

SECTION A: OVERVIEW

CHAPTER 1: INTRODUCTION

1.1 Background

On 1 May 2007, the government introduced two appropriation bills: the *Appropriation (2007/2008) Bill* and the *Appropriation (Parliament 2007/2008) Bill*, into Parliament. These bills, which were subsequently passed through the Parliament, enable the government and the Parliament to deliver planned services and embark on new asset investments during 2007-08.

The appropriation bills sought parliamentary authority to draw an amount of \$28.5 billion from the Consolidated Fund in 2007-08 for government purposes and \$92.1 million for the funding of Parliament's activities. These amounts include funding to meet operating expenditure involved in the provision of outputs (new and ongoing initiatives) and capital additions to the net asset base.

Section 40 of the *Financial Management Act 1994* requires the government to submit to Parliament, along with the appropriation bills, the budget estimates for the forthcoming financial year. The budget estimates include, for the relevant financial year, particulars of:

- goods and services each government department will provide or produce;
- amounts available, or to be available, to each department;
- the estimated amount of the receipts and receivables for each department; and
- the expected financial requirements of Parliament.

The budget estimates also deal with the application of funds that do not require annual parliamentary authority such as:

- special appropriations where there is continuing authority embodied in specific legislation (\$1.8 billion);¹
- agency revenue credited to appropriations (\$2.2 billion);² and
- prior year appropriations carried over to the budget year (\$535.1 million).³

The 2007-08 Budget Estimates identify that the government expects total income from operating transactions of \$34.3 billion and total expenditure from operating transactions of \$34 billion.⁴ Total expenditure from operating transactions is met from the output funding component of the appropriation acts and funds derived from special appropriations, agency revenue and unspent prior year appropriations carried forward.

In addition, net annual infrastructure investments are expected to average \$3.3 billion over each of the four years to 2010-11.⁵ This capital expenditure is met from the cash surplus generated from operating activities (after adding back non-cash items such as depreciation), proceeds from asset sales, the unallocated capital provision for future allocation and increases to net debt.

¹ Budget Paper No.4, *Statement of Finances*, pp.173–176

² *ibid.*, pp.177–179

³ *ibid.*

⁴ *ibid.*, p.9

⁵ Budget Paper No.2, *Strategy and Outlook*, p.5

1.2 Process followed by the Public Accounts and Estimates Committee for its review of the 2007-08 Budget Estimates

The Committee's analysis of the budget estimates aims to:

- facilitate a greater understanding of the budget estimates;
- constructively contribute to the quality and presentation of the budget information; and
- enable more effective monitoring of the performance of departments and agencies.

The inquiry into the budget estimates does not involve an analysis to verify policy statements made by Ministers or the Treasurer or if information prepared by the Department of Treasury and Finance contained in the budget papers is well founded. Rather, the inquiry focuses on transparency and clarity of reporting.

The principal intention of the Committee, in presenting the earlier reports to Parliament on the 2007-08 Budget Estimates (Parts One and Two), was to assist Members of Parliament in their consideration of the appropriation bills and, in turn, to enrich the Parliament's debate on the bills.

As foreshadowed earlier, following the tabling of the *Report on the 2007-08 Budget Estimates – Part One* and the *Report on the 2007-08 Budget Estimates – Part Two*; Part Three of the report contains information relating to:

- analysis, key findings and recommendations pertaining to the 2007-08 Budget Estimates;
- responses to the budget estimates questionnaire that were received subsequent to the tabling of Part Two of the report; and
- responses received to questions taken on notice and unasked questions emanating from the hearings.

1.2.1 Analysis, key findings and recommendations

Section A outlines in summary form key aspects of the budget as well as providing for the first time an in depth analysis of key fiscal parameters, including contingency items, planned efficiency initiatives, revenue foregone and funds carried forward.

Drawing on the material received in response to the 2007-08 Budget Estimates questionnaire and various matters raised through the estimates hearing process, the analysis and issues contained in this report are presented according to a series of themes that have relevance to the examination of the budget estimates. For the first time, key fiscal and economic matters such as productivity, economic reform and staffing are the subject of extensive analysis in a PAEC estimates report. These key themes are highlighted within Section B.

A new feature this year is an evaluation in Section C of the nexus between various issues raised by the Committee at the estimates hearings and the government's *Growing Victoria Together* (GVT) policy vision and goals. This analysis has been incorporated into the report to complete the trilogy of aligning the *Growing Victoria Together* policy vision to the budget estimates reporting format, the Auditor-General's Annual Plan and the Committee's reporting requirements. Under each of the GVT policies, the Committee has subjected several key issues to in-depth analysis leading to substantive recommendations.

Section D of the report includes an assessment by the Committee of the quality of material provided by Ministers and departments in response to questions raised by the Committee.

1.2.2 Recent machinery of government changes

Following the resignation of the Hon. S Bracks MP as Premier of Victoria on 27 July 2007,⁶ the incoming Premier, Hon. J Brumby MP released on 2 August 2007 details of a new Cabinet and two new departments. As these changes occurred after the estimates hearings process had been completed and the tabling of the *Report on the 2007-08 Budget Estimates – Part One* and the tabling of the *Report on the 2007-08 Budget Estimates – Part Two*, references in this report to Ministers and departments reflect the situation at the time of conducting the budget estimates inquiry. The recent administrative changes are set out below:⁷

- a new Department of Planning and Community Development to replace the Department for Victorian Communities, which will include the divisions and authorities that reported to the Minister for Planning within the Department of Sustainability and Environment; and
- the Office of Children to go into the Department of Education to create the Department of Education and Early Childhood Development.

1.2.3 Acknowledgment

The Committee is grateful to Ministers, departmental Secretaries and their staff for their assistance at the budget estimates hearings and the written material prepared in response to the Committee's formal lines of inquiry.

The cost of this inquiry was approximately:

- Parts One and Two \$88,500; and
- Part Three \$96,000.

