MANAGING PUBLIC SECTOR BUDGETS PART ONE

Professional Development Course Book

Presented by Mark Priadko

INSTITUTE OF
PUBLIC ADMINISTRATION
AUSTRALIA

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Introduction

Learning objectives:

- Introduction to financial management basics
- Understand functions and types of budgets
- Understand government budgeting processes
- Get practical insight into managing and controlling budgets.

Self-evaluation

My proficiency in managing budgets and financial plans is:

List of what I need to know to move up one point on this scale.

- .....
- .....
- .....
- .....

Session overview

- Introduction
- Our case study
- Financial management basics

Break

- Terminology
- Finance as an Expression of Strategy
- Context & Public sector finances
- Understanding costs and revenues – Zero-based budgeting

These course notes are designed to support the presentation of information in the module. They are based on the knowledge and experience of Mark Priadko. These notes are not designed to present comprehensive documentation of the nature of financial management or public sector finances. References are provided for those who wish to investigate matters in more detail.

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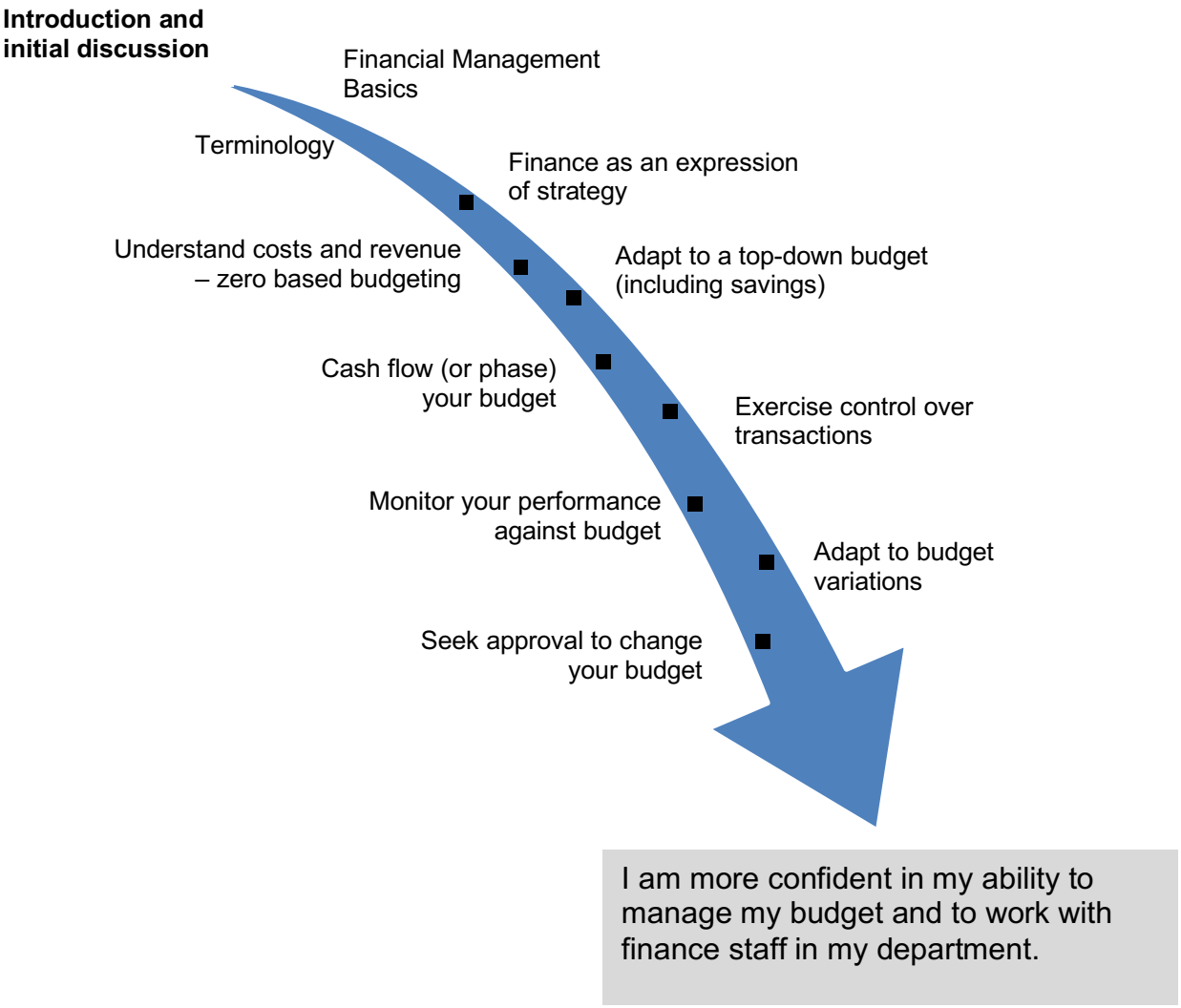

Introduction and initial discussion
Financial Management Basics
Terminology
Finance as an expression of strategy
Understand costs and revenue – zero based budgeting
Adapt to a top-down budget (including savings)
Cash flow (or phase) your budget
Exercise control over transactions
Monitor your performance against budget
Adapt to budget variations
Seek approval to change your budget
I am more confident in my ability to manage my budget and to work with finance staff in my department.

Case Study

We will use a case study to explore various aspects of financial management.

Our scenario is that we have been asked to establish a skilled migrant housing program. The goals of the program are to attract skilled migrants to our state to ensure we have the skills necessary to support departments and local businesses. The program aims to do this by ensuring that in their first few weeks of stay, participants are supported by access to housing, accommodation and support services to make their settlement smooth.

What are some of our initial thoughts on the following aspects of such a program:

Inputs

Activities

Outputs

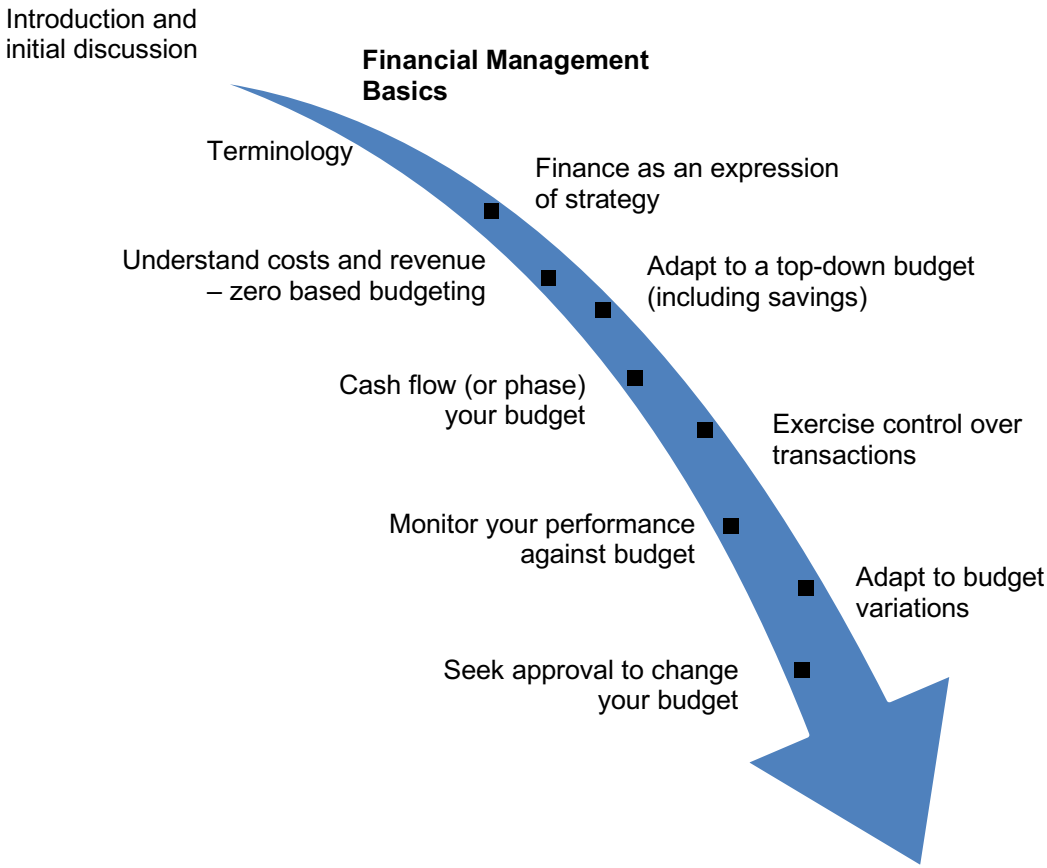
Objectives

Ensuring that in their first weeks of stay, participants are supported

Outcomes

Attract skilled migrants to our state to ensure we have the skills necessary to support departments and local businesses.

What are the different financial management skills we need to have to manage this program?



I am more confident in my ability to manage my budget and to work with finance staff in my department.

Financial Management Basics

Basics in financial management are presented in two parts. The first is the basic organising principles of finance and the second is basic financial management capabilities.

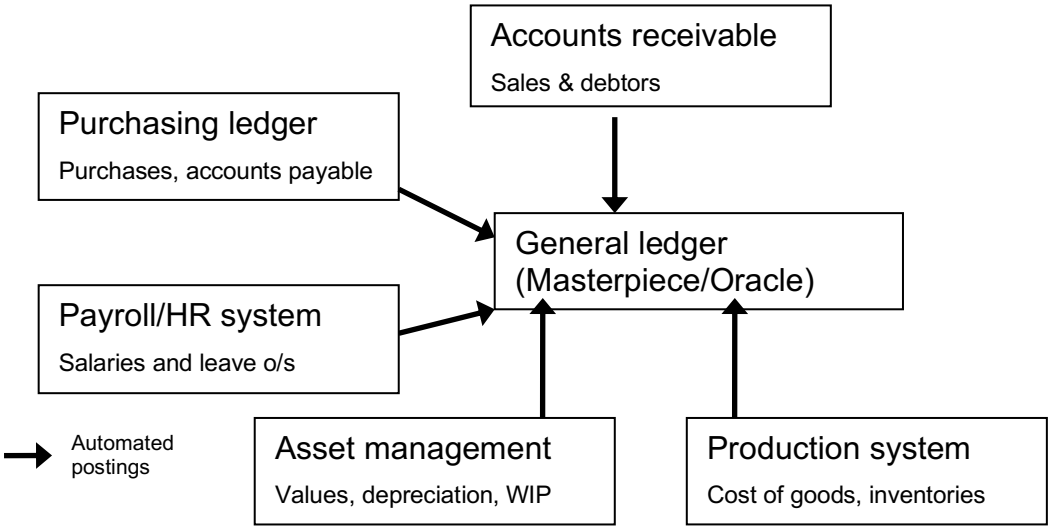
Organising principles for finances

Financial information is created through the recording of business transactions. A transaction is an agreement between two parties (a buyer and a seller) to exchange goods or services. Organisations capture and record each and every financial transaction they undertake. Transactions may be for sales, purchasing or assets with each transaction assigned coding to distinguish between the types of financial information being recorded.

Transactions are recorded by entering the data into a ledger, which acts as a central database for an organisation. For financial reporting - the General Ledger becomes a primary source of the truth. The general ledger represents census data of every transaction that occurs in an entity and is subject to audit each year.

Transactions are recorded in financial systems or databases. In some cases, each type of transaction is recorded in its own system (e.g. payroll, asset register, purchasing, or sales ledger). Data is then transferred from these systems into a central ledger, known as the general ledger. In some organisations, one integrated system is used to capture all this data. These systems are known as enterprise resource platform (ERP) systems. Examples of ERP systems are SAP, Peoplesoft, Oracle, and Masterpiece.

The transactions component of the process ends with the posting of entries into the relevant ledger and with the settlement of the transactions (receiving of cash or paying of cash).



The reporting process requires that the reporting period is closed in each of these source systems and in the general ledger putting an end to transactions for that period.

Transactions are recorded with codes – cost centre codes and account codes. These codes make up what is known as the chart of accounts. All transactions are organised using a chart of accounts.

Charts of accounts are typically arranged into the following account types:

- Asset accounts – something you own, e.g. bank account, investment account, accounts receivable (revenue owned), motor vehicle etc.
- Liability accounts – something you owe, e.g. accounts payable, loans etc.
- Equity accounts – the net worth or value of an organisation to its owners
- Revenue accounts – income you expect to receive for providing a service or item. School examples include materials and services charges, hire of facilities, grants etc.
- Expense accounts – payments you make for purchases or for services received. School examples include stationery, curriculum resources, repairs and maintenance, utilities etc.

These account codes are one element of the chart of accounts. Other elements include:

- Entity codes
- Fund source codes
- Cost Centre codes
- Activity codes

The use of these codes enables transactions to be arranged and reported in different ways.

	Operations					Corporate Support				
	Cost Centre 1	**Cost Centre 2**	**Cost Centre 3**	**Cost Centre 4**	**other CCs**	**Corp Governance**	**Procurement & Contract Management**	**Corporate Finance**	**Legislation & Delegation**	**Total**
Employee entitlements	x	x	x	x	x	x	x	x	x	∑ Labour
Plant, equipment and facilities	x	x	x	x	x	x	x	x	x	∑ Operating expenses
Contracting and consulting	x	x	x	x	x	x	x	x	x	∑ Operating expenses
Supplies and Services	x	x	x	x	x	x	x	x	x	∑ Operating expenses
Operating expenditure	X^1	X^2	X^3	X^4	X^n	CG	PCM	CF	L&D	**Total Costs of Running the business**
Revenue	Y^1	Y^2	Y^3	Y^4	Y^n					∑ Revenue
Net Operating Result	Y1 - X1	Y2 - X2	Y3 - X3	Y4 - X4	Yn - Xn	CG	PCM	CF	L&D	**Total net operating result**

The accounts used in finances form the basis for the reporting of financial information where:

- The values of revenues and expenses are presented in a profit and loss (or operating) statement
- The values of Assets, liabilities and equity are presented in a balance sheet

Examples of financial statements for a Government department are provided below.

South Australia Police
Statement of Comprehensive Income
for the year ended 30 June 2022

	Note	2022 $'000	2021 $'000
Income			
Appropriation	2.1	971 647	943 140
Fees and charges	2.2	30 028	26 470
Commonwealth-sourced grants and funding	2.3	2 882	2 689
Resources received free of charge	2.4	4 659	4 515
Net gain from the disposal of non-current and other assets	2.5	6 025	1 147
SA Government grants, subsidies and transfers	2.6	84 619	81 058
Other income	2.7	6 073	5 593
Total income		**1 105 933**	**1 064 612**
Expenses			
Employee benefits expenses	3.3	783 808	801 265
Supplies and services	4.1	193 182	185 701
Depreciation and amortisation	4.2	44 605	44 281
Write down of non-current assets		1 609	306
Payments to Consolidated Account	2.5	13 945	-
Borrowing Costs		1 265	1 184
Total expenses		**1 038 414**	**1 032 737**
Net result		**67 519**	**31 875**
Total comprehensive result		**67 519**	**31 875**

4.1. Supplies and services

	2022 $'000	2021 $'000
Accommodation	31 369	35 983
Communication and computing	36 389	37 253
Administration *	24 124	23 210
Motor vehicle related	18 745	17 530
Employee programs & housing subsidies	13 432	11 548
Temporary agency staff	9 541	10 411
Cleaning	5 549	6 304
Minor equipment	5 604	6 229
CTP Regulator funded Road Safety Campaigns	6 685	5 595
Utilities	4 901	4 825
Shared Services SA	3 762	3 806
Aviation costs	6 333	4 087
SES CFS resources	2 403	3 100
Insurance	2 137	1 916
Uniforms	8 636	2 225
Legal costs	2 004	1 692
Collection costs	834	807
Consultants	172	182
Short term leases	-	366
Variable lease payments	1 064	734
Other	9 498	7 898
Total supplies and services	**193 182**	**185 701**

Accommodation

SAPOL's accommodation is managed by SAPOL and also is provided by the Department for Infrastructure and Transport (DIT) under Memoranda of Administrative Arrangements (MoAAs) issued in accordance with Government-wide accommodation policies. These arrangements do not meet the definition of a lease and are accordingly expensed. Information about accommodation incentives relating to this arrangement is shown in note 7.4.

