobby the Minister for Finance once they know of the Greens' contents. Even the Finance Minister will sometimes disagree with the contents of a Green.

119. In addition, the submissions are circulated officially to the three central agencies for comments and some new policy proposals may be circulated to other agencies that will be affected by the proposal. The agencies will each prepare "co-ordination comments" on the Portfolio Budget Submissions. These comments will be available to the ERC. No attempt is made to achieve consensus among the three central agencies on these comments.

120. In March, the ERC meets to decide on new proposals. There will typically be about ten meetings over the four-week period. The Treasury and the Department of Finance will have prepared an updated economic and fiscal outlook (based on existing policies) to guide the ERC. The Department of Finance will submit an overview Green on the extent of the new policy and savings proposals contained in individual Greens. This overview Green provides the framework for the ERC discussion and subsequent decisions.

121. Each minister will make the case for his/her particular proposals. The structure of the meetings is essentially that the respective ministers speaks to their proposals and are then questioned by the committee members. The minister is assisted by his/her political advisers and – particularly – by his/her relevant officials. The discussion is almost always based on the Greens.

122. Following their questioning, the ERC forms a view regarding whether the proposal should be supported, rejected, varied, or sent away for further work. The ERC generally makes a case-by-case decision at each meeting.

123. The Department of Finance acts as part of the secretariat for the ERC. The Department provides the Treasurer and the Minister for Finance with "fallback positions" during the discussion and also provides a regular running "score sheet" on decisions made by the ERC which records the financial implications across the forward estimates. Officials from the Department of Finance, the Treasury and the Department of the Prime Minister and Cabinet also participate in the committee, with the latter co-ordinating the decisions. ERC decisions can be appealed to the Prime Minister.

2.3.4. *The "Budget Cabinet"*

124. The decisions by the ERC are discussed by the full Cabinet in April, known as the "Budget Cabinet". At this time, the complete set of ERC decisions is considered. Decisions can be appealed in the Budget Cabinet, but this is rare.

125. The financial implications, in aggregate, made by the National Security Committee are made known to the Budget Cabinet. The Budget Cabinet does not endorse them, as the decisions of the National Security Committee itself are final in this regard.

126. The Cabinet's formal approval of the decisions of the ERC also has a provision allowing the SMR/SBC to make further modification to the budget for any new developments.

2.3.5. *The Ad Hoc Revenue Committee*

127. Under the former government, the *Ad Hoc* Revenue Committee met following the Budget Cabinet in late April. At this meeting, the Treasurer discussed the latest economic assumptions and revenue estimates. In recent years, these revenue estimates had been considerably higher than those submitted earlier in the budget preparation process. The meeting also decided on substantive taxation measures. But

there has long been a desire to treat expenditures and revenues separately in the Cabinet discussions. Thus the new government has decided that revenue measures will henceforth be handled by the ERC and their separation is not as marked.

2.3.6. "Hunting licence"

128. After the *Ad Hoc* Revenue Committee met, a "hunting licence" was issued to senior ministers to settle final details of the budget. The term was first used when the main purpose of the exercise was to finalise outstanding issues and keep a tight rein on expenditures. This was not the case under the previous government, rather the opposite.

129. In recent years – up to the 2007/08 budget – the "hunting licence" has involved senior ministers deciding on major tax cuts, tax expenditures and other "big ticket" expenditure items in light of the latest surplus estimates. These initiatives are developed in close confidence and are often used as the main headlines of the budget.

130. In recent years, the proposals agreed in this stage, at the end of the budget preparation process, have been very substantial – in fact, similar in size to those approved during the entire ERC process. However, this was not the case in the 2008/09 budget, and it remains to be seen whether the hunting license will become part of the new government's budget processes.

131. From April onwards, ministries and agencies work on the preparation of the relevant budget documentation. Their final drafts are submitted to the central agencies for approval. The Department of Finance and the Treasury prepare the *Budget Papers* (see Box 16) while line agencies prepare their Portfolio Budget Statements.

132. The budget is then presented simultaneously to both houses of Parliament on "Budget Night", traditionally the second Tuesday in May (see section 3.4).

Box 14. Economic assumptions and revenue forecasts

The Treasury updates its economic forecasts on a quarterly basis but produces two sets of published forecasts per year – for the budget and for the *Mid-Year Economic and Fiscal Outlook* (MYEFO). The published assumptions provide the economic base for estimating revenue and expenditure items that appear in the budget and in the MYEFO.

These Treasury economic forecasts are presented to the Joint Economic Forecasting Group which consists – in addition to the Treasury itself – of the Reserve Bank (the Australian central bank), the Australian Bureau of Statistics, the Department of Finance and the Department of the Prime Minister and Cabinet. This groups acts as a “quality control” on the forecasts. The group contains officials only; there is no involvement from ministerial offices.

The economic forecasts form an important input into the Treasury’s tax revenue forecasts. The Treasury forecasts tax revenue in consultation with the Australian Taxation Office and the Australian Customs Service. Tax revenue estimates are updated taking into account recent economic outcomes and tax collections and the updated economic outlook. In recent years, the Treasury has allocated significant resources to improving its revenue forecasting skills, particularly in better understanding links between the economic forecasts and various tax bases. For the first time, the 2008/09 budget published information on tax revenue forecasting performance that attempts to explicitly identify the links between the economy and tax revenue.

In recent years, each subsequent economic and revenue forecast has yielded positive “surprises”, explained by improvements in the terms of trade due to increased commodity prices. The economic forecasts are prepared until the end of the budget year; thereafter, projections are adopted on the basis of long-run averages of key economic variables. The past four budgets have included a prudent assumption (disclosed in the *Budget Papers*) that commodity prices would fall off somewhat in the projection years. However, in practice commodity prices have continued to rise. The budget includes sensitivity analysis on revenue and expenditure from deviations from the economic forecasts.

2.4. Conclusion

133. Australia has a rich and long history of pioneering budget reforms.

134. As detailed in the introduction, Australia has enjoyed an enviable economic and fiscal environment in recent years. However, controlling expenditure has become ever more difficult in these circumstances. More and more spending decisions were made outside of the formal budget process as more and more resources became available during the year. It should be borne in mind, however, that Australia had previously paid down all its net debt and had established the Future Fund in order to fully finance all government employees’ future pension obligations. Clearly it is a challenge to maintain fiscal discipline in this context.

135. This situation raises questions about the appropriate design choices for fiscal rules. Australia’s Charter of Budget Honesty is a principles-based approach whereby the government of the day sets its own fiscal strategy within very broad legislated principles of sound fiscal management. It could be argued that a greater focus on expenditure limits – either through legislation or the government’s own fiscal strategy – could have been more effective. However, any fiscal rule is never stronger than the political commitment to adhere to it.

136. The institutional arrangements for budgeting in Australia are unique in many respects. The strong emphasis on Cabinet committees and the multiple central agencies involved in the budget formulation process are hallmarks of budgeting in Australia. Notwithstanding the prior practice of not taking all proposals through the Cabinet, these institutional arrangements provide a solid and unified front for promoting fiscal discipline, despite the costs in terms of time and money for consensus building. The respective roles of the Department of Finance and the Treasury could, however, be clearer, and a greater

role in budgeting for spending ministries within each portfolio *vis-à-vis* their agencies should strengthen the budget process.

137. The forward estimates are the bedrock of Australia's budget formulation process. They have served to lengthen the time horizon in decision making, provided an agreed baseline that allows budget discussions to concentrate on substantive decisions and – very importantly – brought the special (permanent) appropriations systematically into the annual budget process. The processes associated with keeping the forward estimates up-to-date and accurate are most impressive. The forward estimates also form the necessary basis for any top-down budgetary decisions and naturally support any fiscal rule based on expenditures.

138. Australia has extensive experience with successive forms of reviewing the efficiency and effectiveness of existing programmes. This is especially important in Australia due to the large share of special (permanent) appropriations and the reliance on forward estimates which tend to lock in expenditures for future years. The challenge for the new system of strategic reviews is to avoid becoming a mechanical exercise as befell its predecessors.

139. The experience with accrual budgeting has been disappointing. All decision making at budget formulation time and all deliberations in Parliament continue to be carried out almost exclusively on a cash basis, as are the public statements on the government's fiscal position. The near-total disconnect between this situation and the fact that the budget is enacted on an accrual basis is striking. To some extent, however, it reflects that, for the majority of the budget, there is little material difference between cash and accruals. Australia has invested heavily in its accrual budgeting framework and is unlikely to abandon it. However, as one senior official noted, "knowing what we know now, we would not have introduced accrual budgeting." The practice of appropriating cash for non-cash items (such as depreciation) is peculiar and should be reconsidered.

140. The outcomes and outputs framework has served as a catalyst for increasing the focus on results. However, there are a number of significant concerns with the outcomes and outputs framework as currently implemented. More conceptually, the broad and long-term nature of outcomes needs to be better reconciled with the specific and identifiable programmes which form the basis for political decision making and day-to-day operational management.

141. Finally, the overall level of budget transparency and the specific disclosures required by the Charter of Budget Honesty are exemplary. The *Intergenerational Report* and the *Pre-Election Economic and Fiscal Outlook* are especially noteworthy.

142. It is important to strengthen confidence in the economic assumptions and revenue forecasts underlying the budget, especially in regards to the trade "prudence" bias.

143. As noted, a new Labor government came to power in late November 2007. Through Operation Sunlight, it has recognised many of the concerns and issues raised in this section and has announced its intention to resolve them.

3. ROLE OF THE LEGISLATURE

144. The Australian Parliament's role in the budget process is limited due to explicit constitutional restrictions, enshrined Westminster¹⁵ political traditions, strong party discipline in the two major political parties, and an electoral system that does not usually see the election of minor parties to the lower house of Parliament – the House of Representatives. The outcome budgeting framework (see section 3.3 below) has served to further limit Parliament's role.

145. In addition, 80% of annual expenditure is authorised by “special” (permanent) legislation. In other words, Parliament approves only 20% of total expenditure through the annual budget approval process. Although estimates of the expenditure mandated by the special legislation appear in the annual budget documentation and can be discussed as part of Parliament's regular scrutiny, changing them would require alterations to the underlying standing legislation. Thus, yet another practical barrier is imposed on the Parliament's role in the budget process.

146. Nevertheless, the upper house of Parliament – the Senate – has developed a robust budget review and scrutiny function through an effective committee system that examines the government's budget proposal in some detail. This development has been fostered by the fact that the government rarely commands a majority in the Senate. The review and scrutiny function often extends well beyond the budget proposals *per se* and is of a more general political nature.

147. This section reviews the role of the Australian Parliament in greater detail and outlines the annual budget approval cycle. It also discusses the role of the Australian National Audit Office.

