# NEW SOUTH WALES
# AUDIT OF EXPENDITURE
# AND ASSETS REPORT

February 2006

# FOREWORD

This Report is provided in response to Terms of Reference issued by the Government of New South Wales for the conduct of an Audit of Expenditure and Assets. Dr Michael Vertigan AC and Mr Nigel Stokes were appointed to conduct the Audit.

The Audit was principally conducted over the period October 2005 to January 2006. In December 2005, the Government announced budgetary measures influenced in part by preliminary findings of the Audit.

We express our appreciation for the dedication, professionalism and commitment of the team of officers who were drawn together to assist with the task. These officers were made available by the Treasury, Premiers Department, NSW Audit Office, Independent Pricing and Regulatory Tribunal, Ministry of Science and Medical Research, and Department of Commerce and for that we would like to thank the Chief Executives of those agencies. Treasury provided invaluable administrative support throughout.

We would also thank those agencies who assisted through the provision of information.

Michael Vertigan
Nigel Stokes

Sydney
February 2006

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# EXECUTIVE SUMMARY

An audit of expenditure and assets applied to the NSW Government's annual Budget of $40 billion and assets of $200 billion is a considerable task. To be useful, the audit approach must reflect the circumstances of the finances that gave rise to the request. Some reviews of this nature have been conducted as razor gangs with an emphasis on a one-off reduction of the overall level of expenditure. Others have taken a much more structural approach, addressing more systemic issues.

This Report follows the second approach because NSW's finances are strong, but there has been a weakening trend which has been identified by the Government. The Government announced in the December *2005-06 Half-Yearly Budget Review* measures which will begin to slow the growth in expenses.

The Audit seeks to analyse the structural issues affecting NSW's finances, and the forces producing them. It offers proposals about how the NSW Government can reform its procedures and structures to strengthen its ability to deal with these issues. It also makes specific suggestions for dealing with issues of efficiency in administration. The relevant parts of the Report note reform and progress that is already occurring.

However, the Audit recognises that while measures to improve efficiency and reduce waste must be pursued vigorously, the financial task facing the Government requires it to make decisions about policy priorities. The Audit's full terms of reference appear at the end of this report.

The terms of reference raise three key questions:

- defining the financial issues facing the NSW Government
- reviewing the systems and structures needed to assist in dealing with the financial issues
- identifying specific opportunities across government which, if implemented, would bring together growth rates of budget revenues and expenses.

Parts A and B of this Report respond to the first two questions. Part C responds to the third question.

## Part A: NSW Government finances

The financial challenge is defined primarily by the prevailing growth rates in budget revenue and expenses. The underlying growth rates, reflecting trends that have emerged in recent years, are 5 per cent per annum growth in budget revenues and 6 per cent per annum growth in expenses.

This difference of one percentage point, when applied to a $40 billion Budget, widens any gap between revenue and expenses by $400 million every year. The challenge is first to close this gap in growth rates in future Budgets, and second to address the imbalance produced by the difference in these growth rates over the past few years.

These two aspects are closely related. The extent of action needed to address the imbalance will be determined by the effectiveness of government action to close the gap in the growth rates. If the rate of expenses growth is sustained at a level that just matches the rate of growth in revenue, then significant short-term extra effort is needed to reduce the aggregate level of expenses.

However, if the reduction in the growth in expenses is sustained at a level below that of revenue, then the short-term additional requirement will be considerably smaller or eliminated. If this is done it will create capacity to better respond to emerging priority service demands.

The State Budget faces a range of ongoing pressures. On the revenue side there is the slow growth of GST funds in combination with a state tax base overly dependent on economic transactions. In addition, High Court decisions and the GST agreement have mandated the removal of several sources of independent state revenue. The introduction of the GST has provided a new source of revenue for state governments but the allocation of GST revenue on the basis of Grants Commission methodologies has seen New South Wales' share of the growth in Commonwealth revenue fall significantly.

The ageing population and public expectations continue to drive demand for services, particularly in high cost areas such as health, education, public transport, justice and social welfare. These pressures on state government services will grow as the Government's capacity to generate its own revenue declines with an increasing dependence on tied Commonwealth grants. Furthermore, the state has faced sustained wages pressure in critical areas.

New South Wales is currently entering the largest demographic change in the state's history. This change will have repercussions for the state's finances. Past declines in the fertility rate, increases in life expectancy and the baby-boomers reaching retirement age will mean that for the first time in the state, growth in the working age population will slow to below population growth. This will mean slower state GSP growth and perhaps slower state revenue growth. However, the main fiscal impact of this so called 'ageing of the population' is likely to be felt on the expenses side, especially in health services. In 2004, 55,000 people in NSW turned 65. The Australian Bureau of Statistics estimates that in 2012, 80,000 will turn 65. In the next 20 years, the number of people in NSW aged 65 or over will increase from 900,000 to 1,600,000.

## Part B: Improvement in systems and structures

Effective systems and processes and coherent organisational arrangements contribute to improved financial management and better outcomes. But a structural imbalance in the state's finances will not be cured solely by changing budgetary and financial systems and processes, or by making changes to the machinery of government.

This Part outlines the many aspects of government operations where changes would improve budgeting and financial management:

- Cabinet and Budget Committee processes
- priority setting
- information systems
- financial management skills
- central agency support
- performance management and reporting
- accountability and responsibility arrangements.

It also addresses the importance of aligning agency operating plans to budget allocations and of commitment across government to overall financial objectives.

Part B notes that existing forward estimates are viewed as planning targets rather than binding allocations. It proposes that the forward estimates become a base for developing the annual Budget.

It also outlines an approach to modernising the structure of government agencies by providing some specific examples and illustrations of structures which would be comparable with those in some other jurisdictions.

Although it does not give a blueprint for reform ready to implement, it outlines what the reforms need to achieve, and suggests what could serve as starting points for developing the necessary processes. Fortunately, reforms are already underway in NSW and there are successfully operating examples in other jurisdictions. Part B gives guidance about gaps and opportunities that exist, and some suggestions about how to deal with them.

## Part C: Reform across all agencies

This Part examines expenses which apply across government including administration and support. The emphasis is on policies and practices which could be changed to reduce costs or increase efficiency.

These costs are often termed back office costs. Whilst there are significant savings opportunities in the administrative and support areas these fall short of the action required. In recent years there have been a number of programs to improve back office performance that have met with some success. There is still scope for further reform in this area. However, the proportion of total outlays this area represents, is not large enough to satisfy the task of bringing the growth of expenses and revenue into line on a sustained basis.

This Part identifies areas where specific savings can be achieved through changes in:

- management practices across government – ICT, property, procurement, grants administration, outsourcing
- areas where improved human resource management would result in reduced costs – sick leave, overtime, occupational health and safety, flex-leave
- areas requiring explicit government policy and commitment – wages policy, redundancy.

Part C also identifies some areas where significant policy decisions would be required to achieve savings, for example, employee management issues, concessions and tax expenditures.

Some savings opportunities can be readily identified and should result in a reduction of budget allocations to individual agencies. Others provide the opportunity to increase the operational efficiency of all agencies.

Continuing efficiency improvement, both in administration and service delivery, should be an obligation and expectation of every agency. To make that obligation real and to capture the benefits through the Budget, an ongoing 1 per cent Budget reduction should be applied to all operating outlays. This requirement mirrors similar arrangements in the Commonwealth and some other jurisdictions. The Audit notes that the *2005-06 Half-Yearly Budget Review* extended an efficiency dividend requirement to 2007-08.

The Audit examined expenditures of the major spending agencies, analysing expenditure trends and drivers, and benchmarks from other jurisdictions and from national data bases. It also considered the policy basis for the expenditure, any anomalies in how it was applied, and whether efficiency or value for money issues were evident.

The Audit concluded overall that there is no universal pattern of above-benchmark expenditure in service delivery in NSW in comparison with other states. Opportunities for improved efficiency certainly exist, but realising significant savings in these areas is neither simple nor easy. There are also many opportunities for specific outlays to be examined for continued relevance. All of these opportunities require policy decisions by government as none could be effected without impacts on current recipients or beneficiaries. The Government should regularly assess these opportunities on the basis of its priorities for service delivery.

## Key conclusions

- New South Wales' finances are strong but in recent years there has been a weakening trend. There has been a difference in the underlying rates of growth of expenses and revenue which if allowed to continue would ultimately require more severe corrective action.

- The December *2005-06 Half-Yearly Budget Review* contained measures which will begin to slow growth in expenses. However, sustained action is required to bring the growth rates of expenses and revenue into alignment.

- Significant opportunities exist across government to improve the way the NSW Government delivers services, but they require difficult policy decisions.
- These difficult policy decisions require rigorous prioritisation of government objectives.
- Reforms to administrative support systems and processes are critical to support effective decision-making and ongoing fiscal discipline.

### Implementation

Successful implementation of the reforms and opportunities identified in this report will require oversight by the Budget Committee of Cabinet, with a clear implementation plan that includes explicit milestones and targets. To support the Budget Committee, there needs to be an effective management and reporting structure and a timeframe for multi-year activities.