⁶ Hon. S Bracks MP, Premier, Office of the Premier, *Statement from Premier Steve Bracks*, media release, 27 July 2007

⁷ Hon. J Brumby MP, Premier, *Premier announces new cabinet*, media release, 2 August 2007

CHAPTER 2: KEY ASPECTS OF THE 2007-08 BUDGET

Key aspects of the 2007-08 budget:

- 2.1** The 2007-08 budget commences delivery of the government's commitments made during the 2006 election. The Treasurer has indicated the budget starts delivery of all of the government's 2006 election output commitments and just under half of the asset commitments.
- 2.2** The government expects to achieve a budget surplus of \$324 million in 2007-08 and an average surplus of \$424 million over the next three financial years.
- 2.3** Achievement of the 2007-08 targeted budget surplus would represent the eighth consecutive year in which the government has met its commitment to maintaining an annual operating surplus of at least \$100 million.
- 2.4** Two rating agencies have confirmed Victoria's triple-A credit rating. This rating was first confirmed in 1998 and has now been reaffirmed for nine consecutive years.
- 2.5** Over the period 2007-08 to 2010-11, net infrastructure investment is expected to average \$3.3 billion a year funded by a combination of cash operating surpluses (around 60 per cent) and an increase in net debt.
- 2.6** Contingency provisions of at least \$4.2 billion from unallocated outputs and of \$1.6 billion from unallocated capital are available to the government over the four year period to 2010-11.
- 2.7** Significant levels of financial commitments (\$1.5 billion for outputs and at least \$7.5 billion for assets), embodied in policy announcements of the government and not included in the current budget, will require provision in future budgets.
- 2.8** The government's response to serious drought, bushfires and flooding in 2006-07 and 2007-08 demanded urgent funding allocations totalling at least \$375 million.
- 2.9** In a major initiative, the government plans to generate efficiency savings of \$632 million across departments over the four year period to 2010-11.

Key findings of the Committee:

- 2.10** The Committee will evaluate in its outcomes report for the 2007-08 financial year the extent of the implementation of the government's 2006 election output and asset commitments.
- 2.11** Although a key element of the budget, presentation in the budget papers of the government's planned efficiency savings is limited in that it is not possible to identify each department's expected contribution to each efficiency measure. The government should improve presentation of this important issue in future budget papers.

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| 2.12 | The Auditor-General should conduct periodic reviews of the extent to which departments achieve their targeted efficiency savings. |
| 2.13 | Future budget papers should provide a more considered disclosure of the impact of explicit and implicit revenue subsidies over the budget and forward estimates periods. |
| 2.14 | Funding carried forward by departments from one year to the next is significant and should be the subject of specific reporting, encompassing underlying reasons, in the annual financial report. |
| 2.15 | Opportunities exist for further enhancing presentation of material in the budget papers and other financial reports. The Committee will undertake a detailed review of financial reporting in Victoria in 2008. |

2.1 Key themes

The key themes influencing the direction of the 2007-08 budget and its new funding initiatives are identified in the budget documents as:⁸

- sound financial management;
- investing in infrastructure;
- a competitive business environment;
- excellence in education;
- affordable housing;
- meeting environmental challenges;
- a world class health system;
- tackling disadvantage;
- community safety and justice;
- investing in Victoria's transport system;
- provincial Victoria; and
- maintaining Victoria's liveability.

These are key tenets that align closely with the goals of the government's key visionary document *Growing Victoria Together*.

The overview document on the budget published by the government lists the main funding initiatives under each theme heading that have been earmarked for attention over the four year forward estimates period.⁹ The major budgetary initiatives supporting *Growing Victoria Together*, are also summarised in the budget papers.¹⁰ In addition, the strategy and outlook budget document tabulates the aggregate dollar values of initiatives assigned to each department.¹¹ The budget documents also identify that the 2007-08 budget commences delivery of the government's commitments made during the 2006

⁸ Victorian Government 2007-08 Victorian Budget Overview: Delivering for Victorian families, pp.5-7

⁹ *ibid.*

¹⁰ Budget Paper No.3, *2007-08 Service Delivery*, pp.6-36

¹¹ Budget Paper No.2, *2007-08 Strategy and Outlook*, pp.43-44

election. The Treasurer has indicated that the budget starts delivery of all of the government's 2006 election output commitments and just under half of the asset commitments.¹² The Committee will evaluate in its outcomes report for the 2007-08 financial year the extent of implementation of the government's 2006 election output and asset commitments.

An implementation report card identifying the 2006 election costings over the four years to 2010-11 and the extent of budget funding approved for individual costings over that period is included in the budget documents.¹³ This report card shows that, after allowing for expected efficiencies across government, approximately 85 per cent (\$2.1 billion) of the estimated total election output commitments of \$2.5 billion has budgetary provision over the period to 2010-11.¹⁴ With regard to asset commitments, approximately 48 per cent (\$1.5 billion) of total estimated election costings of \$3.1 billion has received funding approval up to 2010-11.¹⁵

The government has indicated that remaining election commitments will be funded in future budgets through contingencies and other provisions.¹⁶

2.2 Fiscal strategy relating to annual operating surplus

The 2007-08 budget provides for the government to continue to meet its commitment to maintain an annual operating surplus of at least \$100 million with an expected budget surplus of \$324 million in 2007-08 and an average surplus of \$424 million over the next three financial years.¹⁷ When delivering the budget, the Treasurer stated the government expected to meet this commitment for the eighth consecutive year.¹⁸ This fiscal strategy is designed to allow for unforeseen circumstances and provide budget flexibility.¹⁹ The Committee noted that the targeted operating surplus of \$100 million has not been adjusted in dollar terms since 1999. The Committee also noted that the \$100 million target has been exceeded every year since 1999 and is budgeted to be significantly exceeded in the budget estimates period.

Table 2.1 shows revenue and expense projections for 2007-08 compared with the original budget and estimated actual position for 2006-07.

Table 2.1: Revenue and expense estimates for 2007-08

Operating item	Column 1	Column 2	Column 3	Column (3-2)/2
	2006-07 Budget	2006-07 Estimated	2007-08 Budget	Variation
	(\$ million)	(\$ million)	(\$ million)	(%)
Revenue	32,442.1	33,351.4	34,269.2	2.8
Expenses	32,125.3	32,729.5	33,944.9	3.7
Estimated operating surplus	316.8	621.9	324.3	-47.8

Sources: *Budget Paper No.2, 2007-08 Strategy and Outlook, p.30 and Budget Paper No.4, 2007-08 Statement of Finances, p.227*

¹² Budget Paper No.1, *2007-08 Treasurer's Speech*, p.2

¹³ Budget Paper No.3, *2007-08 Service Delivery*, pp.261–272

¹⁴ *ibid.*, p.267

¹⁵ *ibid.*, p.271

¹⁶ *ibid.*, p.261

¹⁷ Budget Paper No.2, *2007-08 Strategy and Outlook*, p.3

¹⁸ Budget Paper No.1, *2007-08 Treasurer's Speech*, p.3

¹⁹ Budget Paper No.2, *2007-08 Strategy and Outlook*, p.3

The expected result for 2006-07 is almost twice the previous estimate primarily because of an enhanced revenue position. Increased revenue is estimated to be \$909 million and unbudgeted additional expenditure is expected to be \$604 million. This situation has given the government a much stronger than initially envisaged basis for pursuit of its budgetary priorities during that year.