3.1. The Australian Parliament

148. The Australian Parliament is a bicameral institution composed of the House of Representatives and the Senate. Compared to other Westminster systems, the Australian Parliament is unusual in that the upper house – the Senate – is directly elected.

149. The House of Representatives has 150 members, each representing a separate single-member constituency. Members are elected for terms of up to three years. The election system for the House of Representatives is based on a “preferential” system which can be viewed as similar in impact to the “first-past-the-post” system. It promotes a strong two-party system, heavily discourages smaller splinter parties, and generally results in governments with strong backing in the House.

150. The Senate has 76 senators. Twelve are elected from each of the six states – *i.e.* the states enjoy equal representation in the Senate regardless of their population – and two each for the Australian Capital Territory and the Northern Territory. State senators are elected for six-year terms; territory senators for three-year terms. Half of the state senators come up for election every three years. The Senate's electoral system is based on proportional representation. A number of “minor” parties are represented in the Senate in addition to the two main parties. It is rare for the government to have a majority in the Senate.

¹⁵ “Westminster” refers to the system of government that exists in the United Kingdom and which has been replicated to varying degrees by many Commonwealth countries, including Australia.

151. Voting is mandatory in Australia, and voter turnout in excess of 95% is common. (A nominal fine is imposed on those who do not vote.)

3.2. Restrictions on Parliament's role

152. The fundamental restriction on Parliament's role is the constitutional provision that the initiative to propose any expenditure rests with the government. Thus Members of Parliament can only vote to reject or reduce an expenditure proposed by the government. They cannot propose any new expenditure, nor reallocate funds from one appropriation to another – even if there is no net increase in expenditure.

153. The two houses of Parliament have a distinct role in approving the budget, with further restrictions placed on the Senate's role. The Constitution provides that appropriation bills may originate only in the House of Representatives. Bills which appropriate money for the ordinary annual services of government may not be amended at all by the Senate.

154. The exact definition of "ordinary annual services" has been the subject of debate in Australia over time, with the Senate keen on retaining its authority to amend bills that do not constitute ordinary annual services of government. In 1965, the House and the Senate reached the so-called "Compact" which broadly defines the term. As a result, the government introduces three appropriation bills each year based on the Senate's ability to amend the bills:

- Appropriation Bill 1;
- Appropriation Bill 2;
- Appropriation (Parliamentary Departments) Bill.

155. Appropriation Bill 1 is for the ordinary annual services of government, which was defined in the Compact as continuing expenditure for existing policies. The Senate cannot amend Bill 1.

156. Appropriation Bill 2 is for expenditures outside of the definition for Appropriation Bill 1. The Compact defines this as new policies, new capital expenditure and grants to the states. Once a new policy has been approved in Bill 2, it moves to Bill 1 in future bills. The Senate can amend Bill 2. Over the last three years, the size of Bill 2 has been equivalent to 15% of the total appropriations sought in Bills 1 and 2 combined. The exact demarcation between Appropriation Bills 1 and 2 can be a fine one and is subject to negotiations periodically between the House and the Senate.

157. Both the continuing and new expenditures for Parliament are subject to Senate amendment and are therefore contained in the separate Appropriation (Parliamentary Departments) Bill.

158. A second set of annual appropriation bills ("additional estimates") are usually introduced during the fiscal year – typically in February – where the government has agreed post-budget expenditure measures and/or where variations from the budget warrant additional appropriation. These appropriations are usually limited to particular agencies and portfolios. However, they can be significant. For example, the 2007/08 additional estimates were nearly 5% of the size of the original budget appropriations. A further set of annual appropriation bills ("supplementary additional estimates") can also be introduced where necessary, and are now more and more common. However, these tend to be exceptionally small in fiscal terms.

159. Strong party discipline and the Westminster political tradition mean that even these limited opportunities for amendment are hardly ever used.

160. As noted above, Australia's electoral system favours the two major parties and thus governments with a large majority in the House of Representatives. The political tradition in Australia for strong party cohesion reinforces this situation. As one observer noted, "even abstaining on a government proposal is considered to be a hanging offence" for government MPs. The political tradition also serves to limit any informal intra-party negotiations ahead of the budget being formally introduced in Parliament.

161. The Westminster tradition, which equates any amendment to the budget as a vote of no-confidence in the government is – although waning – yet another practical constraint on Parliament's role in the budget process (see Box 15).

Box 15. The political and constitutional crisis of 1975

In October 1975, the Opposition parties in the Senate – which enjoyed a majority in that house – passed a motion that the two main appropriation bills for the 1975/76 fiscal year would "be not further proceeded with until the government agrees to submit itself to the judgment of the people," *i.e.* an election.

The Opposition argued that the government had therefore lost the confidence of Parliament and that it must resign. The government refused to do so. In November, the Governor-General – in an extraordinary act and on his own initiative – dismissed the Prime Minister and appointed the leader of the Opposition as a caretaker Prime Minister until new elections were held. (Australia is a member of the Commonwealth, and the Governor-General is the Queen's representative in Australia.)

These events have been described as the greatest political and constitutional crisis in Australia's history. Subsequent governments and the Senate have worked to ensure that such a crisis does not re-occur. In short, it is considered unthinkable that the Senate would again refuse to approve a government's budget proposal. However, minor changes at the margins have been accepted by subsequent governments.

3.3. Implications of the outcome budgeting framework

162. 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.

163. The documentation presented to Parliament changed greatly with the introduction of the new framework in the 1999/2000 budget, in particular the supporting documentation known as the Portfolio Budget Statements (PBS). The PBS are the principal documents upon which Parliament relies when scrutinising the government's budget proposal. A separate Portfolio Budget Statement is prepared for each of the 18 budget portfolios. The statements move beyond the description of outcomes presented in the appropriation bills and focus on the outputs and administered items which will contribute to the achievements of the respective outcomes; the statements also present relevant performance information.

164. Significant concerns have been raised, however, about Parliament's ability to hold the government to account with this new framework. These concerns can be divided into three groups:

- the legal status of the Portfolio Budget Statements;
- the contents and relevance of the Portfolio Budget Statements;
- the quality of the Portfolio Budget Statements.

165. The first concern relates to the fact that the PBS are supporting documents and have no legal standing in terms of binding the government. Although they can be used for interpreting the appropriations, a recent decision of the High Court (Australia's Supreme Court) on departmental appropriations affirmed

that the description of outcomes in the actual appropriations act was the only relevant legal reference.¹⁶ Specifically, the High Court concluded that the government could embark on new activities if they fitted with the description of the outcome, even if not mentioned in the PBS. By extension, the government can choose not to implement activities even if called for in the PBS. While the government strives to operate according to the basis of what is put before Parliament in the PBS, which represent the estimated use of resources at the time of the budget, it is not formally bound, in a legal sense, by the contents of the PBS.

166. A Senate committee concluded the following:

The implications of the judgment by the High Court are two-fold. First, the judgment makes plain that under the financial management framework erected since 1997, the Parliament has limited ability to determine how much money is available for particular purposes or the purposes for which money is to be spent ... [S]econd ... because of the government's freedom in relation to the expenditure of its appropriations, there is almost nothing in the appropriations process itself that will provide any restraint on government expenditure ... The judgment raises questions that ... concern the whole financial accountability framework and Parliament's role in monitoring and approving government expenditure. (Parliament of Australia, 2005, as quoted by Kelly, 2007)

167. The next set of concerns involves the contents and relevance of the PBS. The appropriation acts are on an accrual basis only, whereas the PBS are presented on both an accrual basis and a cash basis. The cash presentation was included in response to parliamentary wishes, which reinforces the point that political decision making – by individual ministers and the Cabinet, as outlined in section 2, and in Parliament – remains on a cash basis despite the accrual-based framework. This disconnect between political debate and decision making and the legal basis of appropriations raises fundamental accountability questions. However, as discussed in section 2.4, there is usually little or no difference between the two due to the nature of the government's expenditures.

168. Parliament has also noted its concern with the move away from programmes to a more aggregated level of reporting on outputs and administered items in the PBS. A joint House-Senate committee came to the following conclusions:

The Committee is concerned that there has actually been a regression in the level of detail relating to programs provided in ... the PBS [Portfolio Budget Statements]. This has led to a situation where it becomes impossible to determine what is actually happening with respect to a particular function or program. This had been possible under the previous arrangements. (Parliament of Australia, 2002)

169. Furthermore, the Parliament has noted the low level of integration of the PBS in daily agency operations. This situation reinforces the notion of the “two parallel systems” whereby agencies deal with (legislated) external reporting requirements separately and independently to internal management needs. The Senate committee concluded as follows:

An apparent lack of understanding of the PBS at senior management levels causes the committee to wonder whether the PBS are really a key management tool within certain agencies. The committee respectfully suggests only those officers with a good grasp of the PBS be permitted to attend the Senate estimates hearings. (Parliament of Australia, 2005, as quoted by Kelly, 2007)

¹⁶ Combet case, 2005.

170. Third, the Parliament has voiced concerns about the overall quality of the PBS. These issues mirror those outlined in section 2 and include the brief and broad definition of outcomes, the difficulty in relating individual outputs and administered items, the lack of effective performance information, and the variance and instability in the reporting used by agencies.

171. In response to calls from the Parliament and the Auditor-General over a number of years for improvements – and in line with its own commitments under Operation Sunlight, the new government agreed to revised Portfolio Budget Statements for the 2008/09 budget. Australian officials note two principal changes. First, a resource statement is now prepared to explain all sources of funds available – through annual appropriation bills, special appropriations, and balances of carried-over appropriations. (Previously only some of this information was available in the PBS.) Second, key performance indicators and the allocation of funds to outcomes and the achievements being sought have been given greater visibility in the new-style PBS. Furthermore, Australian officials note that the new government is considering, from the 2009/10 budget, requiring agencies to report on their programmes (including targets, results and trends) in their PBS and annual reports.

Box 16. The "Budget Papers"

The government's key budget documents are the "Budget Papers". Budget Paper No. 1 is the primary budget document in a strategic sense. It provides high-level commentary on the state of the economy and its outlook. The Budget Papers are introduced at the same time as the Treasurer makes the "Budget Speech" and are accompanied by the appropriation bills and the Portfolio Budget Statements. The nature and titles of these documents have varied at the margins over time. For the 2008/09 budget, the Treasurer and the Minister for Finance presented the following papers:

- Budget Strategy and Outlook, containing information on the economic and fiscal outlook, government balance sheet and associated risks to the outlook, as well as a statement outlining its fiscal strategy (Budget Paper No. 1).
- Budget Measures, providing a comprehensive statement on new expense, revenue and capital initiatives in the budget (Budget Paper No. 2).
- Federal Financial Relations, providing information on fiscal relations with the states, territories and local government (Budget Paper No. 3).
- Agency Resourcing, containing information on resourcing for agencies, including all moneys expected to be available including through annual appropriation acts and special (permanent) legislation (Budget Paper No. 4).

