AUDITOR-GENERAL'S REPORT

PERFORMANCE AUDIT

In-year Monitoring of the State Budget

AUDITOR-GENERAL
NEW SOUTH WALES

The Legislative Assembly
Parliament House
SYDNEY NSW 2000

The Legislative Council
Parliament House
SYDNEY NSW 2000

In accordance with section 38E of the *Public Finance and Audit Act 1983*, I present a report titled **In-year Monitoring of the State Budget.**

R J Sendt
Auditor-General

Sydney
July 2005

State Library of New South Wales cataloguing-in publication data

New South Wales. Audit Office.

Performance audit : in-year monitoring of the State Budget / [The Audit Office of New South Wales]

07347 2179X

1. Budget – New South Wales – Auditing. 2. New South Wales – Appropriations and expenditures. 3. Finance, Public – New South Wales. I. Title: In-year monitoring of the State Budget. II. Title: Auditor-General's report : performance audit : in-year monitoring of the State Budget.

352.49944

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Foreword

The annual Budget is one of the most important and visible statements about a government's financial intentions.

Once a Budget is released, it is important to monitor variations from the projections it contains. This is done for two reasons -

- first, to ensure that individual agencies are properly managing their budget allocations and that any genuine emerging need for additional funding is met.
- second, to ensure that any changes to the State's overall financial position are understood and corrective action is undertaken.

This audit dealt primarily with the second of these objectives.

Budget monitoring involves both agencies and Treasury working together to quickly identify factors that might impact the budget, to clearly understand the implications for their budget position and to take any remedial action needed.

Poor monitoring may reduce the confidence that stakeholders have in the government's financial management. It may mean that government decisions made in-year or for the following budget (for example on tax measures or spending increases/savings) are based on an incorrect understanding of the State's true financial position.

I hope that this Report provides some useful insights that will assist in better monitoring.

Bob Sendt
Auditor-General

July 2005

Executive summary

Executive summary

Variations between an agency's budget and the actual outcome are inevitable and may arise from a number of sources including changes in government policy, unexpected service delivery pressures, industrial determinations and accrual accounting adjustments. Some of these variations may require supplementary funding from the Consolidated Fund.

However, effective budget monitoring requires variations to be identified and acted on quickly. This in turn requires effective communication between the agency and Treasury. If not, there is potential for significant impact on the State's budget result.

We reviewed budget monitoring practices in the budget dependent agencies NSW Health, Department of Education and Training (DET), NSW Police, Roads and Traffic Authority (RTA) and Department of Ageing, Disability and Home Care (DADHC), as well as NSW Treasury. The audit focused on agency budget variations for 2002-03 and 2003-04.

Our audit addressed the question: Is the monitoring of budget variations effective in identifying budget variations early?

Opinion

Budget monitoring has been improving, including increased focus on accrual based financial information by Treasury and agencies. It is not yet as effective as it needs to be, but it is reasonable. Some aspects are quite good, particularly those monitoring the level of funding appropriated by Parliament to agencies. This is a legacy of the traditional focus on cash accounting. The move to accrual accounting, and a timely focus on overall expenditure and revenues is not yet fully embraced by NSW budget dependent agencies and in Parliamentary budget processes. This is reflected in the continuing emphasis on cash in the appropriation process and the large adjustments to agency accrual-based results being identified only close to the end of the financial year.

On the positive side, budget monitoring of appropriation funding in the five agencies and Treasury was timely. In particular:

- the number of significant funding variations was small, and
- most significant agency funding variations were for increases outside agencies' control.

We also found budget monitoring practices supported by:

- well established processes, including extensive monthly analysis and reporting of budget trends, and
- businesslike relationships between agencies and Treasury.

The main problems we identified were:

- large adjustments and accelerated spending patterns by agencies at year-end
- Treasury-agency relationships, while businesslike, are not sharing information in the most effective ways
- a focus in Treasury and agencies on year-end budget result and limited focus on monthly targets, and
- Parliamentary budget controls still focusing largely on a cash basis, despite the adoption of accrual accounting a decade ago.

Summary of recommendations

Net cost of services focus by Parliament

We recommend that net cost of services, rather than the cash based Consolidated Fund appropriations, become the prime focus of Parliamentary control and that each agency's net cost of services be set by Parliament as part of the Budget approval process.

Net cost of services (total cost of services less any revenue retained by agencies) is a more relevant measure of the level of agency activity and spending. It also correlates more closely with the overall State Budget result. (page 28)

Monthly budget targets

We recommend that budget monitoring of large agencies should have a greater focus on monthly expenditure and revenue patterns. Treasury should make any necessary modifications to systems to cause agencies to report monthly budgets and forecasts. (page 27) And further, those agencies provide supporting narrative as part of their monthly reports on significant variations to budgets as soon as they are identified. (page 24)

Managing capital acquisition budgets

We recommend that Treasury modify monthly returns from the largest agencies to include capital expenditure against monthly budgeted expenditure patterns. And further, those agencies provide supporting narrative as part of their monthly reports on significant variations to capital budgets as soon as they are identified. (pages 26, 27)

Refining Treasury-agency relationships

We recommend that Treasury extend the principles of it's *Working with agencies: Our Code of Good Practice* into a charter that considers roles and responsibilities between Treasury analysts and agencies. (pages 37, 38)

Developing information exchange

We recommend that Treasury consider the following options for improving information flow with agencies:

- developing its Financial Information System to provide for benchmarking of agencies' budget performance and practices
- extending protocols to allow Treasury analysts greater access to agency financial information reporting. (page 36)

We also recommend that agencies give a high priority to upgrading their information systems and business intelligence tools to assist budget monitoring and reporting. (pages 25, 26)

Strengthening rewards and sanctions

We recommend that:

- more definitive measures of budget performance be introduced into all CEO performance agreements
- Treasury undertake an annual scorecard to indicate how agencies are performing budget monitoring. (page 39)

Key Findings

Chapter 1 - Introduction

Chapter 1 outlines the importance of budget monitoring in managing funding from Parliament and achieving bottom line budget results.

Budget monitoring must ensure that variations are identified in a timely manner and their implications clearly communicated and understood. Poor budget monitoring in agencies can have a big impact on both the agencies and State's budget results, and the delivery of government services.

Budget variations are influenced by government policies, demand for agency services and poor financial management. Each of them has particular implications for budget monitoring.

Chapter 2 - Is budget monitoring a concern?

Chapter 2 examines budget variations at the State level and the implications for budget monitoring.

An analysis of 2003-04 budget variations identified at mid-year, late-year and final budget positions indicates that budget monitoring could still be improved. Analysis of State operating revenues, expenses, capital acquisition and budget result trends indicates that some variations, often large, are not identified until close to year-end.

The chapter sets the stage for further analysis of budget monitoring practices underlying these variations.

Chapter 3 - Do accounting practices support effective budget monitoring?

Chapter 3 discusses budget management practices that are contributing to untimely variations and their reporting. It finds that these issues are of relevance to all agencies and suggests changes to government-wide practices.

Treasury's focus is, appropriately, on early, accurate estimation of the year-end budget position. However, this could be improved by greater monitoring of actual year-to-date results against estimated expenditure and revenue patterns. This is particularly the case for large agencies whose budgets comprise the bulk of the State Budget.

Since 2001, agencies have had an obligation to focus budget control on their net cost of services. This puts increased emphasis on accrual accounting for agency's overall expenses and retained revenues.

However the current Parliamentary budget approval process remains focused on cash appropriations. This tends to promote a view that accrual based-based information is of lesser importance.

Some agencies are not managing their finances on an accrual basis and are leaving major transactions that impact on their budget result until late in the financial year.

In addition, computer systems currently in use are impeding budget information flows within agencies.

These factors are contributing to agencies exceeding their budgets.

Chapter 4 – Is agency funding effectively monitored?

There are well established monitoring processes within all the agencies we reviewed. Analysis of monthly budget trends is extensive. This supports the trend observed in Chapter 2 that budget discipline appears to be improving.

We also found improvements in budget monitoring in Health, RTA, DADHC and DET. At the same time we note that Police and Treasury had problems in agreeing on estimates of Police salaries.

In addition:

- most significant variations to agency budgets are for increases outside their control, for example, government negotiated salary increases
- agencies have received only a small number of substantial budget supplementations during recent years.

Chapter 5 – Can Treasury and agencies improve their communication?

Effective budget monitoring requires good communication between agencies and Treasury. While relationships are business-like we found some areas in need of further improvement.

Monthly reporting between agencies and Treasury and within Treasury is timely and questioning is vigorous. The Treasury Financial Information System that stores the monthly financial data provided by agencies via the Treasury On-line Entry System supports the process adequately.

We note however that the format of the monthly data collection does not align with many agencies' internal reporting and systems. Agency focus is more on program expenditure than the budget line item reporting required by Treasury.

We also note that not all agencies provide narrative to Treasury each month on budget trends and variations.

The quality of relationships between agencies and Treasury analysts, although generally good, varies. The relationships can vary during the course of the year from collegiate to adversarial. If they become too adversarial there is a risk that effective budget monitoring may be impaired. We acknowledge that Treasury is currently conducting a review into how the overall quality of relationships may be improved.

At present there are no effective rewards or sanctions for agencies' budget monitoring results.

Co-ordinated response from Treasury

Thank you for your letter of 1 July 2005 providing the final draft report of the performance audit – In Year Monitoring of the State Budget.

I am pleased to note the generally positive views expressed on both the operations of agencies and Treasury in quickly recognising likely budget variations. The recommendations made in the report are useful and, in some cases, already being implemented.

It is also encouraging that the review concludes that most significant variations between agency budgets and actual outcomes are due to factors outside the control of agencies, such as industrial determinations, actuarial adjustments and changes in government policy. This conclusion demonstrates that variations between budgeted and actual expenses do not indicate any failure in agency and Treasury monitoring.

A principal focus of both the audit opinion and recommendations is the need to focus even more on accrual based financial information.

The principal recommendation is that net cost of services, rather than the cash based Consolidated Fund appropriations, become the prime focus of Parliamentary control and that each agency's net cost of services be set by Parliament as part of the Budget approval process.

It is relevant to note that Treasury's monitoring and reporting processes are entirely accrual based. For example:

- *Treasury's control of agencies' budgets is based on the accrual-based* controlled net cost of services;
- *All budget-dependent general government agencies provide accrual based financial statements each month, which are closely monitored by Treasury analysts; and*
- *The Budget Result and other key Budget aggregates are accrual based.*

In relation to Parliamentary control, Treasury is conducting a review of the appropriation system, with a view to recommending options for change to the Government. The appropriation process is a complex area. There are potential legal and constitutional constraints that need to be addressed in moving from a cash to accrual based appropriation system.

I would like to thank the Audit Office for the cooperative manner in which the performance audit was conducted.

(signed)

John Pierce
Secretary

Dated: 21 July 2005

1. Introduction

At a glance

Chapter 1 discusses the importance of budget monitoring, the consequences of poor budget monitoring and how variations arise.

Budget monitoring must ensure that variations are identified in a timely manner and their implications clearly communicated and understood. Poor monitoring of agency budgets can have an impact on the State's financial position and the ability to deliver services.

Budget variations are influenced by government policies, demand for agency services and poor financial management. Each of them has particular implications for budget monitoring throughout the year.

Background

The aim of budget monitoring is to identify variations quickly and to prompt speedy corrective actions. The variations occur as not all factors are known when a budget is prepared and as circumstances change during the budget period.

In budget dependent agencies budget monitoring can indicate if supplementary appropriation is required from the Consolidated Fund to continue services or if a revised budget for the agency is likely to have a significant impact on the State's budget result.