The estimated revenue growth of 2.8 per cent to **\$34.3 billion** in 2007-08 when compared with the expected result for 2006-07 is mainly attributable to:²⁰

- an increase of \$880 million (5.8 per cent) to \$16.2 billion in Commonwealth grants, including increased GST grants of \$606 million;
- net higher taxation revenue of \$118 million (1 per cent) to \$11.6 billion with the main growth (\$147.6 million) expected to be in payroll tax due to solid employment and higher wages; and
- higher levels of fines and regulatory fees of \$49.5 million (6.2 per cent) to \$842.8 million largely reflecting re-establishment of the Western Ring Road camera network, commencement of the Hume Highway point to point camera system, completion of the roll-out of the red light speed camera network and annual indexation of fees, fines and charges.

The budgeted increase in expenses of 3.7 per cent to **\$33.9 billion** in 2007-08 is principally due to:²¹

- net new output policy funding of \$637 million (including \$190.6 million announced as part of the 2006-07 budget update);
- indexation of total departmental expenses under the departmental funding model for general wages growth and the impact of inflation on non-wage costs;
- flow-on expense impacts of increased Commonwealth specific purpose grants; and
- higher depreciation expense of \$58.1 million reflecting the growth in capital stock and revaluations of physical assets.

Victoria's credit rating is assessed by two international agencies – Standard & Poor's and Moody's Investors Service Limited. Both agencies conduct reviews of the state's economic structure and prospects, financial performance and outlook, balance sheet position, liquidity and debt management strategy, and the government's fiscal strategy.²²

In a bulletin issued by Standard & Poor's on 1 May 2007, the firm stated that:²³

... today's budget for the state of Victoria is consistent with the 'AAA' rating already assigned to the state. The 'AAA' rating is the highest rating assigned by Standard & Poor's. The outlook on Victoria is stable.

The strength of the government's forecast operating performance and balance sheet enables the state to comfortably manage a projected increase in net debt – due to an expanded capital program – funding of election commitments, and some tax relief within its current rating.

²⁰ Budget Paper No.4, 2007-08 Statement of Finances, pp.133–148

²¹ *ibid.*, pp.238–241

²² Department of Treasury and Finance, *Victoria's Credit Rating*, www.dtf.vic.gov.au, accessed 11 July 2007

²³ Standard & Poor's, *State of Victoria's Budget: Forecast Rise In Net Debt No Problem For State*, press release, 1 May 2007

The firm's bulletin also stated:

Downside potential on the rating remains low. Victoria's budget forecasts and commitments to its medium term fiscal strategy continue to support the rating.

Victoria's AAA credit rating was again affirmed by Standard & Poor's on 4 September 2007.²⁴

Moody's Investors Service provided its latest credit rating in January 2007. This rating took into consideration the 2006-07 budget update and reaffirmed the state's AAA credit rating. This rating was first confirmed in 1998 and has now been reaffirmed for nine consecutive years. On Victoria's rating outlook, the agency stated:²⁵

The stable outlook reflects Moody's assessment that the state's strong financial profile and low debt burden position it well to absorb financing deficits (net borrowing result) expected as the state increases capital spending, and an associated increase in the debt burden anticipated over the medium term. The 2006-07 budget indicates that the state's general government sector is expected to incur moderate average deficits of – 2.5 per cent over the medium term, while the non-financial public sector is projected to register average deficits equal to -5.6 per cent of revenues. The recent budget update indicates that the state is generally in line to meet these targets as a significant portion of the increased capital spending commitments made during last year's election campaign are expected to be absorbed by unallocated capital.

2.3 Funding for infrastructure investments

The Treasurer has stated that, over the past seven years, the government has invested \$16 billion in capital works and the 2007-08 budget provides a further investment of \$13 billion. He described this overall investment program as the biggest in 40 years.²⁶

Based on estimates shown in past budget papers, the Committee has calculated that the state's net investment in fixed assets was projected to be 0.9 per cent of gross state product at June 2000 and is now estimated to be 1.46 per cent by June 2008. The percentage increased markedly in 2006-07 from 1.15 per cent to 1.43 per cent because of a significant increase in asset spending in that year. Further commentary on this subject is given in Chapter 5.

The budget papers identify that, over the period 2007-08 to 2010-11, net infrastructure investment is expected to average \$3.3 billion a year.²⁷ The capital expenditure estimates for the three year period 2008-09 to 2010-11 incorporate an unallocated provision totalling \$1.6 billion.²⁸ The government has indicated that this provision will be allocated, in accordance with previous budget practice, to specific projects in future budgets.²⁹

Cash flow projections shown in the budget indicate that around 60 per cent of net infrastructure investment will be funded by the cash surplus, after adjustment for the adding back of depreciation and other non-cash accrual items. The remainder of the infrastructure program will be funded by an increase in net debt.³⁰

²⁴ Standard & Poor's, *Victoria 'AAA' Rating Affirmed; Outlook Stable*, research update, 4 September 2007

²⁵ Moody's Investors Service, credit opinion *Victoria (State of) Australia*, 24 January 2007, accessible via a link from www.dtf.vic.gov.au

²⁶ Budget Paper No.1, *2007-08 Treasurer's Speech*, p.3

²⁷ Budget Paper No.2, *2007-08 Strategy and Outlook*, p.5

²⁸ *ibid.*, p.45

²⁹ *ibid.*

³⁰ *ibid.*

The budget papers state that, over the forward estimates period, general government net debt is projected to rise from \$3 billion at June 2007 to \$8.8 billion at June 2011.³¹ As a percentage of gross state product, net debt is expected to be 2.9 per cent (\$8.8 billion) as at June 2011 compared with 3.1 per cent (\$4.8 billion) in 1999.³²

On the key contemporary environmental issue of water management, the Treasurer announced in the budget several initiatives involving aggregate funding of \$136 million aimed at further improving water efficiency and recycling. The Treasurer also signalled that the government was considering options for the critical issue of addressing Melbourne's future water demands and that it would announce its plans in the coming months.³³

In June 2007, the Premier announced a \$4.9 billion investment in major infrastructure projects under the government's *Our Water Our Future* plan.³⁴ Key elements are:

- an eight year Food Bowl Modernisation Project (total investment of up to \$2 billion) addressing irrigation inefficiencies in Victoria's Food Bowl region and incorporating a new 70 kilometre pipeline connecting Melbourne to the Goulburn river by 2010 – at a first stage estimated cost of \$1 billion including a \$600 million government contribution; and
- construction of a desalination plant in the Wonthaggi region, including an 85 kilometres connecting pipeline to Melbourne, to be completed by late 2011 – at an estimated cost of \$3.1 billion.