Insurance

SAPOL is a participant in the SA Government's Insurance Program. SAPOL pays an insurance premium through South Australian Government Financing Authority (SAFA). SAPOL is responsible for the payment of claim amounts up to an agreed amount (the deductible). SAFA provides the balance of the funding for claims in excess of the deductible.

COVID-19

Various categories of supplies and services due to COVID-19 is $ 27.8 million (2021: $29.8 million).

Administration

* Administration includes Audit fees paid/payable to the Auditor-General's Department (AGD) relating to work performed under the *Public Finance and Audit Act 1987*. The audit fees in 2021-22 were $0.390 million (2021: $0.365 million). No other services were provided by the Auditor-General's Department.

South Australia Police
Statement of Financial Position
as at 30 June 2022

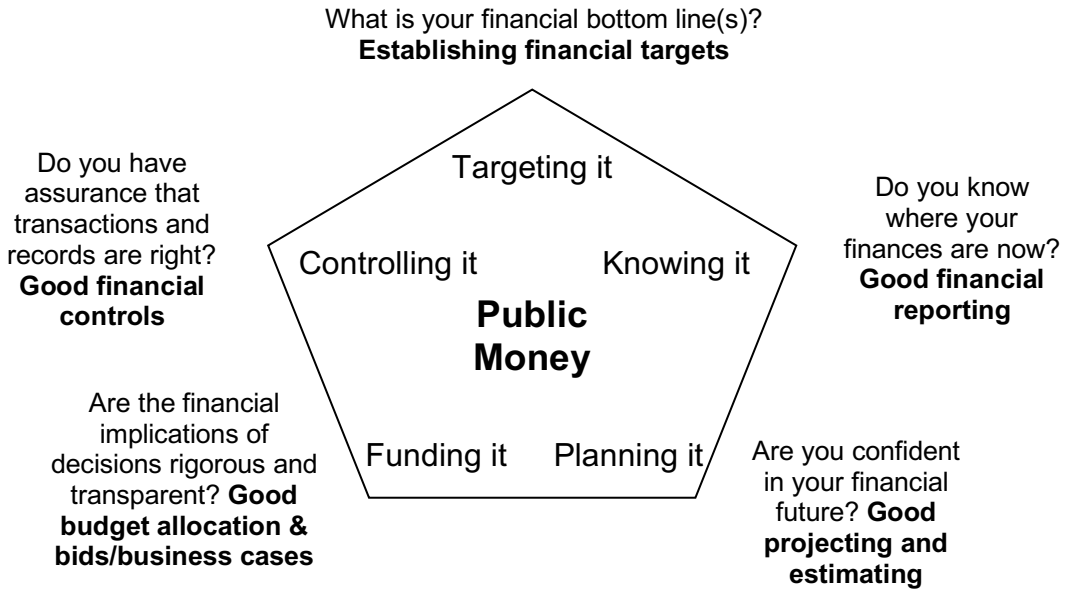
	Note	2022 $'000	2021 $'000
Current assets			
Cash and cash equivalents	6.1	246 665	214 121
Receivables	6.2	14 242	16 120
Inventories		197	237
Non-current assets classified as held for sale	5.5	500	11 714
Total current assets		**261 604**	**242 192**
Non-current assets			
Receivables	6.2	4 216	4 134
Property, plant and equipment	5.1	384 330	392 698
Intangible assets	5.4	24 781	30 744
Total non-current assets		**413 327**	**427 576**
Total assets		**674 931**	**669 768**
Current liabilities			
Payables	7.1	36 270	44 327
Employee benefits	3.4	76 611	77 047
Provisions	7.3	21 041	20 844
Lease liabilities	7.2	13 018	12 919
Other liabilities	7.4	4 475	4 913
Total current liabilities		**151 415**	**160 050**
Non-current liabilities			
Payables	7.1	20 736	23 767
Employee benefits	3.4	165 217	206 888
Provisions	7.3	144 509	145 203
Lease liabilities	7.2	62 349	66 332
Other liabilities	7.4	2 837	2 939
Total non-current liabilities		**395 648**	**445 129**
Total liabilities		**547 063**	**605 179**
Net assets		**127 868**	**64 589**
Equity			
Retained earnings		(98 870)	(162 148)
Asset revaluation surplus	8.1	141 518	141 517
Contributed capital		85 220	85 220
Total equity		**127 868**	**64 589**

The accompanying notes form part of these financial statements. The total equity is attributable to the SA Government as owner.

Financial Management Capabilities

It is my view that there are five components to good financial management:

1. Establishing the financial bottom line(s) (financial targets)
2. Do you know where you are? (reporting)
3. Are you confident in your viability? (estimating & projecting)
4. Are decisions rigorous and transparent? (budget bidding & allocation)
5. Do you have adequate control over transactions? (control & assurance)



The basics apply to any household, business or government. While they sound basic, it cannot be presumed that all are done well.

Very often there is an emphasis on the reporting, control and planning (budgeting) components. However, the establishment of appropriate financial targets and transparency in decisions, if not done well will undermine the benefits of doing the other components well.

The quality of financial management will be related to how well each of the five steps is carried out.

What follows is based on each of these five components of good financial management.

What is your financial bottom line(s)?

Answering this question is the first and most fundamental step to good financial management. Without answering this question properly, financial reporting and financial planning will be unfocused.

There are many possible financial targets – profit, cash holdings, net worth, net financial worth, return on equity, return on assets, net debt etc.

The financial bottom line(s) will be different for different types of organisations and people. A primary determinant of an entity's financial bottom line(s) will be the nature of its assets and liabilities.

The public sector consists of many organisations with assets that do not earn income (non-income earning assets) and organisations with income-earning assets. The financial targets for each of these sectors within the government will therefore be different.

For organisations with income-earning assets, financial targets will usually relate to profitability. The target level of profitability will be based on the amount of profit relative to assets (return on assets), the amount of profit relative to investments in the company (return on capital or return on shareholder funds) etc.

Organisations with assets that do not earn income will need different targets. Because assets are non-income generating, care must be taken that the purchase of assets does not lead to growth in liabilities. In these cases, organisations will need targets that focus on operating results and targets that focus on the impact of asset purchases on liabilities and debt levels.

SA Government financial targets

The financial targets of the South Australian Government define the financial parameters for all agencies and entities within the general government sector. The table below is an excerpt from the State budget summarising fiscal targets.

Table 1.1: Fiscal targets

Target 1	Achieve a net operating surplus in the general government sector every year.
Target 2	Limit general government operating expenditure growth to trend growth in household income.
Target 3	Achieve a level of net debt that is sustainable over the forward estimates.

For agencies in the South Australian General Government sector, the key financial targets are:

- Net operating result (or net cost of services)
- Net lending/borrowing
- Expenditure authority
- FTEs

FINANCIAL POSITION

Assets:

Cash

Investments

Property

less **Liabilities**

Loans

Provisions

Accounts payable

equals **Net worth**

FINANCIAL PERFORMANCE

Revenue:

Fees

Grants

Fund raising

less **Expenses**

Salaries

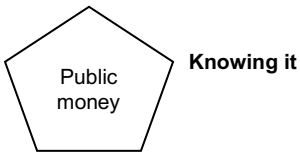
Supplies & Services

Facilities and Utilities

equals **Net cost of services**

Financial position is improved or deteriorated depending on financial performance. Poor financial performance (expenses greater than revenue) will result in a deterioration of financial position. Good financial performance (revenue greater than expenses) will result in an improvement in financial position.

Financial Reporting - Do you know where your finances are?



The next step to managing finances is to know the current status of your finances. You require access to meaningful and accurate information that either assures you that your finances are where you want them to be or that some intervention or action is required. This is the basis for good financial reporting. Knowing where your finances are at a point in time is critical to informing any decision with financial implications.

The act of receiving financial reports or financial statements regularly is no guarantee that you will know where your finances are. Most of us have had some exposure to financial reporting. However, in too many cases, our experience with financial reports is memorable for the wrong reasons. Too many financial reports provide large volumes of information without making it clear what the status of the financial bottom line is. They provide lots of information but not lots of assurance that your finances are where you want them, or they do not make it clear where intervention is required.

An important aspect of knowing where your finances are is being able to assess your key targets against a reference point or benchmark. Examples of reference points or benchmarks include year-to-date budgets or year-to-date actuals in previous years.

Two categories of financial reports are statutory reports and management reports.

1. Statutory reports include financial statements, primarily for those interested parties who are external to the business. The production of external or statutory reports is a function called financial accounting. Statutory reports are:
    - Published in annual reports that are submitted to ASIC, provided to shareholders or tabled in Parliament.
    - They are produced for external consumption according to accounting standards.
    - They are subject to external audit by an independent auditor (e.g. the Auditor-General for Government departments).
2. Management reports are produced for internal use by managers who need both financial and non-financial information to develop and implement strategy by planning for the future; making decisions about products and services; and ensuring that plans are put into action and are achieved through requisite control. These three functions are collectively called management accounting which produces management reports. Management Reports are:
    - Usually produced monthly and are provided to cost centre and division managers
    - They are produced for internal consumption to track performance against targets (usually against budget) hence they tend to focus more on revenue and expenses
    - They are tailored depending on the type of organisation and the needs of its decision-makers.

Knowing where your finances are requires quality financial reports that, without ambiguity, show:

- **Financial performance to date against key targets.** In the case of the South Australian Government, this means receiving reports that show:
    - the status of an agency's net operating result (how much revenue and expenditure has been incurred to date)
    - the status of the agency's net lending/borrowing result and
    - the status of the agency's expenditure against its expenditure authority
- **Current financial position** - that is, what are the value of assets and the value of liabilities? Key measures will include the amount of cash held, borrowings and the level of employee provisions.

In addition to clearly reporting key financial targets, a good financial report in the public sector will also include:

- A comparison of the actual with a budget and reporting variances for these key financial targets
- Commentary on key events that have impacted key financial targets that help the reader understand cause and effect associated with variances
- Seeing trend data gives insight into patterns over time and gives insight into causes and effects.
- Access to more detailed data with breakdowns on a transactional basis (e.g. for salaries, different expenses) and breakdowns on an organisational basis (showing the status of targets for divisions, cost centres or projects that make up your business)

Clarity of presentation and accuracy of information is critical to the effectiveness of financial reports in helping us understand the status of our finances.

An example of a layout of a monthly financial report that meets these requirements for an agency is shown below.

As at	**specify month**												
			Month to date				**Year to date**				**End of year**		
All amounts in $'000		**actual**	**budget**	**variance**	**variance as % of budget**	**actual**	**budget**	**variance**	**variance as % of budget**	**projection**	**approved budget**	**variance**	**variance as % of budget**
Revenue													
	Intra govt transfers			0				0				0	
	Commonwealth Revenue			0				0				0	
	Grants and subsidies			0				0				0	
	Fees, fines and penalties			0				0				0	
	Sales of goods and services			0				0				0	
	Interest			0				0				0	
	Internal Agency revenue			0				0				0	
	Other revenue			0				0				0	
Total Revenue		**0**	**0**	**0**		**0**	**0**	**0**		**0**	**0**	**0**	
Expenses													
	Employee expenses			0				0				0	
	Supplies and services			0				0				0	
	Depreciation			0				0				0	
	Borrowing costs			0				0				0	
	Grants and subsidies			0				0				0	
	Intra govt transfers			0				0				0	
	Internal Agency expenses			0				0				0	
	Other expenses			0				0				0	
Total expenses		**0**	**0**	**0**		**0**	**0**	**0**		**0**	**0**	**0**	
Net cost of services		**0**	**0**	**0**		**0**	**0**	**0**		**0**	**0**	**0**	
Remov	depreciation			0				0		0	0	0	
Add	Capital expenditure			0				0					
Net Lending Impact		**0**	**0**	**0**		**0**	**0**	**0**		**0**	**0**	**0**	
Expenditure Authority		**0**	**0**	**0**		**0**	**0**	**0**		**0**	**0**	**0**	

Good financial reporting is necessary at a number of levels in an organisation. For example, with an agency, financial reporting is required for:

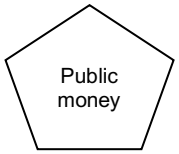
- The entire agency:
  - Executive management reporting – reports delivered to the executive group to inform as to how the whole agency is tracking against budget.
  - End-of-year financial statements and annual reports are also required for the agency.
  - DTF reporting – monthly reporting by the agency on how it is tracking against budget.
- Directorate/division or business reporting to executive directors/General Managers
- Cost centre reporting
- Project & program reporting for project leaders and managers.

Contemporary views in management reporting believe that it is necessary to combine financial reporting with reporting of other key indicators of performance. This has given rise to triple-bottom-line reporting (reporting against financial, environmental and social bottom lines) and to the concept of the balanced scorecard (reporting financial performance along with other key performance indicators like employee turnover and customer satisfaction.

Notes

Estimating & projecting - are you confident in your viability?

Having established that you know your current financial position and financial performance, what level of comfort do you have in your future financial situation? Are you confident that you can continue to operate with a minimum of risk to your financial position?



Planning it

The first level of confidence in viability is in meeting targets for the current financial year. This requires projection and estimation against key financial targets to the end of the financial year.

The second level of confidence in your viability relates to being as sure as you can be about having the capacity to deliver services in the future. This requires projection and estimation from the current year into the future.

It can be false in Government to believe your viability is secure. Many parts of the Government operate projects or programs that are time-limited. It cannot be presumed that they will continue beyond a given time unless steps are taken to secure a future funding source.

If your budget is not consistent with that approved in the Budget by Cabinet, it is not approved!

Government budgets and forward estimates are approved by the Cabinet and Parliament. The budgets for all Government agencies are approved by the Cabinet in the annual budget process. Viability in the public sector can only be assured when each agency/region/unit has a set of forward estimates based on sound assumptions that concur with the forward estimates approved by the Cabinet in the budget process.

The Government maintains forward estimates for four years beyond the current year. Each Government department has an approved set of estimates for the current year and for each of the four years beyond the current year. **Each annual budget process approves changes to these estimates across all years in the forward estimates, not just for the next financial year.**

A key aspect of budgeting is that the onus is on an organisation to ensure that it has a transparent budget that goes out four years, that it is engaged in the budget process and that its budget is adequate to enable the delivery of services (or that the consequences of an inadequate budget are specified in terms of inputs or outputs.). If a business is not viable because of an inadequate budget, the onus is on the business to take all steps possible to get the budget changed by the proper authority (that is, Cabinet approval via the Minister).

