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Budget development and management within departments

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Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my performance audit report on *Budget development and management within departments.*

Yours faithfully

J.W. CAMERON
Auditor-General

26 May 2004

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Foreword

Departments and agencies are expected to manage their annual appropriation efficiently and effectively in order to deliver the goods and services required by government. This requires departments, amongst other things, to have sound internal budget development and management practices, and for internal budgets to be integrated with business planning processes.

This audit sought to answer the question: *How efficiently and effectively are internal budgets developed and managed?* With some minor exceptions, internal budget development and management practices currently used by the Department's of Education and Training and Infrastructure, are substantially in line with better practice.

For the other departments, this report details the characteristics of effective budget development, management and review. These characteristics can be used as a checklist to achieve better practice.

J.W. CAMERON
Auditor-General

26 May 2004

1. Executive summary

1.1 Background

The government sector has 2 budgeting processes. One, the State budget process, which draws together the Government's estimates of revenue and expenditure for the budget year. This is called the external budget (in this report), and provides appropriations to departments to deliver outputs (goods and services).

The second, a departments' own budget setting process, we have called the internal budget. It is part of a department's internal financial management and is important for business planning, resource allocation and performance management.

This audit examined the efficiency and effectiveness of internal budgeting processes and practices within the Department of Education and Training and the Department of Infrastructure, with a focus on:

- the integration of internal budgeting processes with business planning
- the development and management of internal budgets
- monitoring and reviewing budget performance.

The audit focussed on the internal budget processes for the 2002-03 financial year and changes in practice implemented for the 2003-04 budget cycle. The audit covered work undertaken by the 2 Departments from 2001 onwards. The audit did not examine those processes associated with the preparation of budget estimates for, nor each department's participation in, the State's budget process.

1.2 Conclusion

Sound budgeting requires the integration of business planning (corporate, business, workforce and staff performance plans) with internal budgeting. This integration was substantially achieved by the 2 departments.

In 2002-03, for the first time, divisions and offices of the Department of Education and Training linked their business plans to the department's strategic direction. However, at the time business plans were prepared, the department's strategic directions had not been finalised. The business plans were not re-visited to ensure they were consistent with the department's strategic directions once established in July and August.

Both departments link their corporate and business planning activities to the relevant output delivery targets specified for each department in the State budget process. However, both developed their 2002-03 internal budgets based on their organisational structure rather than on output delivery targets. This practice should be re-examined to shift managements focus beyond resource management to one of delivering promised services.

Aside from some minor departures, both departments had appropriate processes to develop their internal budgets. For example, both had a dedicated budget team, formal policies and budget committees.

There are some budget development aspects that need to be addressed. In 2002-03, the Department of Education and Training had 237 budget responsibility centres compared to 20 at the Department of Infrastructure. The number of centres should be set at a level that enables the organisation to deliver services efficiently and effectively while maintaining appropriate accountability for performance. On face value, the number of budget centres established by the Department of Education and Training appears high. Further, the Department of Education and Training had not periodically benchmarked its internal budget development process against other departments with a view to improving efficiency and effectiveness.

The budget methodology adopted by the Department of Education and Training for setting its 2002-03 internal budget was mainly based on the traditional cost plus approach. As this method was found to impact on the rigour of the department's budget base, for 2003-04 it changed to zero-based budgeting. This facilitated the prioritisation of programs, the calculation of program delivery cost from the bottom up, identification of savings opportunities and identification of options for resourcing programs. For 2003-04 savings impact statements were prepared, for the first time, to provide the department with a long-term view of savings options and risks to their achievement.

The Department of Education and Training had not formally evaluated how well its budget management system meets the needs of its managers.

Both departments had substantially adopted adequate practices for managing and reviewing internal budgets. However, some aspects could be improved.

At the Department of Education and Training in 2002-03, important information, consistent with best practice, was not included in monthly reports of the department's budget performance presented to executive management. For example:

- balance sheets and cash flow statements were only reported in the department's annual report
- financial performance against output delivery targets.

Since September 2003, this information has been included in monthly budget performance reports.

At the Department of Infrastructure, since April 2003 monthly and quarterly budget reports have been progressively improved by the inclusion of forward-looking financial information such as future risks and risk management strategies. Including explanations for material variations between actual results and budgeted estimates in the department's annual report would improve departmental accountability and transparency.

Both departments failed to achieve their budget forecast for 2002-03.

For the Department of Education and Training, the 2002-03 result was largely affected by an incorrect external budget base. Some poor budgeting practices adopted at that time were also likely to have contributed to the result. In recognition of the need to improve, over the past few years a range of actions have been taken by the department aimed at improving the efficiency and effectiveness of its internal budget development and management practices. Overall, the budget practices are now substantially in line with better practice.

The Department of Infrastructure's 2002-03 budget result was largely attributable to certain events which could not have been reasonably forecast by the department at the time of developing its 2002-03 budget. Overall, the department's internal budget development and management practices are substantially in line with better practice.

Recommendations

1. **The Department of Education and Training and the Department of Infrastructure should:**
    - **align their internal budgets to output delivery cost targets**
    - **modify their financial management information systems to show budget and actual results against output delivery targets, in addition to the current practice by expenditure categories.**
2. **The Department of Education and Training should regularly assess whether the number of budget responsibility centres it has is appropriate, considering both accountability requirements and the cost of maintaining the centres.**
3. **The Department of Education and Training should evaluate whether the Advisor budget management system meets the needs of its managers.**
4. **The Department of Education and Training should regularly benchmark its internal budget development processes with a view to assessing the efficiency of these processes.**
5. **The Department of Infrastructure should include explanations of significant variations between actual results and budget estimates in its annual report (Budget Portfolio Outcome Statements).**

RESPONSE provided by Secretary Department of Treasury and Finance

The department welcomes the Auditor-General's Report on Budget development and management within departments. The Victorian Public Sector has made substantial inroads to budget formulation and is recognised internationally as being at the forefront of reform. Given the importance of this topic and its interconnection with the development of the State Budget, the Report adds to the ongoing consideration of budget development and management. However, the Report somewhat over simplifies the complex and sophisticated processes of budgeting that all departments utilise.

The scope of the performance audit is focused on specific and narrow control aspects of output budgeting. It excludes detailed examination of capital budgeting processes and the overall frameworks that apply to departmental budgeting, therein missing a critical component of the budgeting process. As a result, the Report does not acknowledge or examine capital management or significant outturn/output improvement interventions and initiatives, such as Gateway.

The limited focus of the Report reduces the general applicability of the suggested improvements and recommendations, and the ability of departments to action and implement these improvements to their budgeting processes. The Report does however provide some salient aspects for operational issues at the departmental level.

2. Internal budgeting, and this audit

2.1 State and internal budgets

The government sector has 2 budgeting processes. One, the State budget process, which draws together the Government's estimates of revenue and expenditure for the budget year. This is called the external budget (in this report), and provides appropriations to departments to deliver outputs (goods and services).

The second, a departments' own budget setting process, we have called the internal budget. It is part of a department's internal financial management and is important for business planning, resource allocation and performance management.

2.1.1 State budget process

The State budget process is underpinned by the submission of budget bids to the government[1] by departments. This involves a 2-stage process.

In undertaking their annual budget development processes, departments are required to update their forward estimates each November to feed into Stage 1 budget deliberations. As part of this process, the Department of Treasury and Finance seeks information from departments to assist in adjusting the aggregate budget sector forward estimates to take account of post-budget government decisions, revisions to current economic parameters and other relevant factors.

In the Stage 2 process, the Department of Treasury and Finance and the Department of Premier and Cabinet present briefs to the government on submissions for new output (goods and services to be delivered) and asset initiatives. The government may consult with the broader community and special interest groups before coming to decisions on which outputs to purchase for what price and the allocation of resources for new fixed asset investment projects.

The decisions arising out of these processes, subject to formal Cabinet approval, form the basis of departmental budgets and the annual state budget.