According to this announcement, the full extent of the financial impact of the construction of the desalination plant on the government's existing budget projections over the forward estimates period to 2010-11 and on future projections will depend on final contractual arrangements.

2.4 New funding initiatives for 2007-08

The government's key themes underpinning the 2007-08 budget are principally reflected in the new revenue, output and asset funding initiatives presented in the budget papers.

An appendix to the service delivery document provides the main budget presentation of output and asset initiatives, comprising an alphabetical listing of all initiatives under the responsible department accompanied by a short description of each initiative and specification of the output to which it contributes.³⁵ Disclosure of this latter relationship between initiatives and output represents a valuable addition to the budget papers introduced in 2007-08.

Table 2.2 shows the aggregate dollar values of the new 2007-08 output and asset funding initiatives assigned to each department:

³¹ *ibid.*, p.58

³² *ibid.*, pp.45,56

³³ Budget Paper No.1, *2007-08 Treasurer's Speech*, pp.7-8

³⁴ Hon. S. Bracks MP, Premier, *More Water for farmers, stressed rivers and Melbourne and Desalination plant to deliver 150 billion litres of water per year*, media releases, 19 June 2007

³⁵ Budget Paper No.3, *2007-08 Service Delivery*, pp.273-348

Table 2.2: New output and asset initiatives funding for 2007-08

Department	2007-08 Output initiatives (\$ million)	2008-09 to 2010-11 Output initiatives (\$ million)	2007-08 Asset initiatives (\$ million)	Total estimated asset investment (b) (\$ million)
Education	81.8	245.4	218.6	505.1
Human Services	269.3	964.7	198.3	783.4
Infrastructure	68.0	123.6	180.0	918.9
Innovation, Industry and Regional Development	73.2	101.1	9.5	92.2
Justice	67.1	239.9	29.9	167.7
Premier and Cabinet	8.3	36.7	16.9	18.9
Primary Industries	32.4	36.3	11.0	181.5
Sustainability and Environment	44.3	109.1	20.7	91.7
Treasury and Finance	24.9	18.1	4.0	7.8
Victorian Communities	64.2	180.3	(c) -19.3	60.2
Parliament	7.0	17.8	0.9	0.9
Government wide	81.8	189.9	17.2	45.4
Total 2007-08 budget funding	822.3	2,263.0	687.6	2,873.8
Less: Funding from demand contingency and efficiencies	375.6	1,537.5	n/a	n/a
Net impact of new 2007-08 budget output and asset funding (a)	446.8	725.6	687.6	n/a

Notes: (a) excludes initiatives funded through internal reprioritisation or other existing funding sources and 2006-07 budget update initiatives

(b) total estimated investment includes projects to be delivered through the public non-financial corporations sector on behalf of the government

(c) negative figure reflects revised timing of funding for Rectangular Sports Stadium initiative to accord with current construction program

n/a not applicable

Some minor variances may occur in additions due to rounding

Source: Budget Paper No.2, 2007-08 Strategy and Outlook, pp.43-44

Although there is extensive coverage of new funding initiatives in the departmental sections of the budget papers, the output and asset initiatives assigned to each department are not grouped, and budget allocations not sub-totalled, according to applicable budget themes. While the interface between some departments and particular budget themes can be readily ascertained, for example, Department of Justice and the Community Safety and Justice theme, the Committee considers it difficult to ascertain from the budget documents the extent of each department's responsibility in servicing the budget themes.

The 2006-07 budget documents grouped budget initiatives (but did not sub-total funding allocations) according to key strategic policy documents such as *A Fairer Victoria*, *Moving Forward*, *Maintaining the Advantage* and *Healthy Futures* etc. However, the relevant 2007-08 budget documents discontinue

this practice and, while identifying all bushfire recovery initiatives, list most other initiatives alphabetically in each departmental area without any connecting link.

The Committee encourages the government to consider adopting as a standard feature of each year's budget papers the linking of output and asset initiatives in each departmental section with the applicable budgetary theme. Such themes form the basis of the government's summary document on the budget and reflect the priorities and directions of funding proposed by the government for the ensuing year.

2.4.1 Contingency provisions

The equivalent table in the budget documents to table 2.2 does not separately quantify the allowance made for demand contingency when computing the net financial impact on the budget of output initiatives or explain the nature of this item. However, the dissection of budgeted operating expenses in note 10 to the estimated financial statements discloses in another budget paper an item *Contingencies not allocated to departments* totalling \$222 million for 2007-08 as part of a total of \$3.7 billion for the four year forward estimates period to 2010-11.³⁶ An explanatory footnote states that this contingency includes a provision for programs lapsing, future demand growth, items not yet formalised at the time of the budget and an allowance for departmental underspending in 2007-08.

Contingency provision for capital expenditure is presented in the budget as amounts not yet allocated to projects over the forward estimates period.³⁷ This provision forms part of the computation of estimates for the net cash investment in fixed assets which, as identified in the budget papers, is funded by a combination of operating cash surplus and an increase in net debt.

Table 2.3 brings together three contingency items extending over the four year forward estimates period, relating to the 2007-08 budget:

Table 2.3: Contingency items within the 2007-08 Budget and Appropriation Act

Item	2007-08 Budget (\$ million)	2008-09 Estimate (\$ million)	2009-10 Estimate (\$ million)	2010-11 Estimate (\$ million)	Total (\$ million)
Output contingencies					
Output contingencies not allocated to departments (a)	222.0	849.1	1,154.5	1,499.4	3,725.0
Advance to the Treasurer to meet urgent claims that may arise before Parliamentary approval (b)	434.0	0.0	0.0	0.0	434.0
Total	656.0	849.1	1,154.5	1,499.4	4,159.0
Asset contingencies					
Unallocated capital provision – to be allocated to specific projects in future budgets (c)	0.0	263.0	532.3	815.9	1,611.2

- Sources: (a) *Budget Paper No.4, 2007-08 Statement of Finances, p.44*
 (b) *Appropriation (2007/08) Act 2007, page 14 of Schedule 1. Based on past practice, it is likely that a similar provision for each year beyond 2007-08 would be included in the respective appropriation Act*
 (c) *Budget Paper No.2, 2007-08 Strategy and Outlook, p.45*

³⁶ Budget Paper No.4, 2007-08 Statement of Finances, p.44
³⁷ Budget Paper No.2, 2007-08 Strategy and Outlook, p.45

The Committee considers that contingency or reserve items within the structure of the budget serve to complement the government's fiscal strategy of delivering an operating surplus of at least \$100 million. They provide the government with the necessary flexibility to address both planned and unforeseen future output and asset occurrences, while remaining within established budgetary parameters relating to budgeted surplus and projected debt levels. They therefore provide a buffer to help avoid any potential risks to the government in implementing its policy of prudent financial management of Victoria's public resources, and ought to be clearly reported and quantified.