For organisations that have a high reliance on fixed assets (that is, their business is focused on assets like roads, buildings or equipment), forecasting and projecting should occur over 10, 20 even 30-year timeframes. This will identify the required maintenance and replacement of assets fundamental to service delivery

Understanding the keys to your viability

Confidence in future viability will be based on the degree of certainty you have over future expenses and revenues. Knowing what the future holds for key sources of income is critical. In Government, because of its ability to tax, it has some control over accessing tax revenue. However, even this revenue is subject to changes in the underlying economy and political circumstances. This demands estimation and projection of key underlying parameters.

With our forecasting, we should attempt to answer two questions:

1. ***What resources do I need to deliver what is expected of me over the next few years?***
2. ***What can I deliver over the next years with the resources that have been allocated to me?***

Where there is heavy reliance on grants or appropriations, viability will depend on the future stability of the grant provider. It is critical for a Government agency to understand the parameters around grant-funded programs or around time-limited programs and projects funded from appropriations.

Where there is heavy reliance on the sale of goods and services in the marketplace there is a need to understand industry dynamics, customer needs and future trends.

In some cases, your delivery of services will rely heavily on property, plant and equipment that you own. In these cases, the health of the property plant and equipment becomes a key to your viability.

Key questions to ask in assessing your viability are:

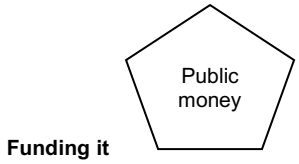
- What will change in the future that will impact on your finances?
- If I continue this way, what will my full-year expenses & revenue be?
- What key factors are likely to change that will change my financial circumstances?
- Do I know my budget for next year and for future years?
- If my budget for future years is changing, what action do I need to take now to deal with that?

Think in terms of tables - can you complete the following table for your directorate, cost centre or project?

	Year 1 $'000	**Year 2 $'000**	**Year 3 $'000**	**Year 4 $'000**	**Year 5 $'000**
Revenue					
Where possible - specify					
Expenses					
Where possible - specify					
Net operating result					
Capital expenditure					
Net lending/borrowing					
Expenditure Authority					

Notes

Budget bidding & allocation - Are decisions rigorous and transparent?



In circumstances where you determine that additional money is required either to ensure your viability or to deliver on a new government program, the process of securing additional public money demands rigour and transparency.

Budget bids and business cases that are poorly structured or that lack rigour and transparency will usually not be approved. If they are approved, they will complicate the reporting and controlling of revenue and expenditure and will complicate future forecasting and estimating because they will create uncertainty regarding financial targets.

How can high standards of rigour and transparency be put in place for the allocation of public money?

It is essential for persons involved in some way in the process of bidding for funds or for reallocation to have an understanding of the overall process by which this happens. The section on the budget cycle will give an insight into how the budget cycle works and what that demands of those involved.

Examples of other steps taken to increase the transparency of decisions include:

- Documentation of the financial implications of budgets and budget decisions – in particular with respect to the financial bottom lines of the government
- Guidelines for the evaluation of initiatives (see Treasurer's Instruction 17)
- Cost-benefit analysis for new initiatives
- Rigorous procurement process around tendering and tender evaluation (refer to State Supply Board guidelines)
- Disclosure of contracts
- Cabinet monitoring of new funding and savings measures.

Example of how rigour can be increased around budget bids and decisions:

- Make underlying assumptions clear
- Don't be afraid to go into detail in documenting assumptions (e.g. number of employees, number of computers, accommodation space, $ cost per square metre of accommodation etc.)

As with the step relating to confidence in viability, think in terms of tables. Use the following table as a template for capturing the budget implications of your initiative.

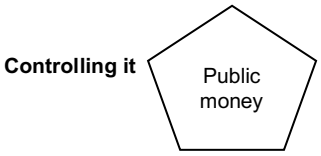
	Year 1 $'000	**Year 2 $'000**	**Year 3 $'000**	**Year 4 $'000**	**Year 5 $'000**
Revenue					
Where possible - specify					
Expenses					
Where possible - specify					
Net operating result					
Capital expenditure					
Net lending/borrowing					
Expenditure Authority					

Many organisations will have budget allocation processes occurring at more than one level. This is true in Government. While there are budget allocation and bidding processes at the whole of

government level, similar processes exist within departments and further they will exist within directorates and across programs. In all cases, some form of prioritisation and decision-making process will be employed. Quality information regarding the impact of decisions on your key financial targets is critical to prioritisation and decision-making at all levels in an organisation.

Notes:

Control & assurance - Do you have adequate control over transactions?



In a large organisation, the processes of ordering and receiving goods, making payments and receiving revenue involve many individuals. These circumstances give rise to a number of risks associated with error or misappropriation.

The fifth element of good financial management is that organisations put in place controls to ensure that error and misappropriation are minimised. This step is also essential to ensuring the previous steps associated with reporting and planning can be conducted with the highest quality data.

Putting in place controls over approval processes and transactions and data provides assurance and increases confidence in information being produced for decision-making.

Understanding transaction processes

Examples of transaction processes in a business include:

- Receipt of cash
- Purchase of goods
- Payment of invoices
- Payment of grants
- Use of credit cards

The first ingredient to having good controls is to ensure that these processes and the approval process preceding these transactions are well documented. This documentation informs where controls are required.

Measures to improve control

Businesses employ audit teams (both internal and external) to provide an independent view of controls within an organisation. In the Government, the Auditor-General provides independent external audit services. Agencies have internal audit teams to identify inadequate controls and to provide advice on improving controls.

Examples of measures that are taken in organisations to improve controls include:

- Systems security and access limits to transactional systems
- Segregation of duties for the handling of cash (e.g. receipting and banking done separately) and in purchasing goods (e.g. certification and approval of invoices conducted by different people)
- Reconciliation of accounts in the general ledger to ensure the movement of monies through accounts can be verified
- Clear and thorough delegations
- Security over cheques
- Guidelines regarding the use of credit card
- Self-assessment checklists
- Purchasing units.

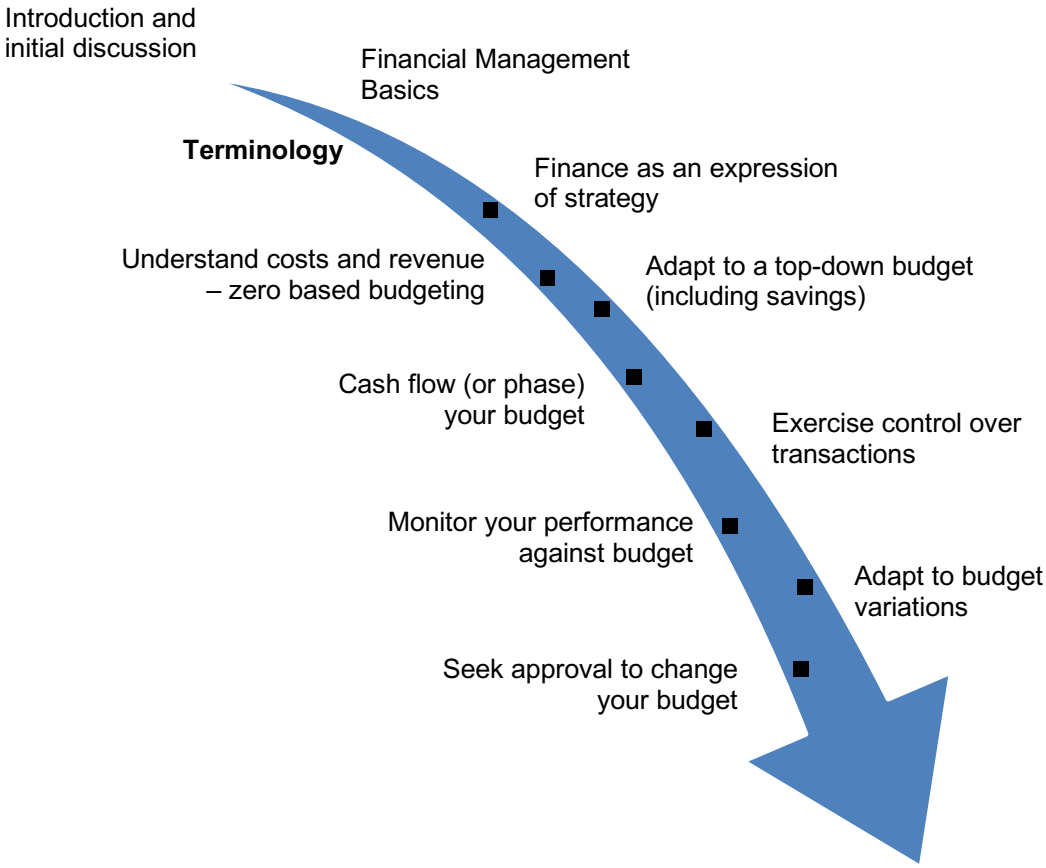
Notes

Transactional cycles

In mature organisations, specific transactions follow agreed procedures and follow their own cycles. As described previously, this is a key element to the control element of good financial management. The table below outlines the cycles followed for key transactional areas.

Examples of transaction cycles are presented below.

Expense types	Requistion/ Order (with approval)	Goods & services change hands	Related information	Approve payment	Post to General Ledger	Pay/Bank	Examples	Comments
Salaries and Wages	Hire person - recognise in CHRIS		timesheets/ flexitime	File generated from Chris - bona fides	Download from Chris	GL file to the Bank		
Grants	receive proposal	evidence of grant conditions being met	specification of grants awarded	by approved delegate different from certifier	object coding included in specification	pay grants	Assistance grants, research grants	Subject to TI 15
Goods and services	Standing orders, major contracts, purchase orders		Invoice specifying goods and services certified and coded	by approved delegate different from certifier	object coding included on the invoice	Cheque or GL file to the Bank	Cleaning contracts, major consultancies, accommodation, stationery	Subject to TI 8, 11
Good and services (with credit cards)	Often includes payment on credit card)		Certified by card holder	By delegate	Transactions allocated to GL codes	Payment to Bank for credit card bill	Travel purchases, special goods	Subject to TI 12
Revenue types	**Requistion/ Order**	**Goods & services change hands**	**Invoicing to customers**	**Cash changes hands**	**related information**	**Post to General Ledger**	**Examples**	**Comments**
Authorisation fees	Retiurn submitted by customer	License approved	approved invoice created by the provider - GL codes entered	Customer pays by cash, credit card, cheque or EFT	remittance advices needed to accompany payments	based on remittance advice	Licensing fees	Invoices require approval from a delegate
Sales of services	order from customer	timesheets and billable hours	approved invoice created by the provider - GL codes entered	Customer pays by cash, credit card, cheque or EFT	remittance advices needed to accompany payments	based on remittance advice	Revenue for consultancy services	Invoices require approval from a delegate



I am more confident in my ability to manage my budget and to work with finance staff in my department.

Terminology

Cash vs. accrual transactions and cash vs. accrual accounting

Differences between cash and accrual accounting are observable at two levels:

1. How they are reported.
2. When transactions are recognised.

With respect to reporting, cash accounting focuses on the source and application of funds, hence the movement in cash balances. However, accrual accounting focuses reports on the financial performance (revenue and expenses) and the financial position (assets and liabilities).

With respect to recognition, timing is the main difference between cash and accrual accounting. When transactions are recognised depends on the accounting method being employed.

Cash accounting recognises the value of a transaction when cash changes hands.

Accrual accounting recognises the value of a transaction when the transfer of the good or service occurs (more specifically, when there is a transfer of value or benefits).

For transactions where the receipt of the good or service occurs at the same time as cash changes hands (e.g. when we buy a sandwich at a café), the recognition of the transaction will be the same under both accounting methods.

However, where there's a time gap between the receipt of a good or service and the handover of cash, the transactions will be treated differently in a cash system vs. in an accrual system.

When there's a time gap between the cash and accrual recognition, it gives rise to items appearing on the statement of financial position such as accounts receivable, accounts payable and provisions. Each is an example of where transactions have occurred, but cash has not changed hands.

Example: Electricity bills are usually paid quarterly (i.e. cash changes hands quarterly) while the electricity is being received and used daily. In an accrual system, expenses will be recognised each month based on a reasonable estimate of electricity used during that month. Every month, this would result in the cost of electricity in a cash system being different to that shown in an accrual system. Over a year, it would be expected that the timing differences would even out and that the results would be similar under each method.

Commitments vs Actuals

Commitments are records of amounts outstanding against purchase orders entered into where the goods or services have not yet been delivered.

They differ from actual spending where goods or services have been delivered.

When recognising actual expenditure by fulfilment of a purchase order, actual expenditure is recognised before payments are made (i.e. before cash is paid)

Revenue is recognised when invoices are issued for work completed and is recognised before cash is received.

Long Service Leave, Superannuation & Annual Leave

Some transactions take years to 'even out'. Long service leave and superannuation are two examples that are the most relevant of such transactions in Government. Each day an employee works, the employer incurs an expense associated with long service leave and superannuation. However, the cash associated with these items will only change hands when an employee takes their long service leave (or receives a lump sum) or when an employee retires. In these examples, the cash transaction will understate the true expenses in most years. Accrual accounting will recognise the long service leave and superannuation expenses when they are incurred at the end of each pay period. This is done by the processing of a journal from the payroll system or by the accounting section within a business.

Long service leave, superannuation and annual leave are good examples of where accrual accounting gives a truer picture of the financial performance of a business. When the expenses in an accrual system are greater than the cash payments, a provision (a liability) must be recognised in the accounts to indicate the value of the cash owed to employees. In the case of superannuation, the government sets aside cash to maintain investment assets at sufficient levels to meet future super payments. The gap between the investment assets and the value of future payments is referred to as unfunded superannuation liabilities. These are the largest liabilities in the SA Government.

Notes

Treatment of asset purchases

Cash and accrual systems also differ in the expensing of major assets. A cash system recognises the cost of an asset as an impact on the cash flow statement when it is bought. An accrual system recognises the cost of an asset as an impact on financial performance, as it is being used. Depreciation is how such an expense is recognised in an accrual system. In accrual accounting, the statement of financial position recognises the value of an asset and offsets this with the accumulated depreciation recognised for the assets.

Example: Purchasing a vehicle for $10,000 at the beginning of the year. The vehicle is estimated to have a useful life of 10 years. Under cash accounting the $10,000 purchase is recognised in the cash flow statement in the year of purchase. However, accrual statements will recognise the use of the vehicle in a year (that is, using straight-line depreciation, 1/10th of the vehicle value is used each year). The accrual statements will recognise a depreciation expense of $1,000 in the first year and an asset with a residual value of $9,000 (that is a purchase value of $10,000 less depreciation of $1,000).

Accrual accounting must be distinguished from commitment accounting. Being committed to future expenditure does not, in all cases, result in the recognition of a transaction. For a future commitment to be recognised in the accounts, there needs to be certainty about its value and its occurrence (e.g. raising a purchase order does not result in the recognition of an expense – a purchase order can be cancelled at any time). Only when future commitments are certain or discharged (i.e. when benefits or value is transferred) is an expense recognised.

Operating vs Capital (or investing) Costs

Company accounts make distinctions between operating costs and capital (or investing costs).

Operating expenses are those expenditures that a business incurs to engage in any activities both directly associated with the production of goods or services and those associated with supporting the running of the business and relationships with customers and suppliers. Some businesses break operating expenses into administrative expenses (indirect costs) and the cost of goods sold (direct costs). The cost of goods sold are costs that are directly associated with the production of goods and services.

