

Chapter 6:

FINANCIAL MANAGEMENT REFORMS

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6.1 INTRODUCTION

This Chapter provides a summary of recent and proposed NSW Budget Sector financial management reforms.¹

The Budget Sector consists of agencies mainly funded from the public purse (the Consolidated Fund) rather than user charges. These agencies tend to be monopolistic suppliers of services. The key Budget Sector agencies include Health, School Education, Technical and Further Education Commission, Roads and Traffic Authority, Police, Corrective Services and the central agencies (Treasury, Premier's Department, Public Employment Office and the Cabinet Office).

Recent and proposed Budget Sector financial reforms are described in the following sections under three broad categories -

- fiscal reforms;
- financial management initiatives and reporting; and
- enhancing public sector efficiency and effectiveness.

¹ A more detailed account of these reforms can be found in the Treasurer's June 1995 Financial Statement. Reference should also be made to the *New South Wales Financial Management Framework* statement released on 2 May 1996. A description of earlier structural reforms can be found in Chapter 8 of the 1994-95 Budget Paper No. 2. Reforms in the Non Budget Sector are described in *Performance of Government Businesses* - an annual NSW Government publication.

6.2 FISCAL REFORMS

The Government's fiscal reform strategy encompasses the following objectives -

- a sustainable, robust financial structure for the State, with zero net debt in the general government sector;
- an efficient and effective social and economic infrastructure; and
- a climate conducive to the growth and development of an internationally competitive, outward looking business sector.

Key reforms relating to achievement of these objectives are outlined below.

DEBT MANAGEMENT

General Government Debt Elimination Act

The General Government Debt Elimination Act, which was proclaimed in February 1996, enshrines the Government's commitment to financial responsibility in legislation. The Act specifies short, medium and long term fiscal targets, establishes fiscal principles, formalises the coverage, presentation and content of the annual Budget and specifies within year reporting requirements.

Fiscal Targets

The Government's short term fiscal target is to achieve a sustainable budget surplus (defined in accordance with Government Finance Statistics principles) for the general government sector by 1998-99.

The medium term target is to reduce, by 30 June 2005, the level of general government debt to a sustainable level (i.e. a level at which the budget can absorb the full impact of an economic cycle without the need for significant corrective action on the revenue or expenditure side) having regard to a number of specified structural and environmental factors.

The long term fiscal target is to eliminate net debt for the general government sector by 30 June 2020.

Fiscal Principles

The Act specifies seven fiscal principles -

- Adherence to fiscal targets;
- Maintaining or increasing general government sector net worth;
- Funding employer superannuation liabilities - accruing employer superannuation liabilities of both the general government and public trading enterprise sectors should be fully funded. Funding of already accrued unfunded liabilities for both sectors is to be phased in;

- Asset maintenance - long lived physical assets of general government sector agencies should be properly maintained in accordance with maintenance plans that are being developed by each agency;
- Constrained growth in net cost of services (total accrual expenses less agencies' own source revenues) and outlays - these are to be kept at or below the growth in inflation and population (but within a 3-5 year time frame for capital outlays to allow for the impact of large projects);
- Prudent risk management - net debt should be managed according to sound risk management principles and agencies are to develop risk management plans covering significant financial and other risks; and
- The level of tax should be restrained to the maximum possible extent and policies should be pursued that are consistent with a reasonable degree of predicability about the level and stability of tax rates for future years.

Budget Coverage, Presentation and Content

The budget is to be presented on a basis that covers the general government sector as defined by the Australian Bureau of Statistics. The Budget will be presented on both a government finance statistics basis and on an accruals basis that accords with generally accepted accounting principles and Australian accounting standards. This initiative will be implemented for the 1998-99 Budget.

As a general rule, the budget papers for the 1996-97 financial year, and each later year, are to be tabled before the end of the previous financial year.

Within-year Reporting Requirements

A statement setting out the budget result on a government finance statistics basis will be released monthly. Each February a statement will be released which contains the latest economic projections and budget projections for the current financial year (as at the end of the previous December) and an explanation of any significant variations from those contained in the Budget Papers. Consolidated financial statements will be presented on an accruals basis for the first 6 months and for each financial year.