3.4. Parliamentary budget cycle

172. The budget is usually introduced on the second Tuesday in May. Then the Parliament has less than two months to scrutinise and approve the budget before the start of the fiscal year on 1 July. The current timing was introduced with the 1993/94 budget. Previously, the budget was introduced in August, *i.e.* after the start of the fiscal year, and the appropriation bills were passed by the end of November. The government received interim funding based on the previous year's budget in order to operate during those early months.

173. The budget is introduced by the Treasurer on "Budget Night".¹⁷ The Treasurer's speech showcases significant points in the budget and provides commentary on the government's overall policy

¹⁷ The Treasurer introduces Appropriation Bill 1. Appropriation Bill 2 and the Appropriation (Parliamentary Departments) Bill are briefly introduced by the Minister for Finance, or a minister representing the Minister for

priorities. The speech is the highlight of the annual parliamentary calendar and receives huge media coverage (see Box 17). The leader of the Opposition offers the formal response in a speech typically taking place two days later. Discussion of the budget is then adjourned for one week.

174. There is no institutional mechanism in place in the Parliament to separately consider the government's Fiscal Strategy Statement prior to the discussion of the budget. That statement is presented to the Parliament at the same time as the budget.

Box 17. Media "lock-up"

Over 500 journalists typically enter a media "lock-up" room by 1:30 p.m. on the day of the budget speech. In this room, officials from the Treasury and the Department of Finance are available to provide information on the overview of the budget and its contents and to answer detailed questions. These officials are available throughout the day to provide background information and clarifications for journalists reporting on the budget. The Treasurer holds a press conference in the lock-up room around 5:00 p.m. focusing on the key points of the budget – economic, financial and political. The journalists cannot leave the room, nor communicate outside the room, until the Treasurer has started the speech in Parliament that evening. At that time, they can publish the stories on the budget that they have been working on throughout the day in the "lock-up" room. This arrangement has served to promote more informed reporting and commentary on the budget.

175. General budget debate then commences in plenary session in the House, generally lasting one week. This debate is for the most part an overall political and economic debate rather than a debate on specific measures in the budget.

176. The general budget debate continues in the Main Committee, generally for another week. The Main Committee is in fact not a committee, but a parallel plenary session of the House. This organisational innovation is designed to speed the work of the House by having two concurrent tracks for consideration of legislation.

Box 18. Parliamentary budget approval timetable

Fiscal year: 1 July – 30 June

Second Tuesday in May	"Budget Night": the Treasurer introduces the budget proposal.
Mid May to	Deliberations in the House of Representatives (plenary), and Main Committee.
Mid June	Senate committees scrutinise the budget proposal.
End June	Approval of the budget.
	Assent by the Governor-General on behalf of the Queen.

177. Following this general budget debate, a vote is taken to approve the second reading of the budget.¹⁸ This is viewed as an "in principle" approval of legislation before it is scrutinised line by line

Finance if the Minister for Finance is a senator, immediately following the Treasurer's speech. The Minister for Finance may also highlight any changes in documentation or technical accounting details.

¹⁸ The formal reading out of the title of the legislation by the Clerk of the House is considered its first reading. The Treasurer's Budget Speech launches the second reading.

(“considered in detail”) and where amendments can be made. In the case of the budget, this is only a perfunctory stage. It lasts for only 1-2 days in the Main Committee; respective ministers are not present and there is generally not enough time to go through the budget as a whole.

178. The House generally prefers to devote its time to a general political and economic debate rather than going through the budget in detail. This is understandable given the restrictions on Parliament’s ability to amend the budget.

179. The budget is then brought to the House in plenary session where the final approval takes place. Reports by the Senate committees scrutinising the budget will generally be available at this stage (see next section) but are not formally considered by the House. The budget bills are then referred to the Senate. This is in practice a formality, as the Senate approves the budget as proposed by the government except in exceptional circumstances.

180. The final stage in the legislative process is assent to the budget by the Governor-General. Under the Constitution, the Governor-General may assent to a bill or withhold assent, but in practice a bill passed by both Houses always receives assent.

3.5. Senate standing committee scrutiny

181. As noted, the budget only comes to the Senate for formal deliberation once it has been approved by the House. This occurs shortly before the start of the fiscal year. In practice, the Senate committees commence their scrutiny of the budget as soon as the budget is introduced in the House. In fact, they have essentially completed their work when the budget proposals arrive formally in the Senate from the House of Representatives.

182. The Senate’s interest in the scrutiny of the budget by specialised committees is because of the opportunity it offers the Opposition, minor parties and individual senators to gather information on the general operations of government from both ministers and (particularly) officials. Again, it is exceptional for the Senate to amend the budget; this is rather an opportunity for holding the government to scrutiny and to account.

183. The Senate’s scrutiny of the budget takes place exclusively in the committees. Only “formalities” related to the budget take place in a plenary Senate session. The scrutiny is based primarily on the Portfolio Budget Statements.

184. There are eight Senate committees which scrutinise on average the budgets of two portfolios. One committee – the Economics Committee – also reviews the budget from an overall fiscal policy point of view. Each committee is allocated four days to conduct hearings on its respective budget portfolios. All meetings of the committees are open to the public.

185. The size of the individual committees varies. Each of the Senate committees has a secretariat consisting of the secretary, an executive assistant and one or more research officers. In addition, committees have access to an independent parliamentary research service with a permanent staff of about 80 persons.

Box 19. Examination of annual reports

The Senate committees also examine the annual reports of ministries and agencies. Annual reports contain a wide variety of information such as roles and functions, organisational structure, financial statements, and significant issues and developments during the year. They also include information on how agencies perform against planned outcomes, using the performance measures set out in the Portfolio Budget Statements. The committees are required to: report to the Senate on whether the annual reports are satisfactory; investigate any matters requiring closer scrutiny; and monitor whether annual reports are received on time. Committees also report to the Senate if an agency fails to present its annual report. The examination of annual reports generally takes place in November.

186. The basic function of the committees is “to require the presence of, and seek explanations from, ministers who formulate policy and officials who implement policy to explain expenditure proposals and to answer questions concerning the effectiveness and efficiency of various programs.” The majority of questions which committee members ask are answered by officials of the respective department or agency. It is usual, however, for ministers to attend meetings of the committees to respond to questions about policy matters, which public servants are not required to comment upon.

187. Once the committees have completed their examination, they report their deliberations to the Senate, highlighting any items of particular concern. A member may attach to the report a minority or dissenting report making relevant conclusions and recommendations. Members of the House of Representatives will have copies of these reports as well as they conclude their deliberations.

Box 20. Australian National Audit Office

The Auditor-General is responsible for providing auditing services to the Parliament and public sector entities. The Auditor-General is appointed by the Governor-General, on the recommendation of the Prime Minister, for a term of ten years. A parliamentary committee must approve or reject any proposed appointment for Auditor-General. A person cannot be appointed Auditor-General twice. The Auditor-General is the chief executive of the Australian National Audit Office (ANAO) and is an independent officer of the Parliament.

The primary client of the ANAO is the Australian Parliament. The purpose of the ANAO is to provide the Parliament with an independent assessment of selected areas of public administration and with assurance about public sector financial reporting, administration and accountability. It does this primarily by conducting audits of financial statements and performance. The ANAO does not exercise management functions, nor does it have an executive role. It performs the financial statement audits of all Australian government-controlled entities and assesses where improvements can be made.

As part of its role, the ANAO seeks to identify and promulgate, for the benefit of the public sector generally, broad messages and lessons identified through the audit activities. The ANAO Better Practice Guides disseminate lessons on specific aspects of administration.

The ANAO has extensive powers of access to documents and information, and its work is governed by its auditing standards which adopt the standards applied by the auditing profession in Australia.

Within the relevant laws, the Auditor-General has complete discretion in the performance or exercise of his/her functions or powers. In particular, the Auditor-General is not subject to direction from anyone in relation to whether or not a particular audit is to be conducted, the way in which a particular audit is to be conducted, or the priority to be given to any particular matter.

However, the ANAO adopts a broadly consultative approach to its forward audit programme which takes account of the priorities of Parliament, as advised by the Joint Committee of Public Accounts and Audit (see Box 21) and the views of other stakeholders. This helps enhance the effectiveness of the final audit programme that the ANAO pursues. The programme aims to provide a broad coverage of areas of public administration and is underpinned by a risk-based methodology. The final programme is determined by the Auditor-General.

An independent auditor must audit the ANAO financial statements.

The Governor-General may remove the Auditor-General from office, if both the House and the Senate so request, on the grounds of misbehavior or physical or mental incapacity.

188. The scrutiny of supplementary budgets (“additional estimates”) takes place in a similar manner. This scrutiny generally occurs in February. The committees usually allot two days to examine their respective portfolios.

Box 21. Joint Committee of Public Accounts and Audit (JCPAA)

The Joint Committee of Public Accounts and Audit is appointed at the beginning of each Parliament. It has 16 members: six appointed by the Senate and ten appointed by the House of Representatives. The Committee has a majority of government members and, by convention, is chaired by a government member. The deputy chair is always a member of the Opposition.

The Committee's role is to hold the government to account for the lawfulness, efficiency and effectiveness with which it uses public monies. The Committee does this primarily by providing a formal link between the Australian National Audit Office and the Parliament. The Committee is required to examine all reports of the Auditor-General which are presented in Parliament and to report to both the House and the Senate regarding any matters that the Committee considers should be drawn to the attention of the Parliament. It advises the Auditor-General on Parliament's audit priorities. Furthermore, the Committee must approve or reject the proposals for appointment of the Auditor-General and the independent auditor of the ANAO. It also reviews the annual resource requirements and operations of the ANAO.

In addition, the Committee may launch independent inquiries itself.

3.6. Conclusion

189. Explicit constitutional restrictions, strong party discipline, and enshrined Westminster political traditions all serve to limit the role of Australia's Parliament in the budget process. The outcome budgeting framework has also had the result of further limiting Parliament's role.

190. Compared to other Westminster Parliaments, the Australian Parliament is unusual in that it directly elects its upper house (the Senate). Due to different electoral rules for the two houses, the Opposition often enjoys a majority in the Senate; this has helped create the significant review and scrutiny role of Senate committees in examining the budget. It is the Senate's primary vehicle for detailed questioning of ministers and officials, and for holding the government to account.

191. By contrast, the fact that the House of Representatives has no similar committee system for examining the budget is striking, albeit perhaps entirely rational. The flip side of the fact that the Parliament approves only 20% of total expenditure through the annual budget process is that it can focus its attention on the "special" (permanent) legislation that accounts for 80% of total expenditures. The Parliament has the power to amend and reject such legislation.