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# PART A. NSW GOVERNMENT FINANCES

The key challenge facing the NSW Government's finances has been the difference between the growth rates of budget expenses and revenue. In the last five years, expenses have risen by around 6 per cent per year while revenues have risen by about 5 per cent per year.

This difference in growth rates of 1 percentage point per annum, applied to an annual budget of $40 billion, means expenses have increased by $400 million more than revenues each year. Because of this the Budget operating result deteriorated from a surplus of $1.6 billion in 2001-02 to a projected deficit of $0.5 billion in 2006-07. Until 2002-03, above average growth in revenue offset the growth in expenses.

The task of correcting this deterioration in the Budget position involves two steps:

The first is to reduce the growth in expenses to match the growth in revenue. This is an ongoing task and must be tackled every year.

The second step is to return the Budget to surplus. The Government should build an operating surplus of at least $1 billion to fund the state's expanded capital works program. While an increase in the state's borrowing program is sustainable, over-reliance on borrowing for capital works will ultimately increase interest expense which will reduce the Government's ability to meet the targets for net debt and net financial liabilities in the *Fiscal Responsibility Act 2005*. These targets were set to guide NSW fiscal policy towards a sustainable path of service delivery. Borrowings by public trading enterprises not supported by the Budget need to take account of the financial and commercial situation of each enterprise.

The Audit notes that in December 2005, the *2005-06 Half-Yearly Budget Review* issued by the Government contained measures aimed at slowing the growth in expenses. The forward estimates reported in the *2005-06 Half-Yearly Budget Review* show a return to an operating surplus in 2007-08. The achievement of this outcome will require the adoption of budgeting and planning mechanisms outlined in Part B and commitment to these financial targets.

# 1. The position of government finances

The state has a strong financial position, but there has been a weakening trend in that position. The credit rating agencies Standard and Poor's and Moody's have made similar assessments in the past two years.

**1.** A strong financial position. In 2005, Standard and Poor's assessed the NSW balance sheet as 'exceptionally strong' (see Table 1). Standard and Poor's also commented that net financial liabilities are 'moderate' and that the state has a 'very strong' liquidity position.

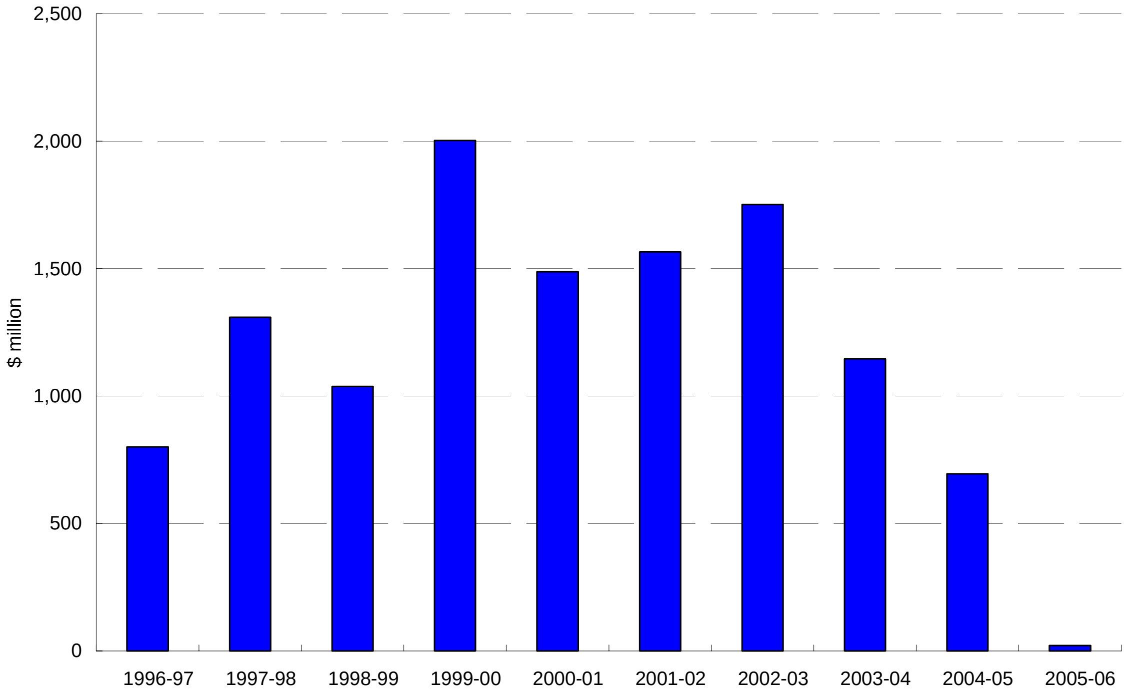
**2.** A weakening trend. Standard and Poor's note that eight successive cash surpluses in the NSW Budget up to 2004 had strengthened the state's balance sheet. However, since 2002-03 Budget surpluses have declined (see Chart 1).

## Table 1: NSW total state sector balance sheet – 30 June 2005

| | $ billion | $ billion |
|---|---|---|
| **Assets** | | |
| Fixed assets, land and other tangible assets | 171.8 | |
| Financial assets * | 26.5 | |
| | | **198.3** |
| **Liabilities** | | |
| Borrowing | 29.1 | |
| Unfunded superannuation | 16.5 | |
| Other employee liabilities | 15.2 | |
| Other liabilities | 8.8 | |
| | | **69.6** |
| **Net worth** | | **128.7** |

* Includes $4 billion in the Liability Management Fund dedicated to meet unfunded superannuation liability.

## Chart 1: NSW Budget net operating balance



## 2. Options to improve government finances

The assessment of the state's finances as strong with a weakening trend over recent years helps clarify the broad policy challenges facing the Government.

To improve the Budget position government policy must address the gap between the growth in expenses and the growth in revenue. Given the limited options for increasing revenue as discussed later, the policy options open to the Government must focus on slowing the growth in expenses.

Measures that contribute to a sustained slowing of growth in expenses often need several years to show results. The strong balance sheet gives the Government time to investigate, plan and carry out such measures. It also allows time for debate and to explain the need for these measures. The Government has already adopted a number of measures of this type, in response to the preliminary audit findings. These measures include extending the efficiency dividend to 2007-08, use of information and communications technology, management of government property assets and capping future wage increases.

The state's strong balance sheet also means that asset sales are not required where there is no other policy rationale to support the sale.

## 3. Recent trends in government revenues and expenses

The following are underlying trends for the five years to 2005-06:

- growth in budget expenses of 6 per cent per annum
- growth in budget revenues of 5 per cent per annum.

Since 2000-01 the average annual growth in expenses has exceeded the growth in revenues by 1 percentage point (see Table 2). Given that expenses and revenue are now both over $40 billion, small differences in growth rates will, over time, produce large differences between expenses and revenue – that is, the operating result. It is significant that the major areas of government service delivery have experienced faster growth in expenses than the growth in total revenue of 5 per cent per annum. Average annual growth in expenses over the past five years were: Health (7.5 per cent); Education (6.2 per cent); Transport (5.8 per cent); Public Order and Safety (6.3 per cent); and Social Security and Welfare (7.6 per cent).

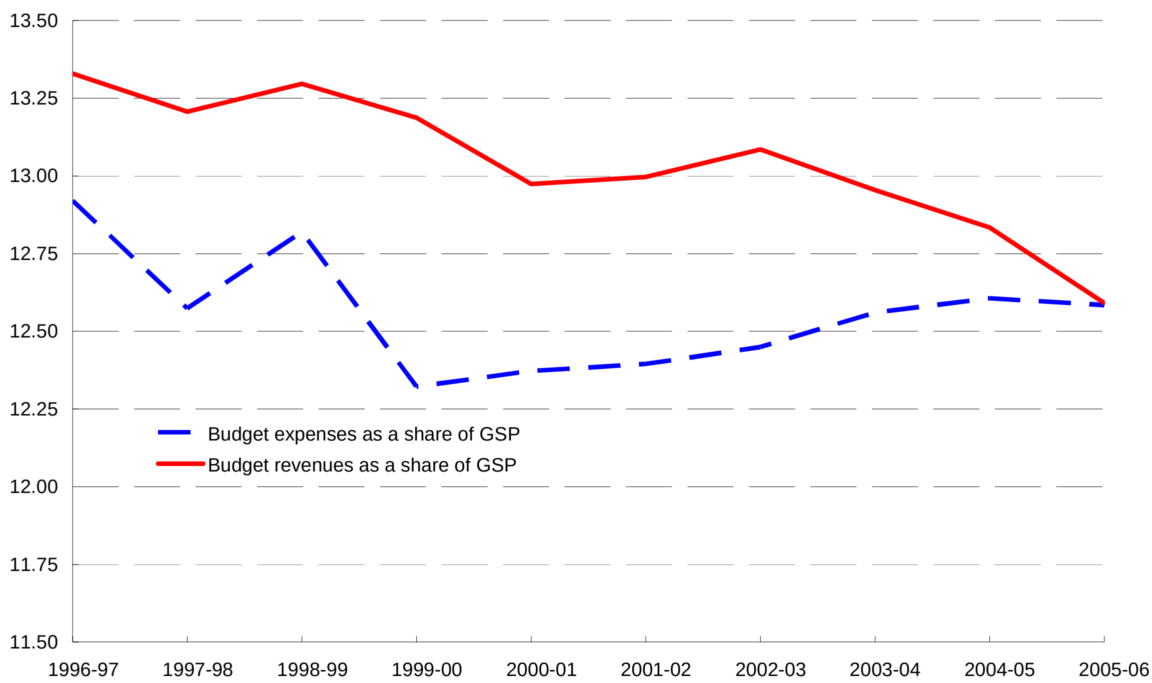
**Table 2: Trends in government revenues and expenses**