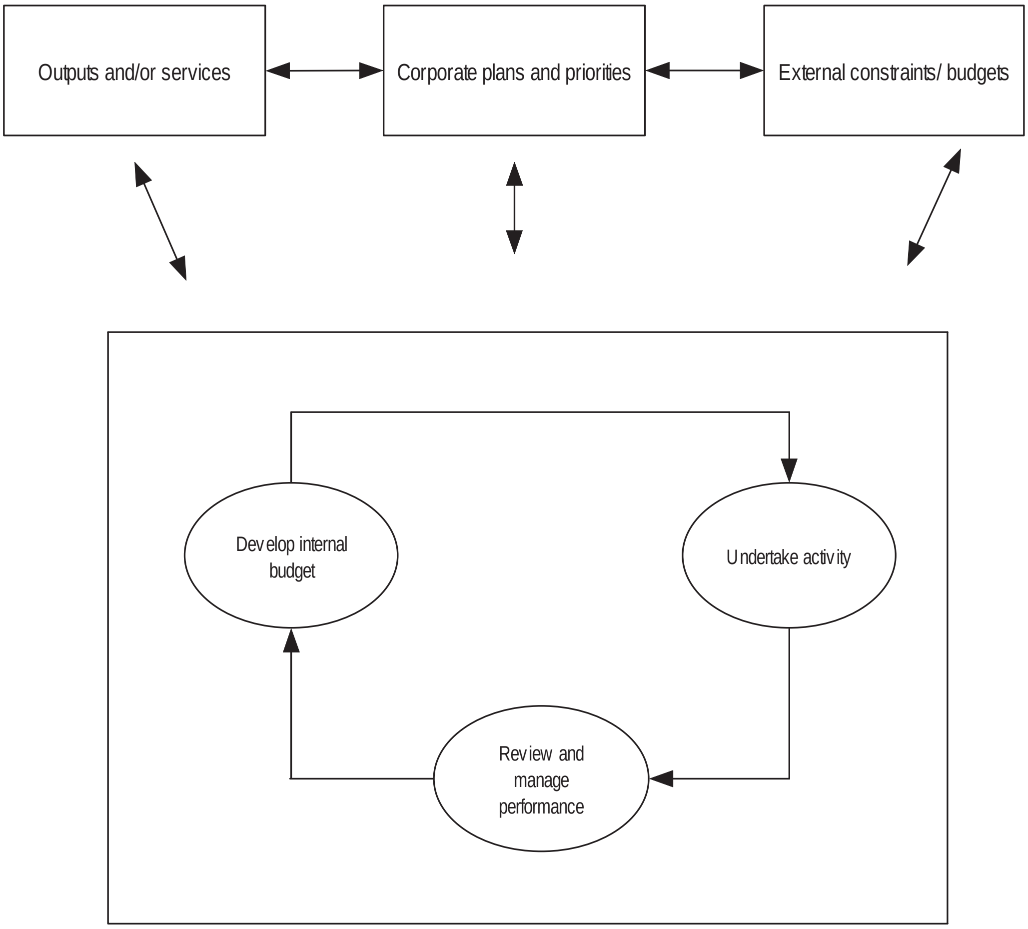
[1] These processes are undertaken by the Expenditure Review Committee, established in 1999 as a sub-committee of Cabinet. It is responsible for monitoring all government funding decisions.

2.1.2 The internal budget process

The internal budget process starts with the requirement by departments to deliver outputs. These are included in the department's corporate and business plans as service delivery targets and priorities. Internal budgeting is affected by external changes where, for example, parliamentary appropriations to purchase outputs are increased or reduced by government.

The internal budget process is an ongoing cycle and shown in Figure 2A.

FIGURE 2A: INTERNAL BUDGET PROCESS



Source: Internal Budgeting Better Practice Guide, Australian National Audit Office, February 2003.

The 3 main components of an internal budget process are:

- develop internal budget: from developing budget policies and guidelines through to departmental executive management approval of the budget
- undertake activity: executing business plans in line with the internal budget
- review and manage performance: monitoring and modifying the budget and holding managers accountable for performance.

An effectively managed internal budget process:

- clearly communicates to staff the department's priorities
- identifies any financial risks to achieving the department's objectives
- underpins the accurate and informed allocation of resources
- provides accurate and timely financial and performance information to support decision-making and performance measurement
- enables the department to identify and respond to changes in business and environmental conditions[2].

2.2 Departments audited

Two departments were examined in conducting this audit: the Department of Education and Training and the Department of Infrastructure.

The Department of Education and Training manages the education and training system in Victoria and provides education and training services through schools, tertiary and further education institutes and adult community education.

The department has 4 Offices (School Education; Finance Strategy and Resources; Portfolio Integration; and Training and Tertiary Education) and oversees 8 statutory bodies. In 2003-04, the department was allocated a budget (output appropriations) of $5.7 billion, (2002-03, $5.4 billion).

The Department of Infrastructure manages major infrastructure projects, including the provision of public transport services, information and communication technology (ICT), energy and security.

Prior to machinery of Government changes in December 2002, the department had 7 business divisions (Planning, Heritage and Building; Public Transport; Infrastructure Projects; Major Projects; Strategic Planning; Ports and Marine; and Local Government and Regional Services). These divisions were supported by 2 corporate divisions (Corporate Finance and Organisational Development). It also had 7 regional offices, providing services in planning, local government, public transport and major projects. In 2003-04, the department was allocated a budget (output appropriations) of $ 2.4 billion (2002-03, $2.6 billion).

As a result of machinery of government changes, a number of functions were transferred out of the department (strategic land use planning, heritage, building and local government) and new functions (multimedia and energy policy) transferred to the department.

[2] Australian National Audit Office, *Internal Budgeting,* Audit Report No. 52 Australian National Audit Office, 2001–2002. Commonwealth of Australia, 2002, Canberra, ACT.

2.3 This audit

2.3.1 Audit scope

This audit examined the efficiency and effectiveness of internal budget processes and practices within the Department of Education and Training and the Department on Infrastructure. In particular, it examined:

- integration with strategic and business planning processes: how internal budgeting processes are integrated with strategic planning (which sets the priorities), aligned with the output delivery targets in the state Budget papers, and supported by financial management processes
- budget development and management processes: how efficient and effective these processes are, including how well technology supports the processes and provides the necessary tools for them
- performance monitoring and reporting framework: how well performance against internal budgets is analysed, how well information is used to monitor and report, and adequacy of public accountability.

Within each department, the central budget unit and a selection of other operational units were examined. This examination covered revenue and expenditure (operating and capital).

The audit did not examine processes to prepare budget estimates for the state's budget process (including costings of capital projects), nor each department's participation in that process. The state's budget process draws together the Victorian Government's estimates of expenses and revenues for the budget year and leads to the State budget[3].

The audit focused on the internal budget processes for the 2002-03 financial year and any changes in practices for preparing 2003-04 internal budgets. Given the lead-time departments need to prepare business plans and frame budgets, the audit covered work by the 2 departments from 2001 onwards.

In assessing the budgeting practices of the 2 Victorian departments, extensive use was made of the publication *Internal Budgeting Better Practice Guide* produced by the Australian National Audit Office in February 2003.

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[3] The legislative and administrative arrangements associated with parliament appropriations were evaluated in the Victorian Auditor-General's special report *Parliamentary control and management of appropriations*, April 2003.

2.3.2 Audit methodology

The audit comprised:

- a detailed examination of the internal budgeting policies and procedures in the selected agencies compared with the Australian National Audit Office's *Internal Budgeting Better Practice Guide*
- interviews with departmental staff from central budget units, as well as other staff involved in budget processes.

The audit was performed in accordance with Australian Auditing Standards applicable to performance audits, and included such tests and other procedures considered necessary in the circumstances.

Specialist advice was provided by Mr Peter Gunning of PJ Gunning and Associates.

I am grateful for the support and assistance provided to my officers by the management and staff of the Department of Education and Training, the Department of Infrastructure, and the Department of Treasury and Finance.