Capital (or investing expenditure) is money spent by a business or organization on acquiring or upgrading fixed assets, such as land, buildings, and equipment. That is, it is expenditure that results in the creation of, or the increase in value of, fixed assets.

The Framework for the Preparation and Presentation of Financial Statements defines an asset as:

> *A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.*

The key features are:

- The agency must control the asset.
- There was a past transaction or event which gave rise to the control.
- There must be future economic benefits expected to flow to the agency.

> *An asset is recognised in the balance sheet when it is probable that future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably.*
>
> *An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current accounting period. Instead, such a transaction results in the recognition of an expense in the income statement. This treatment does not imply either that the intention of management in incurring expenditure was other than to generate future economic benefits for the entity or that management was misguided. The only implication is that the degree of certainty that economic benefits will flow to the entity beyond the current accounting period is insufficient to warrant the recognition of an asset.*

In addition to this test of recognition, many organisations will also apply a test materiality. There will be a threshold value for recognition of assets. This means that even though an item of capital may have been purchased that will deliver future benefits, if its value is below the threshold, its value is deemed too small for it to be recognized as an asset and the expenditure is recognised immediately as an expense on the income statement. The Australian Tax Office sets a threshold of $300 for the recognition of an asset.

In Government, agencies have different thresholds. For example, in South Australia, a number of agencies have a threshold of $10,000 for spending to be determined capital investment.

Capital projects are typically assigned a different cost centre code.

Example – Accrual journals and GST?

An accrued expense is an expense that has been incurred but not yet paid.

An expense must be recorded in the accounting period in which it is incurred. Therefore, an accrued expense must be recognized in the accounting period in which it occurs rather than in the following period in which it will be paid.

An example:

In March, a government department seeks delivery of a training program scheduled for June. They raise a purchase order in March.

I deliver a training course to a government department on 25 June at a charge of $1,100, including $100 of GST.

I send the invoice in early July.

A commitment is recognised in March.

The expense of $1,100 was incurred in June against the purchase order and so the agency will process an accrual journal for June that records:

- $1,000 in training expenses
- $100 for GST paid.

It will pay the invoice in July, sending $1,100 to the bank account I specify (i.e. cash changes hands in July).

What happens to the GST?

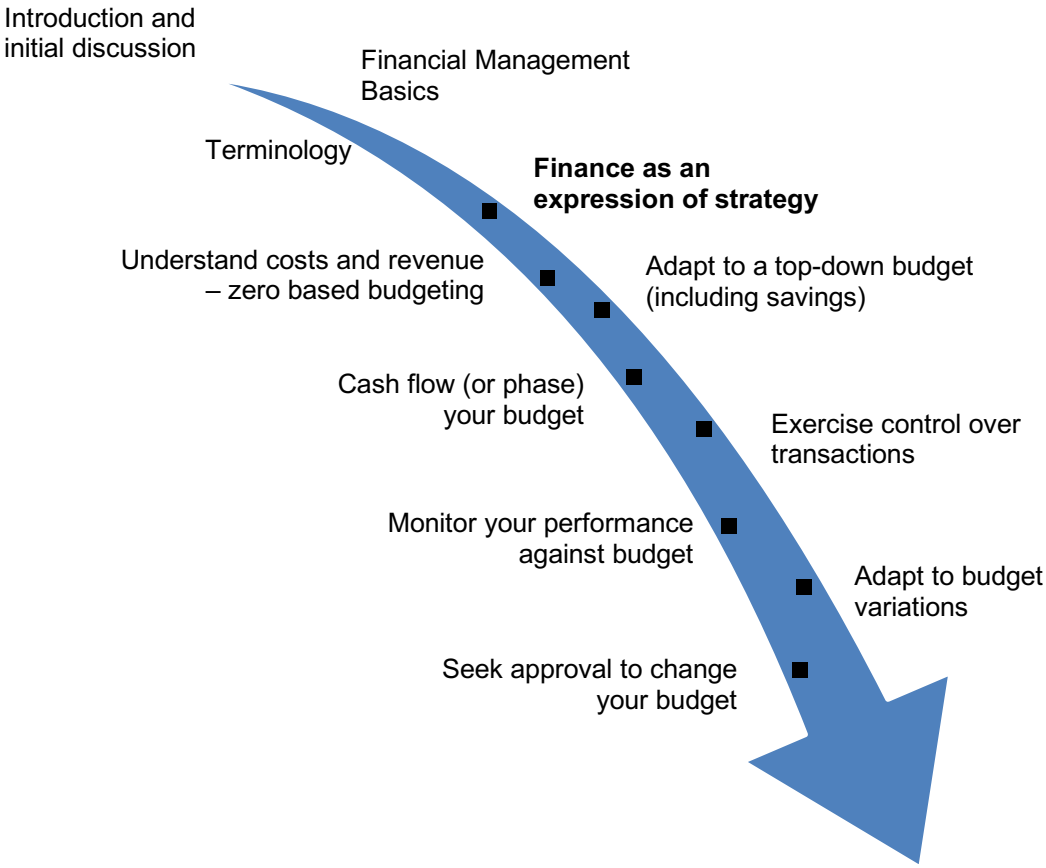
For businesses and government agencies, GST is paid but can be claimed back as an input tax credit.

In the first quarter of the next year, the agency will complete a GST return showing that it paid $100 in GST (to me as the collector of the tax). The tax office will effectively return the $100 back to the department in that quarter.

I will complete my GST return showing that I received $100 in GST and will pay that GST to the Australian Tax Office.

The bottom line for me and the Government is that while the original transaction was charged at $1,100, the cost to the Government was $1,000 and my income is recorded as $1,000.

Therefore, when preparing budgets or costing projects, most government agencies will make their estimates exclusive of GST.



I am more confident in my ability to manage my budget and to work with finance staff in my department.

Finance as an Expression of Strategy

Finances reflect how an organisation keeps count of its value – the value of its revenue and expenses and the value of its assets and liabilities. These will be an indicator of the health of the organisation – it is either creating or sustaining value or it is losing value.

The rationale for the existence of organisations in the public sector is fundamentally different from the rationale for the existence of organisations in the private sector.

DISCUSSION: - How is the public sector different and how would public finances be managed differently?

How would we expect the financial management of a project to differ from the financial management of an operational unit?

Public Sector Differences

Consider the 'means' and 'ends' of different businesses.

Typically, private sector businesses exist to generate profit for their owners and shareholders. Profit is their 'end'. How they go about this is through the provision of goods and services.

For the public sector, this relationship tends to invert. The agencies and departments exist to deliver services, including services that would not otherwise be delivered due to market failures or that are provided to address inequities. The delivery of goods and services is the end. This end is met by attracting funding to support the delivery of goods and services.

This changes the relationship between finances and the strategy of the business.

	Means	**Ends**
Public:	Funding – Attract $	Deliver services/programs
Private:	Deliver services/programs	Profit - Generate $

For a private organisation, the strategy focuses on how the firm can compete better or find unique markets to improve profitability. Finances follow good execution. Customers determine how financially successful you will be.

For public organisations, the strategy focuses on how the organisation scales up or down depending on external needs and the availability of public money. Finances precede delivery. Funders are a primary determinant of financial health.

These relationships impact incentives.

Financial incentives in the public sector are fundamentally different to financial incentives in the private sector. In the private sector, if managers and directors stand to gain from being able to better manage money and produce financial results, budgets are more likely to be devolved to them to harness this. Where managers can own their results and benefit from their results, the circumstances lend themselves to more devolved budgets.

However, in the public sector, there are fewer, if any, personal incentives for managers and as a result there is less flexibility in the way finances are managed. There will still be the need for some 'ownership' of budget parameters. It is the case that if managers do not know the parameters of their budgets and how they have come about, they are less likely to be able to manage their programs or services within these parameters.

Projects vs Operations

Capital budgets are often associated with projects and asset creation. Operating budgets are associated with ongoing business operations and processes. Understanding the distinction between these types of budgets can begin with understanding the difference between projects and processes.

Project	Operations (Processes)
Unique - have not been done like this before	Do the same thing repeatedly
Are time limited with a start date & end date. Projects come and go.	They are ongoing and at the core of the business
Create something new or to implement a change	Create value or deliver outputs by repeatedly performing a task
Project objectives and plans can be changed by whoever gives the approval	Processes can only be changed with significant investment
Projects create change	Standardised processes are usually designed to resist change
Aim to amplify variation or change	Aim to reduce variation

What is a project?

According to the Project Management Institute, a project is "a temporary endeavour undertaken to create a unique product, service or result" and project management is "the application of knowledge, skills, tools, and techniques to project activities to meet the project requirements." Key terms in these definitions are "temporary" and "unique." Projects have defined deadlines with clear start and end points and are designed to be specific to the product or service in question.

Projects are how businesses go about making changes to the way they do business.

Project management has a definite emphasis on achieving the end result.

The unique and temporary nature of projects tends to make them inherently risky and requires significant levels of planning.

What is a process?

A business process or business method is a collection of related, structured activities or tasks that produce a specific service or product (serve a particular goal) for a particular customer or customers.

Processes are not meant to be temporary or unique. Processes are typically designed to be repeatable. Process management involves careful planning and continuous monitoring of the performance of a given process to ensure quality requirements are met. Change, improvement, and re-engineering are all important components of process management. Process management has an emphasis on improving efficiency and improving quality.

Process management tends to focus on consistency, repeatability, reliability and continuous improvement to achieve efficiency. Processes tend to be at the core of how an organisation operates. Business process management activities can be arbitrarily grouped into categories such as design, modelling, execution, monitoring, and optimization.

Implications for financial management

Projects	Operations
Projects will be unfamiliar with budgeting going through different stages and requiring more approvals. Tend to employ zero based budgeting.	Operations are familiar and previous years can serve as the basis for future year budgets. Tend to employ incremental budgeting
Projects will usually be broken down into chunks like activities or milestones. For example, many projects will have work breakdown structures or elements that represent the tasks or activities to be undertaken.	Operational revenue and expenses are usually recorded by transaction type and by cost centres that are aligned with organisational structure.
However, projects can span across financial years and as such need to have expenditure recorded across financial years. Will include inception to date reporting as well as annual reporting	Accounting for operations is typically done in financial years. At the end of financial year, accounts are reset to zero.
Project accounting will also want to record finances by activity or milestone requiring an additional reporting perspective.	Operational revenue and expenses will report variances between actuals and budgets a month at a time.

Projects will therefore require reporting against milestones, the timing of which may change over the life of the project. This can result in a scenario where the budget for a milestone was set for one point in time while the actual milestone was achieved at another point in time. We could therefore be comparing the budget for one month (when a milestone was expected to be achieved) with the actuals for another (when the milestone was achieved).

See Appendix 3 for more details on project estimating and reporting.

Approaches to projecting and budgeting

How we project, budget and forecast will depend on the nature of the organisation or unit in question. Four different approaches to estimating and projecting are presented below:

1. Incremental
2. Zero Based
3. Activity-based
4. Rolling forward estimates

Different Approaches to estimating and projecting

For 'business as usual' functions, because the work being done is familiar and repeated, financial projections and budgets will employ what is known as incremental budgeting.

Incremental Budgeting

Incremental budgeting is the most traditional style of budgeting used. Incremental budgeting involves the rolling over of the previous year's budget into the current year after having made incremental adjustments to reflect changing activity levels, responsibilities or objectives. This has the effect of embedding inefficiencies and can lead to allocation of spending to areas where money has been spent, rather than where it should be spent.

Advantages of incremental budgeting

- The budget is stable and change is gradual.
- Managers can operate their departments consistently.
- The system is relatively simple to operate and easy to understand.
- Conflicts should be avoided if departments can be seen to be treated similarly.
- Co-ordination between budgets is easier to achieve.
- The impact of change can be seen quickly
- Changes to the budget are incremental which enables changes to be tracked over time.

Disadvantages of incremental budgeting

- Assumes activities and methods of working will continue in the same way.
- Few incentives for developing new ideas.
- Few incentives to reduce costs.
- Encourages spending up to the budget so that the budget is maintained next year.
- The budget may become outdated and no longer relate to the level of activity or type of work being carried out.
- The priority for resources may have changed since the budgets were set originally
- Requires the business to maintain processes to identify inefficiencies and improvements.

Zero-based estimating

For projects, the work being done is unfamiliar and uncertain. Financial projections and budgeting will employ what is known as zero-based estimating. Zero-based estimating is an approach in which all expenses are justified for each new period. The process of zero-based estimating starts from a "zero base," and every element of a project or every section in an organization is assessed for its needs and costs. The downside of zero-based estimating is that it is more time consuming and can be too cumbersome for large organisations.

Advantages of Zero-based estimating

- Results in an allocation of resources that is based on needs and benefits
- Provides an opportunity for managers to find cost effective ways to improve operations
- Enables detecting inflated budgets
- Useful for service departments where the output is difficult to identify
- Increases staff motivation by providing greater initiative and responsibility in decision-making
- Identifies and eliminates wastage and obsolete operations.
- When employing this way of budgeting and to ensure that benefits are realised budgets that are developed should be compared back to actual trends for each area of the business.

Disadvantages of Zero-Base Budgeting

- Difficult to define decision units and decision packages, as it is very time-consuming and exhaustive.
- Forced to justify every detail related to expenditure.
- Necessary to train managers. ZBB should be clearly understood by managers at various levels otherwise they cannot be successfully implemented. Difficult to administer and communicate the budgeting because more managers are involved in the process.
- In a large organization, the volume of information may be so large that the process becomes cumbersome. Compressing the information down to a usable size might remove critically important details.
- This process can result in the organisation exceeding approved budgets due to timeframes to develop and assure budgets, divisional areas may commence spending to the inflated budgets.

Activity-Based Estimating

For organisations where finances can be linked with activity, estimates can be based on parameters that indicate that activity. The method requires that activity can be observed and measured and that reasonable estimates of cost per unit of activity can also be measured.

Activity-based estimating is used in the funding models for Health and Education.

Advantages of activity-based estimating

- Allows estimates to be linked with activity and therefore have finances scale up and down
- Provides a line of sight between the finances of an organisation and activity
- Can enable benchmarking of cost per unit of activity to drive efficiency
- Can provide greater certainty to organisations to know the levels of activity they can afford.

Disadvantages of activity-based estimating

- Fixed costs and overhead costs are not easily accommodated in activity-based estimating
- Requires sophistication in the development of cost parameters to maintain the models. In health, there is an industry involved in coding patient data to maintain records of activity and the relative levels of complexity associated with each case
- Activity-based weightings of transactions can be debated
- Subject to averaging methods - average cost per activity and will create debate on how to deal with outliers or cases that are not average.

Rolling forward estimates

A variation on incremental budgeting where estimates are established for multiple years (in government these are referred to as the forward estimates). Estimates are established for multiple years (usually using an incremental method) and each year a new year is added at the end of the forward estimates. That year can be referred to as a horizon year.

Each year in the budget process, participants put forward submissions or bids to add to their forward estimates or savings can be sought from participants that act to subtract from their forward estimates.

This method of forward projecting is used for the budgets of state governments and the federal government in Australia.

Advantages of rolling forward estimates

- Provides medium to long-term clarity about financial projections and facilitates longer-term thinking about the direction of a business
- Is relatively straightforward to administer.
- Provides the ability to track historical changes.
- Supports staffing planning.

Disadvantages of rolling forward estimates

- The cumulative impacts of savings and initiatives can be masked and therefore require the budget to be maintained at levels that reflect the business operation.
- Require more sophisticated budget management systems.
- As with incremental budgeting – this method can embed inefficiencies.