| | 1996-97 $m | 2000-01 $m | 2005-06 $m | Average % growth 1996-97 to 2005-06 | Average % growth 1996-97 to 2000-01 | Average % growth 2000-01 to 2005-06 |
|---|---|---|---|---|---|---|
| Total revenue | 26,086 | 32,072 | 40,617 | 5.0 | 5.3 | 4.8 |
| Total expenses | 25,285 | 30,584 | 40,596 | 5.4 | 4.9 | 5.8 |
| Operating balance | 801 | 1,487 | 21 | | | |
| Gross State Product | | | | 5.7 | 6.0 | 5.5 |

Note: All figures in nominal terms – no inflation adjustment.

While some cyclical elements – largely the rise and fall in property transfer taxes – affect the figures in Table 2, they reveal powerful underlying pressures that would, if not corrected, continue to impact the state's finances. These pressures tend to limit the growth of revenues and accelerate the growth in expenses. Chart 2 shows the development of those trends in revenue and expenses in relation to the size of the NSW economy. The chart indicates that growth in revenues has been below growth in the economy for most of the last decade, while growth in expenses has increased faster than growth in the economy since 1999-2000.

**Chart 2: Revenue and expenses as shares in the economy**



## 3.1 Budget revenues

In 2005-06, over 80 per cent of NSW budget revenue comes from Commonwealth grants and state tax revenues. The remainder of budget revenue includes financial distributions from state-owned corporations, investment income, sales of goods and services, licences, fees and fines.

Following the introduction of the GST and the High Court decisions on excise duties the NSW Budget now depends more heavily on Commonwealth payments. Commonwealth payments are now 42 per cent of budget revenues compared with 32 per cent nine years ago. This heavier reliance on Commonwealth payments, combined with relatively slow growth in Commonwealth general purpose payments, has important implications for future budgets.

Table 3 shows the main categories of budget revenues and their growth rates over recent years. The main points in Table 3 are:

- Over the past five years, total Commonwealth payments to NSW have increased by 5.4 per cent per annum. General purpose payments, including GST revenue, increased by only 4.7 per cent per annum (reflecting the operation of the Grants Commission on NSW share of GST grants). Over the past four years, growth in Commonwealth general purpose payments grew even more slowly – by only 1.6 per cent per annum. While Commonwealth specific purpose payments increased by 6.6 per cent per annum over the past five years, these are mostly tied grants, largely unavailable to meet discretionary expenditures by the NSW Government.
- Changes in Grants Commission relativities have reduced NSW grants by around $800 million per annum since the introduction of the GST. New South Wales is receiving a declining share of the growth of GST revenue.
- Over the past nine years Commonwealth payments appeared to grow more strongly at 8.1 per cent per annum. However, this figure is distorted by the substitution of Commonwealth payments for some state taxes as part of the introduction of the GST and is not a useful guide to the likely future growth in Commonwealth payments. The *Intergovernmental Agreement on the Reform of Commonwealth – State Financial Relations* (IGA) specified that in return for receiving the GST revenue the states had to abolish the following taxes:
  - Bed taxes from 1 July 2000
  - Financial Institutions Duty from 1 July 2000
  - Stamp duties on quoted marketable securities from 1 July 2001
  - Debits tax by 1 July 2005 – NSW abolished this tax on 1 January 2002.

- Revenue from all state taxes rose by only 3.4 per cent per annum over both the past five year and nine year periods. The strong growth in property transfer duty and land tax was offset by slower growth of other taxes and abolition of some taxes as part of the changes associated with the introduction of the GST.

### Table 3: NSW Budget major revenue categories*

| | 1996-97 $m | 2000-01 $m | 2005-06 $m | Average % growth 1996-97 to 2005-06 | Average % growth 2000-01 to 2005-06 |
|---|---|---|---|---|---|
| **Commonwealth payments** | **8,343** | **12,971** | **16,863** | **8.1** | **5.4** |
| General-purpose payments including GST revenue | 4,673 | 8,421 | 10,614 | 9.5 | 4.7 |
| Specific-purpose payments | 3,670 | 4,550 | 6,250 | 6.1 | 6.6 |
| **Total state taxes** | **11,729** | **13,343** | **15,804** | **3.4** | **3.4** |
| Payroll tax | 3,144 | 3,986 | 5,146 | 5.6 | 5.2 |
| Property transfer duty | 1,545 | 2,267 | 3,080 | 8.0 | 6.3 |
| Other stamp duty | 1,127 | 1,762 | 1,605 | 4.0 | -1.8 |
| Land tax | 668 | 929 | 1,660 | 10.6 | 12.3 |
| Motor vehicle taxes | 847 | 982 | 1,366 | 5.5 | 6.8 |
| Gambling & betting | 1,209 | 1,212 | 1,541 | 2.7 | 4.9 |
| Other state taxes | 3,189 | 2,205 | 1,406 | -8.7 | -8.6 |
| **Commonwealth payments & total state taxes** | **20,072** | **26,314** | **32,667** | **5.6** | **4.4** |
| Financial distributions | 1,869 | 1,231 | 1,893 | 0.1 | 9.0 |
| Investment income | 647 | 471 | 1,033 | 5.3 | 17.0 |
| All other revenue | 3,498 | 4,056 | 5,025 | 4.1 | 4.4 |
| **Total Budget revenues** | **26,086** | **32,072** | **40,617** | **5.0** | **4.8** |
| Memo items: | | | | | |
| Gross State Product | 195,697 | 247,208 | 322,600 | 5.7 | 5.5 |
| Revenues as share of GSP | 13.3 | 13.0 | 12.6 | | |

* Totals may not add because of rounding. As at 2005-06 Half-yearly Budget Review.

Note: All figures are in nominal terms – with no adjustment for inflation.

Other revenue sources comprise less than 20 per cent of budget revenues and:

- are outside the direct control of the Government, such as investment income
- are constrained by inflation, such as sales of government goods and services which have declined as a share of total revenue over the last decade
- are unlikely to grow faster than the overall economy.

The options to accelerate growth in budget revenues are limited. The NSW Government has made a case for reversing the decline in the NSW share of Commonwealth payments. However, an assumption that Commonwealth payments will grow faster in future would not be a sound basis for NSW fiscal policy. Moreover, pressure by the Commonwealth to abolish more state taxes (with only partial compensation from Commonwealth grants) represents a further constraint on growth of budget revenue.

Options for increasing state taxation revenue are also limited by:

- the exclusion of the states from excise duties and income tax
- interstate and international competitive pressures that limit the range of taxes that can be imposed as well as the revenues state taxes are capable of generating
- tax expenditures that act to narrow the tax base.

Future growth in NSW budget revenues will be affected by these factors. The slower growth in the economy due to the ageing population will also likely limit revenue growth. Bearing these points in mind, underlying trend growth in budget revenues of 5 per cent per annum serves as a useful guide to future growth in budget revenues.

## 3.2 Budget expenses

Table 4 shows that total budget expenses have grown at an average of 5.4 per cent per annum over the last nine years and by 5.8 per cent over the last five years. The five major areas of government expense - health, education, transport, public order and safety, and social security and welfare - which together account for over 80 per cent of total government expenses, have grown at rates either equal to or above the average increase in total expenses (see Table 4).

Higher growth in these areas reflects both conscious decisions to allocate additional resources to these areas as well as increased costs. Significant pressures for additional resources are likely to continue in these areas.

## Table 4: NSW Budget major expenses – output categories*

| | 1996-97 $m | 2000-01 $m | 2005-06 $m | Average % growth 1996-97 to 2005-06 | Average % growth 2000-01 to 2005-06 |
|---|---|---|---|---|---|
| Health | 6,184 | 7,594 | 10,907 | 6.5 | 7.5 |
| Education | 6,006 | 7,170 | 9,667 | 5.4 | 6.2 |
| Transport | 2,533 | 3,461 | 4,581 | 6.8 | 5.8 |
| Public order & safety | 2,415 | 3,264 | 4,432 | 7.0 | 6.3 |
| Social security & welfare | 1,737 | 2,173 | 3,137 | 6.8 | 7.6 |
| Housing & assoc. amenities | 646 | 1,088 | 1,049 | 5.5 | -0.7 |
| Environmental protection | 494 | 592 | 831 | 5.9 | 7.0 |
| Recreation & culture | 423 | 1,032 | 603 | 4.0 | -10.2 |
| Agriculture, forestry, fishing and hunting | 835 | 502 | 377 | -8.5 | -5.6 |
| Other economic activities | 935 | 1,003 | 1,049 | 1.3 | 0.9 |
| Other purposes ** | 3,076 | 2,704 | 3,925 | 2.7 | 7.7 |
| **Total** | **25,285** | **30,584** | **40,557** | **5.4** | **5.8** |
| Memo items: | | | | | |
| Gross State Product | 195,697 | 247,208 | 322,600 | 5.7 | 5.5 |
| Expenses as share of GSP | 12.9 | 12.4 | 12.6 | | |

* Expenses are as at 2005-06 Budget and are consolidated in this table. Growth rates may differ from agency expenses growth quoted later in the Report.