6.3 FINANCIAL MANAGEMENT INITIATIVES AND REPORTING

In order to support achievement of the Government's fiscal objectives, a number of changes are being made to the public sector financial management framework and associated reporting and accountability arrangements as outlined below.

CONTRACTUAL BUDGETING

Contractual budgeting involves the development of explicit linkages between resource allocation, the outputs (i.e. goods or services) provided by Budget Sector agencies and the Government's intended policy outcomes. The approach is being introduced incrementally within the NSW Budget Sector in order to complement and strengthen the results focus implicit in program budgeting. Implementation of contractual budgeting currently involves -

- development and publication of outcome and output measures in the Budget Papers;
- introduction of Statements of Financial Performance for Budget Sector agencies.

Outcome and output measures were published for the first time in last year's Budget Paper No. 3, for the majority of Budget Sector agencies involved in service provision or regulatory activities. Quantitative outcomes and output data will continue to be published for the Budget year and the three years preceding it. Over time this information will be added to and refined reflecting the results of exercises such as the Commonwealth/State Review of Service Provision (see Section 6.4) and the introduction of Statements of Financial Performance.

Statements of Financial Performance will be used to more closely link outputs and outcomes to resources provided through the Budget. Similar statements have been applied for a number of years to Government Trading Enterprises, where they are used to specify the financial performance expected of GTEs. These agreements were entered into between the Treasurer, the relevant portfolio minister and the respective chief executive officer.

As applied to the Budget Sector, the Statements will cover an agency's mission, objectives and key strategies; funding and financial parameters; outcome and output measures; reporting and monitoring requirements; and performance measures.

During 1995-96, in accordance with the Treasurer's June 1995 Financial Statement, Statements of Financial Performance were developed for 6 pilot agencies - the Departments of Corrective Services, School Education and Mineral Resources, the Roads and Traffic Authority, the Police Service and Tourism New South Wales.

The next steps in implementing contractual budgeting across the NSW Budget Sector will involve -

- extending the coverage of Statements of Financial Performance during 1996-97 to cover remaining service delivery and regulatory agencies; and
- linking the development of Statements of Financial Performance to the Budget process.

CAPITAL MANAGEMENT

The Government is committed to continuing to improve the total asset management framework, key elements of which are Capital Investment Strategic Plans; Asset Maintenance Plans, Economic Appraisals and Value Management studies.

The intention is to identify those Budget Sector agencies that have entrenched the various elements of the framework within their management processes and are now moving towards an outcomes based approach to resource allocation. Under this approach an agency would allocate resources on the basis of the most cost effective means of delivering its services in order to achieve the Government's policy outcome objectives.

Evidence that an agency is adopting this approach would be provided by the quality of its capital investment strategic plan and the development of internal performance monitoring systems based on well defined and relevant output and outcome measures.

Arrangements are currently being considered which will provide agencies that have adopted an outcomes based approach to service delivery with greater certainty in terms of ongoing capital funding. In addition agencies within this category will be granted greater flexibility over internal resource allocation and be subject to less intensive and more strategic reporting and monitoring requirements.

FUNDAMENTAL REVIEW OF FINANCIAL AND ANNUAL REPORTING LEGISLATION

The Treasury is currently undertaking a fundamental review of the State's financial and annual reporting legislation which was enacted some 10 years ago. The existing legislation, in many respects, does not reflect the significant financial management and accountability reforms that have taken place in recent times.

The aim of the review is to develop a new piece of legislation that embodies the modern principles and practices in public policy, public finance, financial management and accountability. The main areas that will be subject to a comprehensive review are financial administration, Parliamentary appropriation and control, financial planning, financial and annual reporting and internal and external auditing.

The new omnibus legislation will replace the existing Public Finance and Audit Act, Annual Reports (Statutory Bodies) Act, Annual Reports (Departments) Act and Public Authorities (Financial Arrangements) Act.

In place of the present somewhat prescriptive and detailed approach, the new Act will be written in terms of broad principles to be followed. This will be supported by Regulations and Statements of Best Practice issued by the Treasurer.

A working party has been established with representatives from central and line agencies and the Audit Office. A consultative document, in the form of a Treasury Green Paper, is planned to be released in May 1996 to all public sector agencies, members of Parliament and other interested parties for comment for a period of two months.