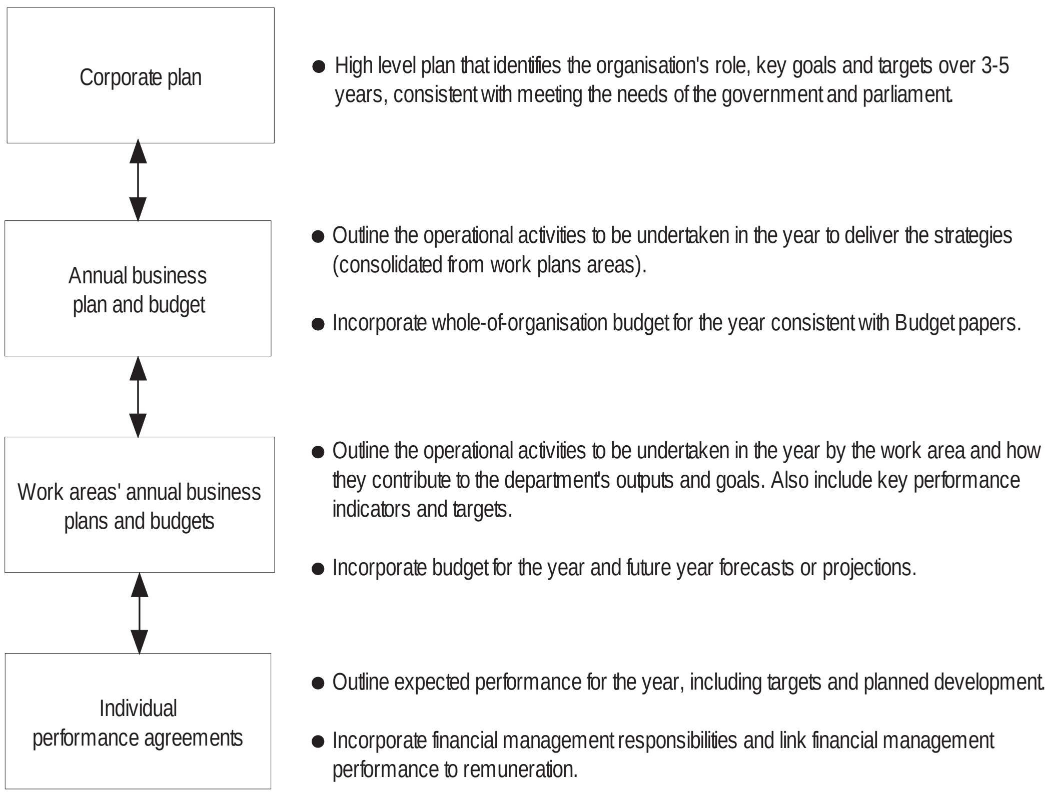
3. Are budgets integrated with business plans?

3.1 Integration of business planning and internal budgeting

A department's business planning process results in long-term and short-term plans for the whole department, its divisions, units and individual officers. To be successful, business plans must be backed by financial plans developed through a sound internal budgeting process. If business planning and internal budgeting are not integrated, there is a risk of too few (or too many) resources being allocated to tasks or programs, or of a department's resources not being used to advance the initiatives contained in its business plans.

Figure 3A shows the ideal relationship between departmental business planning and internal budgeting processes.

FIGURE 3A: INTEGRATED DEPARTMENTAL BUSINESS PLANNING AND BUDGETING



Source: Based on *Internal Budgeting Better Practice Guide*, Australian National Audit Office, February 2003.

3.1.1 Is internal budgeting linked to corporate and business planning?

Both the Department of Education and Training (from 2003-04) and the Department of Infrastructure have an annual planning and budget cycle in line with the government's integrated management cycle[1]. Their business planning processes result in annual business plans at the departmental, office (at the Department of Education and Training) and divisional levels. These are linked to longer-term corporate plans. Business plans are complemented by staff performance plans, so that each staff member can see their contribution to the goals and objectives of the department and the delivery of its programs.

Department of Education and Training

In 2002-03, the Department of Education and Training (and particularly the Office of School Education and Office of Training and Tertiary Education) improved its business planning processes. For the first time all divisions, regions and other entities within the department were required to develop draft divisional business plans for 2002-03. These plans provided the building blocks for the 2002-03 Departmental Business Plan and submissions to the State budgetary process and the budgetary cycle within the department.

At the time divisions prepared their 2002-03 business plans, full information on the strategic directions of the department was not available. Offices and divisions were advised to rely on their own understanding of the department's strategic directions, pending finalisation of the key strategic documents. However, the business plans were not re-visited to ensure that they were consistent with the department's strategic directions once established in July and August 2002.

In 2002-03, considerable effort was put into addressing the inadequacies discussed elsewhere in this report. Development of the department's 2003-04 budget built on this work. Each division, for fiscal 2003-04, was required to develop a zero-based budget and justify spending in each program area as well as identify a number of saving strategies.

The department's 2003-04 business planning process also aimed to ensure that offices and divisions were aware of risks to their ability to deliver specific programs (which would reduce their ability to achieve departmental objectives, goals and targets).

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[1] Integrates decision-making in relation to the government's policies and strategies with decision-making on resource allocation and delivery of outputs. It comprises 4 elements which, taken together, form a continuous cycle of planning, resource allocation, service delivery and accountability.

There was good consistency between the department's 2003-04 business plan and its internal budgets. The objectives in the 4 office statements[2] were derived from the department's corporate plan. Divisional business plans were derived from the office statements. Spending on programs in divisional business plans was justified using zero-based budgeting techniques. There was, therefore, a direct link between spending and the department's objectives.

The 2003-04 divisional business plans were reviewed by the department's Strategic Policy and Resource Division and the Performance Review Evaluation and Audit Division (in June 2003) for alignment with the department's objectives, goals, targets and policy statements. Several shortcomings were identified. For example, Divisions had not consistently used the overarching policy context, and there was little evidence of integrated planning and performance measurement within offices and across the department. The department has now substantially addressed these matters.

Our review of all 4 draft office statements and divisional business plans for 2003-04 confirmed the department's findings. We also found that:

- divisional performance measures were mostly statements of actions to be taken for programs described in business plans, and not actual performance measures
- the department's planning process for 2003-04 had not been completed on time, due mainly to a pending restructure of the department announced by the minister in August 2003. The department's annual business plan is expected to be completed around mid-February 2004 and covers an 18-month period through to June 2005.

Department of Infrastructure

The development of the Department of Infrastructure's internal budget was fully integrated with the corporate and business planning process. Divisional business plans were consistent with the department's 2002-2006 corporate plan and annual business plan. Internal budgets cost the resources required to deliver the divisional business plans.

The machinery of government changes following the November 2002 state election has affected the 2003-04 business planning process. This has resulted in staff changes and a range of new planning processes. Given these changes, the timelines associated with the 2003-04 business planning processes have been extended. This has also required revisions to the 2003-06 corporate plan. These were completed in October 2003.

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[2] Sets out the objectives and strategies to achieve the department's and the government's goals, targets and key outcomes within budget.

3.1.2 Is internal budgeting based on output delivery targets?

Both the Department of Education and Training and the Department of Infrastructure link their corporate and business planning activities to the relevant output delivery targets specified for each department in the state Budget papers.

The department's business planning processes require offices (of the Department of Education and Training) and divisions (of the Department of Infrastructure) to specify in their business plans the outputs that each is responsible for (or contributes to) and which output delivery targets are addressed by each office's or division's strategies and programs. This requirement is intended to ensure that resources are available to implement programs that deliver against the department's output targets; and to link divisional business plans to output delivery targets.

Both departments developed their 2002-03 internal budgets around their organisational structures, rather than on the output delivery targets in the Budget papers. Because most managers manage particular program budgets on a daily basis, they focus on these budgets and not on output delivery targets. Each quarter, a spreadsheet is used to reconcile individual divisional budgets to the Budget paper outputs. Thus internal budgets were not automatically aligned to Budget paper outputs. In the 2002-03 financial year, the Department of Education and Training implemented the Advisor[3] budget management system to overcome past difficulties in reconciling internal budgets with the Budget paper output delivery targets.

Given that output budgeting has operated in Victoria for more than 5 years, we were surprised that the financial management information systems of the 2 departments do not show, on a monthly basis, budgets and actual results against the output delivery cost targets.

While departmental budgeting and reporting should map resources and costs to an organisational structure (because this is how authority to spend and deploy resources is generally specified), consistent with better practice, internal budgeting and reporting should also be aligned to the Budget papers' output delivery targets, because they represent key public and budget accountability measures for departments.

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[3] Proprietary brand (Advisor Series Enterprise Budgeting Solution) used to develop, control and monitor budgets.

Recommendation

1. **The Department of Education and Training and the Department of Infrastructure should**
   - **align their internal budgets to output delivery cost targets**
   - **modify their financial management information systems to show budget and actual results against output delivery targets, in addition to the current practice by expenditure categories.**

RESPONSE provided by Secretary Department of Education and Training

The department recognises that it is funded on an output basis and it is appreciated that the need to manage on this basis is important.

The department monitors and reports on budgets versus output delivery targets on a monthly basis through reports to the department's executive. It remains impractical for the department to completely align internal budgets to output delivery costs as many programs apply to multiple budgetary outputs.

Notwithstanding this, reports are tabled on a monthly basis to the department's executive on progress against budget for both the department's internal business units and budgetary outputs, through a budgetary reconciliation.