192. The parliamentary budget calendar was modernised with the 1993/94 budget. Since then, the Parliament has approved the budget prior to the start of the fiscal year. This was a significant reform, if mainly symbolic in effect. Previously, the Parliament had granted the government interim funding in the beginning of the fiscal year, as is common practice in other Westminster Parliaments.

193. A further modernisation could be considered by having the Parliament separately consider the government's Fiscal Strategy Statement prior to the discussion of the budget. For instance, the Parliament could consider the government's statement two months before the introduction of the budget. This would serve to foster debate and promote understanding of fiscal policy issues and how they relate to overall economic performance.

194. The Parliament has limited independent analytical resources at its disposal in examining the budget and holding the government to account. It draws on the Australian National Audit Office in this regard.

4. BUDGET IMPLEMENTATION AND MANAGEMENT ISSUES

195. This section consists of four stand-alone sub-sections covering the following subjects:

- organisational structure;
- human resource management;
- financial management and reporting;
- execution of budget appropriations.

4.1. Organisational structure

196. Major changes were made to the structure of government in 1987 when the number of ministries (departments) was reduced by nearly half, from 27 to 17. The Prime Minister who introduced the reforms reflected on them as follows:

The purpose of the reforms was to achieve better policy co-ordination, administrative efficiencies and improved budget processes. The changes sought to enhance ministerial control of departments... Each of the sixteen Cabinet ministers was responsible for one of the larger portfolios... The changes made for an improved Cabinet process since all portfolios were now within the Cabinet. The reforms also permitted a greater focus on the main priorities of government, freeing Cabinet ministers from some areas of routine administration... The objective was to reconcile some issues internally rather than at the Cabinet table. Cabinet agendas were getting out of hand. (Hawke, 1994)

197. Since then, the numbers of ministries and their respective competencies have remained comparatively stable. At present, there are 19 ministries in Australia. The organisation of government is the prerogative of the Prime Minister but usually on the advice of the Secretary of the Department of the Prime Minister and Cabinet and after other discussions with senior ministerial colleagues. New arrangements are set out in an “Administrative Arrangements Order” which is formally issued by the Governor-General. Major changes – when they do occur – typically happen at the start of a new three-year term of government.

198. The ministry forms the core of a portfolio of entities. There are some 170 bodies in the Australian government in addition to the ministries themselves.¹⁹ The ministries do not have an explicit and consistent *de jure* co-ordination role in the portfolio. Rather, each body reports directly to the minister. As noted in section 2.2.1, there are several reasons for this. Most important is the fact that legal responsibility for the performance of the body – accountability – rests with the minister and the person(s) heading each body. The heads of agencies are also keen to have a direct relationship with ministers rather than operating through their respective ministries. Ministries are more likely to provide support to their ministers in regard to the operations of smaller agencies. This practice has in fact been increasing over the last several years.

¹⁹ The official *List of Australian Government Bodies and Governance Relationships* contains a total of 1 153 bodies. However, this total encompasses all bodies, including subsidiaries of commercial entities and all commissions, boards and councils, which often have no separate personnel.

199. The subsidiary bodies fall into one of the four following categories:²⁰

- “branded functions” within ministries;
- executive agencies;
- statutory (“prescribed”) agencies;
- statutory authorities.

200. “Branded functions” are legally – and in reality – part of the core ministry but enjoy an independent identity without any independent staffing or financial powers. They are responsible to the secretary of the ministry. The size and/or nature of the activity do not justify a stand-alone independent agency. An example is COMCAR, which is a car-with-driver service for high-level office-holders. It operates as a branded function within the Department of Finance.

201. Executive agencies provide a degree of independence from the core ministry in terms of management where that is appropriate to an agency’s functions. Principally, this allows the agency head (who is directly responsible to the minister) to hire staff independently of the core ministry. Executive agencies are typically also independent in terms of financial management. Examples include the National Archives of Australia and the Bureau of Meteorology.

202. Statutory (“prescribed”) agencies are designated as such by legislation. They are typically headed by a chief executive responsible directly to a minister. Statutory agencies are independent in terms of financial management and – typically – human resource management. Examples include the Australian Taxation Office and the National Blood Authority.

203. Statutory authorities are designated as such in their enabling legislation. They differ from many statutory (“prescribed”) agencies in that they typically have a governing board (board of directors) rather than a chief executive as its head. They can also be said to be more at arm’s length from the government. They are independent in terms of financial management and human resource management. Examples include Tourism Australia and the Australian Sports Commission.

204. In recent years, there have been two distinct trends in the organisation of government. The first is to limit the number of bodies wherever possible. There is a policy preference to curb the growth of new bodies, to have new functions conferred on existing bodies, to merge agencies where possible, and to rely more on “branded” functions within ministries. In fact, several executive agencies have been reversed back as rebranded functions within ministries. That said, the task remains a challenging one, as new functions of government often result in new agencies. For example, despite the strenuous efforts to avoid creating new bodies financially separate from ministries and to reduce the number of existing bodies over the last term of the previous government, there was a net reduction of only three bodies, from 174 to 171.

205. The second trend has involved abolishing undue and excessive governing boards (boards of directors) associated with various agencies. Instead, there is one chief executive directly accountable to a minister. This new arrangement was in response to the conclusions of a review (“The Uhrig Review”) of the corporate governance of statutory authorities, including the relationship between statutory authorities and their respective ministers. The Uhrig Review did not support governing boards in situations where it was not appropriate for the board to be given the full power to act:

²⁰ Classifying agencies is complex, and involves the interaction of a number of legislative instruments, including the Financial Management and Accountability Act 1997, the Commonwealth Authorities and Companies Act 1997, and the Public Service Act 1999. This grouping should be treated as indicative.

...boards can only provide effective governance when they have the full power to act. When a board is created and not given adequate power, not only will it be unable to provide effective governance, but it also introduces an additional layer of participation in the governance framework, potentially clouding accountabilities... The review identified two main factors which diminish some boards' power to act. These are the board not having the power to appoint and terminate CEOs, and strong and effective relations being established between CEOs and ministers. (Australian Government, 2003)

206. The review also commented on the lack of professional calibre of some boards and the potential conflicts of interest of some board members due to their special interest constituency base.

207. As a result, the need for boards has been systematically reviewed over recent years, with many being abolished, including in large and critical bodies. This move has in fact served to blur the lines between statutory/prescribed agencies and statutory authorities, since some authorities are now run by a single chief executive whereas this used to be one of the key defining differences between the two.

208. In cases where governing boards do remain, actions have been taken to improve their effectiveness by the promulgation of guidelines proposed in the Uhrig Review on board size, board committees, the appointment process, tenure, development and performance review. For example, in order to enhance their independence, the practice of having a representative of the portfolio core ministry on a governing board was significantly reduced.

209. In some cases where governing boards have been abolished, advisory boards have been created. Members of the advisory boards may previously have served on the governing boards, especially in cases where the government seeks external expertise to advise agencies on particular matters. But it is not appropriate for the board to have full governance responsibilities. For example, the governing board of the Great Barrier Marine Park Authority transitioned to an advisory board on 1 July 2007.

Box 22. Centrelink

Centrelink is a statutory agency that delivers virtually all welfare payments and transfers (e.g. old-age pensions, disability pensions, unemployment benefits, student grants and loans). It is unique in that its activities cut across all relevant ministries and because it not only handles the actual payment, but is a one-stop shop that assesses eligibility for benefits as well, based on guidelines determined by the responsible ministries. It distributes approximately AUD 66.3 billion annually to 6.5 million clients, or approximately one-third of the Australian population. It administers over 140 different products and services for 11 departments in more than 1 000 service delivery points ranging from large customer service centres to small visiting services. It employs 25 000 staff. Formally it reports to the Minister for Human Services, but it delivers benefits and services for ten other departments.

Centrelink was created in 1997 by merging the service delivery functions of several disparate agencies operating in this area. As part of this process, savings on the running (operating) costs of 10% over three years were realised. Centrelink's running (operating) budget is principally a function of fee-for-services payments it receives from each of the 11 ministries for which it provides services. If any ministry wishes Centrelink to take on new tasks, a marginal cost calculation is done on the basis of a detailed workload measurement system. This forms the basis for cost negotiations with the purchaser ministry.

The "one-stop shop" has been judged to have improved service delivery markedly. In fact, Centrelink surveys 65 000 of its customers twice a year to measure user satisfaction. Customer feedback aside, there has been some criticism regarding the complexity of providing services on behalf of so many "masters" and regarding the ministries' ultimate threat of "pulling rank" and ordering a specific service at a specific price that may not fully take into account the complexity and time required to deliver a new service. This also calls into question Centrelink's fee-for-services model rather than being directly funded through the budget.

210. Each ministry is headed by a secretary as its chief executive. The Prime Minister appoints secretaries following advice from the Secretary of the Department of the Prime Minister and Cabinet. If the position of Secretary to the Department of the Prime Minister and Cabinet is vacant, the Prime Minister must consult the Australian Public Service Commission in the search.

211. Secretaries used to be permanent positions. As part of the reform of the overall human resource framework, secretaries now hold contracts of 3-5 years and at the pleasure of the government. There have in fact been cases of a government retrenching secretaries. This occurred with a change of government in 1996 when the incoming government terminated the appointments of six secretaries. However, it would be unfair to characterise this as the politicisation of the position, since new secretaries are generally selected from a cadre of deputy secretaries and agency heads or by moving existing secretaries. There have been no examples of overt political appointments to this position. Their independence, however, is considered by some to be fragile.

212. Heads of agencies are selected by the minister. Heads of authorities are selected either by the minister or the relevant board; the trend is very much to give the appointment function to the boards. The new government has announced that it will advertise some of these positions with a merit-based assessment and selection process. However, the minister will remain responsible for the final appointment decision.

213. A recent innovation is for ministers to issue annual statements of expectations “to provide greater clarity about government policies and objectives, including the policies and priorities [a body] is expected to observe in conducting its operations.” These are typically very short statements, generally one page in length. In response, chief executives are to issue statements of intent to respond to their ministers, and outline “how [a body] intends to undertake its operations, and how its approach to operations will be consistent with the statement of expectations.” These statements of intent are typically 3-5 pages in length.

214. In addition, there may be specific performance agreements between ministers and secretaries and heads of agencies that would be relevant in this respect. However, they are not public documents.

215. Australia pays great attention to the organisational structure of government (“machinery of government”). The reforms undertaken in the past have contributed significantly to improving the performance of government. The governance principles associated with the Uhrig Review are especially commendable.