Our approach to budgeting (our budget process) will look at how we manage our projections and budgets in an environment where the amount we are provided from a top-down budgeting process differs from the budget constructed from the bottom up.

Public sector finances use a mixture of these methods.

- At a whole of government level, the rolling forward estimates approach is used.
- At an agency level, funding models using both activity-based methods and incremental methods are used.
- Within departments for ongoing operational teams, incremental budgeting will be employed
- Within agencies, zero-based budgeting will be employed to produce estimates for new projects and bids and to review the finances of operational teams.

For **large multifaceted organisations**, preparing budgets and projections will require a combination of 'top-down' methods as well as 'ground-up' approaches that will demand consolidation of estimates.

Large multifaceted organisations and funding models

Many governments will have financial systems that devolve responsibility to portfolio ministers and departments to manage a global budget in delivering certain agreed outputs, programs and projects, which in turn are aligned with departmental objectives. Each department will have a Funding Model.

A **funding model** is a mechanism, usually for non-profit organisations, to determine the basis for how different sources of funding will be allocated to the organisation based on its activities or the outputs that it produces and estimates of costs of these activities and outputs.

As examples:

- A health funding model will detail the parameters for how funding is allocated based on the numbers and types of patients treated and the average cost of treating patients
- An education funding model will detail the parameters for how funding is allocated based on the numbers and types of students enrolled and the average cost of teaching those students.

These funding models support a 'top-down' approach to budgeting that is based on organisational parameters like the number of students and average costs per student that will have been developed based on history and based on benchmarking with other jurisdictions.

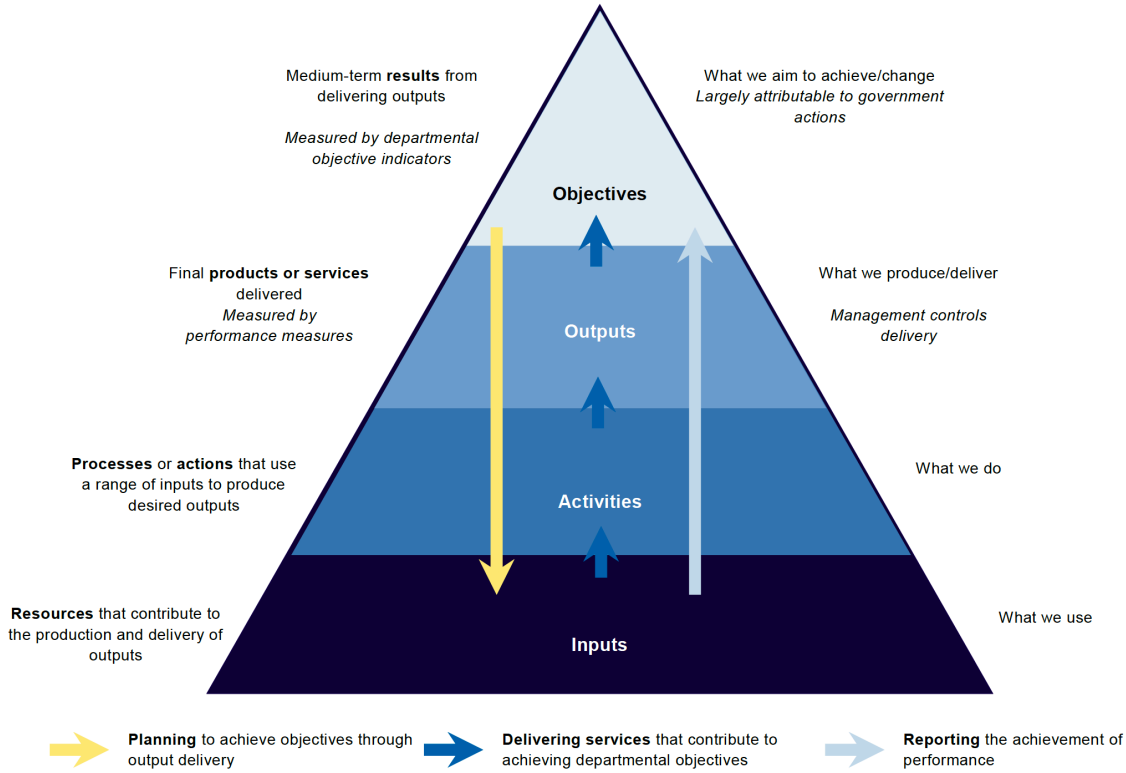
In health, hospital funding models are linked with a National Efficient Price that reflects the costs of delivering a range of health services across Australia.

Projecting and budgeting in large organisations will see:

- The need for a budget process to guide the involvement of others in the process.
- The use of funding models
- The need to consolidate estimates.

The concept of a funding model is applied in the Victorian Performance Management Framework. That framework refers to the need to link objectives with outputs. An excerpt from the Victorian Resource Management Framework is presented below.

Figure 6: Performance management concepts



Logic models like this are also used to help understand the business or operating model of an organisation.

A Business Model Approach

Your strategy is how you choose to go about your business. It is your approach to answering questions about what you do, how you do it, who you do it for and why you do it.

Understanding finances provides insight into aspects of our business model.

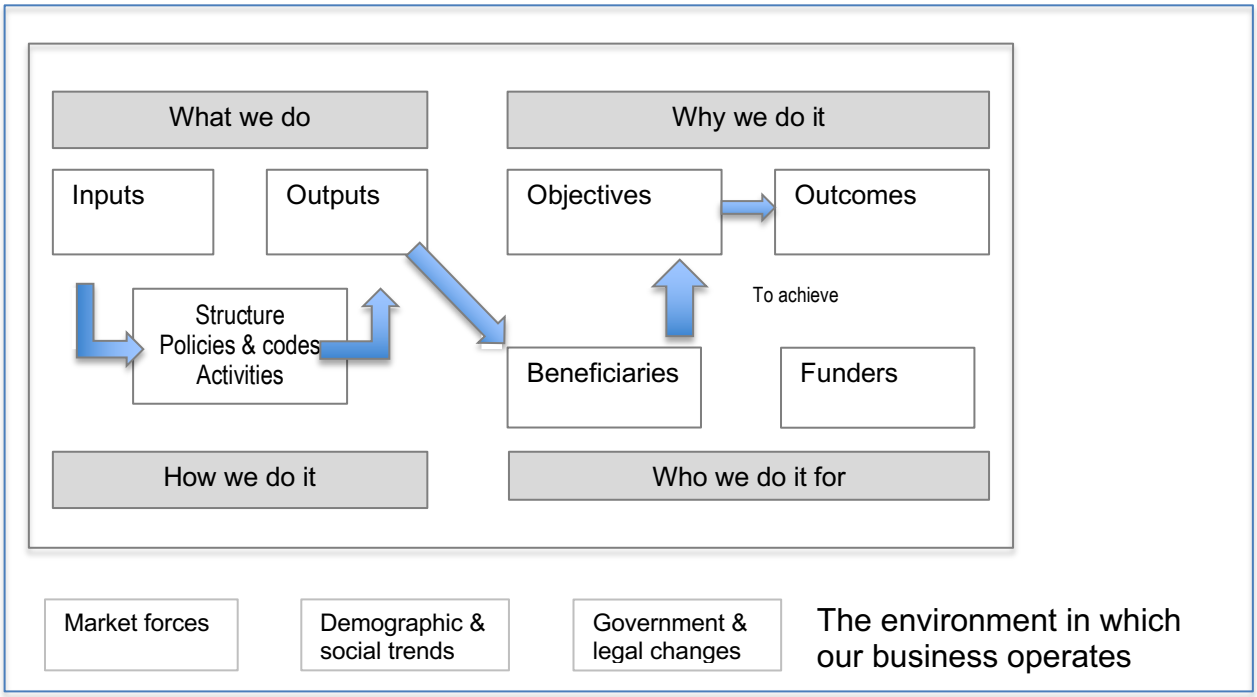
A business model can be defined as:

> *"A business model refers to the logic of the firm, the way it operates and how it creates value for its stakeholders.*
>
> *Strategy refers to the choice of business model through which the firm will compete in the marketplace."*

Casadesus-Masanell, R., & Ricart, J.E. (2010). Strategy to Business Models and to Tactics. *Long Range Planning, 43* (2), 193-215.

> *"A business model describes the rationale of how an organisation creates, delivers and captures value."*
>
> Osterwalder, A., & Pigneur, Y. (2010). *Business Model Generation: A Handbook for Visionaries, Game Changers, and Challengers.* New Jersey: John Wiley & Sons.

Consider the business model below that presents the logic of an organisation in terms of what it does, how it does it, who it does it for and why it does it.



Components of a Business Model

What the business does:

- Converts inputs (people, goods and services, technology, assets)
- Into outputs (products and services)

How the business does it?

- Organisation structure - How authority is exercised and people are structured
- Policies and Codes (of conduct & practice) – how activity and behaviour are guided by values, rules and codes.
- Activities:
  - Processes - series of actions or steps taken to produce a good or service
  - Projects - individual or collaborative enterprises that are carefully planned to achieve specified objectives
  - Programs - temporary flexible organisation structure created to coordinate, direct and oversee the implementation of a set of related projects and activities
  - Workmanship & know-how – skill development and experience of staff and suppliers
  - Marketing – links made between the business and its markets
  - Support functions - HR, Finance, and IT designed to support teams.

Who is involved?

- Employees – staff employed by the business to make it work
- Suppliers – goods or services purchased through contract, including contractors
- Beneficiaries – those who benefit from the goods and services produced
- Funders – those who pay to sustain the business (if a funder is also a beneficiary, they are a customer)
- Owners – those who contribute capital and then receive returns (dividends)
- Financier – lenders that expect interest and repayments.

Why?

- Purpose – visions, goals and aspirations of the business or team
- Objectives – A specific result that a person or system aims to achieve within a time frame
- Outcomes – the consequences of our work – the longer run (ultimate) impact we are trying to have.

The combination of answers to these questions starts to define the business model of an organisation. The elements of a business model can provide insight into the finances, in particular, the financial performance of an organisation. Input and activities will incur costs, while outputs can generate revenue as can our relationship with our funders.

Understanding our business model can then help to identify what aspects of the model can change in the face of financial information that suggests the business is not performing to the standard required.

Context - The Public Sector

<table>
<tr><td colspan="3">Total Public Sector</td></tr>
<tr><td colspan="2">Non-Financial Public Sector</td><td></td></tr>
<tr><td>General Government Sector

Examples:
• Education
• Health and Wellbeing
• Attorney General's
• Premier & Cabinet
• DEW
• PIRSA
• DIT</td><td>Public Non-Financial Corporations
Examples:
• SA Water
• Public Trustee
• Adelaide Venue Management
• Renewal SA</td><td>Public Financial Corporations
Examples:
• SAFA
• Return to Work SA
• Homestart
• Funds SA</td></tr>
</table>

The public sector consists of three types of businesses:

1. General Government – businesses with non-income earning assets

   The General Government sector consists of departments, offices and other entities engaged in providing public goods and services free of charge or at prices significantly below their cost of production. In these businesses, assets (schools, hospitals, roads, art galleries etc.) exist to deliver services, not to generate income.

   In South Australia, this is the budget sector. If your agency or business is part of the general government sector, then all expenses and revenue incurred by your agency and administered by your agency impact on the state budget.

2. Public non-financial corporations (public trading enterprises) – businesses with physical assets that generate income

   Public trading enterprises are organisations primarily engaged in the production of goods and services for sale in the marketplace at prices that aim to recover most of the costs involved.

   This sector includes some trading enterprises such as SA Water, Forestry SA and the Housing Trust. The assets of these businesses (housing, buses, the entertainment centre, the festival centre etc.) exist to deliver services and generate income.

3. Public financial corporations – businesses with financial assets that generate income

   Public financial enterprises are organisations primarily engaged in providing financial intermediation services. These enterprises are trading in financial services and products like loans, deposit facilities and liability management. In these businesses, assets (loans and investments) back liabilities (borrowings). Assets and liabilities are closely linked and are considered together in the management of risk and the generation of income.

References: **www.abs.gov.au**

Incremental budgeting - The SA Government's approach to budgeting

The more sophisticated and larger an organisation, the more difficult it is to realise the benefits of zero-based or activity-based budgeting. In these circumstances, the cost of these methods will usually outweigh their benefits. The South Australian government is a large and complex entity. The sheer number of decisions required to frame a budget demands that the government use incremental budgeting in its approach to the state budget.

The budget cycle is the process by which the government develops, approves and presents the annual state budget (in non-election years).

	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July
Whole of Government		Preliminary planning for the next financial year		Information gathering by DTF		Cabinet Strategy meeting		Bilateral meetings	Cabinet sub committee/ Minister meetings	Cabinet approval	Preparation of the budget	Budget and Estimates Committees	
Minister and Department		Preparation of cost pressures and budget bids					Refining of budget bids	Bilateral meeting documents	Prepare meeting documents		Prepare budget documents & allocate budgets to divisions	Estimates committee document preparation	
Internal		Preliminary planning for the next financial year - preparation of budget bids					Refining of budget bids		Directorate bilateral meeting	Program information for budget documents		Finalise planning for the next financial year	Load budgets to the General ledger

The budget process starts using the previous year's budget as the starting point. At this point, each department in the government has a set of forward estimates for the current year and 4 forward years.

The budget cycle begins with the initial preparation and prioritisation of cost pressures and known policies and bids in the period leading up to and including December. Budget bids represent the amounts by which each agency wishes to change its starting point budget. This initial phase culminates with a Cabinet meeting that sets the financial strategy and targets for the budget and does preliminary prioritisation of bids.

Notes

In the period between January and April, further refinement, prioritisation and negotiation of initiatives occur, including negotiation of priorities with Ministers (in bilateral meetings and meetings with a Cabinet Subcommittee). This phase culminates in the approval of the budget by the Cabinet in April each year. All amendments to this approved budget for each department (both for controlled and administered items) must be approved by the Cabinet.

In parallel with and following the approval of the budget by the Cabinet, preparation of budget documentation is occurring. This involves the production of portfolio statements (primarily by departments), budget documents (by Treasury and Finance) and media statements and press releases (by Ministers in conjunction with departments). The budget is normally tabled on the first or second Thursday of June.