The audit examined the second of these implications – the accuracy and timeliness of budget monitoring processes to identify variances and initiate actions where there is likely to be a significant impact on the State's budget result. It did not examine agency financial management or the decision-making process for additional funding except to the extent that these issues impacted on the monitoring of the State's overall financial position.

What are the consequences of poor monitoring?

At the whole-of-government level, poor monitoring practices will result in having an inaccurate understanding of changes in the State's financial position.

If the State's financial position has deteriorated from a relatively sound position, Treasury and the Government may be unaware until it is too late to take corrective action if needed. In addition, the Government may continue to commit to new expenditure programs or tax reductions, either in the current year or in framing the next year's Budget, which it may now not be able to afford within its overall budget targets.

Conversely, if the State's financial position has improved but this improvement is not known until late, desirable new expenditure programs or tax reductions may be rejected or deferred.

At the agency level, poor monitoring of its finances might also result in poor decisions about the services it delivers. Genuine community needs may be unmet, or services provided with little understanding of their costs.

How do budget variations arise?

Budget variations can arise from many causes. Some of these are listed below, each with its own implications for the monitoring process.

First, governments can make conscious policy decisions post-budget to introduce new services or expand existing ones. This will usually have implications for (i) the level of Consolidated Fund support, (ii) the total expenses of the agency and the General Government Sector and (iii) the bottom line budget result. These implications will generally be known (or at least capable of estimation) at the time of the decision.

Second, the costs of some government programs are formula driven, varying directly with the number of eligible recipients. Such programs include pensioner rate rebates, per student assistance to non-government schools and (given the pre-existing commitment to certain teacher/student staffing ratios) teacher costs in government schools. Variations in these program costs will usually have the same implications as listed above. However information about the numbers "driving" the program costs may only become progressively known over the course of the year.

Third, agencies can raise more retained revenue from selling their goods or services. This may arise from a conscious decision to increase charges or extend the range of products charged for (in which case the agency should be aware at the time of the likely revenue impact) or may reflect increased demand (which may only become evident during the course of the year). While such additional revenue will impact both the agency and the General Government Sector total revenues and the bottom line budget result, it will (generally) not impact on the level of Consolidated Fund support in that year.

Fourth, similarly, Crown taxes and fees may raise more revenue than was assumed. This area is the most difficult to forecast, particularly at the State level because of the volatile nature of the states' tax bases, especially stamp and land tax.

Fifth, agencies can decide to spend more of their cash balances than was assumed in the Budget within certain tolerance limits imposed by Treasury. This will have implications for (i) the total expenses of the agency and the General Government Sector and (ii) the bottom line budget result, but not the level of Consolidated Fund support. These implications will generally be known (or at least capable of estimation) at the time of the decision.

Sixth, agencies with poor financial management may overspend relative to their budget projections. This will have implications for (i) the total expenses of the agency and the General Government Sector and (ii) the bottom line budget result. It may impact on the Consolidated Fund if the agency has no other source (eg uncommitted cash balances) to meet the over-expenditure.

Seventh, costs my also vary due to unforeseen non-discretionary expenditure, such as Industrial Relations Commission decisions, legal judgements and actuarial adjustments.

In each of the above cases, there is a converse possibility - expenditures or revenues may be lower than budgeted.

2. Is budget monitoring a concern?

At a glance

Chapter 2 examines budget variations at the State level and the implications for budget monitoring.

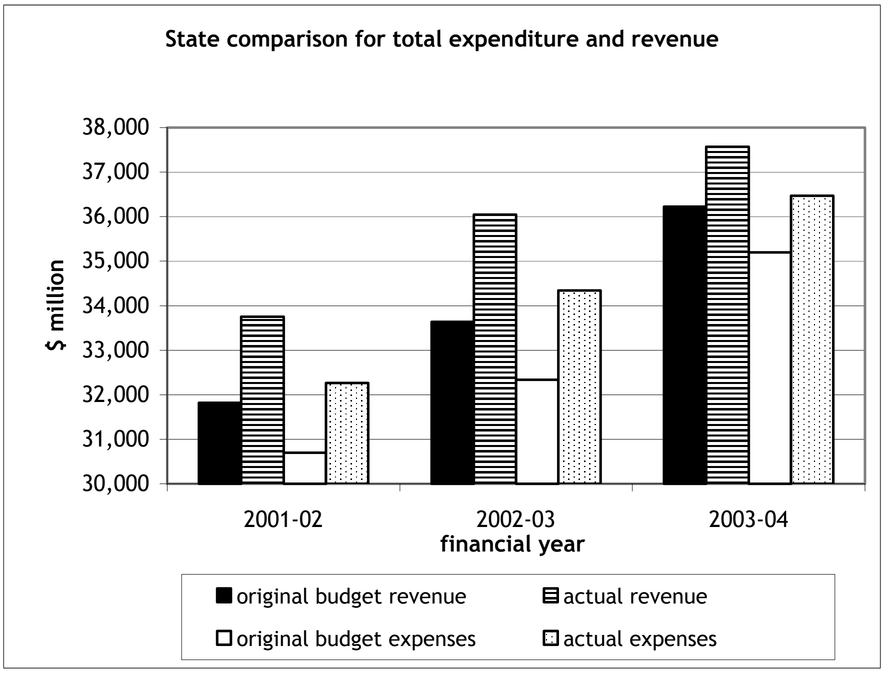
We find:

- comparison of original and final budget results for 2003-04, when compared to the two earlier years, indicate that performance against budget has improved
- more detailed analysis of variations at mid-year, late-year and final budget positions indicating that budget monitoring could still be improved
- analysis of State revenues, operating revenues, expenses, capital acquisition and budget result trends indicate large variations, especially towards year-end.

The chapter sets the stage for further analysis of budget monitoring practices underlying these variations.

Do smaller variances mean improved budget monitoring?

State budget results for 2003-04 expenditure and revenues, when compared to the previous years, indicate smaller variances between original total budgeted expenditure and revenues and the actual results for the year.



Source: Budget Papers; Audit Office analysis

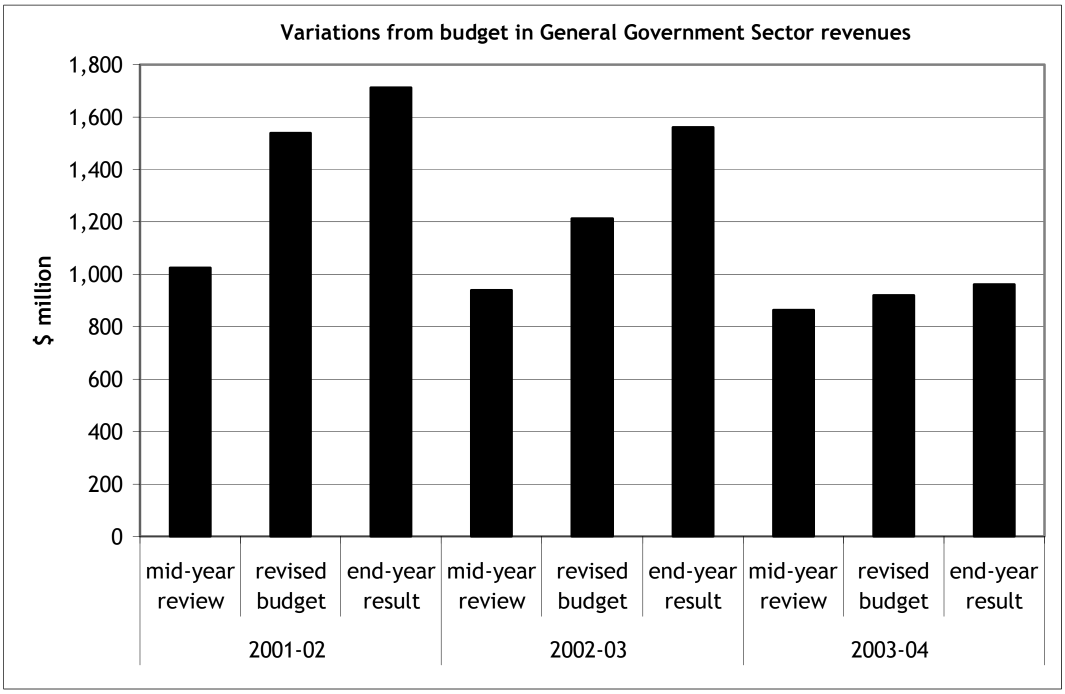
However, more detailed analysis illustrates that in-year budget monitoring could still be improved. The following graphs for State revenues, operating revenues, expenses, capital acquisition and budget result indicate large differences between mid-year, late year and final budget positions, indicating the late pick-up of variations.

Many of the budget variations are within the sample of five agencies we selected for review. Some of the large budget variations relate to whole-of-government factors. These variations were outside the scope of the audit and are not examined in detail in this report.

The graphs plot variations for three years presented at three reporting points. Mid-year figures are taken from the Treasurer's *Half-Yearly Budget Review* presented each December. Revised budget figures are from the May Budget Papers. The end-year result is from the audited *Report of State Finances* released in October each year.

General Government Sector State revenues

State revenues are derived largely from State taxation and Commonwealth Government grants. They are the main source of funding for State government activities.



Source: Budget Papers; Audit Office analysis

The increase of actual revenues over original budgets for the three years is largely due to increases in State taxation revenue from stamp duty and land tax due to the property market boom, most notably in 2002-03. The impact of variations in State revenues and the volatility of State taxes on the State's budget position were not within the scope of the audit.

General Government Sector operating revenues

Operating revenues are earned by agencies in the normal course of their activities. The single largest variations in 2002-03 were due to increases in:

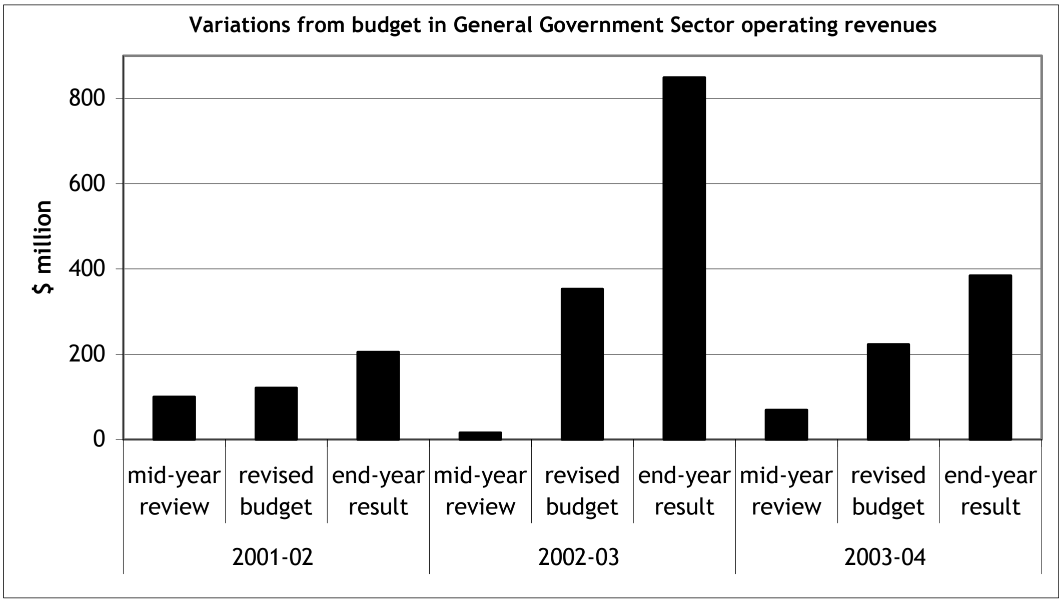
- grants and contributions of $316 million greater than the budget estimate, largely due to a change in accounting treatment requiring DET's first time recognition of school generated revenue from community sources, including school bank balances, which also increased expenditure by a similar amount
- RTA receiving $290 million following the letting of contracts for the construction of toll roads.