Further, all offices and divisions within the department align their activities to budgetary outputs through their business plans. This allows for the reconciliation of program budgets with budgetary outputs, which is then reported to the department's executive.

RESPONSE provided by Secretary Department of Infrastructure

The department notes that:

- *examination of the alignment between internal budgets and output delivery cost targets occurs as part of setting Divisional and Agencies annual budgets*
- *budget and actual results against output delivery targets are reported every quarter with variances analysed and appropriate management action taken.*

3.1.3 Do work force plans adequately complement internal budgets?

Work force plans identify the direct resources (such as time in hours or equivalent full-time days) and indirect resources (such as corporate overheads, leave and staff development on-costs) required to deliver on the activities in business plans. They are an essential complement to internal budgets.

Our consideration of work force planning in the Department of Education and Training did not include schools; this was examined in our November 2001 report *Teacher work force planning*, which concluded that:

- current work force planning activities by the department have been limited in their effectiveness due to a lack of focus on both government and non-government sectors and particular segments of the teacher labour market
- while most schools under take some form of work force planning as part of their local school-based management responsibilities, integrated information and planning tools, better training and support, are required.

The status of our recommendations in that report was recently followed-up in our November 2003 *Report on Public Sector Agencies*. The report concluded that the department has made progress in implementing the recommendations made in the 2001 performance audit report on *Teacher work force planning*. However, the department still needed to take further action in a number of areas.

The Department of Education and Training's 2002-03 business plans set out the staffing requirements (including the number of equivalent full-time staff and their classification) for its program activities. Divisional budgets were supported by work force plans which established (based on current staffing profiles) each staff member's contribution to the delivery of divisional objectives and programs.

The Department of Infrastructure had developed a work force plan to implement its corporate plan.

The 2002-03 budgets of both the Department of Infrastructure and Department of Education and Training (excluding schools) were supported by work force plans, and these plans were adequately linked to departmental corporate and business plans.

3.1.4 Are individual performance agreements linked to business plans?

Individual performance agreements that derive from business plans and budgets show staff how their own performance links with departmental goals and objectives. Individual performance plans are part of a department's performance management function.

At both the Department of Education and Training and the Department of Infrastructure, individual performance agreements were adequately linked to the departments' strategic goals and priorities in that performance objectives were based on the 2002-03 business plan.

4. Are processes to develop internal budgets adequate?

4.1 Elements of budget development

The publication *Internal Budgeting Better Practice Guide*, produced by the Australian National Audit Office in February 2003, details the characteristics of effective budget development. This Guide was used to assess the adequacy of internal budget development processes at the Department of Education and Training and the Department of Infrastructure.

Figure 4A shows the 8 characteristics used and our assessment of practices against these characteristics.

FIGURE 4A: BUDGET DEVELOPMENT SCORECARD, 2002-03

Characteristics of effective budget development	Department of Education and Training	Department of Infrastructure
Is there a dedicated budget team? Provides a central point of reference and advice for those who prepare and manage budgets.	✓	✓
Is there a formal policy about internal budgeting? Outlines the purpose and objectives of internal budgeting, and clarifies the responsibilities of staff involved.	✓	✓
Are adequate annual guidelines produced? Ensures that those who prepare budgets work to the same priorities, assumptions and constraints, and that budget proposals reflect the organisation's strategic directions and priorities.	✱	✱
Are responsibilities appropriately allocated? Budget centres are responsible for preparing their own budgets.	✱	✓
Are budget preparation approaches appropriate? Exhibits characteristics of zero-based budgeting and activity-based budgeting.	✱	✓
Are budget preparation tools appropriate? Budget preparation software which is integrated with the organisation's financial management information system.	✱	✓
Have budget committees been established? Oversee budget processes, evaluate budget bids, and develop and approve policies.	✓	✓
Are budget development processes adequately reviewed? Can include occasional or ongoing self-assessment (using, for example, the Australian National Audit Office's Better Practice Guide), internal audit reviews or larger, formal evaluations.	✗	✓

Legend: ✓ Yes ✱ To some extent ✗ No
Source: Victorian Auditor-General's Office.

Comments on departures from recognised best practice or changes in the development of the 2003-04 budgets are outlined in the following paragraphs.

4.1.1 Are adequate annual guidelines produced?

Annual guidelines ensure that those who prepare budgets work to the same priorities, assumptions and constraints, and that budget proposals reflect the organisation's strategic directions and priorities. Guidelines should cover:

- how the internal budget integrates with the planning cycle and external budget process
- organisational priorities for the next budget
- the methodology to be used to develop internal budgets
- key business principles, assumptions, parameters, priorities and guidance on new initiatives
- staffing strategies
- commentary on how to budget for, and manage, specific expenditure items
- data capture process to be followed
- the internal budget timetable
- key contacts and lines of accountability.

Department of Education and Training's guidelines did not provide guidance on how to treat fixed charges (such as depreciation). Details of the preferred budget methodology, or when and why different methodologies should be used, were also not included. However, the 2003-04 guidelines now include information covering the budget methodology to be applied.

Department of Infrastructure's guidelines for 2002-03 did not provide guidance on how to treat fixed charges (such as depreciation, capital asset charges and office accommodation cost) at the Divisional level. However, the 2003-04 guidelines now include this information to improve consistency across budget centres. The department's intranet also provides business planning support information, including business planning templates, a business plan reporting system, government and department strategy documents (including timelines), and information and links about how to develop divisional budgets.

RESPONSE provided by Secretary Department of Infrastructure

The department notes that the audit findings shown in Figure 4A – Budget Development Scorecard refer to the 2002-03 financial year.

Substantial improvements to guidelines and training occurred in 2003-04 for use across divisions and agencies. Extensive tools are disseminated via the department' s intranet and forums held directly with departmental staff as part of the annual business planning process to ensure consistency and alignment to the department's strategic directions and priorities.

4.1.2 Are responsibilities appropriately allocated?

If managers develop their own budget, they will have a keener sense of what things cost, and be better able to oversight the budget.

In 2002-03, the Department of Education and Training had 195 business units (offices, divisions and agencies) and 237 "budget responsibility centres". Divisional budget officers in each business unit prepared budgets. The Department of Infrastructure had 20 budget responsibility centres (divisions, regions and agencies) in 2002-03. Each centre was responsible for preparing its internal budget.

The number of cost centres should be set by reference to the organisation's accountability framework but at a level that enables the organisation to deliver services efficiently and effectively while maintaining appropriate accountability for performance. On face value, the number of responsibility cost centres for the Department of Education and Training appears high.

Budget responsibilities at both departments were effectively communicated in writing and through performance agreements.

Recommendation

2. **The Department of Education and Training should regularly assess whether the number of budget responsibility centres it has is appropriate, considering both accountability requirements and the cost of maintaining the centres.**

RESPONSE provided by Secretary Department of Education and Training

The department undertakes regular reviews of its budget responsibility centres to ensure that they meet the needs of its business, considering accountability requirements and the cost of maintaining the centres.

The department accepts the recommendation to continue this process.

4.1.3 Are budget preparation approaches appropriate?

Organisations take different approaches to budgeting, with some of the more common being:

- traditional (or incremental) budgeting, where previous year's budget or actual results provide a base line for the current year (adjustments being made for known changes in activity levels or inflation)
- zero-based budgeting, where budget items are justified and prioritised as though budgeted activities are being undertaken for the first time

- activity-based budgeting, where the focus is on activities necessary to deliver services or outputs
- Kaizen budgeting, where budget estimates are based on planned improvements rather than on current practices. Current practices are analysed for potential improvements (like better operating procedures or work processes). The budget includes the cost of implementing changes, and expected savings
- Rolling or continuous budgeting, where budgets are prepared several times a year (such as quarterly) or are built up (for example, monthly) taking account of seasonal variations.

No one budgeting approach is appropriate in all cases. Traditional budgeting may be suitable and effective as long as individual budget components are periodically reviewed and revised, in light of new circumstances and information. However, for new projects, initiatives or policy, activity-based budgeting or zero-based budgeting processes are essential to ensure that budget estimates and costings are accurate, and can be integrated with other budget requirements.

Department of Education and Training

In 2002-03, the Department of Education and Training mainly used traditional budgeting practices for setting internal budgets. This was found to be inadequate given the budget pressures faced by the department and its failure to meet budget forecasts over the past 3 financial years.

As a result, the department adopted zero-based budgeting for its 2003-04 internal budget. This was a more appropriate methodology than the traditional approach because it provided divisions with the opportunity to:

- prioritise programs
- calculate the cost of delivering programs from scratch
- make sure resources were used to achieve objectives
- identify inefficiencies and opportunities for savings
- identify options for resourcing programs.