** Includes finance costs shown in Table 5.

Note: All figures are in nominal terms – with no adjustment for inflation.

Table 4 shows total expenses have risen faster than growth in the economy over the last five years (see Chart 2). Community expectations that expanding government services will match or pass the growth in the economy, plus the ageing of the population, are both likely to see continuing pressure on that growth rate.

**Health** is both the largest functional area of expense and one of the most rapidly growing. It faces pressures to increase expenses from:

- a commitment to providing high standards of medical services free or at heavily subsidised rates
- improvements in medical knowledge, technology and drugs, which expand the range of conditions that can be treated and which may involve higher costs of treatment
- demographic changes such as an ageing population
- a national and international shortage in the medical and nursing workforces.

**Education** expenses, the second largest functional area, have grown faster than total expenses over the last five years. Some of the pressures to increase expenses include:

- policies focused on the quality of teaching, including reducing the number of students per teacher
- demographic shifts increasing the number of smaller schools in both city and country areas and increasing the cost of education per student
- further services and specialist classes for students with a disability, Aboriginal students, students from culturally and linguistically diverse backgrounds and other priority groups
- continuing demand to expand pre-school education.

The costs of providing **public transport**, traffic management and infrastructure in large and long established cities such as Sydney are increasing.

The state's responses to global security and terrorism concerns have placed additional pressures on expenses in **justice and public safety**.

Pressures for increased spending in **social services, welfare and housing** are especially strong. For example, in 2004-05 the Department of Community Services received over 216,000 child protection reports, an increase of 196 per cent from 1999-2000. Demand for assistance to people with a disability is increasing as a result of increasing numbers and changing expectations of services.

Looking at budget expenses from a different perspective, Table 5 shows expenses according to the major input categories.

### Table 5: NSW Budget major expenses – input categories*

| | 1996-97 $m | 2000-01 $m | 2005-06 $m | Average % growth 1996-97 to 2005-06 | Average % growth 2000-01 to 2005-06 |
|---|---|---|---|---|---|
| Employee-related expenses | 11,596 | 14,011 | 20,112 | 6.3 | 7.5 |
| Other operating expenses | 5,444 | 6,487 | 8,131 | 4.6 | 4.6 |
| Maintenance & depreciation | 1,877 | 2,403 | 3,364 | 6.7 | 7.0 |
| Grants & subsidies | 4,820 | 6,668 | 8,114 | 6.0 | 4.0 |
| Finance costs | 1,548 | 1,016 | 877 | -6.1 | -2.9 |
| **Total expenses** | **25,285** | **30,584** | **40,596** | **5.4** | **5.8** |
| Memo item: | | | | | |
| Expenses less finance costs | 23,737 | 29,568 | 39,720 | 5.9 | 6.1 |

*As at 2005-06 Half-yearly Budget Review.

Over the past nine years, the proportion of the Budget devoted to employee-related expenses has grown significantly, from 45.9 per cent to 49.5 per cent.

Wage judgements by the Industrial Relations Commission and shortages of skilled staff in particular areas such as health have driven strong growth in wages. General government sector employees have received wage increases in excess of private sector employees. Over the five years to September 2005, the average NSW general government sector wage increased by 4.7 per cent per annum. Private sector wages in NSW have risen by an average of 3.4 per cent per annum in that period.

Operating expenses, the second biggest area of expenses, have grown at a more modest pace over the last decade. This reflects lower cost increases as well as some success in past efforts to improve efficiency in this area.

Table 5 shows that total budget expenses increased at 5.8 per cent per annum over the past five years. Excluding the effect of declining financing costs, which are unlikely to continue with the expanded borrowing program, the annual growth in expenses over the past five years was 6.1 per cent per annum. Six per cent per annum growth represents the underlying trend in budget expenses.

## 4. Conclusions on the Budget

In recent years, there has been a trend for budget expenses and demand for services to grow at a higher rate than revenues. The underlying growth in expenses has been 6 per cent per annum, while the underlying growth of revenue – making allowance for some cyclical decline in some revenues since the property market peak in late 2003 – is only 5 per cent per annum.

The difference in these underlying growth rates is 1 per cent per annum. Applied to a Budget with expenses and revenues exceeding $40 billion per annum, this difference in growth rates makes expenses grow by $400 million a year more than revenues. In December 2005, the *2005-06 Half-Yearly Budget Review* issued by the Government contained measures aimed at slowing the growth in expenses.

While the 6 per cent increase in expenses per annum has, over the past five years, helped expand health, transport, education, justice and welfare services, addressing the weakening trend in the overall Budget position will involve slowing growth in total expenses. This slowing of expenses growth will, however, need to accommodate some continuing spending increases on new, expanded and urgently needed services.

This situation raises the importance of procedures and processes that prioritise existing and new expenditures, as this Report will discuss.

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# PART B. OPPORTUNITIES TO IMPROVE SYSTEMS AND STRUCTURES

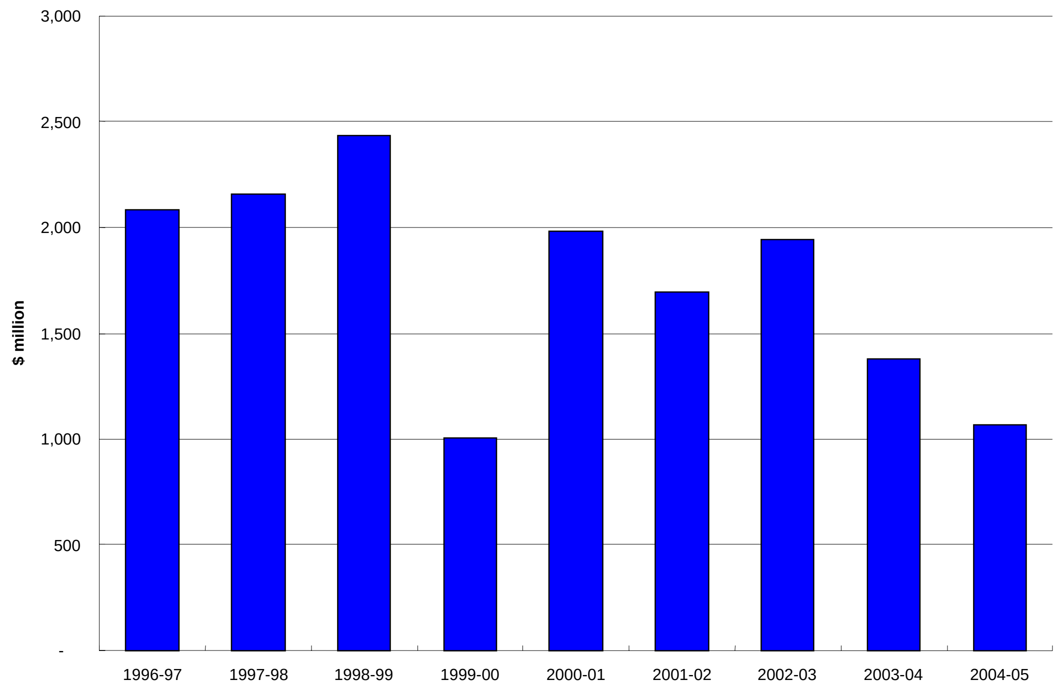
# 5. Governance and accountability

This section deals with the Budget and managerial systems required to deliver outcomes consistent with government priorities.

All state governments in Australia face great pressures in the critical areas of health, education, public transport, justice and social welfare. No government has the capacity to accommodate every expense with the potential for a positive outcome. Consequently, governments need systems that support effective policy and decision making around how much support can be provided to each service and activity.

The need for a more rigorous approach to budget setting and expenses control is illustrated in Chart 3. In each of the past nine years, actual expenses have exceeded budgeted expenses by at least $1 billion. The difference resulted from government decisions to expand services after original budgets were set, from wage increases as well as difficulties in realising savings provided for in agency budgets.

**Chart 3: Actual less budgeted expenses**




To deliver the most effective outcomes for the community, NSW needs a Budget and management environment where government priorities determine service delivery and accompanying budget allocations, and where the chosen services and activities give ‘value for money’. All parties must also commit to operating within budget allocations.