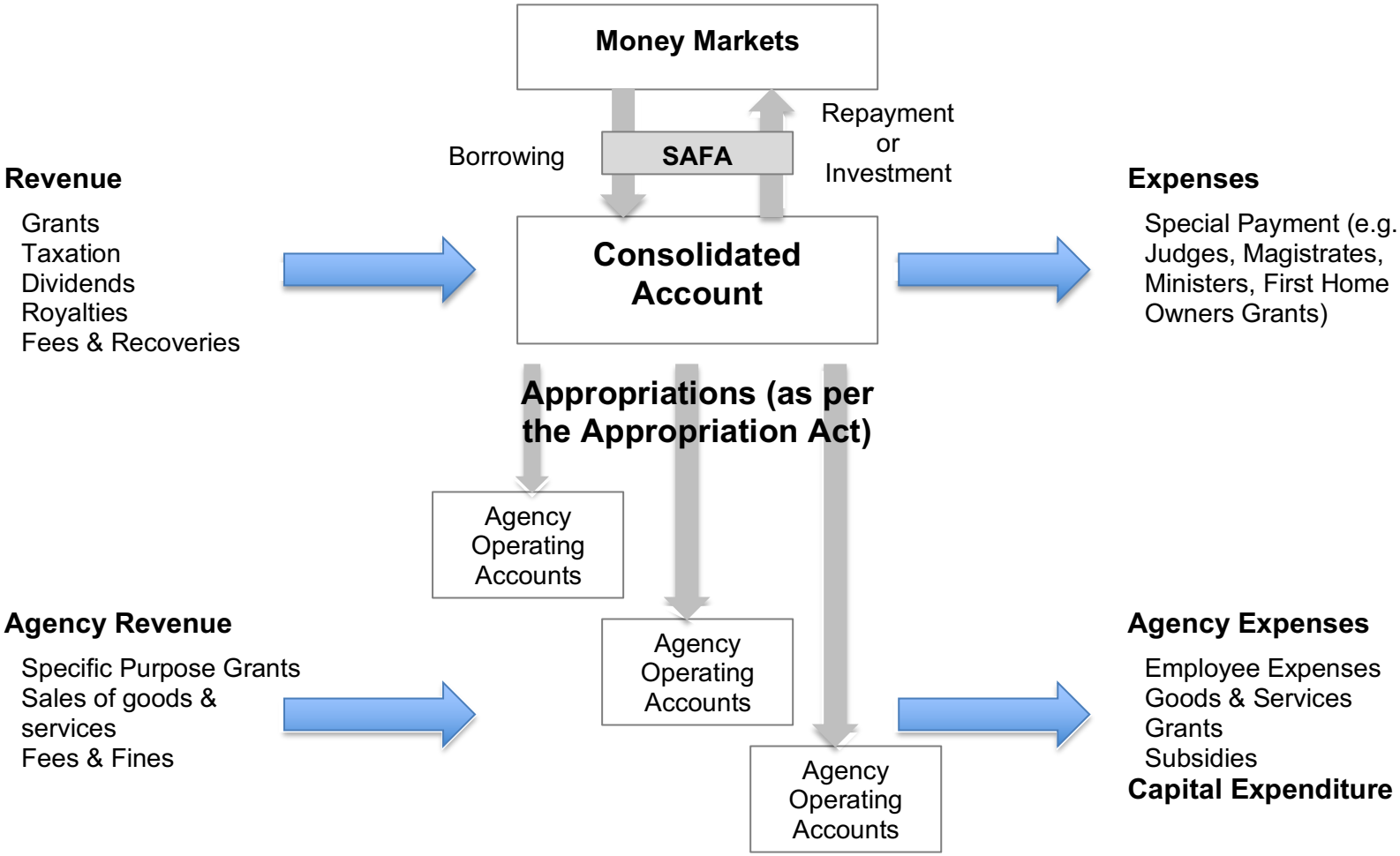
In election years, the cycle can be delayed for two to three months from March onwards.

Agency internal budget processes

Many agencies conduct their own budget and prioritisation processes in conjunction with the process above. Examples include the prioritisation of agency bids to be submitted to Treasury and Finance and the prioritisation of the allocation of capital expenditures within the agency.

The SA Government's financial system

The flow of money around the SA Public sector is presented below. It shows the relationships between revenues and expenses of the government, the accounts into which funds flow and the reliance on appropriations to Government agencies.



Appropriation bill

Appropriation Bill 2022
Amounts proposed to be expended from the Consolidated Account during the financial year ending 30 June 2023—Schedule 1

Appropriation—Estimates of 2022–23	Estimates
Defence SA	$13 499 000
Department for Child Protection	$718 676 000
Department for Correctional Services	$370 762 000
Department for Education	$3 092 779 000
Administered Items for the Department for Education	$189 683 000
Department for Energy and Mining	$103 713 000
Department for Environment and Water	$153 141 000
Administered Items for the Department for Environment and Water	$30 937 000
Department for Health and Wellbeing	$4 814 787 000
Department of Human Services	$982 620 000
Administered Items for the Department of Human Services	$231 162 000
Department for Infrastructure and Transport	$809 577 000
Administered Items for the Department for Infrastructure and Transport	$6 293 000
Department for Innovation and Skills	$376 148 000
Administered Items for the Department for Innovation and Skills	$13 365 000
Department of the Premier and Cabinet	$377 085 000

2024-25 budget numbers

Table A.1
General government sector operating statement ($million)

	2023-24 Estimated Result	2024-25 Budget	2025-26 Estimate	2026-27 Estimate	2027-28 Estimate
Revenue					
Taxation revenue	6,412	6,650	6,907	7,167	7,452
Grants - GST	8,744	8,942	9,446	9,653	9,621
Grants - Other	6,544	7,022	7,446	8,041	8,406
Sales of goods and services	3,226	3,405	3,504	3,678	3,787
Interest income	453	464	389	402	413
Dividend and income tax equivalent income	438	298	332	278	294
Other	1,667	1,791	1,809	1,825	1,848
Total Revenue	**27,484**	**28,572**	**29,833**	**31,046**	**31,822**
less					
Expenses					
Employee expenses	10,179	10,472	10,858	11,160	11,506
Superannuation expenses					
Superannuation interest cost	306	290	269	247	223
Other superannuation expenses	1,142	1,211	1,294	1,327	1,368
Deprecation and amortisation	1,643	1,620	1,687	1,796	1,874
Interest expenses	1,210	1,486	1,598	1,859	2,116
Other operating expenses	8,720	9,184	9,643	9,945	10,074
Grants	3,978	4,061	4,026	4,142	4,257
Total Expenses	**27,178**	**28,323**	**29,375**	**30,477**	**31,419**
Equals					
Net Operating Balance	306	248	458	568	403
Plus					
Other Economic Flows	273	287	197	282	536
Equals					
Comprehensive result - Total change in net worth	579	536	655	851	940
Net operating balance	**306**	**248**	**458**	**568**	**403**
Less					
Net Acquisition of non-financial assets					
Purchases of non-financial assets	3,267	4,495	4,839	5,752	5,719
less Sales of non-financial assets	312	73	65	61	63
less Depreciation	1,643	1,620	1,687	1,796	1,874
plus Change in inventories	0	0	0	0	0
***Equals* Total net acquisition of non-financial assets**	**1,312**	**2,801**	**3,087**	**3,895**	**3,782**
Net lending/borrowing	**-1,006**	**-2,552**	**-2,630**	**-3,326**	**-3,379**

Note: totals may not add due to rounding

Source: SA Government 2024-25 Budget Statement

Table: South Australia State General Government Expenses by Purpose

	2012-13 $m	2022-23 $m	2012-13 Share %	2022-23 Share %
General public services				
Public debt transactions	702	955	4.6%	4.2%
Other general public services	416	1,008	2.7%	4.4%
Total general public services	*1,117*	*1,963*	*7.3%*	*8.6%*
Public order and safety				
Police services	732	984	4.8%	4.3%
Civil and fire protection services	226	378	1.5%	1.6%
Law courts, prisons and other public order and safet	558	887	3.6%	3.9%
Total public order and safety	*1,516*	*2,248*	*9.9%*	*9.8%*
Economic affairs	511	815	3.3%	3.5%
Environmental protection	296	523	1.9%	2.3%
Housing and community amenities	368	381	2.4%	1.7%
Health				
Medical products, appliances and equipment	13	120	0.1%	0.5%
Outpatient services	237	613	1.5%	2.7%
Hospital services	4,230	5,455	27.5%	23.8%
Community health services	261	929	1.7%	4.0%
Public health services	155	676	1.0%	2.9%
Other health	191	271	1.2%	1.2%
Total health	*5,087*	*8,065*	*33.1%*	*35.1%*
Recreation, culture and religion	260	485	1.7%	2.1%
Education				
Pre-primary, primary and secondary education	2,855	3,990	18.6%	17.4%
Tertiary education	644	495	4.2%	2.2%
Other education	45	60	0.3%	0.3%
Total education	*3,544*	*4,546*	*23.0%*	*19.8%*
Social protection	1,701	2,516	11.1%	11.0%
Transport				
Road transport	398	735	2.6%	3.2%
Railway transport	189	257	1.2%	1.1%
Other transport	397	426	2.6%	1.9%
Total transport	*985*	*1,418*	*6.4%*	*6.2%*
Total Expenses	**15,385**	**22,959**	**100.0%**	**100.0%**

Carryovers

Carryovers relate to a delay in expenses associated with a project or program causing it to slip into a future financial year. Carryover approval is required when the budget for that future financial year cannot accommodate the additional expenditure spilling over from previous periods.

A bid for a carryover in the SA Government is a bid for additional expenditure.

The Cabinet determines the highest priority use of all government funds. Authority for agency expenditure is granted through the Cabinet and budget processes and includes authority for both state-funded and externally funded projects. Only expenditure included in an agency's budget and forward estimates approved by Cabinet and maintained and published by Treasury and Finance, on behalf of the Government, is deemed to be authorised.

The Cabinet's approval for expenditure is specific to financial years. A change in the timing of agency expenditure requires approval from the Cabinet. Even though a program or project has been previously approved by Cabinet the deferral of expenditure into different years requires Cabinet approval to be sought again.

The carryover process is part of the budget process coordinated by Treasury and Finance on behalf of the Cabinet. The carryover process applies to all agency expenses (controlled and administered, state-funded and externally funded) and occurs at two points in the budget process:

1. Following the completion of a financial year

   At the end of a financial year agencies become aware of expenditure delays that had not previously been expected. That is, there will be an unexpected deferral of expenditure from year A into year B. Cabinet policy requires that agencies seek and receive approval for additional expenditure authority in year B.

   This process usually occurs between August and October following the end of the financial year and is overseen by the Expenditure Review and Budget Committee of Cabinet (ERBCC).

2. In the lead-up to the budget

   In the lead up to the budget, agencies become aware of expenditure that is likely to be deferred from the current financial year into the next financial year. Cabinet policy requires that agencies seek and receive approval for an increase in expenditure authority in the next financial year(s) for these carryovers.

   This process occurs as part of the budget bidding process and the development of forthcoming financial year budgets. It usually occurs in the period between February and April.

The approval of a carryover requires evidence that the deferred expenditure is still necessary either due to policy commitments or contractual commitments. If these cannot be adequately demonstrated, approval for the carryover expenditure is unlikely to be provided.

The availability of cash balances does not represent approval for expenditure in a time period outside that approved. Approval for changing the timing of expenditure cannot be presumed.

The Treasurer would generally not recommend approval of any carryover of under-expenditure that falls outside the following five categories:

1. Approved major investing projects that have been delayed (excluding annual programs)
2. Commonwealth-funded programs with unspent balances
3. Other joint State Government/external party agreements with unspent balances
4. Committed grant programs with unspent balances (possible from early receipts of funding) and
5. Expenditure specifically tied to a particular source of revenue for which there are unspent balances.

This process further reinforces the need for good reporting and good forecasting and projecting of expenditure.

Early communication of delays or accelerations of revenue and expenses to your agency's finance section is essential to assisting the department in participating fully in carryover bidding processes.

Notes

Managing Budgets and Financial Plans

Managing a budget at a cost centre level involves being able to:

- Understand your costs and revenues
- adapt to being issued a top-down budget, that is lower than a zero/activity-based budget
- cash flowing the approved budget
- exercise control over transactions
- monitoring performance against budget during the year
- adapting to unfavourable variations that occur during the year
- seek approval to change our budget - developing a business case or budget bid to influence the top-down budget.

We will work through each of these elements using our case study.

Following are some known facts about the program and its budget:

- The program runs 20 houses.
- It is assumed that each household will consist of two adults and two children.
- Families will use our accommodation for up to four weeks.
- While staying in the department house, all living costs will be covered by the department and a contribution towards moving costs will also be made.
- Each household will have access to a car that will be owned by the Department.
- Our department already owns the houses and the cars, and each house is furnished with basic furniture and white goods (i.e. no capital budget is required).
- It is envisaged that one case manager would be needed to oversee four houses.

Understand your costs & revenues - Zero based & activity-based budgeting

For a new program like that in our case study, we will employ zero-based estimating.

Developing zero-based estimates occurs in three steps:

1. Identify as many expenses and revenues as possible for the revised initiative, program or project
2. Document assumptions to make estimates of revenues and expenses transparent
3. Populate a table showing all revenues, expenses and budget impacts for the item.

Identifying revenues and expenses

This step requires that we look at the various activities and transactions that will be undertaken by this division to understand the types of revenues and expenses that it will incur.

As a minimum, we should identify the categories of revenues and expenses as per the categories shown below. This process will enable us to eliminate a number of revenue and expense categories.

Revenue

- Intra-Government transfers
- Commonwealth revenue
- Grants and subsidies
- Fees, fines and penalties
- Sales of goods and services
- Interest
- Other revenue
- User fees and charges

Expenses

- Salaries and wages
- Depreciation
- Supplies and services
- Grants and subsidies
- Internal expenses
- Borrowing costs
- Other Government expenses
- Other expenses

To develop a useful budget, it is necessary to be more specific with our expense breakdowns. It is useful to think of the different supplies and services that we will be using. Examples will include office supplies, accommodation, travel, facilities hire, software etc.

Where possible, avoid categorising budget estimates as other expenses or miscellaneous expenses. Doing so will create variances when it comes time to report actuals against the budget.

The table below lists different items we need to budget for.

Input/Activity	Assumptions				Estimate cost
	Quantity	Unit Price	Growth	Timing	
		$			$

Making assumptions

Having identified the types of revenues and expenses that relate to this division, the next step is to make some assumptions about each of these to develop budget estimates.

Work on the most material items first – this will ensure rigour around the majority of the budget.

Examples of the type of assumptions for salaries and wages will be:

- The number of employees
- Their classification
- On-costs

Examples of supplies and services will be:

- Accommodation – lease cost per square metre, number of square metres (this will usually depend on the number of people)
- Travel – number of trips, average cost per trip, average accommodation cost per trip, average meal and incidental cost per trip.
- ICT – there is usually an average cost per employee for computers and mobile phones. Assuming leased computers, the cost will usually be around $1,000 per annum per

computer (for more sophisticated computers the cost will be higher) and for mobile phones, the cost will usually be around $1,000 per annum including calls.

- More specific supplies and services can be estimated by getting quotes from suppliers or based on recent experience in similar projects.

Where possible, avoid categorising budget estimates as other or miscellaneous. Doing so will create variances when it comes time to report actuals against the budget.

This exercise is focused on the transparency of estimates. It is not always possible to accurately predict the future and get estimates right. However, it is possible to make them, and the basis for making them, clear to others so that when the actual transactions differ from the budget, we have some detail to explain the differences.

For our case study, start by listing inputs or the activity base for our Migrant Housing Budget. It is recommended that these, and the assumptions associated with them, be documented using a table similar to that below:

Having documented our assumptions, we can now develop a budget, using various expense categories to generate the total cost for a household and the program.

Using this information, we can produce estimates for the first year of our five-year period. From this, we can estimate the forward estimates by making assumptions about growth across years. **For example**, we can assume:

- Salaries and wages grow by 2% and
- Goods and services growth by 2.5%,

Building a salaries budget

Identify staff requirements – number of staff and classification of staff. Where possible link staffing requirements with measures of activity, output or outcome.

Details the assumptions about staff classifications.

Based on the classifications, identify the base salary level for each position

For each position, apply assumptions for on-costs.