As well as zero-based budgeting, the department prepared, for the first time in 2003-04, savings impact statements. These detailed:

- proposed savings between 2003-04 and 2006-07
- how savings proposals would be implemented
- risks to implementing savings proposals.

4.1.4 Are budget preparation tools appropriate?

An efficient and effective internal budget process needs good development tools. For greatest efficiency, budget preparation software should form part of (or interface with) an organisation's financial management information system.

Both departments use the Advisor[1] budget management system to develop, control and monitor internal budgets. It interfaces with the ORACLE Financials[2] management system. The Department of Education and Training has used Advisor since 2002-03, while the Department of Infrastructure has used Advisor since 2001-02.

Both departments have sufficient controls in place to ensure that data transfers between the financial and budget systems are complete and accurate.

Several managers we interviewed at the Department of Education and Training had not been adequately consulted about their financial information needs. Several divisions had to use other methods (like Microsoft Excel spreadsheets) to generate information not provided by the budget management or financial management systems. The department relies on informal (rather than formal) processes to help managers identify and address aspects of their financial responsibilities.

Although the Advisor budget management system had been in use for over a year at the Department of Education and Training, there has been no formal evaluation of whether the system meets the needs of its managers.

Recommendation

3. **The Department of Education and Training should evaluate whether the Advisor budget management system meets the needs of its managers.**

RESPONSE provided by Secretary Department of Education and Training

The department accepts this recommendation.

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[1] Proprietary brand (Advisor Series Enterprise Budgeting Solution) used to develop, control and monitor budgets.

[2] Proprietary brand (Oracle Corporation) general ledger system.

4.1.5 Are budget development processes adequately reviewed?

Budget development processes need to be periodically reviewed to ensure that they are efficient, effective and meet the organisation's goals. Review processes can include occasional or ongoing self-assessment (using, for example, the Australian National Audit Office's *Better Practice Guide*), internal audit reviews or larger, formal evaluations.

It is important for departments to carefully manage the level of resources applied to the development of the internal budget. The level of resources should be determined in light of each department's circumstances and, in particular, should not unnecessarily tie up resources required for the effective delivery of services.

The Department of Education and Training has not regularly benchmarked its internal budget development processes against other departments to gauge the efficiency and effectiveness of its budget management practices.

It was however able to quantify the resources used (days of effort, cost and staff involved) to develop its 2002-03 internal budget whereas the Department of Infrastructure was not (except for its Budget Management Unit).

The results are similar to the findings of an Australian National Audit Office survey of 50 Commonwealth Government agencies. Nearly all those agencies surveyed considered that preparing or evaluating budgets were the most time-consuming and costly stages, and involved the most staff.

Recommendation

4. The Department of Education and Training should regularly benchmark its internal budget development processes with a view to assessing the efficiency of these processes.

RESPONSE provided by Secretary Department of Education and Training

The department accepts this recommendation.

4.1.6 What are the other characteristics of budget development?

Further details of the other characteristics of effective budget development are as follows:

- Dedicated budget team: coordinates and monitors the preparation process and provides support, advice and guidance
- Formal policy: sets down in writing the purpose and objectives of internal budgeting, and clarifies the responsibilities of staff involved. The organisation's senior management approves formal policy
- Budget committees: are used by many organisations. Key functions are to develop and approve budget policies and guidelines, oversee budget processes, liaise with operational areas about budget processes and proposed changes to budgets, assess revenue and expenditure initiatives, and monitor and review budgets.

5. Are budgets adequately managed and reviewed?

5.1 Managing and reviewing budgets

The publication *Internal Budgeting Better Practice Guide*, produced by the Australian National Audit Office in February 2003, details the characteristics of effective budget management and review. This Guide was used to assess the adequacy of internal budget management and review processes at the Department of Education and Training and the Department of Infrastructure.

Figure 5A shows the criteria used and our assessment of practices against these criteria.

FIGURE 5A: BUDGET MANAGEMENT AND REVIEW SCORECARD, 2002-03

Characteristics of effective budget management and review	Department of Education and Training	Department of Infrastructure
Is monitoring of revenue and expenditure against budgets adequate? Involves comparing actual performance with the approved budget, identifying significant variances between actual results and approved budget estimates and implementing action, if required, in relation to these variances.	✱	✱
Are reviews and revisions adequately managed? Changes to budgets, including approved variations, to reflect changes in estimates and circumstances should be kept to a minimum.	✓	✓
Is external reporting of performance against budgets adequate? Involves monthly and quarterly reporting to the Department of Treasury and Finance and in departmental annual reports.	✱	✱

Legend: ✓ Yes ✱ To some extent × No
Source: Victorian Auditor-General's Office.

Comments on departures from recognised best practice or changes in the management and review of the 2003-04 budgets are outlined in the following paragraphs.

5.1.1 Is monitoring of revenue and expenditure against budgets adequate?

For 2002-03, both the Department of Education and Training and Department of Infrastructure had processes to monitor and evaluate their performance against budget, but they could be improved.

Department of Education and Training

The department mostly monitors revenue and expenditure against budgets monthly. All budget responsibility centres monitor their budgets, using variance, ratio or trend analysis. At key times of the year (mainly May and June), some budget responsibility centres monitor and analyse performance weekly.

Budget responsibility centres submit monthly reports to the department's Budget and Reporting Group, which investigates any issues, summarises the results and reports them to the department's executive management committee. Reports are generated using specialised budget preparation and reporting software and include financial and other information to monitor:

- key outputs, major projects and initiatives
- risks to the department's finances and its ability to achieve outputs
- performance against budgets
- major expenditure items.

In 2002-03, monthly budget performance reports presented to the department's executive management committee did not include certain information expected in best practice reports. For example:

- balance sheets and cash flow statements, were not routinely prepared and only reported quarterly to the Department of Treasury and Finance and in the department's annual report. In other words they did not seem to be used to manage the Departments finances on a regular basis
- financial results against output targets to show the departments performance in meeting its output delivery obligations to government.

Analysis of, and reporting on, budget performance has subsequently been improved. Since September 2003, monthly reports contain information consistent with best practice reports.

Monthly meetings are also held between the department's Financial Services Division and finance managers from the 4 offices at which financial results and variances are discussed. Details of decisions made at, or action to be taken arising from, meetings were not recorded.

The department works in conjunction with a number of sub-agencies[1] in the delivery of outputs for education and training. The department adequately monitors sub-agencies in various ways. For example:

- the Office of School Education monitors schools primarily through school global management reports, which track the school global budget at an overall level. The day-to-day management of the individual school budgets is the responsibility of school principals in conjunction with school councils. The adequacy of financial management practices of schools in the use of their school global budget was examined as part of our *Report on Public Sector Agencies*, tabled in Parliament in February 2003. The report found a number of areas where further improvement could be achieved and recommended that the department issue appropriate guidance to schools to assist in establishing budget management arrangements which facilitate effective decision-making at the school level in relation to their total operations
- the Office of Training and Tertiary Education receives quarterly financial reports from TAFE institutes showing expenditure to date, budget to date and the projected outcome for the year. Institutes' operating statements and balance sheets are also examined. This is supplemented by internal investigations by the Office of Training and Tertiary Education and monthly meeting with TAFE institutes experiencing financial difficulties.

Department of Infrastructure

At the Department of Infrastructure, budget centres (divisions, regions) and the Budget Management Unit monitor performance against budgets. Divisions and regions examine their own performance, and the Budget Management Unit the department's overall performance.

The department's financial management information system and budget management system produces various reports to help divisions and the Budget Management Unit to analyse and report on financial and operational results. Several divisions and regions also use Microsoft Excel spreadsheets to compile budget information not generated through the Advisor financial management information system.

The department 's 20 budget centres prepare monthly analyses of budget results for divisional executive directors who then report to either the Finance or the Capital Sub-committees. The results of budget analysis are ultimately provided to the department's executive management committee.

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[1] This includes government schools, Adult, Community and Further Education Board, Adult Multicultural Education Services, Centre for Adult Education, Driver Education Centre of Australia Limited, International Fibre Centre Limited, Merit Protection Boards, Registered Schools Board, Victorian Curriculum and Assessment Authority, Victorian Institute of Teaching, Victorian Learning and Employment Skills Commission, Victorian qualifications Authority and 14 TAFE institutes and 5 universities with TAFE divisions.