This environment has a complex set of inter-relationships between the decision processes of the Cabinet and its sub-committees, the quality of advice provided by central agencies, especially the Treasury, the quality of information on both performance and resource usage produced by central and line agencies, and the arrangements to evaluate responsibility, accountability and performance. All of these elements are required for an effective Budget process.

Effective budgetary and financial management systems need to focus on results achieved and services delivered. These systems should underpin measuring and evaluating performance in service delivery, results achieved and the performance of individuals and organisational units. Both financial performance and quantitative and qualitative aspects of operational performance need to be measured.

## 5.1 The Budget process – focus on results and services

In NSW, recent development work has built on the Financial Management Framework. This has concentrated on developing Results and Services Plans and Total Asset Management Plans. This has helped to identify the Government's desired results and the specific services and activities that contribute to them.

The existing Budget process has made increasing use of Results and Services Plans. The Plans are of variable quality. They need to more rigorously quantify intended service levels and specify performance indicators for these services and results. The Plans should play a more central role in the Budget allocation process and should be developed to become fully integrated financial and operating plans for agencies. For this to happen they must be used by all parties – operating agencies, central agencies, Budget Committee of Cabinet – in planning and actively managing agency budgets and programs.

Across government, the development of Results and Services Plans has been gradual. There has been some progress in describing results and services, but much more work needs to be done in quantifying service levels and in developing key performance indicators for these results and services. This is the next stage of development. Also, the plans need to be in a form that can have a more significant influence on the Budget allocation process. Certainly the outcomes and outputs listed in the Budget papers require improvement. For an effective Budget process, work on the Results and Services Plans needs to be accelerated.

The Audit notes that in December 2005 the Government announced the development of a new performance management and budgeting system. The Results and Services Plans are a key component of the system.

The existing Financial Management Framework refers to 'results' and 'services', while other jurisdictions use the terms 'outcomes' and 'outputs'. For consistency, this report will primarily use 'results' and 'services', but they are analogous to outcomes and outputs.

There is no doubt that government activity must be focused on achieving results through the delivery of services and activities. The issue is whether its expenditure on, and achievement of, results such as increased literacy and numeracy, improved health, or a safer community, can be effectively managed and evaluated within the annual Budget cycle.

Services, however, can be measured within the annual Budget period, and their delivery, achievement and efficiency assessed.

With either system, periodic evaluation every three to five years is needed to:

- measure how well results are achieved
- assess whether services are contributing as expected to the required results.

Such evaluation will ensure that a preoccupation with services does not develop, as has occurred in some jurisdictions, which can obscure the Government's objective of achieving the overall results.

There are numerous versions of output budgeting, ranging from highly contractually based systems where services are tightly defined and seen as being purchased by government, to systems where the services are much more broadly defined and the purchaser-provider arrangements are much less precise.

For the Government to focus on performance, the Budget and financial management system must fully support a concentration on service delivery. This will remove any inclination to retain cash expenditure or inputs as central to government decision-making or evaluation. This view supports NSW Budget and financial management systems being based on Results and Services Plans.

A desirable form of budgeting is where services are relatively broadly defined, but with sufficient detail to specify the number of units of service delivered for major services. Specifying the quantity and cost of a service, as well as quality and timeliness measures, is integral to this structure. Quantity and cost are the conventional elements of management accounting systems in any environment. Quality and timeliness are necessary performance indicators for products or services.

This approach is a well-developed framework in some other states and builds on the results and services plans approach in NSW. Specifying services as units with a delivery cost measurement is the basis to assess performance and value for money. Efficiency benchmarking is used for both public and private sector service comparisons.

Examples of units of service in major service delivery areas are the number of enrolled primary school students; the number of enrolled secondary school students; the number of prisoners in jails; or the number of suburban rail passengers carried. For hospitals, well-developed service measures of activity are used, such as case-weighted separations.

The Results and Services Plan process is consistent with the recommended structure, but it is only a beginning. The Government must accelerate its development if it is to underpin the arrangements described here.

The services-based budgetary and financial management system requires agencies to:

- deliver the planned volume of services on which the Budget is based
- contain cost within the Budget allocation
- achieve the quality and timeliness performance measures associated with each service.

Flexibility is needed to provide for transfers of Budget allocations between services within a year – with consequent adjustment of performance measures – to reflect changing requirements. While services are the building blocks for establishing agency budgets, the appropriation would remain a global appropriation.

Effective monitoring of performance is also needed. The monitoring process should be transparent and rely on agencies' own reporting as much as possible. Reporting should be against targets produced through the budgeting process. Agencies must feel responsible and accountable for the delivery of the financial and operating plans encapsulated in the Budget allocations. Full performance reporting should occur through financial statements supplemented by quality and timeliness measure reporting. Associated with this should be periodic detailed review of agency operations in terms of effectiveness and efficiency.

An important underlying principle is that revenue should be measured on actual services, not on a time-based share of the annual appropriation, and an agency's operating statement should show this. For example, an agency's chief executive or financial officer would give Treasury a certified invoice based on the work done each quarter. The invoiced amount is the agency's revenue for the period. At the financial year-end, the agency's operating statement would show its total revenues and expenses. If expenditure conforms to the allocation, but services delivery is less than planned, there will be a deficit. Overall agency performance will be transparent and reflected in the financial statements. These arrangements will limit the extent of perceived need for central agencies' micro-management, and improve agencies' accountability for producing and reporting on services delivered.

There are many technical ways to bring about these arrangements. This report, however, does not propose detailed arrangements.

## Capital allocations

Capital expenditure in the general government sector approaches $4 billion per annum and exceeds $8 billion per annum for the total state sector. This investment can have a major impact on recurrent services delivery expenses and similar principles to those outlined above need to be applied to the determination of capital allocations.

Processes have been put in place to assist agencies in asset planning and management. All agencies are required to develop Total Asset Management (TAM) Plans through which investment decisions are to be explicitly linked to service delivery. Proposed investments are required to be evaluated against economic cost/benefit criteria and, before being undertaken, are subjected to a value management study and a detailed risk analysis.

A gateway process is also in place to subject all major capital investments to scrutiny at the critical stages in capital planning and procurement. This process is designed to achieve optimum value for the investment being made and lessen the possibility of cost overruns due to poor planning and loose project management.

PTEs are able to assess capital investments using commercially based criteria such as return on investment and cost/benefit analysis. Investments by general government agencies must be judged through economic appraisals and against government priorities for the delivery of services and the achievement of less quantifiable results.

Currently in the Budget allocation process, a large proportion of the general government capital investment is distributed through standing allocations to several major individual agencies (Department of Education and Training, Department of Health, Roads and Traffic Authority, and Ministry for Transport). By conferring funding certainty on these agencies, which together account for over 60 per cent of capital expenditure in the general government sector, flexibility from a whole-of-government priorities perspective has been diminished.

This arrangement also has the potential to diminish scrutiny over compliance with the requirements to prepare robust TAM plans and undertake effective gateway reviews.

All major new works should be assessed against these requirements and their consistency with overall Budget priorities set by the Cabinet. The Government should, therefore, reconsider the arrangement of block allocations for major agencies.

Periodic assessment should be undertaken of how effectively agencies are utilising amounts within their capital allocations provided as annual provisions for minor capital works (projects with an estimated total cost of less than $250,000).

## Forward estimates

Forward estimates that are understood and accepted by central agencies, operating agencies and Ministers are integral to properly functioning Budget-management arrangements and give a stable base to develop the annual Budget.

The present Budget process is more complex and contentious than is necessary or desirable. Past behaviour suggests that agencies regarded forward estimates as the starting point for negotiation about Budget allocations. The extent of requests for maintenance funding, namely extra funding to maintain existing policy, shows clearly that the forward estimates system has not operated as it should.

To be effective, forward estimates must be accepted as representing expenditure limits in succeeding periods, and Ministers and their agencies should have plans and commitments to contain their operations within those estimates. Forward estimates are not effective if they are only targets or aspirational levels for expenditure, or are seen merely as Treasury projections of the future.

New South Wales should adopt a system of forward estimates based on maintaining both existing policy and existing levels of physical service delivery.

There are two aspects to the development of the annual Budget.

- The forward estimates process sets the funding of existing policy and services.
- Cabinet makes explicit decisions on policies and priorities, which the Budget Committee of Cabinet then implements, before services are expanded or enhanced.

Forward estimates for maintaining existing policy and services require escalation for annual price movements. Operating agencies must accommodate any net price expenditure increases above the annual escalation through improved productivity.

The forward estimates should also include an aggregate provision to meet increases in demand. Individual agencies would receive such an allocation during the annual Budget process according to increases in service delivery obligations or entitlements that are in line with existing policy, recognising that increases in service quantity require explicit decisions. There will be circumstances where it will not be possible to meet all requests for increased service delivery. The demand provision should be based on demographic and economic projections. Some demand increases occur through universal entitlements, such as school education, while others are more discretionary and require a decision on the level of demand that the Government is committed to support. Explicit Budget Committee of Cabinet decisions should be required on funding increases for discretionary-type services.