The lesser increase in State operating revenues for 2003-04 compared to 2002-03 were due to:

- increases in investment income managed by Treasury ($204 million)
- RTA receiving reimbursement of costs from road construction contracts ($79 million).

The largest source of operating revenues for agencies is user charges to recover costs of providing goods and services. However, variations in these over the two years were relatively small. The largest increases in user charges occurred in 2002-03 and were for higher than expected fees for Health from private patients, and increased overseas student fees and the recognition of revenue from school canteens for the first time in DET.

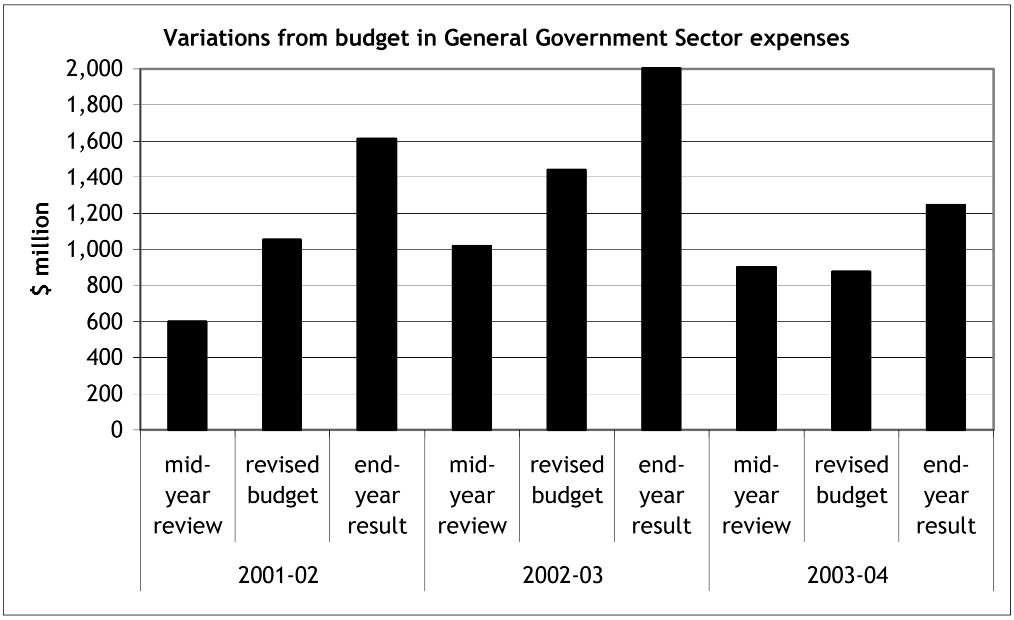
The graph below indicates that, even excluding the accounting adjustment in respect of DET's first time recognition of school generated income, much of the variations in operating revenues were not picked up until late in the year. The variations in RTA are examined further in the next chapter.



Source: Budget Papers; Audit Office analysis

General Government Sector expenses

Expenses are the largest single budget aggregate under an agency's control and were the focus of the audit.



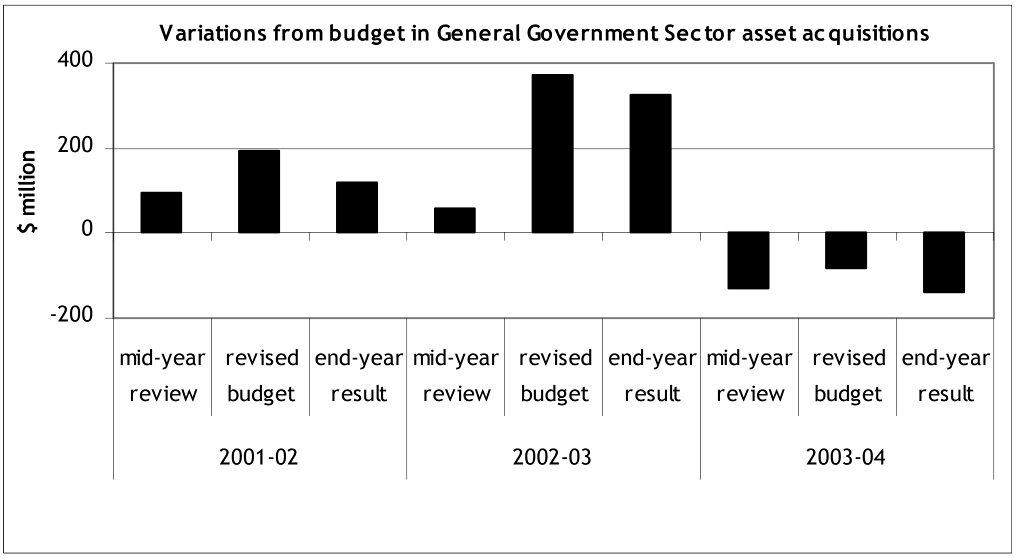
Source: Budget Papers; Audit Office analysis

During 2002-03 and 2003-04 the single most significant increases in expenses across the State were for salary increases in Health and DET, negotiated by government and outside the control of the agencies. The implications of supplementary budget funding are examined in Chapter 4. DET's expenses in 2002-03 also increased considerably through the inclusion of school bank balances that also increased revenue by a similar amount. RTA had significant increases in depreciation expenses for both years.

These three agencies contributed the most to increases in State expenses over the two years. As indicated in the graph, although it appears for 2003-04 that variations were picked up earlier, the variation between the revised budget estimate in May and the audited budget result in October still indicates a monitoring problem.

These budget variations and the underlying financial practices and relationships are discussed in some detail in the following chapters.

General Government Sector asset acquisitions



Source: Budget Papers; Audit Office analysis

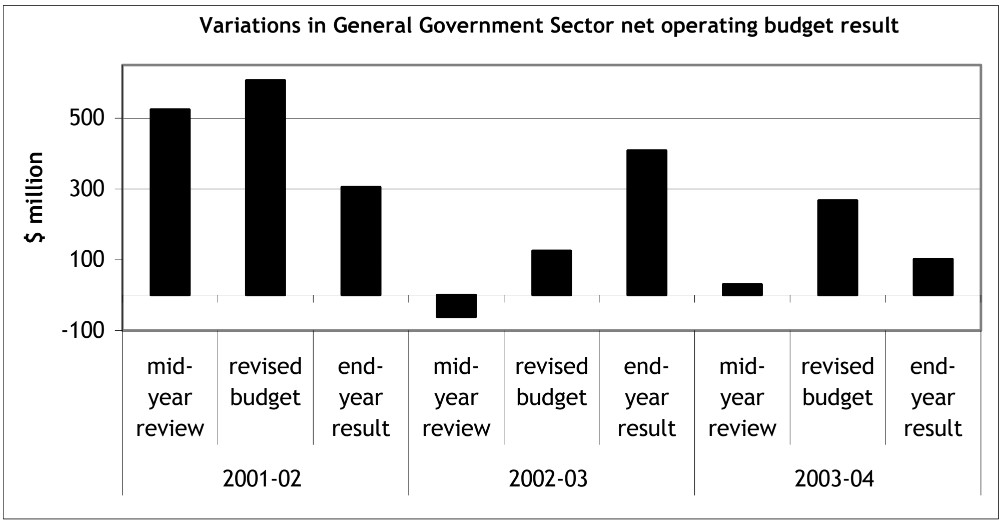
The most significant increase in asset acquisitions for 2002-03 was for government's motor vehicle leases of $344 million. Changes in accounting treatment required them to be classified as assets in the total State accounts, but this had no impact on individual agency budgets. The trends for the other years indicate good performance and that variations are being picked-up earlier in the year.

Large decreases in 2003-04 were due to:

- delays in projects towards year-end, including RTA delays in obtaining planning approvals and in purchasing properties
- agencies, including Health, expensing a portion of capital project costs, reducing asset acquisition budget and increasing expenses.

These instances are discussed in the following chapter.

General Government Sector budget result



Source: Budget Papers; Audit Office analysis

In the above graph, past budget results are presented on a net operating result basis, consistent with the Government's current reporting policy. The result is also determined in accordance with the Government Finance Statistics (GFS) principles applied by the Australian and other state governments. Although the net operating result basis provides a generally higher result than the previous method, it shows a similar trend to the previous treatment.

The net operating result basis (equal to all revenues less expenses) is broadly consistent with the agency budget control measure of net cost of services (equal to expenses less operating revenues). They both include accounting accruals and provisions such as monies to be paid or received at the end of the year and non-cash expenses for depreciation of assets and long service leave entitlements. However, the GFS principles require that valuation changes are excluded from the net operating result. These include sales of assets and property revaluations.

Putting aside State revenues, variations in the General Government Sector budget result are closely reflected in variations in budget dependent agencies' net cost of services, which is one of the agency budget controls used by Treasury. This is examined in the following chapter.

3. Do accounting practices support effective budget monitoring?

At a glance

Chapter 3 examines budget monitoring and accounting issues that are specific to individual agencies and of relevance to all agencies.

Some budget management practices and processes in agencies are contributing to untimely variations and reporting, including:

- large adjustments at year-end contributing to agencies exceeding net cost of services budgets
- computer systems impeding budget information flows within agencies
- the focus on year-end budget position not supporting effective monitoring of annual expenditure and revenue cycles on a monthly basis.

Recommendations to improve budget monitoring practices are included.

Controlling agency budgets

The primary focus for budget dependent agencies is the amount of cash appropriated by Parliament each year. The amount both supports and limits how much agencies can spend on their activities. It is a very exact control as agencies cannot draw down more than has been appropriated. A result is an emphasis on cash accounting in agencies.

However, the focus of financial control over a budget dependent agency should be on how much government must contribute in total for it to perform its functions. In public sector accounting terms, this amount is called the net cost of services. It is the total of an agency's expenditure to deliver services minus any funds retained from sales of goods and services. This approach is consistent with how the State budget is reported, monitored and controlled by Treasury.

As the government operates on accrual accounting, net cost of services is determined on that basis. Accrual accounting means that not only cash payments are counted but also provisions and accruals for expenses that have been incurred. Examples are depreciation over the life of assets such as hospitals or roads, recognition of doubtful debts and long service leave earned but not yet taken.

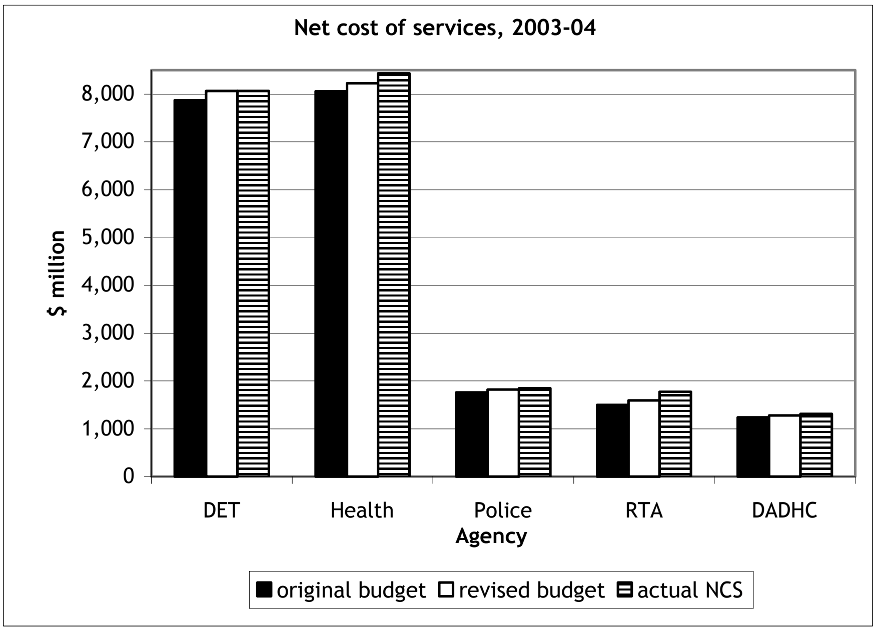
Since 2001 agencies have had a supplementary budget control based on their net cost of services, which is derived on an accrual accounting basis.[1] As a control it is less exacting than cash appropriations requiring only significant variations to agency net cost of services limits requiring Treasurer and/or Budget Committee approval. Conversely, net cost of services is a more accurate measure of agencies' activities.