4.2. Human resource management

216. Human resource management reform occurred closely with the budgeting and financial management reforms. In short, the heads of each agency have the responsibility for the recruitment, classification of positions, wage-setting and dismissal of employees. It should be emphasised that this devolution is explicitly set forth in legislation; it is not an administrative delegation of power from a central agency.

217. The overall employment framework is provided by legislation. Wages and conditions are decided in agreements at the individual agency level. In recent years, there have been two types of agreements:

- collective agreements;
- personal (individual) agreements, known as “Australian Workplace Agreements”.

218. There has been increased similarity between the public sector framework and the approaches used in the private sector. Both the collective agreements and the Australian Workplace Agreements were

used in the private sector as well. Personal agreements often followed a standard template. The type of framework used was a question of organisational culture. For example, most Department of Defence staff were on collective agreements whereas all Department of Finance staff were on individual agreements. The most common approach was for agencies to use a mix of both types of agreements.

219. Under the new government's approach, most employees will be covered by collective agreements at the agency level. However, there is some scope for personal agreements, particularly for members of the Senior Executive Service (see Box 24) and other higher classified employees. Such personal agreements can also be used to "top up" the collective agreements.

220. Collective agreements are negotiated at the level of each agency; there are no public-service-wide collective agreements. However, the government sets broad policy parameters to be followed by agencies in settling their agreements, known as the "Australian Government Employment Bargaining Framework".

221. Each agency head is responsible for setting the respective agency's overall human resource management policy parameters. Agencies have embraced this to varying degrees. Some have largely "copied" the old, centralised framework and localised it with the same or similar processes. At one extreme, agencies have practices which reflect those used in the past. At the other extreme, agencies have used the new flexibility to develop a very tailored approach to the needs of their organisations. Some agencies have mechanisms such as remuneration committees to guide agency policy on remuneration and other terms and conditions of employment.

222. Recruitment must follow the principles of transparency, merit and competitiveness. Most vacant positions are now advertised internally and externally. Historically, most vacancies were only advertised internally (within the public service), with outside recruitment focused mainly on "entry-level" positions. Mobility between the public and private sectors is increasing. However, the labour market in Australia is tight.

223. An eight-level classification system is used in the public sector excluding the Senior Executive Service (see Box 24). Allocation of a classification to employees is the responsibility of each respective agency head. Each agency uses its own standards to determine the value of a group of duties, the responsibilities and the skills required to perform those duties. This determines the classification to be applied. There are no pay scales associated with the classification. The eight-level classification system provides a common structure in the APS and facilitates mobility across the public service.

224. Approximately 90% of positions in the government are considered as "ongoing", irrespective of whether the collective or personal agreements were used. The remaining 10% are considered as "non ongoing", referring to positions established for a specified term, specific task, or for duties that are irregular or intermittent. Non-ongoing positions are used across a wide spectrum of roles, historically concentrated at the lower classification levels. In 2007, the Australian Taxation Office was the largest user of non-ongoing employees.

Box 23. Contractual employees

Contractual employees are outside the formal Australian Public Service (APS). They number about 10% of total government employees, or equivalent to about 1.5 times the number of “non-ongoing” APS employees.

The Australian National Audit Office (ANAO) reported on Non-APS Workers in 2007.^a In a survey of government agencies, the most frequent reason given for engaging non-APS workers was the need for specialist skills (52% of all contracts) followed by the need for skills currently unavailable in the agency (33% of all contracts) and the need for independent research or assessment (12%). Agencies also provided specific justifications for contract renewals and extensions, including the need for business continuity through the retention of knowledge and the associated cost of retraining new individuals.

In comparison to “non-ongoing” workers, contractual employees are concentrated at the (equivalent of) higher classification levels in the APS. The share of contractual employees is increasing, while the share of “non-ongoing” APS employees has stabilized. The ANAO report noted that this was a reflection of the higher skills generally required by government.

a. Australian National Audit Office (2007), *Non-APS Workers. Audit Report No. 49*, June, Canberra.

225. Terminations/retrenchments are not common and usually take place due to three factors: misconduct, underperformance and organisational restructuring. All are used with the last category, accounting for the greatest number of terminations/retrenchments. In those cases, the agency concerned offers severance packages to the affected staff, the amount being based on length of service. Voluntary redundancy is the most common approach to downsizing.

226. Performance management systems are used across the public service. All increases to employees’ salaries must be linked to performance. In some cases, performance management systems incorporate performance bonus arrangements. In rare cases, bonuses have been as high as 20% of an individual’s total pay. However, it is more common for bonus payments to be equivalent to around 10% of total pay. Currently there is no maximum bonus set centrally. The use of a maximum bonus varies greatly between agencies. Some agencies apply it only to the most senior levels. Others apply it only to the successful completion of “flagship” projects. Bonuses must also be seen in the context of the ability to individualise pay through the personal agreements, especially at the more senior levels. All such arrangements are established at the agency level.

Box 24. The Senior Executive Service and the Australian Public Service Commission

Special provisions apply to the Senior Executive Service (SES), and the Australian Public Service Commission (APSC), the central human resource management policy advisory body, retains a direct involvement in this area.

The SES consists of three levels: deputy secretary/deputy head of agency, head of division, and head of branch. Note that the positions of secretary and head of agency are not SES positions.

The secretary/head of agency decides on the number of positions classified as SES within his/her organisation, subject to budget constraints. A selection panel is appointed for each SES opening, and it includes a representative of the Australian Public Service Commission. The final selection decision is made by the secretary/head of agency who also sets the salaries for SES positions within his/her organisation. The role of the APSC representative on the selection panel is to certify that all appropriate procedures have been followed for the appointment and that the process has been merit based. The Commissioner must endorse the certification of the process by the APSC representative before the final selection can be effected.

The SES is regarded as a cross-service leadership cadre, even though their employment is agency based. The APSC is interested in the development of the SES cadre and encourages mobility of SES members between departments and agencies. In this context, and as noted in section 4.1 on organisational structure, the positions of secretary/head of agency are generally filled from the ranks of the SES, although around 20% of current secretaries were selected from outside.

In addition to the SES, the Australian Public Service Commission is responsible for ensuring that the principles of transparency, merit and competitiveness in hiring are upheld, and provides training services. It is also responsible for an annual "State of the Service" report which is submitted to the Parliament. This report broadly covers the public service workforce profile, values, diversity and development processes.

227. Australia has made great progress in devolving the human resource function to the respective agencies. This devolution has been aided by the fact that it is explicitly set forth in legislation; it is not an administrative delegation of power from a central agency. At the same time, the Australian Public Service Commission has focused its attention on the development of the Senior Executive Service cadre. The effects of the new government's intention to limit personal agreements and move towards a system primarily based on collective agreements (at agency level) can only be determined over time. It could serve to reduce flexibility.

4.3. Financial management and reporting

228. Australia has been at the forefront of financial management and reporting among OECD countries. As a discussion of the move to accruals was included in section 2.2.4 above, this section focuses on institutional arrangements for accounting standard setting, financial reporting, and cash and asset management.

4.3.1. Accounting standard setting

229. Australia has one standard setter – the Australian Accounting Standards Board (AASB) – that covers both the private sector and the public sector. The separate Public Sector Accounting Standards Board and the former Australian Accounting Standards Board were merged in 2000. The current Board has characterised the previous arrangements as "result[ing] in much duplication of effort in reaching the same conclusions." The basis of the merger was that public sector financial reporting issues would continue to receive appropriate attention; whether this is the case is debatable, although the work programme of the Board currently includes a range of public sector issues.

230. The AASB has a full-time chair appointed by the government and part-time members appointed by the Financial Reporting Council (FRC), which acts as the independent oversight board of the AASB.

The number of part-time members is decided by the FRC each time. At present, there are twelve part-time members, of whom three are public sector preparers and one is a state auditor-general – giving the public sector a one-third weight among the part-time members. While there is no official quota system, the intent is that the Board will contain appropriate representation from the public sector, academia, the accounting profession and corporations. The Board also has a representative of the New Zealand Financial Reporting Standards Board. The AASB has its own technical, research and administrative staff.

231. The AASB had a policy of sector neutrality as it promulgated its accounting standards, *i.e.* that the same standard should be applicable in the private sector and the public sector. This policy was amended in 2006 to a focus on transaction-neutral standards, *i.e.* that the same transaction should be treated the same way in the private sector and the public sector, augmented where necessary by topic-specific standards. This change has facilitated the withdrawal of several public-sector-specific standards “inherited” from the previous Public Sector Accounting Standards Board.

232. The AASB relies principally on (private sector) International Financial Reporting Standards (IFRS) as the basis for its standards, and adds wording and expands definitions in the form of “Aus Paragraphs”²¹ in order to make them applicable in a public sector context (see Simpkins, 2006). The IASB is currently revising its conceptual framework to focus more strongly on private sector entities which may increase the difficulty of promulgating standards based on IFRS that would be applicable to the public sector as well.

233. In this context, it is important to note that the International Public Sector Accounting Standards Board has embarked on its own conceptual framework project, and this can be used in considering transaction-neutral standards in the future.

234. The future of neutral accounting standard setting in Australia will therefore continue to be a balance. Will it be possible to maintain the current regime? Will a separate set of public-sector-specific accounting standards emerge? A matrix of the two seems a likely outcome. Some would question the logic of a single accounting standard setter for both the private and public sector, but it has worked well in Australia to date. However, requiring the National Archives to depreciate its contents in order to conform to Australian Accounting Standards – as noted in section 2.2.4 – highlights the differences between the public and private sectors and the difficulties faced by specific classes of public sector agencies.

4.3.2. Agency financial reporting

235. The Department of Finance issues “Finance Minister’s Orders” (FMOs). These are the regulations specifying in detail how all government agencies (except commercial entities) produce their annual financial statements. The FMOs specify the use of Australian Accounting Standards (AAS). In addition, the FMOs have two purposes. First, where an AAS would allow more than one option in reporting, the FMOs mandate which option to use in order to promote consistency and facilitate consolidation. Second, the FMOs contain additional reporting and disclosure requirements to be contained in the notes to the financial statements in order to enhance accountability and transparency in government financial management.

236. The FMOs do not apply to the consolidated financial statements based on AAS (see below). There have been instances where the Australian National Audit Office did not accept that the provisions of the FMOs were in compliance with AAS. This related to depreciation and the useful life of heritage and cultural assets.

²¹ Aus Paragraphs supplement the International Financial Reporting Standards (IFRS) where additional or alternative requirements are needed to tailor the standard to the public sector.

237. The financial statements of all Australian government agencies are subject to audit by the Auditor-General and are published in the respective agency's annual report. Individual agencies are strongly encouraged to publish their annual reports, including financial statements, on the Internet and virtually all do so.