A budgeting system based on global allocations for agencies rather than inflexible line-item budgeting has been in place in NSW for some time. The feature of the global budgeting system is the flexibility allowed for services to be altered within the existing allocation.

Where an agency changes its mix of services during a period, it should meet any consequences of these changes from within its forward estimates. There should be no adjustment of the forward estimates for agency-initiated actions during a year. Any adjustment should only occur through the annual policy process and depend on whether the changes meet the priorities for the basis of the Budget. These arrangements are designed to prevent agency-initiated ‘mission creep’, where expenditure commitments expand outside of explicit decisions by Cabinet or the Budget Committee.

Any extra Budget allocation to an individual agency to meet an increased demand for services or for new or amended policy – known as enhancements – should only occur through the annual Budget process.

## 5.2 Budget priority setting and decision-making

For more effective Budget systems and arrangements, the following conditions or circumstances should be in place.

### Cabinet and Budget Committee

A key characteristic of an effective Budget decision-process is a shared commitment to fiscal goals and targets within the Cabinet, and an empowered Budget Committee. The Committee would consider agency spending proposals within a structured process and recommend the final Budget allocations to Cabinet.

In arriving at its recommendations concerning individual spending proposals the Budget Committee of Cabinet should have in mind three criteria:

- consistency with government service delivery priorities
- consistency with overall fiscal strategy (can it be afforded?)
- feasibility of the agency's plan to deliver services at appropriate cost, timeliness and quality.

Because resources are always constrained for competing expenditure proposals, Cabinet should determine overall government Budget priorities.

The Treasurer should annually recommend to Cabinet, via the Budget Committee of Cabinet, the level of expenditure for new or changed policy that will support a long-term sustainable financial position and the fiscally responsible goals and obligations.

Individual Ministers and their agencies should establish service levels that their forward estimates can accommodate. These should be tested through the Budget Committee of Cabinet.

The Budget Committee of Cabinet should consider proposals for additional expenditure from the demand provision in the forward estimates and from any extra allocation available for new or changed policy.

By the end of its processes, the Budget Committee of Cabinet should be satisfied that each agency has coherent financial and operating plans to achieve the Government's agreed outcomes. No agency should have an operating plan inconsistent with the Budget allocation. For these arrangements to work, the Ministers and the Cabinet must resolve all the necessary policy decisions involved.

The final Budget should contain all Budget Committee of Cabinet recommendations.

## Central agencies

Operating agencies should be responsible for monitoring and reporting their performance against the Government's agreed outcomes. Central agencies should be responsible for oversight and for validating agency performance. This works best when responsibility and accountability for performance rests with the operating agency, and the central agencies focus on ensuring information is reliable.

The central agencies have an important role, alongside operating agencies, in periodically evaluating services, results, and the relationship between a service and its intended result. A structured evaluation process is desirable.

The Premier's Department, The Cabinet Office and the Treasury are obliged to give quality and reliable advice to the Cabinet and the Budget Committee of Cabinet through the Budget determination process. Although the perspectives of these agencies differ, they should coordinate their activities so that their advice supports priority-setting and contains authoritative analysis.

## Systems, processes and people

An agency's management should focus on the quantity, cost, quality and timeliness of its services and the systems, processes and people-capacity needed to achieve results. Agencies do not fully possess these elements yet, and if this does not change in the short term, the success of budgetary and financial management reforms will likely be limited.

All agencies require accounting systems to support management accounting information needs, including cost accounting. These systems should have the capability to feed directly into central Treasury systems. Treasury requires an improved data management system for maintaining Budget and forward estimates, with modelling capability and the capacity for two-way use by Treasury and the operating agencies. Software recently installed by both the Commonwealth Department of Finance and Administration and the Victorian Department of Treasury and Finance are examples of such systems.

The management processes of operating agencies need to be structured to support the services and results approach.

All agencies need staff with financial qualifications and experience. In particular, every agency should have a qualified chief financial officer as part of the agency's senior management team.

Treasury, in collaboration with agencies, should fully assess agencies' necessary investment in systems, processes and people. While systems will need to be tailored, common systems should be used as much as possible, with a common high-level chart of accounts.

Budget allocations to support these investments should be a high priority.

## 5.3 Time frame for change

The Government should move in stages towards having a fully services-based Budget in place for 2008-09. This should build on and be consistent with the work already done in developing Results and Services Plans.

Each agency should develop an implementation plan by no later than 30 June 2006. The 2006-07 and 2007-08 Budgets should have an allocation to support this investment.

Cabinet should determine the priorities for the 2006-07 Budget in February 2006. To the extent that any enhancement bids can be accepted, the Budget Committee of Cabinet should assess them using those priorities. By October 2006, Cabinet should have determined its priorities for 2007-08.

From 1 July 2006, any submission either to Cabinet or the Budget Committee of Cabinet that includes a funding requirement should:

- explain its relation to Budget priorities, for results and services
- explicitly include any adjustment to forward estimates that needs approval.

If approval is given to an adjustment, the adjustment should be a recorded part of the approval. Using this as a basis, no submission approved outside the normal Budget process should lead to any later request for extra funding.

While it will not be feasible for the Budget and forward estimates to be fully based on services before 2008-09, work should start immediately on reforming the forward estimates along the lines suggested, with the concepts in place in 2007-08.

### Illustrative Budget process

- In October, the Budget Committee of Cabinet, following advice from central agencies, drafts proposed Budget priorities for Cabinet. Cabinet agrees on a final priorities statement, and the Treasurer determines the extent of funds for new and amended policies.

- Ministers submit brief proposals for any new and amended policies in line with the agreed priorities.

- In November and early December, the Budget Committee of Cabinet discusses proposals with individual Ministers.

- In late December, the Budget Committee of Cabinet tells Ministers which proposals require full submissions.

- By the end of December, Ministers and agencies advise which services and measures will be delivered within their forward estimates.

- In January, the Budget Committee of Cabinet examines draft Results and Services Plans. As a minimum, agencies must maintain the level of service delivery established in the previous year. The Committee will also consider bids for allocations from the demand provision in the forward estimates to deliver more services.
- During February and early March, the Budget Committee of Cabinet considers final submissions for new or amended policy.
- In mid-March, the Budget is finalised.

## 6. Re-engineering government structures

The NSW Government has over 100 general government agencies, with 69 Budget dependent agencies. It also has 39 public trading enterprises. The number of agencies is large relative to the other states. This in part reflects the significant number of independent or "watchdog" agencies in NSW. NSW has rationalised some agencies with the creation of the Departments of Education and Training, Environment and Conservation, Commerce, and Primary Industries for example. There are significant opportunities for NSW to improve management, simplify budget processes and to reduce duplication by extending this process further.

This section provides analysis of the costs and benefits of reducing the number of Budget dependent agencies and then identifies possible groupings that would form the basis of further investigation.

These groupings have been portrayed solely for the purpose of illustrating the synergies possible through combining agencies that provide services with like results. It is recognised that detailed work is still required before decisions could be taken by the Government on the most beneficial grouping of functions and precise administrative structure. This work should commence immediately.

It should be further noted that the intent would not be to lose the identity of smaller agencies, but simply integrate them within larger and stronger administrative structures.

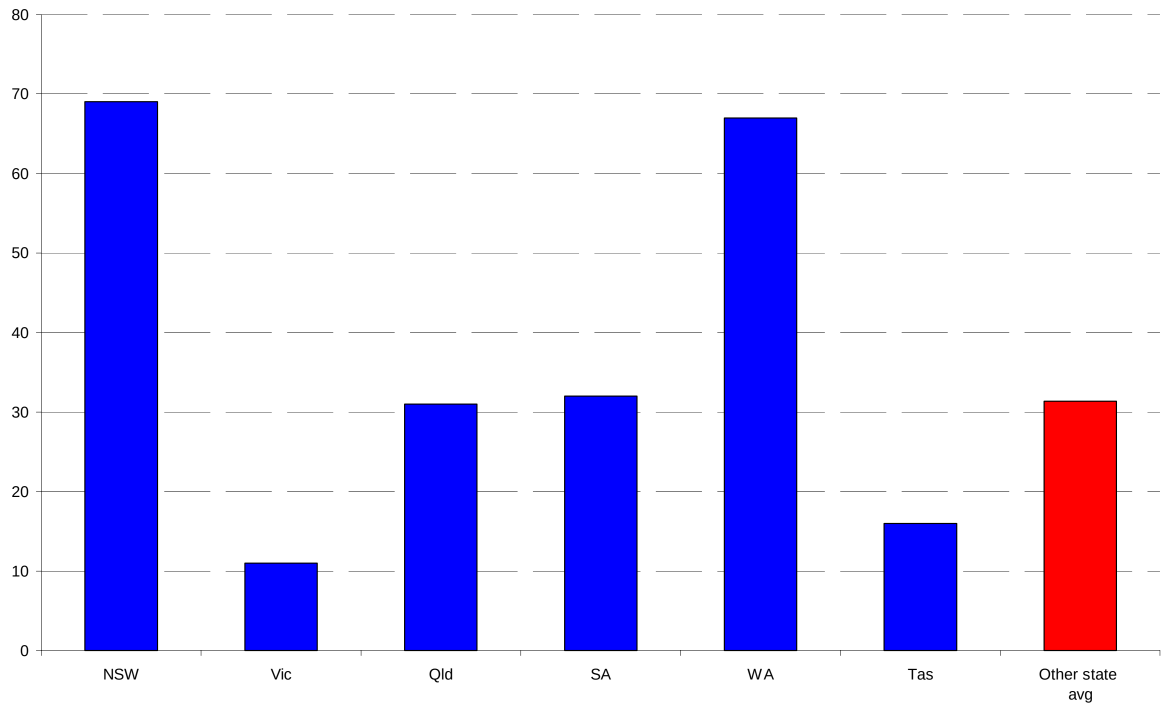
### Inter-state comparison

Although all governments previously had a large number of Budget dependent agencies, four states and the Commonwealth have now significantly rationalised their agencies. The total number of Budget dependent agencies in each state is:

- New South Wales: 69
- Victoria: 11
- Queensland: 31
- South Australia: 32
- Western Australia: 67
- Tasmania: 16.