During the estimates hearings, the Committee sought a reconciliation from the Treasurer between the unallocated capital provision of \$1.6 billion, as shown in the budget papers (see table 2.3 above) and a figure of \$2.9 billion cited by the Treasurer at the estimates hearing as representing Total Estimated Investment (TEI) which will be fully funded in future budgets and included in relevant four year forward estimates. The Treasurer's response and commentary by the Committee are presented in Chapter 5 of this report.

Relevance of contingency management to future budgets

The magnitude of the above contingency items may appear, on an initial assessment, to be considerable and it is difficult to be precise on what constitutes an appropriate level of contingency provisions for any four year forward estimates period.

Table 2.4 compares the quantum of unallocated output and asset contingencies over the four year forward estimates period as shown in the 2007-08 and 2006-07 budgets.

Table 2.4: Comparison of the quantum of unallocated output and asset contingencies for forward estimates period shown in the 2006-07 and 2007-08 budgets

Contingency item	2006-07 Budget (%)	2007-08 Budget (%)
Output contingency		
Contingencies not allocated to departments expressed as a percentage of total operating expenses	2.2	2.6
Asset contingency		
Unallocated capital provision expressed as a percentage of net cash investment in fixed assets	17.5	12.3

Sources: *Budget Paper No.2 2007-08 Strategy and Outlook, p.45, Budget Paper No.4, 2007-08 Statement of Finances, p.44, Budget Paper No.2, 2006-07 Budget Strategy and Outlook, p.49, Budget Paper No.4, 2006-07 Statement of Finances, p.44*

On the basis of the percentages shown in table 2.4, there has been a small increase in the 2007-08 output contingency and a larger decrease in the asset contingency, relative to 2006-07. The latter movement may have been influenced by the growing size of the government's infrastructure investment program and its desire to keep the level of increase in net debt associated with servicing that program within acceptable limits.

From a budget perspective, the benefit to the government of contingency items, particularly those of an output nature, is twofold in that they:

- provide the capacity to respond to unforeseen occurrences such as climatic disasters or economic factors; and
- give the government the potential, in a stable budget environment, to utilise any unused portion for priority output and asset allocations. The progressive availability of additional resources via unused contingencies would be particularly valuable for servicing over the forward estimates period the government's expanding infrastructure investment programs and helping to keep the associated level of debt financing within targeted levels.

The government's current strategy of aiming to achieve maximum efficiencies from departments in the delivery of output services under its *Efficient Government* policy, discussed in the following section, is conducive to increasing the likelihood that unused contingency allocations could become progressively available in future years to meet emerging budgetary needs. The potential value to the government of such allocations is reinforced by the significance of the following financial commitments, embodied in recent policy announcements, which require provision in future budgets:

- **Unallocated balance of 2006 election commitments** – output and asset election commitments requiring funding approval in future budgets are estimated by the government to be **\$368 million** and **\$1.6 billion** respectively.³⁸ As mentioned in an earlier paragraph, Moody's Investor Service stated in its January 2007 assessment of Victoria's credit rating outlook that '*... the recent budget update indicates that the state is generally in line to meet targets as a significant portion of the increased capital spending commitments made during last year's election campaign are expected to be absorbed by unallocated capital spending*'.³⁹
- **The ten year Victorian Schools Plan** which documents the government's commitment to rebuild or modernise every Victorian government school. The plan's target for the first four years is to rebuild or modernise 500 schools and TAFEs at a cost of \$1.9 billion – the 2007-08 budget delivers the first stage of the plan with an asset provision of \$555 million, with the balance of **\$1.3 billion** requiring provision in budgets over the next three years.⁴⁰
- **The 2006 \$10.5 billion ten year *Meeting Our Transport Challenges* transport plan** – estimated budget output and asset commitments under this major transport initiative subject to funding provision in future budgets are:
 - **Output funding of \$1.2 billion** comprising unfunded provisions of \$1.2 billion as per the 2006-07 budget papers less 2007-08 budget initiatives of \$65.6 million.⁴¹
 - **Asset funding of \$4 billion** representing the total estimated unfunded commitments of the special asset reserve created for this plan, (\$4.1 billion identified in the 2007-08 budget papers for future budget funding less a contribution of \$100 million to the reserve from the Public Transport Fund).⁴²
- Future budget funding commitments arising from the major water infrastructure investments of \$4.9 billion (described in section 2.3) announced by the government after the 2007-08 budget in June 2007 – comprising **at least \$600 million** as the government's contribution to the first stage of its planned eight year Food Bowl Modernisation Project. The government will decide later in 2007 on the method of delivering its other major water project, the proposed \$3.1 billion desalination plant. The government's decision will clearly impact on the quantum and timing of funding provisions for the desalination plant, including the extent to which such provisions will be financed, directly or indirectly, from future budgets.

³⁸ Budget Paper No.3, *2007-08 Service Delivery*, pp.267–271

³⁹ Moody's Investors Services, credit opinion *Victoria (State of) Australia, 24 January 2007*, accessible via a link from www.dtf.vic.gov.au

⁴⁰ Budget Paper No.3, *2007-08 Service Delivery*, pp.7, 281

⁴¹ Public Accounts and Estimates Committee, *Report on the 2006-07 Budget Estimates*, September 2006, p.258 and Budget Paper No.4, *2007-08 Statement of Finances*, p.226

⁴² Budget Paper No.4, *2007-08 Statement of Finances*, p.226

Provision of government assistance in response to recent drought, bushfires and flooding

The importance of the adequacy of contingencies within the annual budgetary framework is also clearly illustrated by the extent of financial assistance provided by the government since 2006 for unplanned infrastructure works and community support services in response to serious drought across the state, followed by extensive bushfires and, more recently in mid-2007, major flooding in the Gippsland region.

Drought response

With regard to the government's drought response package, the Committee's examination of relevant budget papers (2006-07, 2006-07 update and 2007-08) and government media releases identified allocations of at least \$240.4 million were approved for output and asset purposes. However, a significant proportion of this funding, approximately \$131.9 million, was expected to be provided from existing budget and outer-budget provisions such as:⁴³

- a departmental contribution levy of \$50 million sourced from existing 2006-07 appropriations across departments;
- reprioritisation and redirection of existing services, \$40 million;
- road upgrades in drought affected areas, \$24 million, funded from the Better Roads Victoria Trust Account; and
- funding for drought purposes brought forward from the Regional Infrastructure Development Fund, \$10 million, and the Small Towns Development Fund, \$7.9 million.