238. Since adopting accruals, Australia has invested significantly in training and recruiting accounting professionals in government. Australia uses a decentralised accounting system where government entities typically have their own internal accounting systems and produce their own financial reports. They transmit necessary information to the Department of Finance on a monthly basis for the production of the government's financial statements. All of this takes place on the basis of Australian Accounting Standards.

4.3.3. Consolidated whole-of-government financial reporting

239. In-year reporting in Australia consists of monthly financial statements that outline each month's results and the accumulated year-to-date results with a comparison to the budgeted figures for the fiscal year as a whole. The monthly statements are only prepared on a GFS basis (government finance statistics; see Box 25). These statements are generally available within four weeks of the end of each month. The reports for the first three months of the fiscal year are generally produced with an eight-week lag, as the government's annual accounts for the previous fiscal year are being finalised. However, it is important to note that the statements do not contain a comparison with the apportioned budget figure for the same time period, nor with the actual figure for the same time period the previous year. The statements provide a fair degree of disaggregation of expenditures by purpose but not, for example, on a portfolio-by-portfolio basis.

240. Australia publishes two sets of end-of-year statements. The *Final Budget Outcome* report is published by the end of September, *i.e.* three months after the end of the fiscal year. It provides information on both the AAS and GFS bases of financial reporting. This report is not audited. The Consolidated Financial Statements are submitted to the Auditor-General by the end of November, *i.e.* five months after the end of the fiscal year. The Consolidated Financial Statements are presented on the basis of Australian Accounting Standards only.

241. The Australian National Audit Office certifies the Consolidated Financial Statements in terms of their compliance with Australian Accounting Standards.

242. Australia compares very favourably to other OECD countries in terms of financial reporting. However, there is room to improve the monthly statements as detailed above. The timeliness of the Consolidated Financial Statements could also be improved.

Box 25. GFS: Government Finance Statistics

The Australian government embraces two external standards in its budget and related financial reporting. The first are Australian Accounting Standards (AAS) as described above. The second are Government Finance Statistics (GFS) standards as promulgated by the Australian Bureau of Statistics and based on the International Monetary Fund's Government Finance Statistics manual. The GFS as used in Australia focus only on the national government.^a Although both AAS and GFS report on both cash and accruals, the AAS standards are the benchmark for accrual reporting and the GFS standards are the benchmark for cash reporting. Cash reporting has exceptional public visibility in Australia and its figures are generally used by ministers, members of Parliament and the media in quoting the government's budget surplus or deficit.^b

In scope, AAS and GFS are very different. AAS is based on the "control" notion and, as such, consolidates all government entities, including government business enterprises. GFS is a statistical standard and focuses on the notion of "general government"; as such, it treats government business enterprises as belonging to different sectors of the economy. The AASB has recently promulgated a new standard that will apply to "general government" as a reporting entity itself, in addition to whole-of-government reporting. Aside from these inherent differences in scope, Australia has been most active internationally in explicitly mapping the differences between the two systems in the treatment of individual transactions and seeking to eliminate any unnecessary differences.

It is recognised that reporting on two separate bases adds to the length and complexity of the budget documents and often causes confusion among users of government financial reports, although reconciliation statements between the two are prepared. A new "harmonised" standard seeks to eliminate this dual reporting, and was in place for the 2008/09 budget.

It should be noted that all agencies report financial results to the Department of Finance on the basis of AAS, and the Department of Finance centrally converts them to GFS.

a. The government also used to diverge from "pure GFS" in that it did not report as revenue and expenditures the taxes collected on behalf of lower levels of government (they were netted out). The new government has decided to include them in future. Also, Australia does not report certain transactions related to the Future Fund in order to quarantine its operations.

b. The cash surplus or deficit is identified by the term "underlying cash balance". This is derived from the GFS cash flow statement.

4.3.4. Cash and asset management

243. Each agency has transaction bank accounts with either the Reserve Bank of Australia (the central bank) or with commercial banks. Agencies request their daily cash on an "as needs" basis from the Department of Finance based on their full fiscal-year cash apportionment forecasts. All agency bank account balances are swept overnight to the government's Official Public Account in the Reserve Bank of Australia and then swept back the following day into the agency bank accounts. The Australian Office of Finance Management (AOFM) is responsible for cash and debt management on behalf of the government.

244. The Australian government previously used an "agency banking incentive scheme" whereby agencies were able to keep in their transaction accounts appropriated moneys over and above immediate needs; they earned interest on this money. A system of capital use charges was also in place to promote good asset management practices. Agencies received appropriations equivalent to the capital use charges on their "starting" assets. Agencies were able to keep a portion of the appropriation for their capital use charge as an incentive if they reduced their level of assets. Both schemes were introduced as part of the overall accrual budget framework in 1999. They were both abolished in the 2002/03 budget. Both measures created too much complexity for little positive result and encouraged agencies to "game" the system.

4.4. Execution of budget appropriations

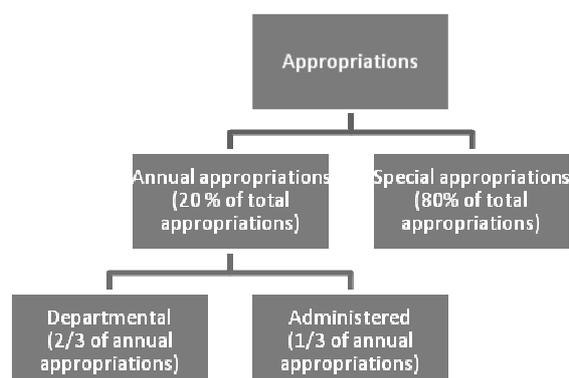
245. As noted previously, the Australian budget contains two main types of appropriations:

- annual appropriations (roughly 20% of total spending); and
- special (standing) appropriations (roughly 80% of total spending).

246. The annual appropriations are contained in Appropriation Bill 1, Appropriation Bill 2, Appropriation (Parliamentary Departments) Bill and any supplementary appropriations bills as discussed in section 3. Annual appropriations are decided on a year-by-year basis and limited by specific amounts in the annual budget.

247. Special (standing) appropriations are decided by legislation other than the annual appropriation acts. Special appropriations typically refer to various transfer programmes where entitlement is based on fulfilling certain criteria – such as age for old-age pensions. Special appropriations are usually open ended, but in some cases they can be limited to a specific amount (so called “limited by amount” special appropriations). The estimated amounts for special appropriations are included in the respective Portfolio Budget Statement but, as noted above, in most cases with no binding limits on expenses. No supplementary bill is necessary if spending differs from the indicative amount provided.

Figure 7. Appropriation structure



248. Annual appropriations are made on the basis of outcomes to each individual agency in the respective appropriation acts. Each act specifies appropriations by outcome for departmental expenses and for administered expenses.

249. Departmental appropriations can generally be seen as appropriations to cover running (operating) costs and closely related expenditures within its outcomes, *i.e.* salaries, operational expenditure and depreciation. Departmental appropriations can be seen as the “price” paid by the government to achieve outcomes. If an agency has more than one outcome, the departmental appropriation is split notionally and for information only between outcomes as an indication of the amounts an agency will spend to achieve each outcome. Outcomes do not limit the purposes on which departmental appropriations can be spent. They can be spent on any purpose within the ambit of the relevant ministry or agency.

250. Administered appropriations are transfer programmes to entities outside of government; in other words, ministries and agencies “administer” the money on behalf of the government rather than being able to use it for their own purposes. Administered appropriations generally exhibit the same characteristics as special (standing) legislation except that they are enacted on an annual basis. They may cover grants and other transfers decided by some criteria beyond the control of government. Both departmental and

administered appropriations may have operating and non-operating (or capital) components which are separately appropriated.

251. Almost all special (standing) legislation can be viewed as administered appropriations. A very limited number have departmental components.

252. This split between departmental and administered appropriations ostensibly reflects the accounting notion of “control”. It also reflects the previous system of programme budgeting. The departmental costs are equivalent to the previous running costs regime, and the administered appropriations are equivalent to the previous programmes. Funding for assets, however, was shifted from programmes to departmental expenses. The fact that departmental costs are fungible across multiple outcomes within the same agency reflects the desire not to reduce flexibility.

253. Responsible ministers can reallocate individual administered items within the same outcome, but not across outcomes. The vague wording of outcome definitions in practice gives responsible ministers and heads of agencies wide latitude in this regard. As noted, there are no restrictions on reallocating departmental costs – even between outcomes – within the same agency. The responsible line minister can approve reallocations of less than AUD 5 million. Reallocation of more than AUD 5 million can be done with the approval of the Finance Minister. Reallocation is not allowed between appropriations in different bills, or between departmental and administered appropriations without the approval of the Parliament. Similarly, reallocation between special (standing) legislation is not possible without the approval of the Parliament.

254. Annual administered appropriations lapse at the end of the year and no amount can be carried forward unless it has been expensed prior to the end of the year. Annual departmental appropriations are indefinite in duration, with no restrictions on carry-forwards.

Box 26. Regulation 10: Annual budget and multi-year contracts

The Australian budget cycle is annual, but agencies regularly need to enter into longer-term commitments. This is usually the case for property rentals/leasing, research projects and capital projects. To handle these situations, government agencies may, with the approval of the Finance Minister, enter into contracts and other arrangements even though they do not currently have all the money to cover the full cost of the contract. This process occurs under Regulation 10 of the relevant legislation.

Regulation 10 prohibits ministers and government officials from committing money that is not fully supported by available appropriations, without special authorisation. This authorisation has to be obtained before a multi-year commitment or indemnity can be approved. Approval is obtained from the Finance Minister, who can delegate this authority to the chief executives of agencies.

It is important to note that the Finance Minister only authorises the agency to consider entering into a long-term contract, but has no responsibility to approve or oversee the actual contract. If authorisation is provided, the spending proposal can then be approved by a minister or an official within a ministry or agency. When deciding to approve a contract or other arrangement, a minister or an official must assess whether it is consistent with government policy and makes efficient and effective use of government resources.

255. Appropriations – both departmental and administered – can be designated as “net appropriations” with the agreement of the Department of Finance. Under such circumstances, appropriations can be increased up to the same amount as the offsetting revenue received.

Box 27. The advance to the Finance Minister

The advance to the Finance Minister (the Advance) is a provision in the annual appropriation acts which enables the Finance Minister to provide additional appropriation funding to agencies. It can be seen as a central contingency fund to provide urgent and unavoidable funding to agencies throughout the fiscal year. The amount of the Advance varies; in the 2007/08 budget, it amounted to a total of AUD 390 million.

The Finance Minister must give the Parliament details of the use of this Advance.