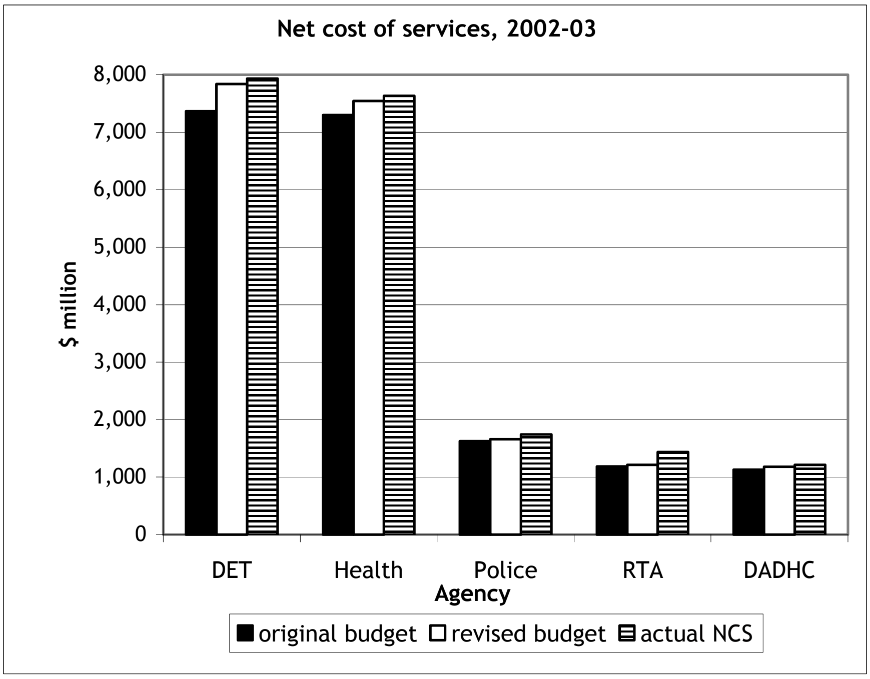
The challenge for agencies has been to both report and control budgets applying accrual accounting practices.

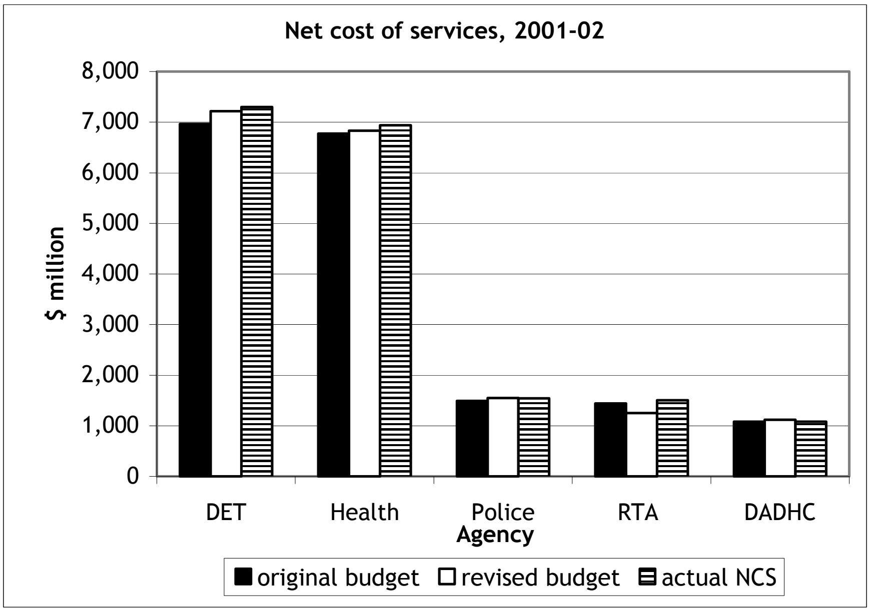
[1] See Treasury Circular 01/21 *Budget Controls – Net Cost of Services* 10 October 2001.

Variations against net cost of services budgets

As can be seen from graphs below, all the agencies reviewed exceeded their budgeted net cost of services for the past three financial years.







Source: Budget Papers and Agency Annual Financial Statements; Audit Office analysis

The variations can arise from policy decisions and demand for services. These may result in budget supplementation. Variations can also occur because of agency budget practices which become apparent at year-end. The matter of agency supplementations is addressed in the next chapter. Many of those adjustments were for factors outside agency control such as salary increases and government program initiatives. The focus of this chapter is those variations caused by agency budget practices. These are of two types:

- those practices contributing to agency budget positions being exceeded, such as
  - large adjustments late in the financial year that could be better anticipated
  - computer systems impeding budget information flows within agencies
  - late posting of approved budgets to financial systems by agencies
- and, those practices contributing to year-end budget management pressures within agencies, including
  - high levels of year-end expenditure, especially capital expenditure
  - an absence of variation reporting of actual expenditure against monthly budget targets to Treasury
  - limited support for net cost of services as the means of budget control.

Practices contributing to agency budgets being exceeded are discussed initially.

Significant adjustments at year-end affecting budget results

Our observations confirmed a Treasury report's statement that:

'Evidence suggests higher levels of operating and maintenance expense accruals tend to occur in June of each financial year. However, the aggregated impact of bringing these expenses to account in June causes an inflated expenditure level in these line items.'
source: Treasury Budget Management Report for 30 June 2004

Examples of significant increases in agency expenses at year-end follow.

Roads and Traffic Authority

RTA made large variations at year-end to its depreciation expense and maintenance expenditure relating to the road program.

Depreciation expense adjustments at year-end for 2002-03 were $185 million and for 2003-04 were $255 million higher than estimated. Contributing to this were higher road valuations due to the lack of rainfall, valuations conducted only every five years and the use of under-stated indexes to adjust values during the intervening years. RTA has revised the basis of calculation for depreciation of road assets for 2004-05 to improve accuracy.

On the other hand, increases in maintenance expenditure at year-end are due to operational difficulties with road construction. The increases were $88 million in 2002-03 and $53 million in 2003-04. In those years the RTA experienced problems with land acquisitions and bad weather in some coastal regions.

RTA also received higher than expected payments associated with contracts for the construction of toll roads. These were received late in both years and helped offset increases in expenditure. For 2002-03 RTA had a budget variation of $290 million from receipt of revenues for development contributions for the Cross City Tunnel and Western Sydney Orbital Motorway. Similarly, in 2003-04 RTA received revenue of $79 million from the letting of contracts for the Lane Cove Tunnel project.

Health

Health had large year-end increases in expenses caused by the accounting treatment of capital project expenditure not recognised as an asset. For example, in 2002-03 and 2003-04 the adjustments were $78 million and $54 million respectively. Health has advised that changes to its capital program systems will allow more accurate and timely estimation in future.

There are also large end of year accounting adjustments for increases in leave provisions stemming from award increases made through the year. They were prompted by changes to accounting standards. The adjustments require actuarial estimates of future award increases and their impact on leave payable.

Earlier attention to adjustments

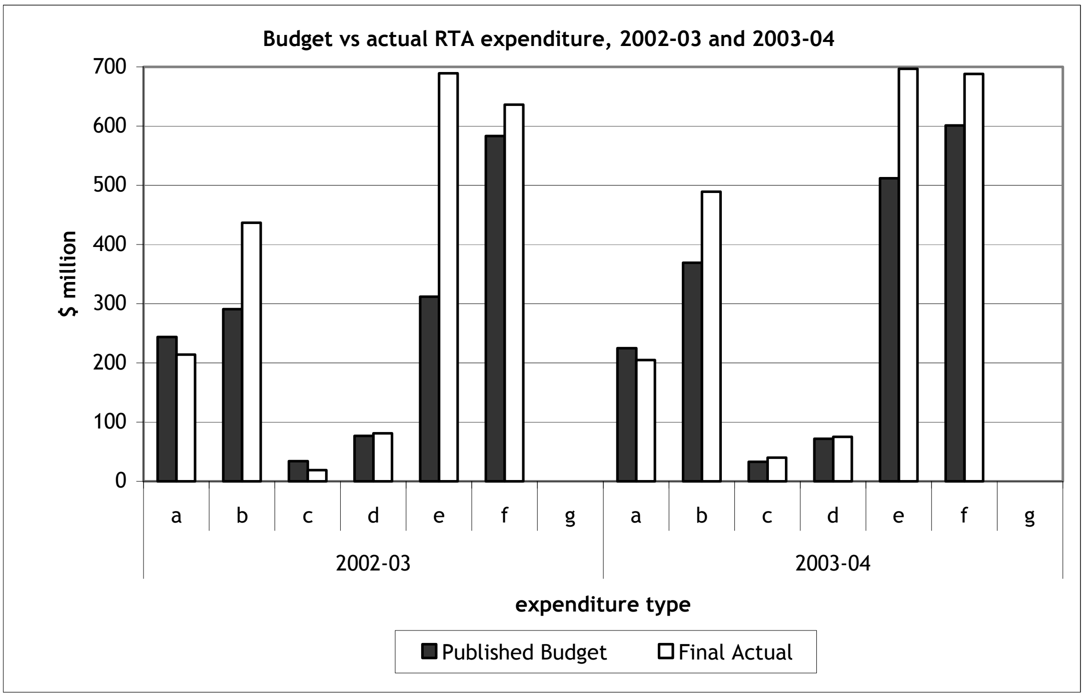
Significant and untimely adjustments of the types referenced above threaten an agency's and the State's budget results. The earliest identification and reporting of them is required. Agencies, Treasury and The Audit Office can play a role in this.

Reporting of potential and significant adjustments of an accounting nature by agencies should be specifically included in monthly budget reporting to Treasury. This should include accruals, changes in accounting treatment and the impacts of operational difficulties. This would also facilitate Audit Office consideration of them prior to 30 June.

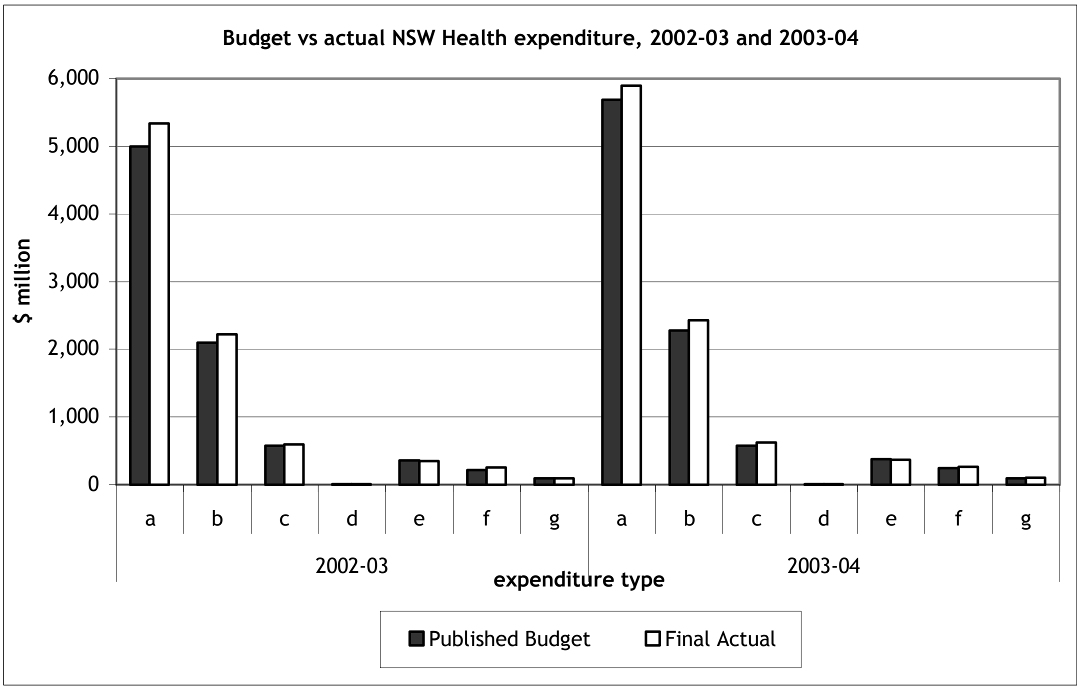
Recommendation

We recommend that Treasury design a template for agencies to supply narrative in support of their monthly TOES budget return. It should require the earliest reporting of traditional year-end budget adjustments such as accounting accruals, changes in accounting treatment and operational impacts.