A reference panel will be established with representatives from a range of key agencies, the Public Accounts Committee and the Public Bodies Review Committee to assist in the examination of the major issues raised in submissions and in finalising the legislative proposals. The intention is to introduce the new legislation into Parliament during the 1996 Spring Session.

6.4 ENHANCING PUBLIC SECTOR EFFICIENCY AND EFFECTIVENESS

Some of the specific initiatives which are being implemented to achieve further improvements in public sector efficiency and effectiveness include -

SERVICE COMPETITION POLICY

Service competition policy aims to harness competitive forces to drive performance improvement. In the June 1995 Financial Statement, the Treasurer announced that the Government was committed to pursuing the policy in order to deliver to taxpayers the benefits of better value for money and to consumers the benefit of better quality services. This reflects previous experience that significant savings can be achieved through the appropriate introduction of competition in selected areas.

At the individual agency level, service competition policy involves -

- Identifying contestable activities which could be let to contract. These commonly include maintenance activities, transport services, cleaning, catering, information technology services and various office and professional services;
- Deciding whether to proceed to tender. This is a matter for judgement in each case based on the estimated costs and benefits of this course;
- Facilitating an in-house bid in some cases and ensuring competitive neutrality. The process must be fair to both, internal and external bidders;
- Awarding the work to the bidder offering the best overall value both in terms of cost and quality; and
- Managing the contract and retaining ultimate accountability. Effective supervision and monitoring of contracts is essential to ensure sound performance and to stay in touch with the activity.

Arrangements are being developed to share savings between agencies and the Budget, with the focus being on shifting resources from low to high priority areas.

REVIEW OF COMMONWEALTH/STATE SERVICE PROVISION

The July 1993 Premiers' Conference established a Steering Committee to review Commonwealth, State and Local Government service provision. The Steering Committee, which is chaired by the Industry Commission, produces an annual report on the effectiveness and efficiency of service providers. The first annual report was published in December 1995 and focussed on the priority areas of health, education, vocational education and training, police, courts, corrective services, public housing and community services.

The Steering Committee noted further work is required to develop consistent measures of effectiveness and efficiency for service providers to assist with the measurement of broad performance and the development of benchmarking measures of best practice.

As part of the review the Steering Committee is assessing the merits of more sophisticated techniques to measure efficiency, such as Data Envelopment Analysis (DEA). A DEA Working Group (convened by NSW Treasury) has been established to explore the opportunities for applying the technique to the service provision areas under review.

DEA is a linear programming based technique, that operates to identify best performers in terms of input use and output production. Other service providers are allocated a single efficiency score based on their performance relative to these best performers.

Unlike most productivity measurement techniques, DEA can handle a multiplicity of outputs and inputs (a feature of government service providers) and does not require the measurement or estimation of market prices for inputs and outputs to measure the technical efficiency of service providers. Technical efficiency reflects the ability of a service provider to produce maximum outputs for a given set of inputs.

Technical efficiency can be analysed to determine if the main source of inefficiency is the scale of operations or the managerial capabilities of the service provider. Further, DEA can incorporate environmental variables that influence the technical efficiency of a service provider but are beyond its control, for example the education and wealth of clients.

As part of this review, NSW Treasury is using DEA to assess the performance of several service providers. It has completed studies on the technical efficiency of NSW police patrols, corrective services and motor registries. Studies have commenced to determine the technical efficiency of NSW local courts, TAFE colleges and non-teaching hospitals. NSW Treasury is also examining further opportunities to apply the technique to other service providers.

The Steering Committee will issue an information paper on the use DEA later this year.

COUNCIL ON THE COST OF GOVERNMENT

The Council on the Cost of Government is an independent government agency which advises the Premier on ways of improving public sector efficiency and effectiveness. The Council is made up of seven members, four of whom are drawn from the private sector.

The Premier approved a work plan for the Council in September 1995 which includes the following priorities -

- analysis of areas which have been the source of escalations in the costs of Government operations and development of recommendations on ways of reducing these costs where appropriate;

- the identification of potential savings, including savings in the overheads of government agencies and savings generated through the application of service competition policy, to help fund the Government's priority programs;
- a strategic review of programs;
- review of past recommendations of the Auditor-General and the Public Accounts Committee and advice on strategies to implement outstanding recommendations where appropriate; and
- strategies for enhancing management information systems within the public sector.