Labour Oncost Breakdown – Example

Superannuation	12.00%
Payroll Tax	5.00%
Long Service Leave	4.00%
Maternity Leave	0.50%
Insurance (e.g. workers comp)	0.20%
Leave Loading	0.30%
Total	**22.00%**

These calculations become more complex for services that operate outside of normal working hours and where staff are working shifts and out-of-hours rosters. For example, if when staff take leave, their positions need to be filled to enable continuity of service, estimates need to be made of the 'backfilling' requirements for a position. An example of a backfilling calculation is presented below.

Backfill calculations

			Hours
Full year	52	38	1,976
Annual leave	4	38	152
Public Holidays	10	7.6	76
Available work time			**1,748**
Sick leave	10	7.6	76
Work time after sick leave			**1,672**
PD time	3	7.6	23
Estimated average work time			**1,649**
Gap between full year & est work time			327
Extra FTE required per FTE			**0.20**

Building a goods and services budget

Categories for non-salary expenses will include:

- Staff related costs:
    - Training
    - Uniforms
    - Mobile phones
    - Car leases
- Vehicles (aside from staff-related leases)
- Accommodation related expenses
    - Leases
    - Utilities
- Technology related expenses
    - Computers
    - Software and applications
    - Networks and cabling
    - Printers and other devices
    - Website management
- Services
    - Legal
    - Insurance
    - Freight
    - Storage
- Travel related expenses
    - Accommodation
    - Airfares
    - Car hire and taxis
    - allowances
- Asset related expenses
    - Maintenance and support
    - Repairs
    - Parts
    - Specialist equipment
- Event-based expenses
    - Marketing
    - Venue hire
    - Catering
    - Security

Some departments collect information on commitments and contracts to gather much of this information as part of their zero-based budgeting.

Below is an example of a salaries build or staff establishment.

					Allowances (if applicable)					On costs				
Positions required	**# FTE**	**Class**	**Annual Rate**	**Salary before allowances**	**Penalties**	**Public Holidays**	**Variable**	**Leave loading**	**Salary after allowances**	**Long Service Leave**	**Payroll tax**	**Super**	**Workers compensation insurance**	**Salary after allowances & on costs**
					0.00%	***0.00%***	***0.00%***	***0.00%***		***3.50%***	***5.75%***	***12.00%***	***0.75%***	
Core positions														
Program Manager	1.00	ASO6	100,000	100,000	0	0	0	0	100,000	3,500	5,750	12,000	750	122,000
Case Manager	1.00	ASO4	75,000	75,000	0	0	0	0	75,000	2,625	4,313	9,000	563	91,500
Case Manager	1.00	ASO4	75,000	75,000	0	0	0	0	75,000	2,625	4,313	9,000	563	91,500
Case Manager	1.00	ASO4	75,000	75,000	0	0	0	0	75,000	2,625	4,313	9,000	563	91,500
Case Manager	1.00	ASO4	75,000	75,000	0	0	0	0	75,000	2,625	4,313	9,000	563	91,500
Case Manager	1.00	ASO4	75,000	75,000	0	0	0	0	75,000	2,625	4,313	9,000	563	91,500
Sub total				***475,000***	***0***	***0***	***0***	***0***	***475,000***	***16,625***	***27,313***	***57,000***	***3,563***	***579,500***

Version with allowances and backfill

					Allowances (if applicable)					On costs				
Positions required	**# FTE**	**Class**	**Annual Rate**	**Salary before allowances**	**Penalties**	**Public Holidays**	**Variable**	**Leave loading**	**Salary after allowances**	**Long Service Leave**	**Payroll tax**	**Super**	**Workers compensation insurance**	**Salary after allowances & on costs**
					15.00%	***3.00%***	***2.00%***	***2.00%***		***3.50%***	***5.75%***	***12.00%***	***0.75%***	
Core positions														
Program Manager	1.00	ASO6	100,000	100,000	15,000	3,000	2,000	2,000	122,000	4,270	7,015	14,640	915	148,840
Case Manager	1.00	ASO4	75,000	75,000	11,250	2,250	1,500	1,500	91,500	3,203	5,261	10,980	686	111,630
Case Manager	1.00	ASO4	75,000	75,000	11,250	2,250	1,500	1,500	91,500	3,203	5,261	10,980	686	111,630
Case Manager	1.00	ASO4	75,000	75,000	11,250	2,250	1,500	1,500	91,500	3,203	5,261	10,980	686	111,630
Case Manager	1.00	ASO4	75,000	75,000	11,250	2,250	1,500	1,500	91,500	3,203	5,261	10,980	686	111,630
Case Manager	1.00	ASO4	75,000	75,000	11,250	2,250	1,500	1,500	91,500	3,203	5,261	10,980	686	111,630
Sub total				***475,000***	***71,250***	***14,250***	***9,500***	***9,500***	***579,500***	***20,283***	***33,321***	***69,540***	***4,346***	***706,990***
Backfill positions (if required)														
Case Managers	0.99	ASO4	75,000	74,309	11,146	2,229	1,486	1,486	90,657	3,173	5,213	10,879	680	110,601
Total	**6.99**			**549,309**	**82,396**	**16,479**	**10,986**	**10,986**	**670,157**	**23,455**	**38,534**	**80,419**	**5,026**	**817,591**

Way of allowing for contingencies in our budgeting:

- An explicit Contingency line within unit/project budgets - this approach is applied as a standard in building projects where a budget is set aside for risks like not knowing what is under the ground.
- Parameter contingencies where we include conservative estimates for contingencies (e.g. fuel prices) that make some allowance for increases.
- Insurance – the most common way to financially manage uncertainty is to outsource it through an insurance policy.
- Organisational contingencies – instead of allowing for contingencies against specific projects or programs, some organisations will hold an organisational contingency that is available for units or teams to access should an unexpected event occur.

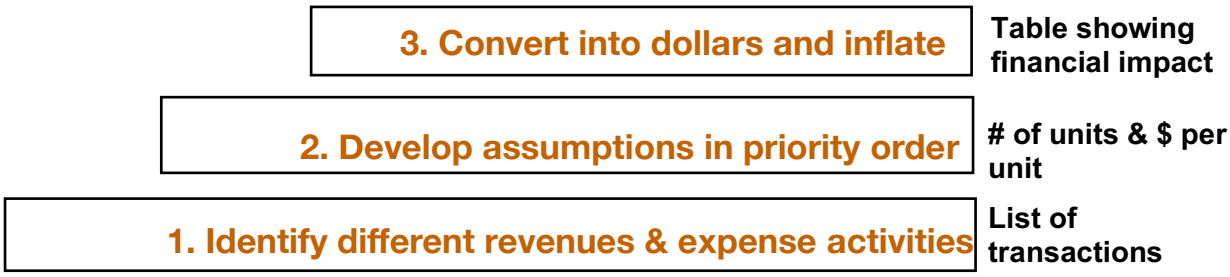
	Year 1 $'000	Year 2 $'000	Year 3 $'000	Year 4 $'000	Year 5 $'000
Revenue Where possible - specify					
Expenses Where possible - specify					
Net operating result					
Capital expenditure					
Net lending/borrowing					
Expenditure Authority					

Conclusion

Rather than focus on whether a budget is right or wrong, it is more productive to focus on the quality of the estimates. The quality of estimates can be observed in at least three ways:

1. Rigour – the extent of activity and cost drivers and detail in the assumptions made are indicators of quality.
2. Substantiation – the extent to which assumptions can be checked or verified to reliable sources (e.g. wages to EB agreements).
3. Transparency – the observable trail from cost driver, through assumption to dollars

Developing a Budget



Wrap up and questions

What has been my most important learning and why?

Appendix 1: Understand the fungibility of public money

Fungibility is the property of money that enables it to be moved from one area to another without reducing its value or failing to meet obligations. Highly fungible money can be interchanged and reallocated easily and therefore provides flexibility to managers. Less fungible money has restrictions over its movement. This money is harder to access and therefore more rigid.

The nature and implications of fungibility can be seen across different levels of government and organisations. It can be seen:

- Within the federation
- Within states
- Within agencies and departments.

Within the federation

State Governments in Australia receive large amounts of grants from the Commonwealth Government. The Commonwealth has a greater capacity to earn taxes while states have primary responsibility for the delivery of services. This imbalance is referred to as vertical fiscal imbalance. Grants from the Commonwealth to the States are categorised into:

- General Purpose Grants and
- Specific Purpose Grants

Within the Federation	General purpose grants	Specific purpose grants
	Fungible	**Non fungible**

General Purpose Grants, primarily funded by the GST, are fungible. The State Governments can use and allocate this money to any purpose without restriction from the Commonwealth.

Specific Purpose Grants are non-fungible. These grants are tied or specified to a particular purpose. The allocation of the money from the Commonwealth to the state is conditional on the state using the money for a purpose, the details of which are captured in grant agreements. At the end of each year or the end of the period covered by funding agreements, the States are required to acquit that they have spent these funds as per the agreements.

Within State Governments

State Governments, through their Treasury and Finance, receive taxes and untied Commonwealth Grants into a public account (often referred to as the Consolidated Account). The money from this account is then transferred (appropriated) to Government departments.

Money is received by agencies from Parliamentary appropriations, from the sale of goods and services or from specific levies or taxes that are passed into special purpose or hypothecated funds.

Within the State Govt	Money from sales	Appropriation	Appropriation for specifically approved initiatives	Legally Hypothecated or contracted funds
	Fungible			**Non fungible**

For agencies, money from the sales of goods and services is highly fungible. Money appropriated from Parliament will have different grades of fungibility. The vast amount of what is appropriated will be provided to agencies to deliver services and programs of that agency. This is documented in budget papers. Within these purposes, Chief Executive Offices can allocate funds within their agency with some discretion.

These can be classified as allocated funds.

Limits on this will include:

- Budget measures – money provided in the budget for specific initiatives that are detailed in budget papers. Money for these measures must be allocated for that purpose as documented.
- Cabinet approvals – money provided in the budget to fund specific measures approved by the Cabinet for the agencies. Again, these measures must be allocated for that purpose as documented in the Cabinet submission that sought approval.

These latter examples can be classified as committed funds.

Agencies will also receive money from legislated arrangements like fees and levies that are required to be set aside into a specific fund defined in legislation. An example in South Australia is the Emergency Services Levy. These are known as hypothecated funds and are not fungible. The purposes to which the monies can be applied are typically prescribed by the legislation that enables the levy and creates the fund.

Within Agencies

Finances are allocated within agencies across cost centres and projects usually designed to align with the organisational structure of the agency. This allocation will largely be at the discretion of the Chief Executive Officer subject to the limits described in the previous sections. The Chief Executive will delegate their authority to positions within the organisation to manage these monies and, if necessary, to reallocate these monies.

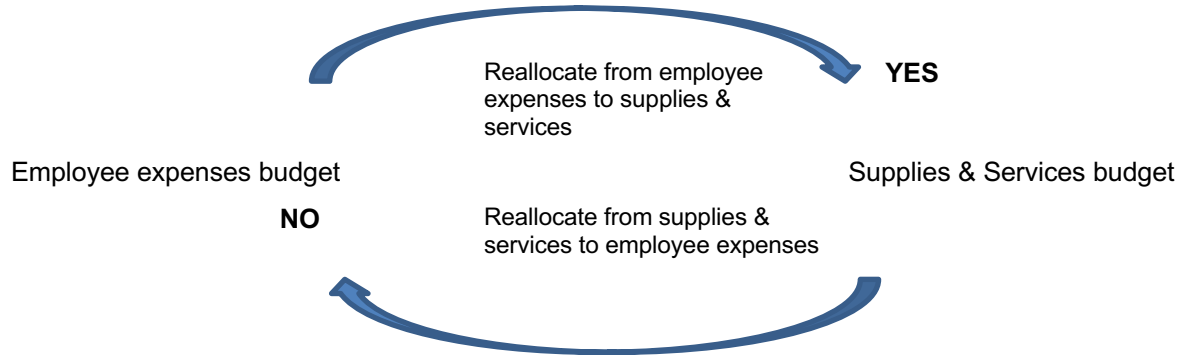
The reallocation or movement of money will therefore be subject to policies and rules within the agency.

In many cases, managers will operate to the budget bottom line (i.e. total expenses or surplus or deficit).

A budget allocated to a cost centre or project will be broken down into a budget for staff (employee expenses) and budgets for various types of goods and services. However, agencies will usually put some limits on how managers can reallocate money within their budgets.

A final category of budget is allocated to projects or programs where contracts or agreements have been entered into. These are examples of contracted funds that are non-fungible.

A common question raised in workshops is: Can the budget allocated for employee expenses be reallocated by a manager to the budget for goods and services or to another cost centre or project?



Agencies will usually allow the reallocation of employee expenses budgets to supplies and services but will not allow reallocation in the opposite direction. Commitments of money to supplies and services can be limited by specific purchases and contracts, while the hiring of employees brings with it ongoing liabilities and matters of tenure.

Understanding the concept of fungibility in public money helps us understand that not all money is the same. Some can be more flexibly applied giving leaders and managers varying levels of discretion in how they apply public money.

Across all layers of government, the limits on fungibility will be captured in documentation between the relevant parties (like contracts, agreements, legislation and budget papers) and documentation of policies and rules in agencies.

Appendix 2: The functions that budgeting serves

Strategy and Planning

- To outline financial objectives and the allocation of $ across functions (at the whole of government and agency levels)
- Gives assurance that you or your organisation is financially viable.

Political

- A basic mechanism for transparency in the use of public money
- A central plank of political activity – the single biggest day for political announcements

"*The business of government is the business of society…..there will be winners and losers."*

Accountability and control

- A systematic means of allocating resources and assigning financial responsibility
- Is a communication tool outlining commitments and allocation of resources
- Control mechanism – target against which accountability will be held.

Key budget function	Instruments	Main aims/concerns
Political	Budget speech and documentation, ministerial statements, press releases and media engagements, parliamentary debates	Reception and spend, selling and message-writing the headlines for the media, highlighting the government's record, strategies and plans
Economic	Midyear economic and fiscal outlook, medium-term fiscal strategy, fiscal balance	Fiscal discipline and stability, reception of the economic statement aimed at financial markets and business
Revenue/Income	Taxation authority and types of tax instruments, some user-charging and sales of services	Provision of resources for collective needs, notions of tax efficiency, nor arbitrariness, simplicity, fairness, compliance
Allocative	Strategic review, current priorities, policy review, contest ability, revenue retention, expenditure shares	Priority need, redistribution, services or targeted assistance, service providers, agencies, range and type of public goods to the community
Technical Efficiency	Resource management, purchase provide models, price reviews, efficiency audits, best practice guides	Productivity improvement, offsets/savings, cost effectiveness
Accountability	Appropriation bills and associated documents, public scrutiny, parliamentary debates	Electorate, Parliament, audit, media, pressure groups
Financial/Outlay	Agency resourcing (revenues and expenses), measures, and intended outcomes	Public sector, agencies and departments, performance and financial management compliance
Investment	Capital statements, specific policy statements/commitments	Capital works, economic and social infrastructure, asset base, equity injections

Source: Wanna, Kelly & Forster 2000:40

Appendix 3: Project Estimating and Reporting

Estimating costs for a new project is fundamentally a matter of educated guesswork. We are trying to estimate:

1. The breakdown of the type of work required for our project – what are the stages, what are the tasks (these may be different from the project stages or phases).
2. The ingredients (labour, goods and services and capital) required for each of the stages and each of the tasks.
3. The time required for each of the stages and tasks and therefore the time required for labour and contractors (aligned with the school year and the budget available for each year)
4. The cost per unit for each of the ingredients required.