The charts below plot RTA and Health's variations over the past two financial years.



a - Operating Expenses - Employee
b - Operating Expenses - Other
c - Grants & Subsidies
d - Borrowing Costs
e - Depreciation & Amortisation
f - Maintenance
g - Other Expenses



a - Operating Expenses - Employee
b - Operating Expenses - Other
c - Grants & Subsidies
d - Borrowing Costs
e - Depreciation & Amortisation
f - Maintenance
g - Other Expenses

Source: Treasury's Financial Information System; Audit Office analysis

Late posting of budgets by agencies

Some agencies are prone to delaying the posting of budgets to the accounting system. Late posting carries the risk of spending by managers that is inconsistent with the budget that is formally allocated.

Police did not load its 2003-04 recurrent budget into its financial information system until December 2003. The capital budget was not loaded until after this date. The previous year's budgets were posted equally late.

Recommendation

Treasury resource allocation analysts should confirm each year that agencies are loading their approved budgets to their financial management information systems by mid-July.

Information systems

The degree to which information systems are supporting budget monitoring varies from agency to agency. This is due to the variety and age of the systems.

We observed that agencies use a variety of Financial Management Information Systems such as SAP, Oracle, and JD Edwards. Some agencies use add-on business intelligence tools that sit over their operating systems and allow advanced analysis of data.

We also observed that some financial systems require or are likely to undergo upgrades in the near future. The Health and DET financial information systems are in need of overhauls, although DET's executive information system is highly advanced and includes a range of financial performance, program and line item reporting features.

The two largest agencies, Health and DET, are presently undergoing the consolidation of corporate services, including financial and information technology functions. This provides an opportunity to improve management systems.

For example, budget monitoring in Health is hampered by financial management information systems that are not well connected or standardised. Charts of accounts are not consistent across area health services and Health's head office does not have instant access to up-to-date financial data. As a consequence monthly reporting to Treasury is slow, with full reporting not reaching Treasury until the third week of the month. This lessens Treasury's ability to analyse budget performance.

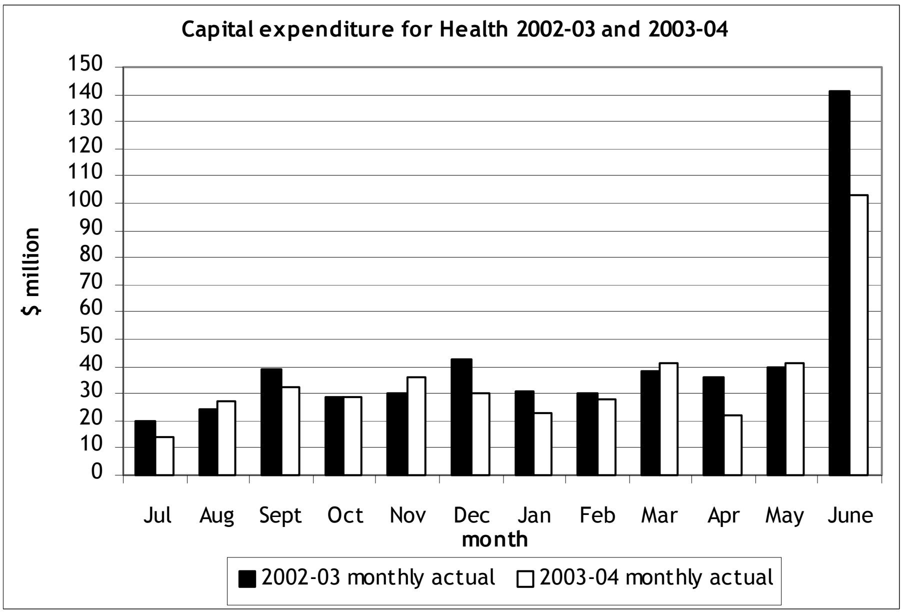
Recommendation

We recommend that the agencies continue actions to upgrade their information systems and business intelligence tools to support more timely and comprehensive budget monitoring.

The following sections deal with those practices that are causing year-end budget pressures for agencies. Possible solutions are recommended.

Late capital expenditure puts pressure on budget monitoring

Capital expenditures by agencies are not evenly spread throughout the year. There may be delays in commencing capital projects due to lead times, contractor's delays or adverse weather patterns. The receipt of significant Commonwealth Government funds in September and March influences the expenditure pattern for grants each year. Health's capital expenditure trends for the last two financial years illustrate year-end spend.



Source: Treasury's Financial Information System; Audit Office analysis

Treasury has stated: 'There is [also] typically higher level of capital expenditure in the last month of each financial year as agencies tend to 'spend-up' to meet their allocation.'
Source: Treasury's Budget Management Report for 30 June 2004

It is critical that agencies identify changes in capital programs and amend current and future budgets as soon as possible. As indicated in the above quote, the position with underspending of capital allocations can tempt less than optimal acquisition decisions. Variations identified mid-year can be included in changes to agencies' capital program for future years in the May State Budget. Capital program under-expenditure identified later in the financial year needs to be negotiated with Treasury and budget supplementation sought for the next year. There is generally sufficient flexibility in the overall capital acquisition program and budget position for Treasury to support these requests for carry-over. But this is not the preferred position.

Recommendation

We recommend that Treasury modify monthly returns from the largest agencies to include capital expenditure against monthly estimated expenditure patterns. And further, those agencies provide supporting narrative as part of their monthly returns on significant variations to capital budgets as soon as they are identified.

Lack of a monthly net cost of services focus

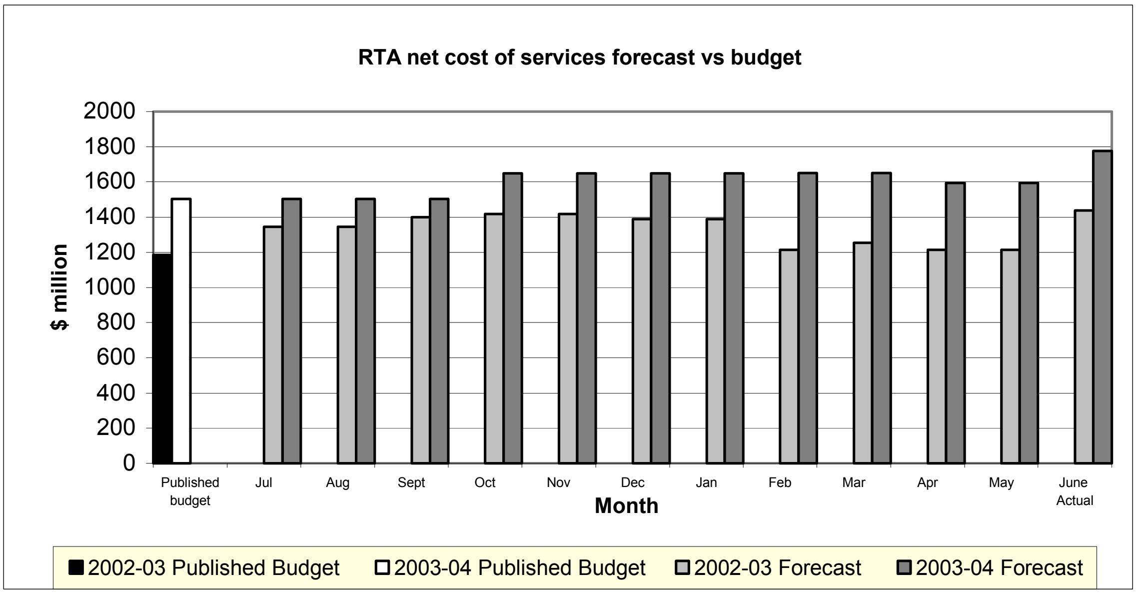
Agencies' monthly reporting to Treasury advises of variations to their projected final result for the year. The Treasury On-line Entry System (TOES) does not highlight possible significant effects on the budget of uneven expenditure and revenues patterns, for example expenditure dependent on Commonwealth program payments and implementation difficulties with capital projects. Comparison of expenditure against monthly targets would enable Treasury to better identify and take action on variations earlier. This is particularly relevant in larger agencies where the impact on the budget result is greatest. Treasury should make any necessary changes to its Financial Information System and TOES to allow larger agencies to load monthly budgets and forecasts. The data reported should be at a high level, for example at the aggregated expense levels used in the Budget Papers. If a threshold of total expenses in excess of $400 million were applied, data would be required from the top 15 budget dependent agencies. (This is based on figures from the 2004-05 Budget Papers.)

We acknowledge that some Treasury analysts are gathering and analysing monthly budget information.

The chart below for RTA illustrates the continual adjustment of the anticipated budget result during 2003-04 and 2002-03. For example, in 2003-04, forecasts in April and May reversed earlier trends and anticipated a position further away from the actual June result.

Recommendation

Budget monitoring of large agencies should have a greater focus on monthly expenditure and revenue patterns. Treasury should make any necessary modifications to systems to allow agencies to report monthly budgets and forecasts.



Source: Treasury's Financial Information System; Audit Office analysis

Increasing focus on net cost of services

The recent changes in the reporting of the State's Budget places a greater emphasis on an agency's net cost of service position.

The State's budget position is now reported as a GFS net operating result. This closely equates to the sum of agencies' net cost of services less total State revenues (largely State taxation and Commonwealth grants). An impact of the recently changed State budget reporting is that depreciation, which was previously excluded from the budget result, is now included and will need to be more accurately determined by agencies for budget purposes.

In light of these changes there is a need for increased encouragement for agencies to manage their net cost of services position.

Coincidently, we noted that NSW Treasury is assessing changes to the format of annual appropriations by Parliament to agencies. This could reinforce agencies controlling their budgets on a net cost of services basis and also allow some flexibility for the payment of capital commitments in the next financial year.

Recommendation

We recommend that net cost of services, rather than Consolidated Fund appropriations, become the prime control focus and that each agency's net cost of services be set by Parliament as part of the Budget approval process.

Net cost of service is a more relevant measure of the level of agency activity and spending. It also correlates more closely with the overall State Budget result.

4. Is agency funding effectively monitored?

At a glance

In Chapter 2 we observed that trends indicate improving budget discipline. This chapter suggests that this is occurring because of the standard of budget monitoring processes applied by agencies. We conclude that these processes are reasonable. In particular, agency monitoring of funding levels is well managed.

We find:

- well established monitoring processes within all the agencies we reviewed - analysis of monthly budget trends is extensive
- a number of improvements in relation to past agency budget performance
- agencies have received only a small number of substantial budget supplementations during the past two years
- most significant variations to agency budgets are for increases outside their control, for example, government negotiated salary increases
- the processing of budget variations is timely.