5. REDUCING RED TAPE WITHIN GOVERNMENT

5.1. The initiative

256. The Australian government launched an initiative aimed at reducing red tape within government in 2007. The initiative evolved from work launched by the Department of Finance and derives directly from a report published in November 2005: *A Report on Red Tape in Internal Australian Government Administration*. The report was commissioned by the Management Advisory Committee which consists of secretaries and heads of major agencies. The policy is explained and guidance on achieving its objectives is provided in two documents: *Reducing Red Tape in the Australian Public Service* and *Reducing Red Tape: Dispelling Some Myths in Australian Government Administration*, both published in early 2007.

Box 28. Defining "internal regulation"

The term regulation, as commonly understood, refers to rules, specified through legislation or other policy instruments, through which governments require external parties – most commonly business – to behave in certain ways. However, governments also promulgate larger numbers of rules to govern the behaviour of individual agencies within government, notably in areas such as financial management, purchasing, recruitment and record keeping. These rules can be considered as “internal regulation”. While internal regulation is necessary, it can easily become “internal red tape”.

257. Two basic problems are identified in respect of internal regulation. The first is that the processes by which internal regulation is developed and implemented have not been sufficiently rigorous, consistent or systematic. The second is that internal regulatory requirements are often poorly understood by agency staff and that risk aversion often leads them to adopt unduly onerous processes that are not actually required by the internal regulation in place.

258. The initiative for reducing red tape within government seeks to address both of these problems. Thus, the policy is intended to improve the efficiency of the use of budget sector resources by ensuring that practices reflect actual regulatory and administrative requirements as promulgated and by ensuring that these requirements are the minimum necessary, consistent with the maintenance of accountability and transparency requirements.

259. As two basic problems in relation to internal regulation have been identified, two distinct initiatives have been adopted to address them. These are:

- the adoption of a “framework for design and review” of intra-governmental regulatory and administrative processes; and
- a programme aimed at improving understanding of actual internal regulatory requirements, particularly through identifying and correcting common “myths” regarding these requirements.

5.2. The process for developing new regulatory requirements

260. All government agencies are required to use the framework in developing new internal regulation. Existing requirements must also be reviewed using the same framework. Regulation internal to an agency is to be reviewed at intervals of three to five years, while “whole-of-government” internal regulation is to be reviewed at five to ten-year intervals.

261. Three “underlying principles” for the framework are identified. They are that regulation should effectively address the issue of concern, be the most efficient option and have benefits that substantially exceed costs.

262. Based on these principles, a four-stage process has been developed, encompassing:

- design and analysis;
- stakeholder consultation;
- independent advice; and
- decision making.

5.2.1. Design and analysis

263. The design and analysis phase involves several steps. The first step includes correctly identifying the problem to be solved and, in particular, ensuring that the problem and its symptoms are clearly distinguished. An analysis of the “circumstances, failures or behaviours” that have led to the problem is also required, and the specific objective to be achieved must be identified.

264. Second, an explicit process of identifying options for achieving the alternative is required, with emphasis being placed on taking a broad view and looking beyond “traditional” options. The viability of the options must be assessed, based on judgements as to effectiveness and proportionality. The preferred option should be identified on the basis of a preliminary benefit/cost analysis.

265. Third, a full benefit/cost analysis of the preferred option is required, using a specific methodology (the business cost calculator, based on the standard cost model methodology widely used to assess administrative burdens) to assess costs. In addition, the “efficiency” of the option is to be assessed. This involves assessing the proposal against a number of specific criteria: whether it duplicates existing requirements, whether it imposes minimum administrative burdens, whether the financial impact of administration and compliance are minimised, whether the size of the problem is sufficient to justify action, and whether the proposal is clear and unambiguous. These additional tests are apparently intended to function as checks on the quality of the broad benefit/cost analysis.

266. Fourth, an implementation and review strategy must be developed. Finally, a decision as to whether the proposal meets the framework principles, and should therefore proceed, is required.

5.2.2. Stakeholder consultation

267. The framework establishes several objectives of stakeholder consultation. These are to identify obstacles to successful implementation, the extent of required changes to systems and processes, the administrative burdens involved, the implications for other aspects of an agency’s administration, and alternative options that might not have received adequate consideration.

268. Agencies are given discretion to determine their own consultation process where internal regulation is concerned. Where whole-of-government regulation is being considered, the required extent of consultation depends on the significance of the proposal. Thus, “broad agency consultation” is generally required for significant proposals, though it is stated that considerations of sensitivity or urgency may preclude this. Targeted consultation with “key stakeholder agencies” or a small group of affected agencies is regarded as adequate in the case of less significant proposals.

5.2.3. *Independent advice*

269. The requirements in relation to independent advice are also flexible in nature. For internal requirements, broad discretion is again provided with guidance suggesting that it is sufficient for a “senior manager” who is at arm’s length from the proposal to consider it. For significant whole-of-government requirements, the Red Tape Deputy Secretaries Group should be approached, unless there has been extensive formal consultation at chief executive level.

270. Independent advisers are required to be given “all relevant information”, including the results of the analysis of the preferred option and of the stakeholder consultation. The advice received should be considered before the proposal is put to the ultimate decision maker, while the independent adviser’s opinion should also be conveyed to the decision maker.

5.2.4. *Decision making*

271. The framework notes that legislation or other requirements may specify the required level of the decision maker. Where this does not occur, a proportionate approach is counseled. Thus, significant whole-of-government requirements should generally be approved at least at the level of deputy secretary, while less substantial proposals can be approved by more junior officials. Emphasis is placed on the need to provide the decision maker with adequate information (see above), including detail on how any concerns raised by stakeholders, independent advisers or others have been handled.

272. The decision maker should base decisions on whether the framework process has been followed, whether the most effective and efficient option has been chosen, whether benefits substantially exceed costs, and whether there is an appropriate review strategy.

273. As this description indicates, the process established via the framework is quite detailed and should ensure a high degree of consistency in approaches to developing internal regulation. At the same time, it incorporates significant elements of flexibility, with a stated aim of ensuring that a proportionate approach is adopted and that issues of sensitivity and urgency can be accommodated.

5.3. *Addressing “myths” about internal regulation*

274. The second identified contributor to the problem of excessive internal regulation (in addition to inadequate processes for developing internal regulation) is widespread lack of understanding of what internal regulatory requirements actually exist. In particular, numerous “myths” have been identified which, it is asserted, have led to a widespread belief that internal regulatory requirements in many areas are more onerous than is actually the case. Consequently, the programme seeks to identify major “myths” and, in doing so, improve understanding of what are the actual regulatory requirements in major areas. Since this should lead to actual practice conforming more closely to the existing regulatory requirements, this is seen as an important way of reducing internal regulatory burdens, particularly in the short term.

275. Two mechanisms have been adopted. First, the second half of *Reducing Red Tape in the Australian Public Service* identifies major myths in relation to the key areas of procurement and recruitment. The approach taken is to identify a particular myth and to highlight the actual internal

regulatory requirement in each case. This is supplemented by general discussions of the main sources of internal regulatory requirements in relation to recruitment and procurement and of the major concerns in relation to poor practices in these areas.

276. Second, a separate publication – *Reducing Red Tape: Dispelling Some Myths in Australian Government Administration* (referred to as “the Mythbook”) – addresses key myths in three more areas including financial delegations to officials and record keeping. The format of this document is tabular, with specific “myths” and “realities” juxtaposed throughout. Table 1 shows a sample of the myths identified, and the corrections offered, in the *Reducing Red Tape* document and the Mythbook.

Table 1. Myths and realities

Myth	Reality
Procurement	
Three written quotes must be obtained for all procurements.	No minimum number of quotes is specified in policy, but there is a strong presumption in favour of open tendering for larger contracts.
All approaches to the market advertised on the AusTender website must also be advertised in the press.	No specific requirement to advertise. Agencies should consider whether this is needed in order to encourage competition.
External probity advisers are required for medium and high-value procurements.	No “hard and fast” policy exists as to when external advisers are required.
Recruitment	
You cannot personally contact people and invite them to apply.	Individuals can be targeted and encouraged to apply for a position.
A vacancy must be filled at the same job level.	A vacancy provides an opportunity to reassess and/or redefine the role, including the level.
A selection team must have three members.	A selection team can be a single person.
Chief executive’s financial delegations	
CE delegations must be reissued when a new CE is appointed.	No. Previous delegations continue to apply until revoked or varied.
Powers should not be delegated below senior executive level.	Not true. The choice of delegate, including the level, is largely a matter for the CE.
Chief executive instructions	
All CE instructions should address the same topics, in the same level of detail.	No, CEIs should be tailored to agency needs.
A CE can issue CEIs on any matter.	No. A CE cannot issue CEIs on matters outside the Financial Management and Accountability Framework.

5.4. Regulatory reform

277. The initiative for reducing red tape within government must be seen in the context of broader regulatory policy. Almost all governments of OECD countries have explicit programmes in place to improve the quality of regulation making and review processes. In some countries, these programmes have been developing for over twenty years. Their existence recognises the fundamental importance of regulation as a government policy tool and reflects substantial theoretical critiques of the dynamics of regulation and its use by government. In many countries, this “regulatory policy” or “regulatory

governance” agenda has substantially changed the way regulation is developed and used, and significantly improved regulatory performance.²²

278. However, this regulatory policy agenda has essentially focused only on regulation that affects parties external to government. Thus, the Australian initiative effectively expands the scope of systematic regulatory quality assurance policies to include intra-governmental regulation. The adoption of similar formal requirements in this context is a novel development and a potentially important innovation.

279. As might be expected, given the substantial experience accumulated with regulatory policies, the model required to be adopted in assessing proposals for new internal regulation draws substantially on the frameworks used to improve the quality of external regulation.

280. Australia is a leading player in regulatory reform, having been engaged with this issue since the mid 1980s. The current policy context for the initiative to reduce internal red tape is one in which a number of major regulatory reform initiatives have recently been taken or are currently under way. For example, the 2007 *Report of the Taskforce on Reducing Burdens on Business* (Banks Review) led to significant strengthening of processes for developing external regulation and to a number of important regulatory reforms in specific policy areas. The newly elected government also has a strong regulatory reform policy, which may be symbolically reflected in its recent renaming of the finance ministry as the Department of Finance and Deregulation. While substantively the change essentially reflects the transfer of existing regulatory reform functions from the Treasury and the Department of the Prime Minister and Cabinet, the inclusion of “Deregulation” in the title of an important central agency appears to be intended to indicate that greater priority is to be accorded to this agenda.

Box 29. Why combine finance and deregulation?

Australian officials have proposed three potential explanations for combining finance and deregulation:

- First, in Australia the Department of Finance does not carry out any external regulation, so it has no inherent conflict of interest in achieving a deregulation agenda.
- Second, through the budget functions, the Department of Finance is already fully linked into the government’s Cabinet and other decision-making processes, and this significantly facilitates the deregulation agenda.
- Third, finance ministers are already unpopular with their colleagues on financial grounds, so adding unpopularity on deregulation grounds is not a major problem.