The quality of our estimating

Different classes of cost estimates are defined by the level of definition that has occurred for a project or undertaking.

For a new project that is unfamiliar to the organisation and to an individual, there will be low definition and therefore cost estimating will be 'low' class.

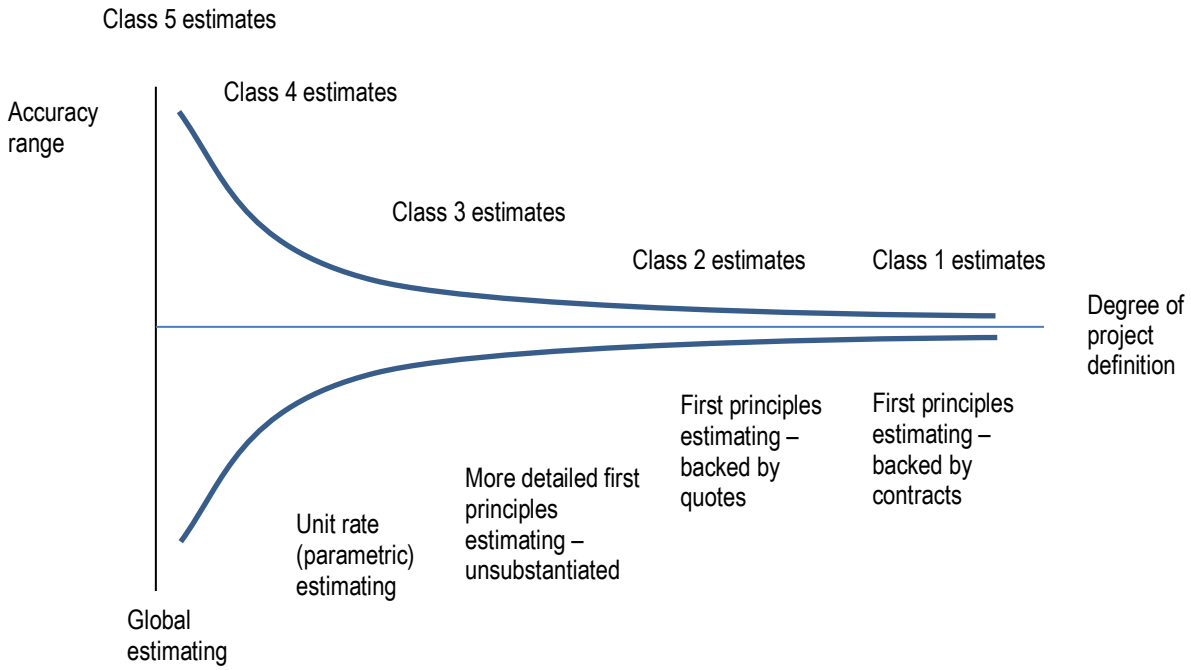
At the other end of the spectrum, projects or tasks that have been done repeatedly and are therefore well specified and defined have cost estimating that is 'high' class.

Engineering and construction standards refer to five classes of cost estimates:

- Class 5 (lowest quality) – used for long-term planning, project and concept screening. Expected to have a low degree of accuracy.
- Class 4 – Study or feasibility and preliminary budget approved.
- Class 3 – Budget authorisation is used to seek funding approval and will often be an estimate which is subject to budget control.
- Class 2 – Contractor bid/tender control – based on detailed estimates from providers that become a form of baseline.
- Class 1 (highest quality) – used for final project control and for specific items to be negotiated with contractors.

Each of these classes corresponds with the degree of project definition and maturity. In the early stages of defining a project, there are higher levels of uncertainty regarding costs. As the project matures and is better defined, the levels of uncertainty around costs should decrease.

The graphic over the page attempts to capture these concepts. The graphic has been termed the cost estimating 'cone of uncertainty'.



The cone of uncertainty attempts to capture the relationship between the accuracy of cost estimates and the degree of project definition. In the early stages of estimating a project's costs, a wider range of outcomes can be expected because we know less about the project.

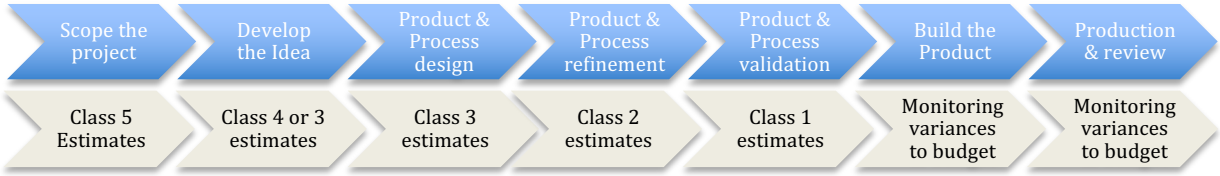
The concept of the cone of uncertainty should be front and centre in the process of considering and approving projects to overcome psychological biases that are likely to be present in the consideration of projects.

The different classes of costing are presented with the cone of uncertainty. Some cost estimating standards will go so far as to assign the class of cost estimates with the extent of project definition. For example, class 5 estimates relate to projects that are barely defined (0 to 2% definition) and class 3 estimates relate to projects that are between 10% and 40% defined, while class 5 estimates relate to projects that are between 70% and 100% defined. Note that the extent of project definition is of itself an estimating process.

There are different cost-estimating methods used across each stage of a project's definition.

As the level of project definition increases, the estimating methodology tends to progress from conceptual (stochastic/parametric) techniques to deterministic/definitive techniques.

The class of estimates can be incorporated into different project planning stages.



Global estimates

At the very early stages of estimating (class 5) the costing method applied is global estimating (or "Order of Magnitude" estimating). An order-of-magnitude estimate is prepared when little or no design information is available for the project. It is called an order of magnitude because that may be all that can be determined at an early stage.

Global estimating describes an approximate or low-order method of estimating involving the use of 'all-in' or 'global' rates. The project could be considered as consisting of one or two estimating elements only and the estimate prepared on this basis.

Examples:

- A road costs $1.5 million per kilometre and we want to build 20 km. Estimated project cost is $30 million.
- Business X implemented a new IT system at an average cost of $3,000 per user across 10,000 users ($30 million). We have 8,000 users, so our initial estimate is $24 million.
- We want to build a new classroom – a global estimate is $2,500 per square metre. Our room is 650 square metres. In this case, the global estimate is $1.625 million.
- We want to run a conference – a global estimate is $300 per attendee per day. We are estimating 500 attendees for two days. In this case, the global estimate is $300,000

Unit rate estimating

Unit rate estimating calculates the cost of each element of the project by multiplying the quantity of work by historical unit rates. The project cost is then determined by the sum of the elemental costs.

This is a class 4 estimating method progressing from a broad order of magnitude to the use of more sophisticated parametric estimation that adds more detail to some of the parameters around the project.

This type of estimating is also referred to as parametric estimating.

For a software project, it might say that the project has the following conceptual ingredients with comparisons to a comparator project:

Element	per user	number of users	Estimate
Procurement	$100	8,000	$800,000
Licence and support	$250	8,000	$2,000,000
Design, building and testing	$500	8,000	$4,000,000
Hardware requirements	$1,000	8,000	$8,000,000
Training requirements	$600	8,000	$4,800,000
Activation requirements	$200	8,000	$1,600,000
Help desk	$500	8,000	$4,000,000
Total Unit cost estimate	**$3,150**		**$25,200,000**

Better estimates of each parameter could be determined based on the number of users or number of devices and the fixed and variable components of each.

First principles estimating

The foundation of "first principles" estimating is the calculation of project-specific costs based on a detailed study of the resources required to accomplish each activity of work determined necessary in the completion of the project and subsequently recorded within the project's work breakdown structure.

The first iteration of first principles estimating is a class 3 estimate. A class 3 estimate has more detail for each of the components, supported by more detailed resource planning, but that has not yet been fully substantiated by market-based quotes. They could be substantiated by other examples or indicative quotes. Class 3 estimates reflect a significant increase in planning and costing detail.

Class 2 estimates are based in detail and are substantiated by market-based quotes from suppliers and contractors. That is, it is first principles estimates backed by specific quotes from suppliers and contractors.

A class 1 estimate will have this planning detail and that is substantiated and supported by contract arrangements. That is class 1 estimates will be largely 'locked-in' by contractual arrangements.

At the later stages of project definition, more detailed estimating methods are used. These are referred to as definitive estimates or detailed estimates. Examples include:

- Activity-based estimates – where estimates are made for the costs of pieces of work
- Unit costing estimates – where estimates are made for each of the specified ingredients to the project based on the unit cost of each ingredient.

To achieve activity and unit-based costing estimates, a breakdown and definition of work is usually required to enable specified units of inputs to be estimated.

Detailed estimates will be required of the following:

- The number of units of inputs (e.g. labour hours)
- The cost per unit (hourly rates or rates per litre or rates per kilogram)
- Escalation rates – the increases in costs over the whole of lifecycle.

Project Resource Planning

For a project that relies primarily on staff to undertake activities and deliver outputs, resource planning for staff can be done to estimate costs.

Resource planning is the process of assigning people to tasks or tasks to people and estimating the duration of the task assignment.

A resource plan will result in estimates of the number of FTEs needed at different times for a project and provide the FTE levels linked with the project's timetable. An example of a resource plan for an IT project is below.

Resource plan template																								
				1-Jul-20	8-Jul-20	15-Jul-20	22-Jul-20	29-Jul-20	5-Aug-20	12-Aug-20	19-Aug-20	26-Aug-20	2-Sep-20	9-Sep-20	16-Sep-20	23-Sep-20	30-Sep-20	7-Oct-20	14-Oct-20	21-Oct-20	28-Oct-20	4-Nov-20	11-Nov-20	18-Nov-20
Phase	**Deliverable**	**Directorate**	**Role**	Wk1	Wk2	Wk3	Wk4	Wk5	Wk6	Wk7	Wk8	Wk9	Wk10	Wk11	Wk12	Wk13	Wk14	Wk15	Wk16	Wk17	Wk18	Wk19	Wk20	Wk21
Options Analysis	Options assessment	PMO	Project Manager	0.8	0.8	0.8	0.8																	
Options Analysis	Options assessment	Client Services	User support	0.1	0.1	0.1	0.1																	
Options Analysis	Options assessment	Technology	Technical Analyst	0.4	0.4	0.4	0.4																	
Options Analysis	Technical analysis	PMO	Project Manager					0.2	0.2	0.2	0.2													
Options Analysis	Technical analysis	Client Services	User support					0.5	0.5	0.5	0.5													
Options Analysis	Technical analysis	Client Services	User support					0.1	0.1	0.1	0.1													
Options Analysis	Technical analysis	Client Services	Training					0.2	0.2	0.2	0.2													
Options Analysis	Technical analysis	Technology	Technical Analyst					0.4	0.4	0.4	0.4													
Options Analysis	Technical analysis	Technology	Software specialist					0.1	0.1	0.1	0.1													
Options Analysis	Technical analysis	Technology	Testing					0.1	0.1	0.1	0.1													
Configuration	Configure changes	PMO	Project Manager									0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	
Configuration	Configure changes	Technology	Technical Analyst									0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	
Configuration	Configure changes	Technology	Software specialist									0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	
Configuration	Configure changes	Technology	Testing									0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	
Configuration	Configure changes	Technology	Technical Analyst									0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	
Configuration	Configure changes	Client Services	User support									0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	
Configuration	Configure changes	Client Services	Training									0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	
Deployment	Technical deployment	PMO	Project Manager																					0.3
Deployment	Technical deployment	Technology	Technical Analyst																					0.4
Deployment	Technical deployment	Technology	Software specialist																					0.4
Deployment	Technical deployment	Technology	Software specialist																					0.1
Deployment	Technical deployment	Client Services	User support																					1
Deployment	Technical deployment	Client Services	Training																					1

The FTE estimates in the resource plan can be used to estimate the cost of the project and for the costs of phases of the project by adding assumptions about the cost per role and on-costs. A version of the resource plan with cost estimates is shown below.

Resource plan costing																									
					1-Jul-20	8-Jul-20	15-Jul-20	22-Jul-20	29-Jul-20	5-Aug-20	12-Aug-20	19-Aug-20	26-Aug-20	2-Sep-20	9-Sep-20	16-Sep-20	23-Sep-20	30-Sep-20	7-Oct-20	14-Oct-20	21-Oct-20	28-Oct-20	4-Nov-20	11-Nov-20	18-Nov-20	
Phase	**Deliverable**	**Directorate**	**Role**	**Weekly cost**	Wk1	Wk2	Wk3	Wk4	Wk5	Wk6	Wk7	Wk8	Wk9	Wk10	Wk11	Wk12	Wk13	Wk14	Wk15	Wk16	Wk17	Wk18	Wk19	Wk20	Wk21	
Options Analysis	Options assessment	PMO	Project Manager	2,094	1,675	1,675	1,675	1,675																	
Options Analysis	Options assessment	Client Services	User support	1,978	198	198	198	198																	
Options Analysis	Options assessment	Technology	Technical Analyst	2,211	884	884	884	884																	
Options Analysis	Technical analysis	PMO	Project Manager	2,094					419	419	419	419													
Options Analysis	Technical analysis	Client Services	User support	1,978					989	989	989	989													
Options Analysis	Technical analysis	Client Services	User support	1,978					198	198	198	198													
Options Analysis	Technical analysis	Client Services	Training	2,094					419	419	419	419													
Options Analysis	Technical analysis	Technology	Technical Analyst	2,211					884	884	884	884													
Options Analysis	Technical analysis	Technology	Software specialist	2,327					233	233	233	233													
Options Analysis	Technical analysis	Technology	Testing	1,862					186	186	186	186													
Configuration	Configure changes	PMO	Project Manager	2,094									628	628	628	628	628	628	628	628	628	628	628	628	
Configuration	Configure changes	Technology	Technical Analyst	2,211									1,105	1,105	1,105	1,105	1,105	1,105	1,105	1,105	1,105	1,105	1,105	1,105	
Configuration	Configure changes	Technology	Software specialist	2,327									233	233	233	233	233	233	233	233	233	233	233	233	
Configuration	Configure changes	Technology	Testing	1,862									372	372	372	372	372	372	372	372	372	372	372	372	
Configuration	Configure changes	Technology	Technical Analyst	2,211									221	221	221	221	221	221	221	221	221	221	221	221	
Configuration	Configure changes	Client Services	User support	1,978									1,187	1,187	1,187	1,187	1,187	1,187	1,187	1,187	1,187	1,187	1,187	1,187	
Configuration	Configure changes	Client Services	Training	2,094									838	838	838	838	838	838	838	838	838	838	838	838	
Deployment	Technical deployment	PMO	Project Manager	2,094																					628
Deployment	Technical deployment	Technology	Technical Analyst	2,211																					884
Deployment	Technical deployment	Technology	Software specialist	2,327																					931
Deployment	Technical deployment	Technology	Software specialist	2,327																					233
Deployment	Technical deployment	Client Services	User support	1,978																					1,978
Deployment	Technical deployment	Client Services	Training	2,094																					2,094
Total					**2,757**	**2,757**	**2,757**	**2,757**	**3,328**	**3,328**	**3,328**	**3,328**	**4,584**	**4,584**	**4,584**	**4,584**	**4,584**	**4,584**	**4,584**	**4,584**	**4,584**	**4,584**	**4,584**	**6,748**	**86,096**