Comprehensive monitoring and reporting

There were well established and comprehensive reporting and monitoring processes within all the agencies we reviewed.

The five agencies we reviewed had established financial executive teams with extensive experience in managing budget issues. The large agencies had separated their financial and management accounting functions. These activities were well understood and co-ordinated by their Chief Finance Officers. Agency head office budget units drove and co-ordinated budget monitoring. Agency relationships with Treasury were mature and businesslike. (See Chapter 5 for a more detailed examination of the relationship between agencies and Treasury.)

Agency processes

Agency focus on monitoring revenue and expenditure against budgets includes monthly reporting to:

- Treasury, including actual performance against budget and impacts on in-year estimates and forward year estimates. This is done via the Treasury On-line Entry System (TOES).
- an agency Finance / Budget Committee
- agency cost centres, allowing more detailed analysis of their budget performance.

Agencies produce monthly financial reports in a broadly consistent format, including the following information:

- agency operating statement year-to-date
- budget revenues and expenditure, including specific revenue or expense issues eg grants
- forecasts and expected variations from budgets
- cash holding forecasts
- capital program performance and forecasts

- comparison of actual to budget
- variances and impacts on projections
- narrative of causes of variances and corrective actions
- analysis of core operational issues and likely financial implications.

"Flash" financial reports are produced within one to five days of month end. This means the review of financial results for the period are available within 10 days or less.

Improvements in agency budget monitoring practices

In recent years agencies have made a number of significant improvements in budget monitoring. For example:

- NSW Health has improved its management of its dispersed, complex budget. Budget monitoring in Health must balance both centralised and decentralised processes. This means that budget positions can vary across the agency. For example, Health's budget position at 30 June 2004 was the result of ten Area Health Services being over budget with seven under budget.
- RTA is improving the administration of its depreciation expense. Calculations were based on understated asset valuations, resulting in large year-end adjustments for depreciation expense.
- DADHC has improved its budget management. Some years ago, DADHC's perceived poor budget monitoring performance prompted a review initiated by the Services Performance and Financial Management Committee of Cabinet at the request of DADHC and central agencies. The review committee comprised senior officers from Cabinet Office, Premier's Department and Treasury. The review prompted an organisational restructure and the development of a new business model to, amongst other things, better support budget forecasting.
- Following large budget variations in 2002-03, Treasury and DET conducted a detailed expenditure review. This has improved budget monitoring through better analysis by DET and Treasury of potential budget variations.

Budget supplementation – numbers and type

The main causes of agencies receiving budget supplementation are:

- circumstances beyond an agencies control, such as funding of government negotiated industry salary increases, Commonwealth grant payments and policy initiatives made during the year
- variations to expenditure and revenue budgets arising from internal issues identified by agency budget monitoring.

In the agencies that we reviewed there have been only a small number of substantial supplementation requests during the past two years of the second type.

To take one example, DET has had relatively few in-year appropriation increases for such a large agency. In 2002-03, fourteen requests totalling $425 million for variation to expenditure were approved. Of this total, $240 million related to salary increases and $55.5 million to additional Commonwealth funding. This represents a small percentage of total expenses for the year of $8.1 billion. Conversely, increases in DET operating costs during the year led to Treasury initiated expenditure review indicated above.

DET's budget supplementations and other approved budget variations for 2002-03 are outlined in the table below. Also included below are Health's budget supplementations for 2003-04 which indicate a similar position. The largest funding variations being for government policy initiatives and salary increases.

Budget funding variations for DET 2002-03

Variation requests approved

number	value $000	payment type	main reasons
4	276,000	inter-agency transfer of funds	salary adjustments ($240m) & operating costs ($35m)
6	68,808	Treasurer's Advance	operating costs including Commonwealth funding & maintenance
2	35,750	additional Commonwealth government specific purpose payments (section 26 of the Public Finance and Audit Act 1983)	agreement based
1	25,000	additional expenditure for necessary services or works (section 22 of the Public Finance and Audit Act 1983)	student enrolment growth
1	(19,000)	intra-agency transfer of funds	capital funding to recurrent operating costs

Budget variations for NSW Health for 2003-04

Variation requests approved

number	value $000	payment type	main reason
4	132,365	additional expenditure for necessary services – section 22	base funding adjustment, salary award increase
4	11,942	Treasurer's Advance	investment earnings from Health Growth Fund
1	(8,000)	inter-agency transfer	under-expenditure transfer to another agency
1	(2,760)	intra-agency transfer	under expenditure
1	3,528	Commonwealth funding	increased services

Timeliness of processing budget variations

Our review of the Treasury supplementation register and discussions with agencies and Treasury revealed that the processing of budget variations is timely. However, we observed that in some cases the register was not being updated to reflect requests and negotiations.

We noted in three of the agencies (Police, Health and DET) that in a number of cases the recording of requests in the supplementation register and communication between the parties took place over an extended period of time. While several of these examples represented disagreements between Treasury and the agency, none of them threatened the agency's budget position.

However, in some cases extended negotiations between agencies and Treasury had the potential to cause budget monitoring problems. For example, we note that Police and Treasury still have problems in agreeing on the estimation of Police salaries. This causes Police to seek budget supplementation early in the year.

Recommendation

We recommend that Treasury should register all significant consultations with agencies about the extent and cause of potential agency budget variations in the Financial Information System. This should be done at the time they occur so they can be included in periodic reporting to government and Parliament, for example the *Half-Yearly Budget Review* tabled in December.

5. Can Treasury and agencies improve their communication?

At a glance

This chapter examines the quality of the Treasury monitoring processes and analyses the relationship between Treasury and the agencies.

We find:

- monthly reporting between agencies and Treasury and within Treasury is timely and questioning is vigorous. Relationships between Treasury and the agencies are businesslike
- there is room for improving agency reporting to Treasury and responsibility for budget monitoring.

Monthly reporting between agencies and Treasury and within Treasury

Monthly reporting between agencies and Treasury and within Treasury is timely and questioning is vigorous. The Treasury Financial Information System (FIS) stores the monthly financial data provided by agencies via the Treasury On-line Entry System (TOES). Treasury has the ability to further analyse the data contained in FIS through the use of COGNOS PowerPlay software.

Treasury's primary focus is on monitoring agencies' financial performance. Consequently, monthly budget reporting by agencies in TOES is financially focussed and allows only limited analysis of agencies' strategic and operational performance.

However, TOES variations do prompt questioning by Treasury of broader agency strategic and operational issues outside the financial reporting framework. This questioning commonly results in extensive dialogue between Treasury and agencies. The lack of alignment between TOES's reporting requirements and the agencies' reporting systems is causing additional effort by the agencies in providing TOES reports as well as communication difficulties with Treasury in discussing variances.

Recommendation

We recommend that Treasury consider the following options for improving information flow with agencies:

- Treasury to develop its budget information system to provide additional benchmarking of agencies' budget performance and practices. At the same time it could provide a complementary database to analyse the results/ performance measures being developed within the Results and Service Plans (RSP)
- recognising that the agencies have the best data and that both parties should have shared access to it, Treasury to extend information exchange protocols with large agencies to ensure Treasury have greater access to agencies' information.

Narrative Reporting to Treasury

We also note that some agencies (Health and DADHC) support their monthly financial report to Treasury with narrative explanation on budget trends and variations. The exchange of supporting explanations between Police, RTA, DET and Treasury is less formalised. We consider that the provision of supporting analysis each month significantly improves the quality of the reporting and provides a good platform for subsequent monitoring and discussion between Treasury and the agency.

Recommendation

We recommend that Treasury design a template for agencies to supply narrative in support of monthly budget returns. The reports should have financial and narrative information for capital and recurrent expenditure covering year to date actual figures, projections, budget and status of all funding requests.

Signing off returns to Treasury

Treasury periodically require responses from general government agencies to information requests affecting budgets and estimates. In some instances Treasury will follow-up the request and the response rates are high. Such an example is the request for global savings plans for 2004-05. Other requests by Treasury require sign off by CEOs. In the case of the review of budget and forward estimates for the half-yearly budget review for 2004-05 Treasury requested that CEOs sign off responses. Only 63% of CEOs provided signed returns to Treasury. However, we note that the CEO's of the five agencies reviewed did provide returns.

Recommendation

We recommend that Treasury revisit this issue and take action to ensure compliance by CEOs with a workable sign off process.

Relationships between Treasury and the agencies

On the whole, the relationship between Treasury and the agencies we examined are businesslike and constructive. This conclusion was confirmed by evidence we collected from all parties. However, the quality of relationships between agencies and Treasury analysts can vary during the course of the year from collegiate to adversarial. If they become excessively adversarial it can affect information sharing and has the potential to limit the understanding of issues. For example, Treasury and one particular agency, while maintaining a continuing if tense communication, have run two separate sets of analyses and at times found it difficult to agree.

While there is a natural level of tension in these relationships, that tension should be constructive. Treasury relies on open communication with agencies and a high degree of mutual trust to ensure the best results in the budget monitoring process. Where that trust does not exist, Treasury becomes more insistent and adversarial in its questioning and the agency tends to become more defensive and guarded in its answers.

Treasury's Office of Financial Management's statement on *Working with agencies: Our Code of Good Practice* sets out broad client relationship management principles. They include regular consultation, openness and courtesy; consistent accurate advice; and timely responses. The Code applies only to Treasury and does not touch on the role and responsibilities of agencies.

Treasury checks on agency perception of the quality of Treasury practices every two years in an agency relations survey. The most recent survey included responses from a number of agencies on how Treasury budget analysts could improve their level of assistance. Agency satisfaction with their relationship with Treasury has been steadily increasing in the surveys. The 2004 survey measured the level of satisfaction at 78 per cent.

Treasury is reviewing budget analysts in their role as the primary contact with agencies. The review is considering skills levels, team approaches and co-ordination of inquiries. A challenge for the review is to balance Treasury's focus on budget constraint and broader issues of strategic resource management with the prerogative of agencies (and Ministers) to manage their own resources and focus on the provision of services and the results of their programs.

Other challenges include the development of pathways for resolving disagreements between Treasury and agencies and aligning budgets and strategies through results and service plans. There is also room for the better use of data and information systems for the analysis of program performance.

The review's recommendations, which are to be implemented over the next 18 months, and which we support, envisage a revised role for budget analysts featuring:

- increased analyst knowledge of agency operations
- more constructive relationships between Treasury and agencies
- greater focus on agencies' operations and the strategic issues
- greater streamlining of reporting processes.

Recommendation

We recommend that Treasury extend the principles of their *Working with agencies: Our Code of Good Practice* into a charter which considers roles and responsibilities between Treasury analysts and agencies. The charter should address:

- the obligations of both parties
- specific deliverables from agencies
- how to deal with disputes between Treasury and agencies
- access to and sharing of information
- confidentiality of exchanges and notification of communication to other parties.

Strengthening rewards and sanctions

At present there are no systematically applied rewards or sanctions for good or poor budget results by agencies. Effective rewards and sanctions would reinforce the systematic budget management practices within agencies and between agencies and Treasury. However, we noted earlier in this chapter the high rate of non-compliance by CEOs with the Treasury requirement that they personally certify budget reports.

We also understand that budget achievement is not enforced in the performance agreement of all CEOs. This may influence the non-achievement of government productivity savings. All the agencies reviewed, except RTA, received supplementary funding in 2002-03 or 2003-04 for the unachieved savings. The funding totalled $82.1 million.

Notwithstanding the lack of a systematic framework for dealing with poor budget performance, if a particular situation has become sufficiently serious, Cabinet and Premier's Department can step in. In this regard we note DADHC's perceived budget problems over the period 2001-02 to 2003-04 resulted in the agency's management being required to appear before a Cabinet Committee and being subject to Premier's Department/Cabinet Office/Treasury Review. DADHC requested that the Cabinet oversight continue during 2004-05.