281. Australia’s processes for developing and assessing new regulation closely reflect the OECD best practice model for assessing proposals for new external regulation. Unsurprisingly then, the framework adopted for reducing internal red tape demonstrates a high degree of commonality with the OECD best practice model for regulatory impact assessment (RIA). Shared elements between the framework model and the RIA best practice model are:

- an explicit process of identifying the underlying objective of the regulatory proposal;
- the use of systematic approaches to both identifying options to address it and assessing the benefits and costs of each;

²² For an overview of regulatory policy, see OECD (2002).

- the implementation of a decision rule requiring net benefits to be demonstrated before a proposal is adopted;
- mandatory stakeholder consultation (with some exceptions);
- “independent and objective” feedback to be sought on the analysis undertaken – and particularly in relation to whether the principles underlying the framework have been met;
- decision makers to be provided with all relevant information produced via the process; and
- regular review of existing requirements to be undertaken at specified intervals.

Box 30. Internal versus external regulation

Regulation can generally be defined as the use of authority to require actors to behave differently from what they would voluntarily choose. Regulation is essentially justified where private incentives do not align closely with broader social welfare imperatives. Where external regulation is concerned, the government is generally acting to correct market failures or to promote equity of treatment or distributional goals. In regulating within the government, the goal is to ensure that individual agencies contribute to ensuring that the government as a whole meets expected standards in areas such as policy effectiveness, efficiency in the use of public funds, transparency and accountability.

Regulation imposes costs, as well as conferring benefits. Complexity means that these costs are often difficult to assess and sometimes derive from unanticipated effects of imposing regulation. A corollary is that the “hidden” nature of many regulatory costs, compared with usually highly visible benefits, provides incentives for the government to use this tool excessively.

Moreover, the political risks of not regulating may frequently be greater than those of regulating. A culture of “risk aversion” is often cited as a major cause of over-regulation. This dynamic can apply to internal as well as external regulation.

While many regulatory dynamics – as suggested above – are common between “internal” and “external” regulation, some important differences exist. First, an important concern with the use of external regulation is that the hidden nature of many costs it imposes means it may be preferred to more visible policy actions based on taxing and spending. This incentive to over-use external regulation is not obviously replicated in relation to internal regulation, since the costs and benefits of regulation both accrue within government.

Second, when a government is regulating itself, the cost implications of particular decisions are, at least potentially, better understood than in most regulatory contexts. Thus there is a lesser likelihood of over-regulation arising due to under-estimation of regulatory costs. That said, the development of the Australian programme suggests that, despite the greater feasibility of conducting effective benefit/cost assessments, agencies imposing internal regulation have often made little systematic attempt to evaluate or even consider the cost of internal regulation.

Finally, internal and external regulation differ in that, where over-regulation arises in the internal regulatory context, there are fewer incentives for those affected to lobby to correct the situation, since they are not expending private resources on regulatory compliance. Similarly, there may also be fewer opportunities for such lobbying.

5.5. Assessment of the initiative

282. As demonstrated above, the initiative for reducing internal red tape shares with best practice regulatory reform models a focus on ensuring that regulatory development is undertaken using consistent processes that are systematic and rational. It thus favours rational decision models over other alternatives (e.g. expert, benchmarking, or consensus models).

283. Given the substantial resource costs that internal regulation involves and the important similarities between external and internal regulation, broadening the application of regulatory reform disciplines to this area appears to constitute an important step forward. The adoption of a widely accepted model for regulatory development, adapted to the internal regulatory context, should provide a high level of confidence that better regulatory decisions will result. That said, one apparent departure from standard regulatory reform practice is the adoption of a different decision rule: where RIA systems generally require that benefits exceed or “justify” costs, the framework states that an internal regulation should be adopted only if its benefits “substantially exceed” the costs. The justification for adopting an apparent bias against internal regulatory controls should be clearly established.

284. Another positive element of the initiative is the supplementation of the broad framework for regulatory development with detailed and specific guidance in particular areas that have been identified as being of critical importance. The material on recruitment and procurement serves to clarify expectations by helping to illustrate specific applications of the general approach to assessing proposed internal regulatory and administrative requirements set out in the framework. The fact that additional material in these areas is contained within the same document that describes the decision-making framework should help ensure that this guidance is effectively communicated.

285. This supplementation of process requirements with specific guidance is taken a step further with the identification of key “myths”. Identifying specific areas in which practice is commonly poor, particularly because of a lack of understanding of actual requirements, provides the basis for immediate-term change and visible gains to be seen from the policy.

286. The concept of proportionality is well embedded into the process requirements, reflecting a conscious attempt to balance the need for a consistent, high-quality regulation-making process and the need to avoid imposing inappropriate “red tape”. A particular strong point of the regulation-making process is the inclusion of external oversight by a dedicated, high-level group (the Red Tape Deputy Secretaries Group) which can ensure that a whole-of-government view of proposals is adopted and that the external oversight role wields a high level of authority. This approach should constitute an effective means of quality control in respect of the use of the benefit/cost analysis framework specified. It should also help to ensure a high level of compliance with the framework overall. That said, the rotating membership arrangements for the group may pose some risk of impeding the development of programme-specific expertise – a matter that might, however, be dealt with via appropriate secretariat arrangements.

287. The initiative could potentially be further strengthened by publishing an analysis of the underlying causes of the problems of excessive or poor-quality internal regulation. At present, this analysis is limited to an asserted widespread lack of understanding of actual regulatory requirements, allowing costly “myths” to arise in a context of risk aversion on the part of officials. By contrast, the broader regulatory reform agenda is based on a detailed analysis of the causes of over-regulation and poor-quality regulation, and an ongoing discussion of both problems and solutions.

288. A key benefit of disseminating an expanded problem analysis is that it would provide the basis for the development of more sophisticated and closely adapted solutions to the problems that exist. A generically applicable framework and an identification of a range of specific problem areas are both important tools. However, there is scope to both develop and supplement these policy tools. Moreover, better explaining the specific nature and extent of the problems associated with internal regulation may enhance agencies’ commitment to the policies adopted to address them and, consequently, improve the effectiveness of the policy.

289. Developing a detailed analysis of the problem is arguably particularly important in the specific Australian context: many of the internal regulatory requirements relating to transparency and

accountability arrangements set out broad obligations, but allow flexibility for departmental secretaries and agency chief executives to tailor their own requirements in major areas such as procurement and recruitment. Such a model is not obviously faulty, yet the development of this programme results from a conclusion that poor outcomes are being achieved in many cases.

290. An aspect of the initiative which may particularly benefit from greater analysis of the underlying issues is that of the prevalence of “myths” about what internal regulation exists. The approach adopted, of identifying specific myths and correcting them by identifying actual requirements, should be effective in improving practices in the short term. However, a longer-term approach would involve investigating the underlying reasons for the lack of understanding of existing internal regulatory requirements and seeking to address these underlying causes systematically.

291. That said, giving immediate priority to addressing identified myths is an important first step, since consistent application of existing internal regulations by all agencies would seem to be a precondition for accurately gauging the nature and extent of any problems arising from them and, hence, of the nature and extent of the reforms needed.

292. Finally, the development of a more detailed problem analysis could lead to consideration of changes in the scope of the programme. Given the incentive issues identified in the previous section, the question arises as to whether internal controls that apply only within one agency should be subject to the framework. That is, when considering administrative and regulatory arrangements within one government department or agency, the incentive problem of costs being imposed on one party while benefits accrue to another does not obviously arise – that is, the agency has a clear incentive to optimise, since the benefits and costs of the measure both essentially accrue to it. This raises the issue of whether such a narrowing of the scope of the policy could constitute a better focusing of scrutiny and reform efforts.

5.6. Conclusion

293. The initiative for reducing internal red tape is a pioneering attempt to address regulation inside government. The adoption of this approach represents a significant step forward in ensuring that internal processes are based on systematic and rational analysis. Consequently, it has significant potential to improve the efficiency with which budget sector resources are employed. The approach adopted, of establishing a consistent process for developing and reviewing internal regulation which adopts the essential features of best practice processes for developing external regulation, as identified by the OECD, is a sound one. Supplementing this process-based approach with targeted initiatives to highlight and resolve major specific issues is likely to be an effective way of achieving important improvements in the short to medium term.

294. In common with broader regulatory reform policies, it can be expected that policies aiming to improve the quality and efficiency of internal regulation will need to be expanded and refined over time. Some potentially important steps in this direction would involve ensuring that a fully developed analysis of the problem of excessive internal regulation is published, and designing and implementing additional programme elements that respond to this analysis.

295. Also fundamental is the development and implementation of appropriate performance monitoring and review mechanisms for the programme. Such mechanisms would provide an appropriate feedback mechanism and allow the programme to be revised as required in response to identified successes and problems.

ANNEX 1 OPERATION SUNLIGHT

On 16 April 2006, the current Minister for Finance (then as the Shadow Minister for Finance) released a discussion paper entitled “Operation Sunlight”. Operation Sunlight sets out the new Australian Government’s policy to enhance budget transparency and accountability in the following key areas:

- **Tightening the outcomes and outputs framework:** Operation Sunlight highlights that while the outcomes and outputs framework was intended to shift the focus of reporting from inputs (programmes, expenses and recipients) to outcomes and outputs, it has not worked in practice. Operation Sunlight proposes more consistent and tangible outcome statements, improved programme evaluations, and better reporting on the provision and use of appropriations.
- **Changing *Budget Papers* to improve their readability and usefulness:** Operation Sunlight indicates dissatisfaction with the readability and therefore the usefulness of the *Budget Papers*. Operation Sunlight proposes improved programme-level detail, a greater focus on information that helps assess the merits of government spending, the introduction of a single reporting standard, and treating the goods and services tax as a Commonwealth tax.
- **Improving the transparency of estimates:** Operation Sunlight states that there is no system of continuous disclosure and that material estimation errors could be obscured by parameter variations. It proposes more reporting of relevant financial statements throughout the year.
- **Expanding the reach of budget reporting:** Operation Sunlight proposes that significant increases in transparency are warranted on the disclosure of appropriations, particularly in respect of special appropriations (including net appropriations and special accounts). Operation Sunlight also proposes additional transparency for tax expenditures and the contingency reserve.
- **Improving intergenerational reporting:** Operation Sunlight suggests that the *Intergenerational Report* should be published more frequently and should include more information and disaggregated programme information.

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- Consolidated Financial Statements
- Final Budget Outcome Report
- Fiscal Strategy Statement
- Intergenerational Report
- Mid-Year Economic and Fiscal Outlook
- Portfolio Additional Estimates Statements
- Portfolio Budget Statements
- Pre-Election Economic and Fiscal Outlook
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