Previous agency amalgamations and restructures in NSW have in part focused on reshaping particular aspects of service delivery. There needs now to be a comprehensive approach to agency amalgamation that incorporates all aspects of government.

**Chart 4: Number of Budget dependent agencies**




## 6.1 Costs and benefits

### Benefits

Reducing the number of Budget dependent agencies in NSW has several potential benefits:

- There would be a better focus on overall strategic results for portfolios currently split across two or more agencies.
- Internalising individual business-unit allocation decisions within a single portfolio will allow a wider range of priorities to be compared and assessed.
- There would be greater opportunities to combine and move resources within a portfolio and to manage whole processes previously split between agencies.
- There will be improved synergy between like-operating functions across otherwise diverse portfolio areas, with only high-level policy and purchaser functions segregated.

- A logical and rational organisation of agencies will improve information, decision-making, resource allocation and value for money through better coordination and reduced duplication.
- There will be savings of scale leading to efficiencies, particularly in non-operational and management areas such as corporate services.
- The Budget Committee of Cabinet can concentrate on allocating funding between major portfolio areas, rather than making numerous and time-consuming decisions about many small individual agencies.
- The Budget Committee of Cabinet can review key agency business plans, including joint financial and operating plans, and more effectively manage Budget resource allocation.

### Costs

It is difficult to accurately quantify the financial benefits that could be realised from reorganising the structure of agencies. This is because the advantages tend to be in improved service delivery and reduced transaction costs.

However, the costs of reorganisation are immediate, such as relocation expenses, costs of new systems and employee-related costs including award alignment and redundancies, but should be offset over time by the greater benefits.

**Employee-related costs** include the cost of redundancies caused by any realignment of staff after a new agency is created. There may also be award-related costs if staff of former agencies are employed under different award conditions. The new agency may then have employees in similar positions with different expectations about pay rates, leave entitlements, work hours and so on. The agency's management may face a challenge in harmonising such expectations and not being able to offer these staff preferred or familiar working conditions.

**Relocation expenses** are incurred when the change in organisational structure also means physically relocating staff. These expenses include staff and equipment relocation costs, leasing new premises and costs of ending existing lease arrangements. When staff relocate to other towns, the Government also faces costs such as removal-assistance and stamp duty payments on new homes. Even relocations of employees within the Sydney metropolitan area can prompt increased staff turnover and may cause higher recruitment for temporary staff costs.

**Systems costs** occur when a new agency needs to incorporate staff of former agencies into its existing computer systems, such as a payroll system. This may mean expanding an existing system or buying a new system. However, in the December 2005 Half-Yearly Budget Review, the Government announced new centralised arrangements for information and communications technology. This should assist in standardising systems and reducing these costs.

Overall, the up-front costs of an agency restructure are likely to broadly offset the savings it generates in the first few years. The financial savings and benefits of the reorganisation will become more apparent after two to three years, and will be a permanent feature of any restructure. It is crucial that any decision to amalgamate agencies or their functions remains in place for the longer term to ensure stability and to realise improved policy development, resource allocation and cost savings.

### Areas for review by government

As noted earlier, before any decision to proceed with large scale amalgamations take place there needs to be significant detailed work undertaken. What is suggested here is a starting point for that work, using a set of criteria to help determine which agencies could be grouped together.

### Criteria

Specific criteria were applied developing grouping of small agencies:

- to reduce policy overlap, duplication and potential cross-agency activities and ensure clear agency objectives, with no two agencies trying to achieve the same result or delivering the same service or function
- to achieve economies of scale
- to separate regulatory functions from service delivery functions
- to separate commercial activities from Budget dependent activities.

These criteria represent the starting point for such an exercise. A more detailed analysis would include other considerations, such as whether Ministerial responsibility for a single agency could be shared by more than one Minister, as is presently the case with some departments.  In other jurisdictions, this issue is addressed through the creation of Cabinet sub-committees to include Ministers involved in a single agency, or through a senior Minister/junior Minister structure.

### Reduce duplication and group similar activities

Agency groupings should aim to reduce policy overlap, that is, reduce the number of agencies trying to achieve the same results. Customers of a similar type of service should be serviced by only one agency. Otherwise agencies’ conflicting or competing activities may impair their service delivery. This could also result in duplicated service delivery.

### Economies of scale

Economies of scale arise when it is cheaper to have one large provider than a number of smaller providers. Benefits of economies of scale should be maximised where possible, and where there are no insurmountable conflicts with other principles or service delivery objectives. This leads to more efficient delivery of government services and regulations.

### Separate regulatory and service delivery functions

As a general principle, regulatory and service delivery functions should be separated. Separating these two aspects of government activity ensures that regulation benefits the community as a whole, and is not only for the benefit of government operations. This transparency increases business confidence in the regulatory system and encourages economic growth and better service delivery performance.

### Separate commercial and budget dependent activities

Fully commercial activities should be separate entities, so they can focus clearly on commercial delivery arrangements. This allows much greater scrutiny of the efficiency of their operations, which should reduce their cost burden to the community. Also it will remove the scope for commercial activities to charge higher prices than necessary to recover costs, but conceal this by channeling the extra revenue into Budget dependent activities. This effectively places a hidden tax on consumers by funding services that are outside the regular scrutiny of the Budget process.

### Other considerations

There are a number of further considerations. First, the role of statutory bodies to undertake functions and the form they take. The proposals below could involve incorporating these entities within broader structures. A 2004 Federal review into corporate governance in statutory authorities found that where the activities of statutory authorities are commercial, then generally the authority should have a board. Where the activities are Commonwealth service provision or regulatory, delegation to an executive group is more appropriate. This raises the issue of whether a separate body needs to exist at all in these latter cases. Alternatives are to consolidate functions within a department or to create statutory offices within departments, such as the Commissioner for State Revenue or the Director of Liquor and Gaming.

In some departments, staff of statutory bodies have been incorporated in the new, larger departments, yet the statutory body and the board still remain such as the TAFE Commission or the Tourism Commission. These should be reviewed with a view to updating relevant legislation. Where external advice is deemed to be required, new advisory bodies could be created to replace the statutory boards.

Another issue is the opportunity for agencies to act as lead agency or to share in the provision of services. Examples include the RTA providing boating licences and registration on behalf of the Maritime Authority and the boating inspection roles for fisheries and maritime operations.

## 6.2 Potential groupings – reducing the number of budget agencies

A restructure using the outlined criteria could reduce the number of Budget dependent agencies.

### Culture, sport and recreation

The most obvious grouping of similar functions is culture, sport and recreation. This grouping would allow government to make a single allocation for this category of expenditure and allow the responsible Ministers to determine how best to allocate the funding amongst individual services. This should improve resource allocation overall and reduce the burden on the Budget Committee of Cabinet of taking individual decisions for a number of small agencies. Individual cultural institutions could retain their separate identities.

The agencies and functions are:

- Australian Museum
- Film and Television Office (part)
- State Records Authority (part)
- Historic Houses Trust
- Ministry for the Arts
- Museum of Applied Arts and Sciences
- NSW Heritage Office (part)
- State Library
- State Sports Centre Trust
- Sport and Recreation in the Community Division of the Department of Tourism, Sport and Recreation.
- Centennial Park and Moore Park Trust.

The Sydney Olympic Park Authority should be reviewed to determine their suitability for inclusion in this group or as a stand alone agency alongside the group.

### Community development

The criteria identified a group with the shared objective of providing assistance to communities and disadvantaged groups. This group would build on the Government's initiative in July 2004 to establish the Communities Division of the Department of Community Services. This aimed to improve planning, integration and delivery of the Government's community development efforts. A single agency with overall responsibility for community development would bring together all of the Government's various community support activities. This would give the Government a clear and strong internal voice representing the entire community, including priority groups.

This group should include responsibility for administering community grants. Similarly, responsibility for concessions policy could be centralised in this agency. This would make it easier for non-government organisations to deal with government, while reducing the scope for them to receive multiple grants from various parts of government for related activities.