A possible motivator, therefore, for agencies to manage their budgets effectively is having their performance systematically and regularly benchmarked and reported to government. Currently, Treasury undertakes only limited benchmarking of budget monitoring practices and performance.

Robust benchmarking, and a visible annual scorecard of agencies' budget performance, would increase the motivation of agencies to perform better. The disadvantage of introducing such benchmarking would be that it could introduce a degree of tension into the relationship between Treasury and poorly performing agencies, which would not be conducive to an open and cooperative relationship.

Recommendation

We recommend that:

- more definitive measures of budget performance be introduced into CEO performance contracts. Treasury would need to consult with Premier's Department on how this could be achieved
- Treasury compile an annual scorecard to indicate how well agencies are performing in regard to managing their budgets. This scorecard be communicated both to government and to the public.

Appendices

Appendix 1: About the audit

Objective

General government agencies and the Treasury are expected to manage and oversight annual budgets approved by Parliament. However, variations are inevitable, as not all factors are known and circumstances change. What is important is that these variations are identified quickly and that remedial action is taken and the implications understood, such as impacts on budget strategies.

The audit examines the timeliness and accuracy of in-year budget monitoring in five agencies and Treasury.

Criteria

The audit assessed whether there is adequate:

- monitoring of progress against annual budgets,

  including analysis of actual performance against approved budget and related strategies and operational targets, identifying significant variances and implementing necessary remedial action
- review and revision of budgets,

  including sign-offs from by those accountable for budgets, proactive consideration of threats and opportunities
- reporting of budget performance,

  including regular reporting consistent with business and Treasury requirements.

Scope

The audit examines in-year monitoring in a selection of large budget dependent agencies and Treasury's in-year monitoring of agency budgets.

The audit did not examine processes associated with the preparation of budget estimates or the allocation of budgets.

Focus

The audit focused on in-year budget monitoring of expenditures for the 2003-04 and 2002-03 financial years and makes comparisons to 2001-02 as required.

Approach

The audit was a collaborative effort between the financial and performance audit branches. It drew on financial audit knowledge and expertise, and involved them in all phases of the audit

The audited analysed budget variations within agencies and reviewed budget processes for monitoring, revising and reporting on variations.

Audit team

Our team leader for the audit was Chris Bowdler, who was assisted by Sandra Tomasi. Financial auditors providing advice and assistance were Peter Barnes and Sheryn Walford. Sean Crumlin provided direction and quality assurance.

Cost

Including printing and all overheads the estimated cost of the audit is $314,100.

Appreciation

The Audit Office would like to thank all those in the five agencies and Treasury for their co-operation and assistance with the audit.

Appendix 2 Glossary

accounting adjustments	Events occurring at the end of, or just after the end of, the financial year, requiring adjustments or alterations to financial statements; usually internal transactions.
accrual accounting / accruals	Accounting for revenue and expenses in the financial year they are earned or incurred, and not when cash is received or paid.
allocation letters	Letters sent by the Treasurer/NSW Treasury to Ministers and their agencies to advise them of their budget for the year and forward estimates. The aggregated details form the State Budget.
Appropriation Act	Contains the funding allocations from the Consolidated Fund to agencies for each financial year. Appropriation (Budget Variation) Acts are passed that allow additional funding for a year. *See also appropriations*
appropriations	Monies allocated by Parliament from the Consolidated Fund to Ministers, to fund agencies in providing goods and services to the public. It is one (albeit the major) source of cash for the agency. As such it provides a major limit on what may be spent or incurred for the purposes described for a particular period. The Treasurer, pursuant to parliamentary or other authorisation, may advance additional amounts to government departments for nominated purposes. *See also Appropriation Act and Consolidated Fund*
Australian accounting standards	A set of accounting principles and rules used to prepare financial statements.
benchmarking	Process of comparing agencies practices against the best practices of others.
Budget Committee	The Cabinet Standing Committee on the Budget. Chaired by the Premier, it oversees the development of the State's fiscal strategy, in-year changes and the formulation of the State Budget.
Budget dependent agencies	Agencies that are predominantly funded from the Consolidated Fund, rather than from user charges.
Budget Papers / Budget Estimates	These include the schedules of permitted or authorised expenditures for state government agencies, and the way they will be financed over the financial year. They also include supporting commentary on financial trends, program activities and strategic directions. Forward estimates of expenditure are included for three years beyond the current year.
business intelligence tools	Technological systems that allow businesses and agencies to analyse large amounts of available data to make better business decisions. For example, COGNOS PowerPlay. *See also executive information system*
Cabinet Office	The Premier's primary source of policy advice. Assists Cabinet in making decisions about Government policy.
capital expenditure	Expenditure which is expected to benefit a future period, and which is recorded as an asset in the financial statements.

Chart of accounts	A list of account items to record financial transactions. It is based on the nature and activities of the agency, the information needs of its management, Treasury and legislative requirements.
Commonwealth Specific Purpose Payments	Commonwealth funding for specific programs/reasons provided to state governments.
Consolidated Fund	The fund of money for the State, and the main bank account of the Government. It records • taxes, fines, fees collected • Commonwealth grants • financial distributions from non-General Government agencies • recurrent and capital appropriations to agencies, as authorised by Parliament.
depreciation and amortisation	Depreciation allocates the cost of a physical asset through the wearing out, consumption or other loss of value over time. For example, use of road construction equipment. Amortisation of non-physical (intangible) assets allocates the cost or value of the asset as an expense over a period of time. For example, research and development costs
executive information system	Information system that consolidates transactions within an organisation. Provides management with required information from internal as well as external sources. *See also business intelligence tools*
Financial Information System (FIS)	Treasury system for budgeting, external reporting and monitoring of General Government agencies. It mirrors Treasury's TOES. *See Treasury On-line Entry System (TOES)*
financial management information systems	Systems for collecting, processing, and communicating data useful for the managerial functions of decision making, planning and control, and for financial reporting. For example, systems by SAP, Oracle, JDE and Mincom.
fiscal strategies	The Government's medium to long-term Budget plan which sets out the intended relationship between Government program expenditure and Government revenues. *See also Budget Papers / State Budget*
forward (year) estimates	These are published in the annual Budget Papers for the three years beyond the budget year. *See also Budget Papers / State Budget*
General Government Budget Statement	These are unaudited financial statements tabled each month in Parliament by the Treasurer. They compare actual budget performance against the approved budget figures.
General Government Sector (GGS)	Agencies primarily funded from State taxes or Commonwealth taxes passed onto the State. Many General Government agencies are Budget dependent. The funding provided is used to deliver programs and services of a public policy nature at either no cost to users or at subsidised rates.
General Government Statistics (GFS)	This is a uniform presentation of government budgets and financial statements applying most accrual accounting principles. The main variation to accounting presentations are 'valuation adjustments' such as non-cash actuarial adjustments and major asset writedowns. They are excluded to more accurately reflect the underlying costs of government. The GFS standards are maintained by the Australian Bureau of Statistics.

in-year budget monitoring	Monitoring of budgets allocated within the financial year between 1 July and 30 June.
line-item	Account categories used to describe the budgeted amounts allocated to agencies in Budget Papers. Are likely to be account items in the agency's Chart of accounts. *See Budget Papers* and *Chart of accounts*
Net Cost of Services (NCS)	Measures the net cost of providing Government services. It equals Operating Expenses less Retained Revenues, and excludes State Revenues.
net operating result	The financial result arrived at subtracting total revenues from total expenses.
NSW Treasury	Comprises two Offices. The Office of Financial Management (OFM) is the Government's principal adviser on State financial management policy and practice, and economic conditions and issues. It includes the budget management and monitoring function. The other is the Office of State Revenue (OSR) which collects the majority of State revenue.
operating statement	Reports the revenues generated and expenses incurred by a government agency, and appropriations allocated for a period. This information is relevant to assessing an agency's performance for the period and can be used as input to decisions about the resources that should be provided to support the department's operations in future periods. Also known as a Statement of Financial Performance.
posting of budgets	The recording of the budget in the agency's accounting system.
productivity savings	Savings targets for agencies that should reflect their budgeted efficiency gains. They support government policies, including savings in support of Government negotiated salary increases.
protected items	Demand driven items and contingency items outside an agency's control. For example, payments from Commonwealth Specific Purpose Grants and the first year for funding new initiatives, both of which the agency must spend on the specific programs. Agencies can only spend the budget funding identified by Treasury as being protected on the specific item. Under expenditure must be returned to Treasury; over expenditure (where outside the agency's control) will usually be funded by additional Consolidated Fund appropriation.
Public Finance and Audit Act 1983 (PF&A Act)	The principal legislation dealing with the State's financial administration. Specific sections relevant to budget funding are - • section 22 – additional sums determined by the Treasurer to be payable from the Consolidated Fund to provide for expenditure of a recurrent nature or for capital works and services. Payments under this authority are approved by Parliament in the following year's Appropriation Act. • section 24 – funding made under the Appropriation Act can be transferred and applied for or towards a service or function that has been transferred between agencies during the same financial year. • section 26 – Commonwealth Specific Purpose Payments to the state, the expenditure of which was not provided for in the original Budget Estimates, can be adjusted.

recurrent expenditure	Four types of recurrent expenditure - 1) operating expenses for agency expenses on employee-related and other operating expenses, these mainly being the purchase of goods and services 2) maintenance expenses to maintain agency assets. 3) grants and subsidies for payment to other bodies, mainly outside the Public Sector 4) other services for activities, which are usually unique to a Department or are of a minor nature.
Results and Service Plan (RSP)	A high-level business plan negotiated between agencies and NSW Treasury. It shows what an agency plans to achieve with its current resources, with a focus on results. It supports better resource allocation and management and improved reporting. It shows the relationship between the services delivered by agencies and the results they are working towards.
Services Performance and Financial Management Committee of Cabinet	The Cabinet Committee's focus is on streamlining service delivery across government, programs providing value for money and the successful of government administrative initiatives.
supplementary funding/ Budget supplementations	Additional Consolidated Fund cash appropriations to agencies to meet needs arising after the State Budget has been issued. NSW Treasury maintain a Treasury Supplementation Register for each agency that lists all supplementation requests made by agencies, and the extent to which they have been processed. *See also appropriations*
State Budget	The annual fiscal plan supporting government activities. It incorporates the schedules and strategic directions of the Budget Papers. Forward estimates give the budget a medium-term focus.
Treasurer's Advance	A form of supplementation. It is designed to cover unforeseen expenses not able to be quantified at the time of preparing the Budget. *See also supplementary funding* and *appropriations*
Treasury budget analysts	The main Treasury contact with agencies. They set and monitor compliance with expenditure targets; advise on policy and financial aspects of agency spending proposals and associated resource allocation issues; advise on the efficiency of budget dependent agencies; advise on how asset management strategies can better support service delivery. Also known as Treasury resource allocation (RAD) analysts
Treasury On-line Entry System (TOES)	The electronic on-line system that Treasury uses to collect agency financial data. TOES data is provided by agencies and used by Treasury in FIS to produce various consolidated financial reports for the government. TOES is a mirror image of FIS. *See also Financial Information System*

Performance Audits by the Audit Office of New South Wales

Performance Auditing

What are performance audits?

Performance audits are reviews designed to determine how efficiently and effectively an agency is carrying out its functions.

Performance audits may review a government program, all or part of a government agency or consider particular issues which affect the whole public sector.

Where appropriate, performance audits make recommendations for improvements relating to those functions.

Why do we conduct performance audits?

Performance audits provide independent assurance to Parliament and the public that government funds are being spent efficiently and effectively, and in accordance with the law.