The net financial impact on the 2006-07 and 2007-08 budgets of the government's drought response package is therefore around \$108.5 million. Re-direction of these funds and the impacts on previously planned allocations need to be detailed and adequately reported.

Bushfire recovery

The government's bushfire recovery funding initiatives are more readily identifiable in the 2007-08 budget papers which show aggregate funding of at least \$64.6 million⁴⁴

Major flooding

For the most recent climatic event affecting the state, the major flooding in the Gippsland region, the government has announced flood recovery funding packages of over \$70 million.⁴⁵

In each case, the seriousness of these climatic developments and the extent of their impact on communities across Victoria demanded an immediate response from the government.

⁴³ Hon. S Bracks MP, Premier, *\$114 million State Government drought assistance announced*, media release, 23 October 2006

⁴⁴ Budget Paper No.3, *2007-08 Service Delivery*, pp.274–335

⁴⁵ Hon. S Bracks MP, Premier, *Over \$60 million flood recovery package for Gippsland*, media release, 10 July 2007 and Hon. S Bracks MP, Premier, *Gippsland to get an extra \$10 million for flood relief*, media release, 16 August 2007

Summary comments on contingencies

The Committee views the management of contingencies as a significant element of the government's fiscal responsibilities. It recognises the importance of the government's policy aimed at achieving prudent financial management of Victoria's public resources, which has resulted in highly favourable external credit ratings over successive years for the state.

From an accountability perspective, the Committee considers there is scope for greater transparency by the government in the presentation of contingencies, including their role and impacts in the budgetary process and the basis adopted for their quantification.

2.4.2 Major planned efficiencies across government outlined in the 2007-08 budget

The budget papers indicate that the 2007-08 budget implements the government's *Efficient Government* policy, which formed part of the government's 2006 election commitments. The policy includes a strategy of *Buying Smarter, Buying Less*.⁴⁶ The Government Services Group within the Department of Treasury and Finance has primary responsibility for delivering the *Efficient Government* policy.

The budget papers disclose the following eight efficiency measures, six falling under the umbrella of the *Efficient Government* policy, to be implemented with effect from 2007-08, with targeted savings totalling \$632 million over the four year forward estimates period to 2010-11.⁴⁷

Efficient Government policy – targeted savings of \$447 million

- Improvements in government procurement under *Buying Smarter, Buying Less* – \$292 million
- A whole of government approach to shared services – \$60 million
- Implementation of best practice grant administration – \$35 million
- More efficient management of the government vehicle fleet – \$20 million
- A reduction in advertising and consultancy expenditure – \$20 million
- Better integration of ICT services across government – \$20 million

Other efficiencies – targeted savings of \$185 million (not dissected)

- Merger of the Victorian Office of Multicultural Affairs and Victorian Multicultural Commission
- General efficiencies across government, including limiting the future growth of head office staff

The budget papers also state that the savings generated from these measures will be reinvested back into frontline services to the community.⁴⁸

The Committee recognises the importance of this major government initiative. Commencement of pursuit of such significant levels of efficiencies across the departmental sector is clearly a feature of the 2007-08 budget.

⁴⁶ Budget Paper No.3, *2007-08 Service Delivery*, p.35

⁴⁷ *ibid.*, p.344

⁴⁸ *ibid.*, p.35

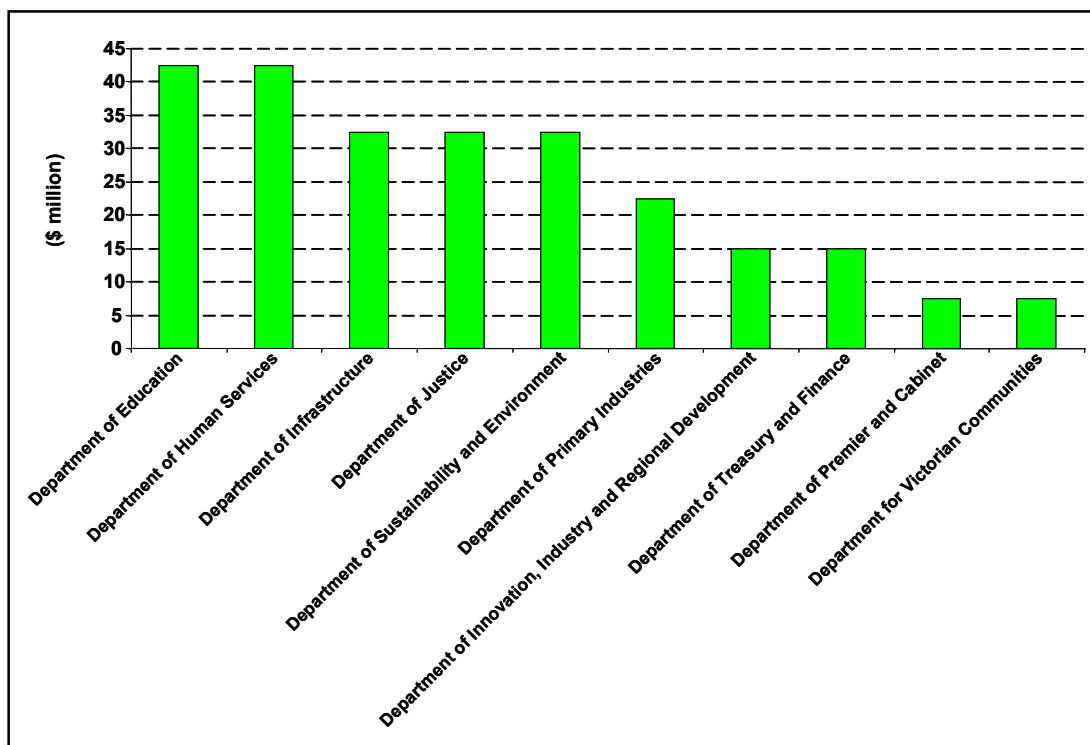
The Committee found that the presentation of this key aspect of the budget in the budget papers is somewhat limited in that it is not possible to identify the estimated savings expected by each department for the various components of the initiative as a result of:

- the dissection of each department's expected savings within the output initiatives section of the budget papers into only two categories, the *Buying Smarter, Buying Less* strategy and Other efficiencies – the latter consolidates the seven other measures using the same heading as that presented elsewhere in the budget papers, which covers only the two measures not forming part of the main policy; and
- the tabular dissection in the budget papers disclosing the composition of the targeted savings of \$632 million has a footnote indicating that the numbers differ from the information shown in each departmental section because '*the above table includes revenue to be received from outer budget agencies and excludes implementation costs*'.⁴⁹

The Committee was disappointed with this limited approach to presentation of such a key aspect of the 2007-08 budget. It suggests that future budget papers or annual reports incorporate a simple reconciliation between the targeted savings under each efficiency measure and each department's expected contribution, and a more distinct separation of savings into the various measures of efficiencies.