Monthly reports are not presented to the executive management committee until 3 or 4 weeks after the end of the month. The department is examining ways of improving the timeliness of these reports.

The Budget Management Unit regularly compares the whole-department budget against actual performance, and reports to an internal Finance Sub-committee (comprising Secretary, Chief Finance Officer and divisional directors) and to senior management. It reports monthly, quarterly and annually.

In 2002-03, the Unit's monthly and quarterly reports highlighted significant variances from budgets and analysed the causes of variances. However, the analyses of budget performance could have made greater use of forward-looking financial information (such as is used by the department's Project Governance and Review Group, (responsible for monitoring capital projects), particularly about future risks and risk management strategies.

Since April 2003, monthly budget reports prepared by the Budget Management Unit have been progressively improved. The Units September 2003 report not only provided the typical budget and actual analyses, but also contained:

- remedial action taken to date, or proposed
- likely events within the foreseeable future
- current and ongoing risks (including the likelihood and potential impact of risks, action that can be taken to reduce the likelihood or severity of the risk, the staff responsible for managing the risk and when any proposed action should be taken).

The department's portfolio includes one sub-agency (VicRoads) that operates relatively independently of the department. VicRoads has its own internal budgeting processes that are reviewed regularly by the department.

The Budget Management Unit adequately monitors VicRoads' performance reports. A designated officer is responsible for receiving, analysing and reporting financial information to senior departmental management.

RESPONSE provided by Secretary Department of Infrastructure

The department notes that the audit findings shown in Figure 5A – Budget Management and Review Scorecard refer to the 2002-03 financial year.

Substantial improvements to the department's monitoring of revenue and expenditure against budgets' occurred in 2003-04 as described in the audit findings (5.1.1. Is monitoring of revenue and expenditure against budget adequate?). The department regards its current performance as more than adequate.

5.1.2 Is external reporting of performance against budgets adequate?

All government departments submit monthly and quarterly reports to the Department of Treasury and Finance. Monthly reports contain detailed trial balance information which enables that department to prepare consolidated departmental monthly financial statements and supporting explanations. The reports allow for prompt corrective action to be taken, if required, by departments or the Department of Treasury and Finance in relation to any emerging whole-of-government budget risks.

Quarterly departmental reports to the Department of Treasury and Finance include information about implementation of departmental business plans, financial performance, progress with major asset investments, risks and the budget outlook. They provide the Department of Treasury and Finance with information about performance, by each department, against the output delivery targets in the budget estimate papers. These reports support the departmental quarterly claims for the application of appropriations by the Treasurer.

Monthly reports to the Department of Treasury and Finance prepared during 2002-03 by the Department of Education and Training and the Department of Infrastructure were of good quality, and had an appropriate level of analysis and detail.

Quarterly reports prepared by all departments were recently examined as part of our April 2003 report on *Parliamentary control and management of appropriations.* The report concluded that:

- better-focused performance measures are required to enhance departmental performance and accountability
- a comprehensive methodology needs to be developed by the Department of Treasury and Finance (in consultation with other departments) to better guide assessments of departmental output performance (particularly the value of revenue to be certified, approved or rejected) and ultimately drive the delivery of improved outcomes. The methodology should aim to enhance the objectivity, consistency and defensibility of such assessments.

These issues are now being considered by the Department of Treasury and Finance.

Our November 2003 *Report on Public Sector Agencies* commented that, during 2002-03, the Department of Infrastructure received appropriation funding of $207 million ahead of service delivery. The amount was subsequently transferred into 2 trust accounts within the Trust Fund and remained unspent at 30 June 2003.

The effect of the above transactions was to increase the value of Consolidated Fund payments (and the Consolidated Fund deficit) during 2002-03 and provide funding for future years towards roads and other transport expenditure without impacting on the Consolidated Fund reported result for those years.

These issues are now being considered by the Department of Infrastructure.

The annual report of each department also compares actual financial results with budget estimates. This is presented in the report of operations which is not subject to audit. Annual reports are the main way that departments discharge their accountability obligations to parliament, and provide an insight into their operations.

The 2002-03 annual reports (Budget Portfolio Outcome Statements[2]) of the Department of Education and Training and the Department of Infrastructure compared the actual financial results (using statements of financial performance, statements of financial position and statements of cash flow) with the estimates published in Budget Paper No.3 (excluding Treasurer's advances). The Department of Infrastructure's annual report did not, however, explain budget and actual variances, some of which were well over 100 per cent above and below budget. Such lack of explanation weakens departmental accountability and transparency.

Recommendation

5. The Department of Infrastructure should include explanations for significant variations between actual results and budget estimates in its annual report (Budget Portfolio Outcome Statements).

RESPONSE provided by Secretary Department of Infrastructure

The department notes that the audit findings for 'external reporting of performance against budgets' in 2002-03 was due to limited explanation of budget versus actual variances in its Budget Portfolio Outcomes statements presented in the Department's 2002-03 Annual Report. The department's Budget Portfolio Outcomes statements presented in its Annual Report will include improved explanations of significant variations.

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[2] Budget Portfolio Outcome Statements provide a comparison between the actual financial information of all entities within the portfolio and the forecasted financial information published in Budget Paper No. 3.

5.1.3 What are the other characteristics of budget management and review?

Further details of other characteristics of effective budget management and review are as follows:

- Reviews and revisions: as departments operate in often rapidly changing environments, approved budgets should be periodically reviewed and revised to ensure the estimates remain appropriate. Processes must be flexible enough to enable modification of priorities as events or circumstances change. Better practice is to limit the number of changes to the budget so that it does not lose relevance, and to ensure that significant resources are not tied up in the process of transferring budgets which have little impact on overall performance. Formally reviewing and revising the budget once or twice a year or alternatively by using rolling projections by forecasting the likely result of change on budgetary requirements can achieve this.

5.2 Performance against budget for 2002-03

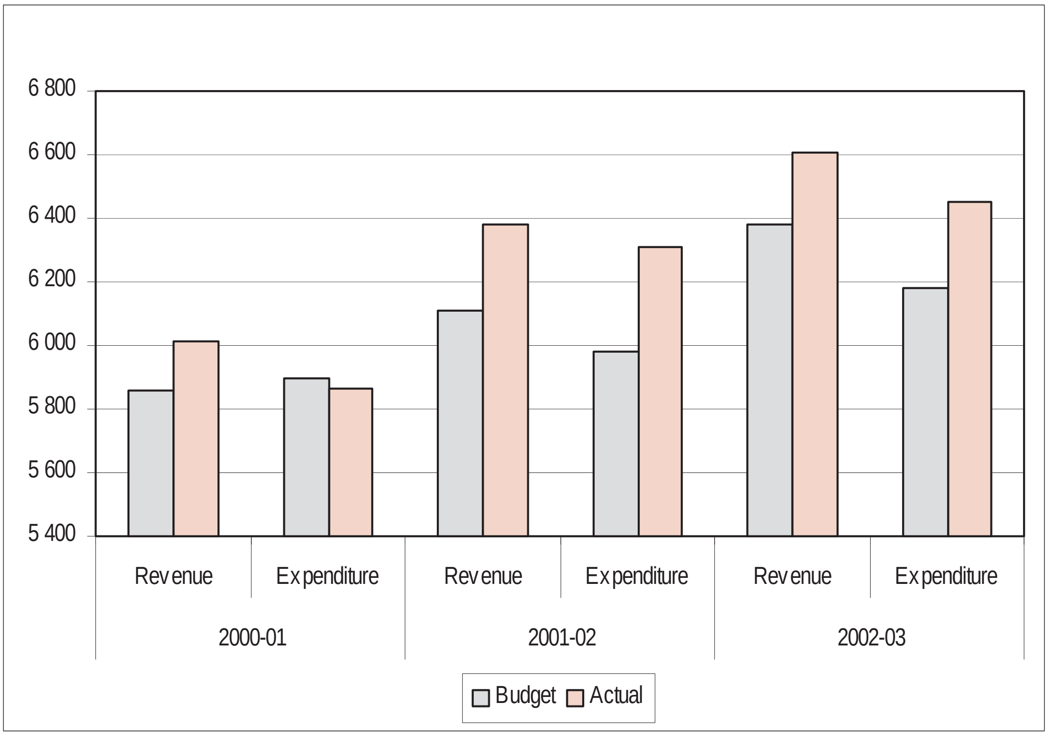
The reason why departments develop and manage budgets is so that they can deliver specified outputs using the resources provided for the purpose. To some extent, the budget performance of a department provides a measure of the adequacy, or otherwise, of the department's internal budget development and management practices.