They seek to improve the efficiency and effectiveness of government agencies and ensure that the community receives value for money from government services.

Performance audits also assist the accountability process by holding agencies accountable for their performance.

What is the legislative basis for Performance Audits?

The legislative basis for performance audits is contained within the *Public Finance and Audit Act 1983, Part 3 Division 2A*, (the Act) which differentiates such work from the Office's financial statements audit function.

Performance audits are not entitled to question the merits of policy objectives of the Government.

Who conducts performance audits?

Performance audits are conducted by specialist performance auditors who are drawn from a wide range of professional disciplines.

How do we choose our topics?

Topics for performance audits are chosen from a variety of sources including:

- our own research on emerging issues
- suggestions from Parliamentarians, agency Chief Executive Officers (CEO) and members of the public
- complaints about waste of pubic money
- referrals from Parliament.

Each potential audit topic is considered and evaluated in terms of possible benefits including cost savings, impact and improvements in public administration.

The Audit Office has no jurisdiction over local government and cannot review issues relating to council activities.

If you wish to find out what performance audits are currently in progress just visit our website at <www.audit.nsw.gov.au>.

How do we conduct performance audits?

Performance audits are conducted in compliance with relevant Australian standards for performance auditing and operate under a quality management system certified under international quality standard ISO 9001.

Our policy is to conduct these audits on a "no surprise" basis.

Operational managers, and where necessary executive officers, are informed of the progress with the audit on a continuous basis.

What are the phases in performance auditing?

Performance audits have three key phases: planning, fieldwork and report writing.

During the planning phase, the audit team will develop audit criteria and define the audit field work.

At the completion of field work an exit interview is held with agency management to discuss all significant matters arising out of the audit. The basis for the exit interview is generally a draft performance audit report.

The exit interview serves to ensure that facts presented I in the report are accurate and that recommendations are appropriate. Following the exit interview, a format draft report is provided to the CEO for comment. The relevant Minister is also provided with a copy of the draft report. The final report, which is tabled in Parliament, includes any comment made by the CEO on the conclusion and the recommendations of the audit.

Depending on the scope of an audit, performance audits can take from several months to a year to complete.

Copies of our performance audit reports can be obtained from our website or by contacting our publications unit.

How do we measure an agency's performance?

During the planning stage of an audit the team develops the audit criteria. These are standards of performance against which an agency is assessed. Criteria may be based on government targets or benchmarks, comparative data, published guidelines, agencies corporate objectives or examples of best practice.

Performance audits look at:

- processes
- results
- costs
- due process and accountability.

Do we check to see if recommendations have been implemented?

Every few years we conduct a follow-up audit of past performance audit reports. These follow-up audits look at the extent to which recommendations have been implemented and whether problems have been addressed.

The Public Accounts Committee (PAC) may also conduct reviews or hold inquiries into matters raised in performance audit reports. Agencies are also required to report actions taken against each recommendation in their annual report.

To assist agencies to monitor and report on the implementation of recommendations, the Audit Office has prepared a Guide for that purpose. The Guide, *Monitoring and Reporting on Performance Audits Recommendations*, is on the Internet at <www.audit.nsw.gov.au/guides-bp/bpglist.htm>

Who audits the auditors?

Our performance audits are subject to internal and external quality reviews against relevant Australian and international standards. This includes ongoing independent certification of our ISO 9001 quality management system.

The PAC is also responsible for overseeing the activities of the Adit Office and conducts reviews of our operations every three years.

Who pays for performance audits?

No fee is charged for performance audits. Our performance audit services are funded by the NSW Parliament and from internal sources.

For further information relating to performance auditing contact:

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Performance Audit Reports

No	Agency or Issues Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
65	Attorney General's Department	*Management of Court Waiting Times*	3 September 1999
66	Office of the Protective Commissioner Office of the Public Guardian	*Complaints and Review Processes*	28 September 1999
67	University of Western Sydney	*Administrative Arrangements*	17 November 1999
68	NSW Police Service	*Enforcement of Street Parking*	24 November 1999
69	Roads and Traffic Authority of NSW	*Planning for Road Maintenance*	1 December 1999
70	NSW Police Service	*Staff Rostering, Tasking and Allocation*	31 January 2000
71*	Academics' Paid Outside Work	*Administrative Procedures* *Protection of Intellectual Property* *Minimum Standard Checklists* *Better Practice Examples*	7 February 2000
72	Hospital Emergency Departments	*Delivering Services to Patients*	15 March 2000
73	Department of Education and Training	*Using Computers in Schools for Teaching and Learning*	7 June 2000
74	Ageing and Disability Department	*Group Homes for People with Disabilities in NSW*	27 June 2000
75	NSW Department of Transport	*Management of Road Passenger Transport Regulation*	6 September 2000
76	Judging Performance from Annual Reports	*Review of Eight Agencies' Annual Reports*	29 November 2000
77*	Reporting Performance	*Better Practice Guide* *A guide to preparing performance information for annual reports*	29 November 2000
78	State Rail Authority (CityRail) State Transit Authority	*Fare Evasion on Public Transport*	6 December 2000
79	TAFE NSW	*Review of Administration*	6 February 2001
80	Ambulance Service of New South Wales	*Readiness to Respond*	7 March 2001
81	Department of Housing	*Maintenance of Public Housing*	11 April 2001
82	Environment Protection Authority	*Controlling and Reducing Pollution from Industry*	18 April 2001
83	Department of Corrective Services	*NSW Correctional Industries*	13 June 2001
84	Follow-up of Performance Audits	*Police Response to Calls for Assistance* *The Levying and Collection of Land Tax* *Coordination of Bushfire Fighting Activities*	20 June 2001
85*	Internal Financial Reporting	*Internal Financial Reporting including a Better Practice Guide*	27 June 2001

No	Agency or Issues Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
86	Follow-up of Performance Audits	*The School Accountability and Improvement Model (May 1999)* *The Management of Court Waiting Times (September 1999)*	14 September 2001
87	E-government	*Use of the Internet and Related Technologies to Improve Public Sector Performance*	19 September 2001
88*	E-government	*e-ready, e-steady, e-government: e-government readiness assessment guide*	19 September 2001
89	Intellectual Property	*Management of Intellectual Property*	17 October 2001
90*	Intellectual Property	*Better Practice Guide* *Management of Intellectual Property*	17 October 2001
91	University of New South Wales	*Educational Testing Centre*	21 November 2001
92	Department of Urban Affairs and Planning	*Environmental Impact Assessment of Major Projects*	28 November 2001
93	Department of Information Technology and Management	*Government Property Register*	31 January 2002
94	State Debt Recovery Office	*Collecting Outstanding Fines and Penalties*	17 April 2002
95	Roads and Traffic Authority	*Managing Environmental Issues*	29 April 2002
96	NSW Agriculture	*Managing Animal Disease Emergencies*	8 May 2002
97	State Transit Authority Department of Transport	*Bus Maintenance and Bus Contracts*	29 May 2002
98	Risk Management	*Managing Risk in the NSW Public Sector*	19 June 2002
99	E-Government	*User-friendliness of Websites*	26 June 2002
100	NSW Police Department of Corrective Services	*Managing Sick Leave*	23 July 2002
101	Department of Land and Water Conservation	*Regulating the Clearing of Native Vegetation*	20 August 2002
102	E-government	*Electronic Procurement of Hospital Supplies*	25 September 2002
103	NSW Public Sector	*Outsourcing Information Technology*	23 October 2002
104	Ministry for the Arts Department of Community Services Department of Sport and Recreation	*Managing Grants*	4 December 2002
105	Department of Health Including Area Health Services and Hospitals	*Managing Hospital Waste*	10 December 2002
106	State Rail Authority	*CityRail Passenger Security*	12 February 2003
107	NSW Agriculture	*Implementing the Ovine Johne's Disease Program*	26 February 2003

No	Agency or Issues Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
108	Department of Sustainable Natural Resources Environment Protection Authority	*Protecting Our Rivers*	7 May 2003
109	Department of Education and Training	*Managing Teacher Performance*	14 May 2003
110	NSW Police	*The Police Assistance Line*	5 June 2003
111	E-Government	*Roads and Traffic Authority* *Delivering Services Online*	11 June 2003
112	State Rail Authority	*The Millennium Train Project*	17 June 2003
113	Sydney Water Corporation	*Northside Storage Tunnel Project*	24 July 2003
114	Ministry of Transport Premier's Department Department of Education and Training	*Freedom of Information*	28 August 2003
115	NSW Police NSW Roads and Traffic Authority	*Dealing with Unlicensed and Unregistered Driving*	4 September 2003
116	NSW Department of Health	*Waiting Times for Elective Surgery in Public Hospitals*	18 September 2003
117	Follow-up of Performance Audits	*Complaints and Review Processes (September 1999)* *Provision of Industry Assistance (December 1998)*	24 September 2003
118	Judging Performance from Annual Reports	*Review of Eight Agencies' Annual Reports*	1 October 2003
119	Asset Disposal	*Disposal of Sydney Harbour Foreshore Land*	26 November 2003
120	Follow-up of Performance Audits NSW Police	*Enforcement of Street Parking (1999)* *Staff Rostering, Tasking and Allocation (2000)*	10 December 2003
121	Department of Health NSW Ambulance Service	*Code Red:* *Hospital Emergency Departments*	15 December 2003
122	Follow-up of Performance Audit	*Controlling and Reducing Pollution from Industry (April 2001)*	12 May 2004
123	National Parks and Wildlife Service	*Managing Natural and Cultural Heritage in Parks and Reserves*	16 June 2004
124	Fleet Management	*Meeting Business Needs*	30 June 2004
125	Department of Health NSW Ambulance Service	*Transporting and Treating Emergency Patients*	28 July 2004
126	Department of Education and Training	*School Annual Reports*	15 September 2004
127	Department of Ageing, Disability and Home Care	*Home Care Service*	13 October 2004
128*	Department of Commerce	*Shared Corporate Services: Realising the Benefit* *including guidance on better practice*	3 November 2004

No	Agency or Issues Examined	Title of Performance Audit Report or Publication	Date Tabled in Parliament or Published
129	Follow-up of Performance Audit	*Environmental Impact Assessment of Major Projects (2001)*	1 February 2005
130*	Fraud Control	*Current Progress and Future Directions including guidance on better practice*	9 February 2005
131	Follow-up of Performance Audit Department of Housing	*Maintenance of Public Housing (2001)*	2 March 2005
132	Follow-up of Performance Audit State Debt Recovery Office	*Collecting Outstanding Fines and Penalties (2002)*	17 March 2005
133	Follow-up of Performance Audit Premier's Department	*Management of Intellectual Property (2001)*	30 March 2005
134	Department of Environment and Conservation	*Managing Air Quality*	6 April 2005
135	Department of Infrastructure, Planning and Natural Resources Sydney Water Corporation Sydney Catchment Authority	*Planning for Sydney's Water Needs*	4 May 2005
136	Department of Health	*Emergency Mental Health Services*	26 May 2005
137	Department of Community Services	*Helpline*	1 June 2005
138	Follow-up of Performance Audit State Transit Authority Ministry of Transport	*Bus Maintenance and Bus Contracts (2002)*	14 June 2005
139	RailCorp NSW	*Coping with Disruptions to CityRail Passenger Services*	22 June 2005
140	State Rescue Board of New South Wales	*Coordination of Rescue Services*	20 July 2005
141	State Budget	*In-year Monitoring of the State Budget*	July 2005

* Better Practice Guides

Performance Audits on our website

A list of performance audits tabled or published since March 1997, as well as those currently in progress, can be found on our website <www.audit.nsw.gov.au>

If you have any problems accessing these Reports, or are seeking older Reports, please contact our Executive Officer on 9275 7220.