Figures 2.5 and 2.6 aggregate each department's expected share of savings over the four year period to 2010-11, based on the two categories disclosed for each department in the budget papers:⁵⁰

Figure 2.5: Savings targeted under 'Buying Smarter, Buying Less' strategy, 2007-08 to 2010-11

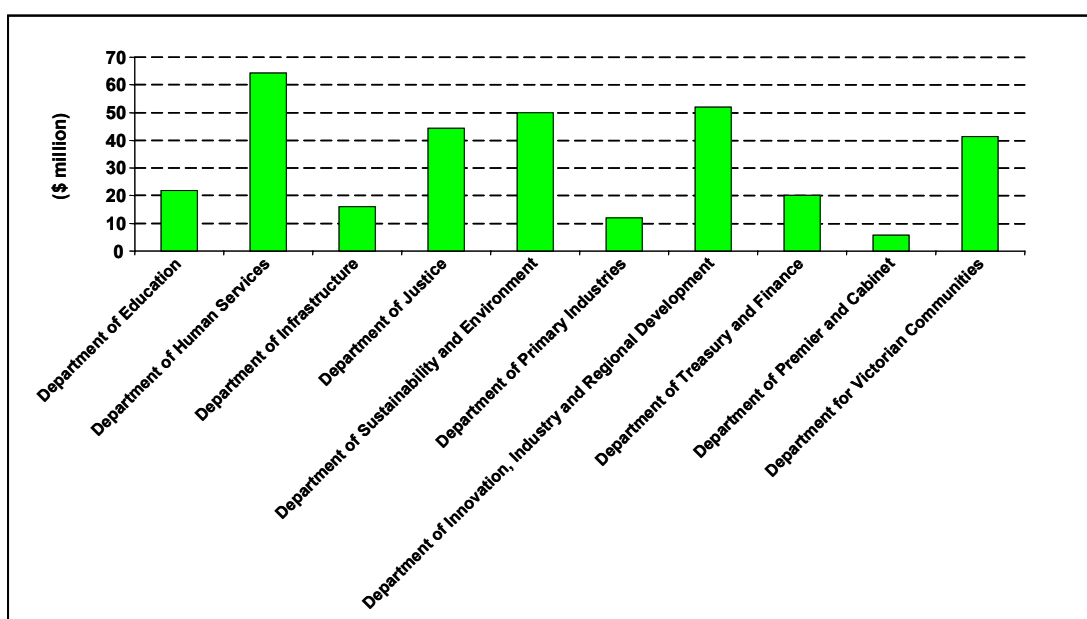


Source: Information compiled by Committee based on data in Budget Paper No.3, 2007-08 Service Delivery, pp.278–337

⁴⁹ *ibid.*, p.344

⁵⁰ *ibid.*, pp.278–337

Figure 2.6: Targeted savings under all other efficiency measures, 2007-08 to 2010-11



Source: Information compiled by Committee based on data in Budget Paper No.3 2007-08 Service Delivery, pp.278–337

From the information shown in tables 2.5 and 2.6, it would appear that the savings targets under the *Efficient Government* policy, at least for the one item, the *Buying Smarter, Buying Less* strategy separately disclosed in the budget, have been allocated on a proportionate basis across departments. Similar targets have been assigned to particular groups of departments, for example, \$42.5 million over four years to the Departments of Education and Human Services, and \$32.4 million to the Departments of Infrastructure, Justice and Sustainability and Environment.

The Committee sought information from departments on their planned savings strategies as part of its budget estimates inquiry. Most departments responded in broad terms on the nature of proposed actions to achieve assigned savings targets.

The Department for Victorian Communities advised the Committee that work has commenced in reviewing all of the cost areas affected by the policy to identify the specific areas and implement the necessary change and business re-engineering projects.⁵¹

The Department of Justice stated that, along with other departments, it was advised late in the 2007-08 budget process of the breakdown of the total savings published prior to the 2006 election. The department indicated it had now established a project group to identify strategies and develop proposals to achieve the savings requirements. It envisaged such actions were likely to be in the nature of more rigorous reporting and cost control regimes, continued standardisation and rationalisation of systems and occupancy related costs arising from its recent relocation, a review of cost recovery policies and practices and grant administration, and stringent management of staff turnover.⁵²

⁵¹ Department for Victorian Communities, response to the Committee’s 2007-08 Budget Estimates questionnaire, received 1 May 2007, p.13

⁵² Department of Justice, email, received 16 May 2007

The Committee noted it is important that all departments have strategies for the identification, and subsequent implementation, of action to achieve assigned targets on a sound and timely basis.

In making the above comments, the Committee is aware that much post-budget activity is occurring across the government in addressing the challenges identified in its *Efficient Government* policy. One important example relates to the Department of Treasury and Finance, which is developing a whole of government Shared Services Strategy as part of the policy. As mentioned in an earlier paragraph, this component of the policy aims to generate savings totalling \$60 million over the next four years. On 18 June 2007, the department held an information session for the IT industry about the strategy.⁵³

In summary, the Committee looks forward to improved presentation of material on this major government initiative in future budget papers. Such material should complement information incorporated in published accountability documents such as departmental annual reports. The Committee considers that future revisions of efficiency savings in forward estimates should better reflect each department's unique organisational circumstances. The Committee also considers that the overall significance of the savings initiative warrants periodic reviews by the Auditor-General of departmental performance under the initiative.

2.5 Revenue foregone initiatives contained in 2007-08 budget

The 2007-08 budget papers outline the components of revenue foregone as a result of a range of tax cuts and subsidies totalling \$835 million introduced by the government which extend through the forward estimates period to 2010-11. Table 2.7 identifies these foregone amounts.