The implementation of best practice budget development and management practices does not necessarily ensure a department will achieve its budget forecast. Budgetary funds allocated by government may prove to be insufficient to deliver the required outputs. Unforeseen events may also arise which cannot be controlled by the department. Adopting best practice should at least lead to a department taking all reasonable steps to identify and minimise any impediments to achieving the forecast budget result.

5.2.1 Department of Education and Training

Figure 5B shows actual revenue and expenditure against budget for the Department of Education and Training (and all associated budget sector agencies[3]) for 2000-01, 2001-02 and 2002-03.

FIGURE 5B: DEPARTMENT OF EDUCATION AND TRAINING REVENUE AND EXPENDITURE AGAINST BUDGET
($M)



Source: Department of Education and Training annual reports 2000-01, 2001-02 and 2002-03.

[3] This includes government schools, Adult, Community and Further Education Board, Adult Multicultural Education Services, Centre for Adult Education, Driver Education Centre of Australia Limited, International Fibre Centre Limited, Merit Protection Boards, Registered Schools Board, Victorian Curriculum and Assessment Authority, Victorian Institute of Teaching, Victorian Learning and Employment Skills Commission, Victorian qualifications Authority and 14 TAFE institutes and 5 universities with TAFE divisions.

Figure 5B shows that for 2000-01, 2001-02 and 2002-03, apart from expenditure in 2000-01, revenue and expenditure has exceeded budget in the 2 more recent years. What is also common to each year is that the department has relied on the Treasurer's advance[4] (totalling $283 million over the 3 years) to ensure that sufficient funds were available to meet expenditure. This result could have been caused by a number of factors. For example, expenditure was not contained within budgetary limits, expected savings were not achieved and the budget was incorrectly prepared.

Figure 5C shows the Department of Education and Training's (including all associated budget sector agencies) actual performance against its budget for 2002-03.

FIGURE 5C: DEPARTMENT OF EDUCATION AND TRAINING, PERFORMANCE AGAINST BUDGET, 2002-03

	Budget (Budget Paper No. 3)	Actual	Variance	Variance
	($m)	($m)	($m)	(%)
Revenue -				
Output appropriations	5 368.5	5 533.6	165.1	3.1
Commonwealth grants	258.1	315.4	57.3	22.2
Sale of goods and services	485.5	461.6	(23.9)	(4.9)
Other revenue	271.5	296.6	25.1	9.2
Sub-total	**6 383.6**	**6 607.2**	**223.6**	**3.5**
Expenses -				
Salaries and wages	3 729.9	3 901.8	171.9	4.6
Grants and other payments	576.1	555.7	(20.4)	(3.5)
Depreciation and amortisation	265.1	288.1	23.0	8.7
Capital asset charge	565.3	565.3	-	-
Supplies and services	1 041.3	1 140.0	98.7	9.5
Other	1.3	1.7	0.4	30.8
Sub-total	**6 179.0**	**6 452.6**	**273.6**	**4.4**
Surplus (Deficit)	**204.6**	**154.6**	**(50.0)**	**(24.4)**

Source: Department of Education and Training.

[4] Specific appropriation given by the Treasurer each year as part of the annual Appropriation Act to meet any urgent claims that may arise before parliamentary sanction is obtained.

Figure 5C shows that the department failed to achieve its 2002-03 budget in that its actual operating surplus of $154.6 million was $50 million less than the budgeted surplus of $204.6 million. The major variations were:

- output appropriations, were $165.1 million (3.1 per cent) above budget. Additional revenue including $149.2 million from the Treasurer's advance, was provided to the department to meet the additional costs of delivering the government's required goals and targets for education and training (i.e. increasing student numbers required employing more teachers)
- Commonwealth grants, were $57.3 million (22.2 per cent) above budget. Additional revenue was received from the Australian National Training Authority for TAFE institutions
- salaries and wages expenditure, was $171.9 million (4.6 per cent) above budget. This was primarily due to the employment of additional teachers to reduce student-teacher ratios and salary increases approved after the budget was finalised
- depreciation and amortisation charges, were $23 million (8.7 per cent) over budget. This was due to asset purchases by schools from additional locally raised funds and TAFE institutions that received additional funding from the Commonwealth. Depreciation for these additional assets were not provided for in the original budget for depreciation
- supplies and services, were $98.7 million (9.5 per cent) over budget. This reflected the additional purchases made in line with additional revenue from locally-raised funds in schools and higher government funding received for schools and TAFE institutions. (i.e. the additional expenditure resulted in a budget overrun but was covered by the additional revenue received).

As part of the 2002-03 budget process, the department estimated that it would incur a capital asset charge[5] of $565.3 million for 2002-03. However, due to an increase in the actual value of the department's assets (arising from the revaluation of land and buildings), the capital asset charge should have been $644 million for the year.

According to guidelines issued by the Department of Treasury and Finance any increase in a department's controlled non-current physical assets during the year above the budgeted levels will increase the capital asset charge without increasing the department's revenue (output appropriation). Departments are required to make compensating savings, or present a business case for additional output revenue to offset this increased cost.

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[5] Capital asset charge is imposed by the Department of Treasury and Finance and represents the opportunity cost of capital invested in the non-current physical assets used in the provision of outputs. The amount is calculated on the carrying amount of non-current physical assets (excluding heritage assets).

Where revaluations or devaluations are material and unrelated to management effectiveness, any adjustment to departmental revenue must occur through either change to output price or additional capital.

As the department was unable to absorb the additional expense in its 2002-03 budget, the Minister for Finance did not require it to pay the higher charge. This improved the 2002-03 budget result.

Action taken to address budget pressures

When developing its 2002-03 budget (as part of its Stage 1 State budget submission in November 2001), the department identified a number of budget pressures. Although the Government did not accept the department's position, it agreed to review the department's submission at a later date.

In July 2002, following determination of the State budget, the department alerted the government that it predicted expenditure for 2002-03 would exceed budget by $173.3 million. As a result, an Education Sub-committee, supported by a working group of staff from the Department of Premier and Cabinet, the Department of Treasury and Finance and the Department of Education and Training, was established to consider these budget issues.

A number of measures were subsequently implemented which reduced the projected 2002-03 budget shortfall to $88.9 million. However, the government still recognised the likely requirement for a Treasurer's advance of $52 million to cover the shortfall in the school global budget. A number of reviews of the department budget situation were subsequently undertaken by the Education Sub-committee.

In March 2003, the Department of Treasury and Finance completed the School Education Output Review. That review provided the department with a better understanding of why the school global budget caused pressure on its budget. The review examined the efficiency and effectiveness of 4 school education outputs (primary, junior, senior secondary and non-government schools). The review found that while the current level of school performance was comparable with other states, it had been achieved at the cost of budget shortfalls, deteriorated school infrastructure and restricted teacher professional development opportunities. The review concluded that total resources allocated to schools should move in line with changes in student enrolment numbers; and that resourcing should be based on the actual price of the various stages of learning, and which takes account of the particular needs of equity groups.

By February 2003, an expected expenditure overrun of $135.5 million was identified from monthly performance reports. At that time, the department realised that if this trend continued it would substantially exceed its 2002-03 budget and the overrun was likely to flow on to the 2003-04 budget.

By the end of 2002-03, action was taken by the department to reduce its expenditure, secure Treasurer's advances for $149.2 million and gain relief from the Department of Treasury and Finance from meeting the increased capital asset charge of $78.5 million.

The department has been pro-active in addressing factors within its control that put pressure on its budget. The work undertaken with the Department of Premier and Cabinet and the Department of Treasury and Finance has resulted in a common understanding between the department and these other agencies about the department's overall budget situation and about what drives its cost.

The 2002-03 budget result was largely caused by an incorrect base budget, including the school global budget, the underpinning rationale of which was problematic. An additional $81.5 million was provided in the department's 2003-04 base budget to implement a reform and demand strategy, which would assist the department in addressing its cost pressures and progress towards achievement of the goals and targets for education and training.

Poor budget development and management practices adopted during 2002-03 also contributed to the 2002-03 result. However, the department has progressively improved its practices since 2002-03. The effectiveness of the department's internal budget practices will, to some extent, be reflected in how well it meets its 2003-04 budget forecast. Our assessment of these budget development and management practices is detailed in Parts 3, 4 and 5 of this report.

RESPONSE provided by Secretary Department of Education and Training

The State Budget Papers realise, by noting a start of year target and end of year expected outcome, that there may be a difference between the initial budget target and the expected budget outcome.

During the course of the year a department will receive supplementation from the Treasurer for any number of reasons including employment agreements, ERC decisions and other cost pressures that cannot be addressed in the original budget as they are unknown at the time of budget preparation.

The fact that the department received additional funding does not indicate that the budget was inappropriately managed or incorrectly prepared, but rather that the department was supplemented for costs which were allocated from Treasury as a result of specific circumstances or decisions. Of the $283m Treasurer's Advances provided to the department over the 3 year period, $159m related to approved wage increases (which the Department of Treasury and Finance funds from a central contingency fund), and other Government decisions. The remaining $124m related almost exclusively to the 2002-03 financial year and included $11m for the unusually high number of school fires occurring in that year.

RESPONSE provided by Secretary Department Treasury and Finance

The department advices that under the government's resource management framework, government purchases the school education outputs from the Department of Education and Training with specified performance measures including quality, quantity, timeliness and price targets. The Department of Education and Training is required to manage their costs under this purchase arrangement.

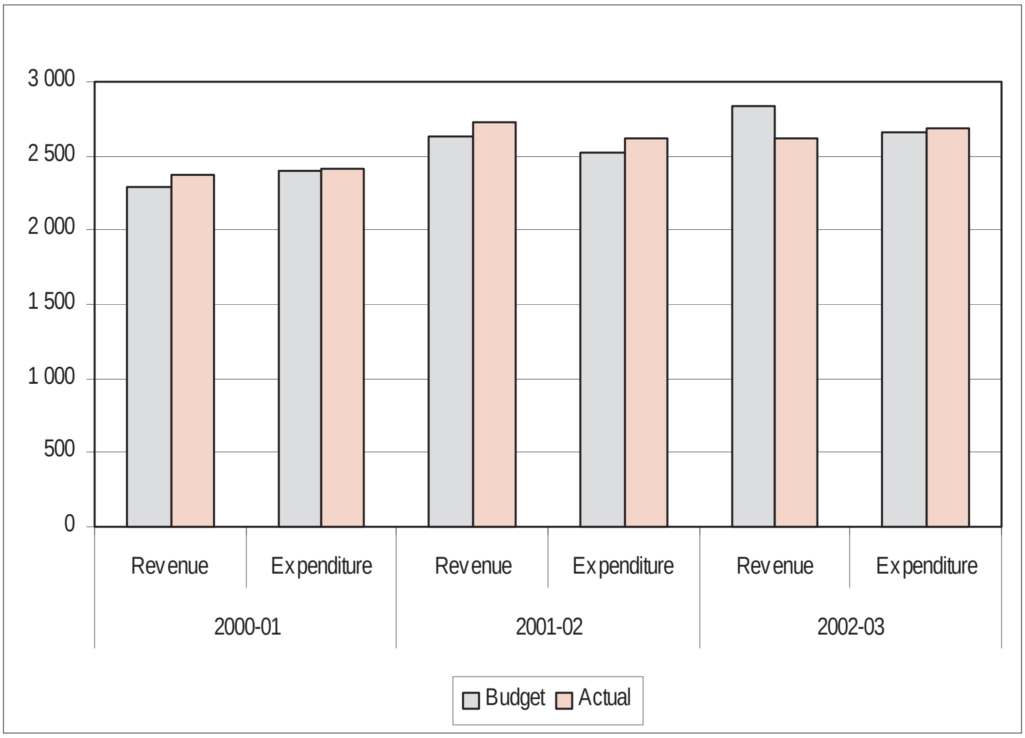
As noted by the Auditor-General, the $81.5 million provided to the Department of Education and Training in the 2003-04 budget was to implement a reform and demand strategy that would assist the department in achieving the goals and targets for education and training. A major element of the strategy was the department's 'Blueprint for Government Schools', which was launched in November 2003. The Blueprint includes a range of initiatives aimed at building the skills of the education workforce and continuing improvement and progress in the quality of the government school system.

5.2.2 Department of Infrastructure

Figure 5D shows actual revenue and expenditure against budget for the Department of Infrastructure (and associated budget sector agencies[6]) for 2000-01, 2001-02 and 2002-03.

[6] This includes VicRoads and Heritage Council Victoria.

FIGURE 5D: DEPARTMENT OF INFRASTRUCTURE REVENUE AND EXPENDITURE AGAINST BUDGET
($m)



Source: Department of Infrastructure annual reports 2000-01, 2001-02 and 2002-03.

Figure 5D shows that apart from revenue for 2002-03, revenue and expenditure of the Department of Infrastructure (and associated budget sector agencies) for 2000-01, 2001-02 and 2002-03 has exceeded budget in every year.

Figure 5E shows the Department of Infrastructure's (and associated budget sector agencies) budgeted and actual performance for 2002-03.

FIGURE 5E: DEPARTMENT OF INFRASTRUCTURE, PERFORMANCE AGAINST BUDGET, 2002-03

	Budget (BP3)	Actual	Variance	Variance
	($m)	($m)	($m)	(%)
Revenue -				
Output appropriations	2 542.8	2 442.5	(100.3)	(3.9)
Sale of goods and services	101.1	130.2	29.1	28.8
Taxes	48.1	50.5	2.4	5.0
Other revenue	137.9	(7.9)	(145.8)	(105.7)
Sub-total	**2 829.9**	**2 615.3**	**(214.6)**	**(7.6)**
Expenses -				
Salaries and wages	223.6	286.3	62.7	28.0
Grants and other payments	553.1	585.7	32.6	5.9
Capital asset charge	105.0	68.3	(36.7)	(35.0)
Supplies and services	1 523.0	1 482.4	(40.6)	(2.7)
Depreciation and amortisation	241.1	259.4	18.3	7.6
Other expenses	8.3	11.7	3.4	41.0
Sub-total	**2 654.1**	**2 693.8**	**(39.7)**	**(1.5)**
Surplus (Deficit)	**175.8**	**(78.5)**	**(254.3)**	**(144.7)**

Note: The statement reflects the machinery-of-government changes effective from January 2003 and consolidates information for the Department of Infrastructure, VicRoads and Heritage Victoria.
Source: Department of Infrastructure.

As shown in Figure 5E , the department did not achieve its budgeted surplus in 2002-03. The actual operating deficit of $78.5 million was $254.3 million (144.7 per cent) less than the original forecast operating surplus of $175.8 million. Primary reasons for the variance were:

- output appropriations, $100.3 million (3.9 per cent) below budget mainly due to revisions by the Commonwealth Government to funding for the Mitcham-Frankston Freeway. Commonwealth funding to states and territories was not finalised until after development of the 2002-03 state Budget
- sale of goods and services, $29.1 million (28.8 per cent) above budget. Additional revenue was received by VicRoads and from public transport services, particularly metropolitan bus services, due to the growth in patronage exceeding expectations

- other revenue - $145.8 million (105.7 per cent) below budget. Largely attributable to the write-off of $250.6 million of City Link assets (in accordance with Australian Accounting Standards) following the transfer of these assets to City Link[7]. This was partially offset by a one-off payment by National Express (which went into receivership) of $135 million to the department following default on its performance obligations under the transport franchise arrangements. Neither of these events was foreseen during development of the 2002-03 state Budget
- salaries and wages expenditure, $62.7 million (28 per cent) over budget. This included a recalculation of the superannuation liability for VicRoads of $44 million
- grants and other payments, $32.6 million (5.9 per cent) over budget. This was caused mainly by payments of $11 million for the transfer of development rights for Docklands, electricity network tariff rebates of $8 million and country private rail services, including the express passenger train subsidy of $3 million
- capital assets charge, $36.7 million (35 per cent) under budget. This occurred because of delays in the capital works program for a number of rail projects
- supplies and services, $40.6 million (2.7 per cent) under budget. This was due to a number of factors, including the underperformance by franchise operators, and delays in the works program. These were partially offset by additional costs for franchise payments following the receivership of National Express.

The Department of Infrastructure did not achieve its 2002-03 budgeted surplus, largely due to events which could not have reasonably been foreseen at the time of developing the original budget in January and February 2002 (reduced Commonwealth funding, National Express being put into receivership and City Link asset write-off). The department's budget development and management practices are substantially in line with better practice. These practices are commented upon in Parts 3, 4 and 5 of this report.

[7] The Departments annual financial statements correctly show this item as an expense.

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(a) This report is included in Part 3.2, Human Services section of the *Report on Ministerial Portfolios*, June 2001.

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