Table 2.7: Revenue foregone initiatives in 2007-08 budget

	2006-07 Budget (\$ million)	2007-08 Budget (\$ million)	2008-09 Estimate (\$ million)	2009-10 Estimate (\$ million)	2010-11 Estimate (\$ million)
Tax relief					
Land tax cuts	0.0	-123.7	-129.2	-126.0	-122.6
Motor vehicle duty cuts	-6.2	-39.7	-41.6	-43.6	-45.7
Special land tax reform	0.0	-1.5	-1.5	-1.6	-1.6
Zone transition for congestion levy	-0.2	-0.2	0.0	0.0	0.0
Payroll tax (b)	-26.0	0.0	0.0	0.0	0.0
Land transfer duty (b)	-19.0	-47.0	-47.0	-95.0	-97.0
Total tax relief	-51.4	-212.1	-219.3	-266.2	-266.9
Other revenue initiatives					
Wagering commission rate adjustment	0.0	3.9	4.0	4.2	4.3
Payroll tax harmonisation	0.0	2.0	2.0	2.1	2.2
Health benefit levy increase	0.0	39.0	39.0	39.0	39.0
Total other revenue initiatives	0.0	44.9	45.0	45.3	45.5
Total tax initiatives announced since Pre-Election Budget Update	-51.4	-167.2	-174.3	-220.9	-221.4

Notes: (a) a negative figure indicates reduced revenue

(b) announced in the 2006-07 budget update

Source: Budget Paper No.2, 2007-08 Strategy and Outlook, p.35

⁵³ Department of Treasury and Finance, www.dtf.vic.gov.au, accessed 18 July 2007

The major tax initiative relates to land tax cuts which complement the government's earlier land tax reforms. The budget papers estimate that these cuts will amount to \$508 million over four years and benefit over 40,000 taxpayers. The budget papers also indicate that the land tax changes will further improve Victoria's tax competitiveness as Victorian businesses will now face the lowest levels of land tax in Australia for virtually all landholdings valued between \$400,000 and \$4.5 million.⁵⁴

The budget papers include a reduction to 2.5 per cent in the effective duty rate on passenger vehicles valued between \$35,000 and \$57,000. This initiative is estimated to provide tax relief totalling \$177 million over five years from 2006-07.⁵⁵

The Committee looks forward in future financial reports to a more considered exposition of explicit and implicit subsidies in budgets and forward estimates.

2.6 Unapplied budgets carried forward to 2007-08 by departments

Section 32 of the *Financial Management Act 1994* provides the authority for unapplied output and asset appropriations to be carried forward to the following year. The capacity to carry forward unapplied appropriations formed part of legislative amendments introduced several years ago to increase the flexibility of departments in their management of appropriations.

The budget papers summarise, in aggregate form, the amounts to be carried forward from 2006-07 to 2007-08 for each department.⁵⁶ The total of these carried forward amounts (not shown in the budget papers) is \$535.1 million comprising \$272 million for output funding and \$263.1 million for asset funding purposes. The budget papers do not contain any information on the underlying reasons for each department's funding carry over or the intended revised timing for use of carried forward funds.

As part of its 2007-08 Budget Estimates inquiry, the Committee sought information from departments on the factors giving rise to the need for the carry over of funding. The responses received from departments, which were included in the Committee's *Report on the 2007-08 Budget Estimates – Part One* and the *Report on the 2007-08 Budget Estimates – Part Two*, disclose a wide range of underlying circumstances including:

- delays of many categories (such as contractor issues, delivery of key equipment, revisions to cash flow forecasts and availability of staff experienced in the management and implementation of programs, including new funding initiatives);
- timing differences between the funding and implementation of programs across calendar and financial years;
- problems arising from grant recipients not achieving milestones; and
- redeployment of staff and formulation of new milestones arising from the drought and bushfires.

The Committee considers that, given the high dollar value of carried forward appropriations, more extensive coverage under each department, as appropriate in the budget papers and specifically in the annual financial report, would enable Members of Parliament and other readers to assess the reasons for carry over funding, particularly relating to delays in the delivery of programs, and to seek explanations where deemed necessary.

⁵⁴ Budget Paper No.2, *2007-08 Strategy and Outlook*, p.36

⁵⁵ *ibid.*

⁵⁶ Budget Paper No.4, *2007-08 Statement of Finances*, pp.177–179

2.7 Opportunities to further enhance presentation of material in financial reports

For some years now, the government has made progressive improvements to the presentation of material in the annual budget papers and other financial reports.

Improvements reflected in the 2007-08 papers include a valuable connecting link between each new departmental output initiative and the related output through which the delivery of new services under the initiative would be made. Before this enhancement, it was difficult to identify where new budget allocations fitted into the service delivery framework.

Financial reporting to Parliament is governed by the *Financial Management Act 1994* which was revised by Parliament in 2000 to widen financial reporting in line with the principles of sound financial management. Currently, financial reports consist of:

- the annual budget papers published at the time of Parliament's consideration of the annual appropriation bills;
- the estimated financial statements which are audited by the Auditor-General and included in the annual budget papers;
- a budget information paper issued during the spring session outlining each year's public sector asset investment program;
- an annual budget update published in December of each year;
- an annual financial report which is audited by the Auditor-General;
- a mid year financial report;
- a quarterly financial report; and
- a pre-election budget update prepared by the Secretary of the Department of Treasury and Finance.

The Committee noted that the Labor Party's policy document, *Financial Statement 2006*, issued before the last election, promised improvements in the clarity and content of financial reports.

The Committee agrees that it is opportune to review financial reporting to Parliament in order to increase transparency on the one hand and to improve accessibility to basic fiscal information on the other hand. The Committee intends to undertake in 2008 an investigation into financial reporting including best practice reporting internationally.

In the meantime, the Committee brings together its initial suggestions, as outlined in earlier paragraphs, for enhancing presentation of material in future budget papers. The suggestions, which are aimed at assisting the government to further build on its past reporting initiatives, are as follows:

- the linking of each year's output and asset initiatives to the applicable themes underpinning the direction of the budget (section 2.4);
- more informative presentation of contingencies, including their role in the budgetary process and the basis used for their quantification (section 2.4.1);
- clearer presentation of efficiency savings targeted across departments over the forward estimates period (section 2.4.2); and

- expanded presentation of factors supporting unapplied output and asset funding carried forward to an ensuing year by departments (section 2.6).

The Committee also advocates that the government assess the feasibility of including within the budget papers tables showing the main components of each department's output funding (such as provision of continuing services, new funding initiatives and any deducting items) which are reconcilable to a macro table covering the total output provisions within the budget. The inclusion of this information would give a clearer picture of the aggregate budgetary responsibility assigned to each department. It would also assist the government in its ongoing challenge of converting complex budget material into as simple a form as possible for readers.

All of the above suggestions will be further considered by the Committee as part of the planned review of financial reporting practices in the Victorian public sector, including those under the *Financial Management Act 1994*.