The agencies and functions are:
- Communities Division of the Department of Community Services
- Community Relations Commission
- Office for Women in Premier's Department
- Office of Ageing in Department of Ageing, Disability and Home Care
- Casino Community Benefit Fund of the Department of Gaming and Racing
- some functions of the Department of Energy, Utilities and Sustainability relating to concession payments, for example water and sewerage assistance
- rate rebates for Pensioners Division of the Department of Local Government

The recently created Redfern-Waterloo Authority would sit alongside this group. In the medium term the Department of Aboriginal Affairs could be reviewed to assess its suitability for inclusion in this group.

### Economic development

The criteria identified a group which would bring together all of the Government's activities in the area of actively promoting certain sectors of the economy. Such decisions can be best made in a coordinated manner, and the funds for these activities should be part of the same Budget allocation, as identified by the criteria.

The agencies and functions are:
- Department of State and Regional Development.
- development of the Tourism Industry Division of Department of Tourism, Sport and Recreation
- Ministry for Science and Medical Research
- Film and Television Office (part)
- individual overseas project operations of various agencies.

### Property Authority

The Government has already decided to establish a Property Authority. This further proposal would ensure that the Authority has the appropriate responsibilities. The group includes relevant property assets and amalgamates various small existing agencies with a focus on property management.

The agencies and entities are:
- Crown Leaseholds Entity
- Crown Property Portfolio
- Honeysuckle Development Corporation
- Luna Park Reserve Trust
- Sydney Region Development Fund

The Authority's role should be reviewed in the future to determine if there are further opportunities to streamline functions across government with related agencies such as the Department of Lands.

## Commercial regulation

The criteria indicate that certain government functions involving business regulation should supplement functions of the Department of Commerce. This would give businesses a near single point of contact for government regulations. It would ensure that the highest regulation standards while helping to relieve unnecessary red-tape burdens on business. This would include the possibility of self-certification regimes, as currently exists with occupational health and safety standards. The Government would be able to more effectively monitor the overall regulatory demands, and remove any inconsistencies or conflicts that may currently occur between different regulatory bodies. The new department would be largely cost-recovering.

The agencies and functions are:

- Building and Construction Industry Long Service Leave Payments Corporation
- some functions of Department of Energy, Utilities and Sustainability (dealing with regulation of electricity, gas and water utilities)
- Department of Gaming and Racing (excluding the Casino Community Benefit Fund)
- Land and Property Information
- Motor Accidents Authority
- Office of Fair Trading in Department of Commerce
- Office of Industrial Relations in Department of Commerce
- Registry of Births, Deaths and Marriages
- Rental Bond Board
- WorkCover Authority

The NSW Food Authority should be reviewed to determine its suitability for inclusion in this group.

## Government services

The criteria suggest grouping the functions that deliver services to other government agencies. Creating a clear focus for shared and consistent servicing will improve service quality efficiency.

The agencies and functions are:

- Businesslink
- NSW Procurement Division of Department of Commerce
- Service Improvement Division of Department of Commerce, including the Central Corporate Services Unit
- some functions of Department of Local Government
- State Records Authority (part).

### Natural resources management

The criteria suggest grouping the functions and agencies that address issues of natural resource management. This would include a number of land stewardship functions. While logically this would particularly include the National Parks and Wildlife Service functions, it is worth considering whether the benefits of reallocating the responsibilities of the Department of Environment and Conservation are justified. This department is widely regarded as successful, and the proposal would involve it in further significant structural change.

The remaining agencies and functions to be considered are:

- Department of Lands (part)
- Department of Natural Resources
- Maritime Authority (part)

The role of the Natural Resources Commission should be reviewed within 5 years of its operation.

As well, some functions of the recently created Department of Primary Industries could also be included with industry regulation functions, some with natural resources management functions and some with economic development functions. On the other hand, if this department were to continue in its current form for stability reasons, it could include the functions of the Coal Compensation Board.

### Justice

South Australia and Queensland have under half the justice service agencies that NSW has. Taking a similar approach would produce six groups of agencies and functions.

- Attorney-General's Department
  Public Trustee
  State Electoral Office

- Ministry for Police
  Police Service

- Fire Brigades
  Rural Fire Service
  State Emergency Service
  Office of Emergency Services

- Department of Corrective Services

- Legal Aid Commission

- Office of the Director of Public Prosecutions

Victoria's more aggregated approach has rolled these functions into one agency.

## Central agency functions

The other states have a single Department of Premier and Cabinet that gives policy leadership and manages the machinery of government. The Government could similarly group together certain agencies and functions.

- Premier's Department
  The Cabinet Office
  Parliamentary Counsel's Office

## Planning

Planning functions in other states are generally grouped as one agency. This increases the potential for better coordination and overall consistency. The Government could adopt this model as follows:

- Growth Centres Commission
  Department of Planning (including EP & A Act)
  Heritage Office (part)

## Human services

South Australia and Queensland provide human service functions through considerably fewer agencies than NSW. If the Government follows this trend, there would be four groups of agencies and functions.

- Health
- Department of Ageing, Disability and Home Care
  Home Care Service
- Department of Community Services
  Department of Juvenile Justice
- Home Purchase Assistance Fund
  Department of Housing

The Aboriginal Housing Office should be reviewed for its suitability for inclusion in a larger group.

Victoria's more aggregated approach has rolled these functions into one agency

# PART C. REFORM ACROSS ALL AGENCIES

This Part details the options to reduce costs and improve efficiency across government identified by the audit when it reviewed existing issues and practices.

# 7. Government-wide target for expenditure savings

This Report has already noted the need to reduce annual growth in spending to match the trend in revenue growth.

The NSW Budget includes savings in the operational expenditure of each agency in both 2005-06 and 2006-07. Generally, in calculating the increase in an agency’s operating Budget from one year to the next, 1 per cent was subtracted before applying the usual cost and demand factors. This saved $270 million in 2005-06, and a further $285 million in 2006-07. The annual savings after two years will be $555 million, which will be a permanent reduction in agencies’ base funding.

Following the interim findings of this Audit, the Government has also incorporated a further spending reduction of $300 million into its estimates for 2007-08.

## 7.1 Areas of investigation

### Commonwealth and Victorian governments’ experience

Measures to achieve continuing government-wide efficiency savings have been a regular feature of budgeting by other governments, including the Commonwealth and Victorian Governments, with substantial success. Based on their experience, there are several reasons to support a crude measure such as a standard efficiency dividend.

**The most effective process is one that ensures all Ministers and agencies seek and deliver savings.** Successful systems ensure that Ministers and agencies are committed to making the process work. Experience has shown that the more categories of exemptions allowed, the more exemptions are sought pushing unintended expenditure into exempt categories.

**A savings requirement that is part of the usual annual Budget process means that agencies and Ministers continually look for savings.** All governments prefer to make savings from back-office functions rather than front-line services to the public. It also makes sense to look for possible savings in all parts of agencies, by comparing the services that an agency provides with the Government’s policies and priorities.

**Ministers and agencies are the best placed to find savings.** Identifying savings opportunities within an agency generally requires a detailed knowledge of its operations. Although external consultants and Treasury departments can help, they cannot plan or make savings as effectively as agencies themselves. Experience has shown that agencies’ own savings measures work better than specific measures imposed from outside. Agencies plan such measures better over a longer time period, and execute them better and with less unintended side-effects. Also, when governments impose specific measures from outside, Ministers and agencies see efficiency as outside their responsibility.

**The most successful savings reflect a longer-term strategy.** When savings targets are adopted at the last minute, it is usually too late to implement them in a sustainable way. On the other hand, when agencies know their savings targets years in advance, they can invest in new processes and systems that may take time to deliver savings. The subsequent savings can be achieved with a much smaller effect on service delivery than if the same savings had been made without any advance notice.

### Scope of across-the-board savings targets

As noted above, the most effective savings process is one that offers the least exemptions. However, some spending is not under the control of individual agencies. This includes items such as interest and depreciation, as well as items that are fixed by agreement with the Commonwealth Government. In 2004-05 these inflexible categories of expenditure amounted to about $10 billion, out of total expenses of about $38 billion. The 1 per cent across-the-board savings target for 2006-07 applies to the remaining $28.5 billion, and should save $285 million.

## 7.2 Areas for review by the Government

The 1 per cent across-the-board spending reductions for 2005-06 and 2006-07 are already a significant requirement from agencies. Since they are still working to meet these targets, it is not feasible to increase the savings targets for those years.

### Set a savings target of 1 per cent as a regular feature of the Budget

The Government has the opportunity to adopt the successful policy of the Victorian and Commonwealth Governments and extend the 1 per cent across-the-board spending reductions indefinitely. This would deliver savings of $300 million in 2007-08, allowing for a similar base as in previous years. Agencies' funding would still **increase**, only it would be by 1 per cent **less** than usual. Extending this policy would effectively address in large part the ongoing gap between the growth trends in revenue and expenses.

As happens now, the Budget Committee of Cabinet would be responsible for ensuring the integrity of the across-the-board savings process. In particular, the Committee should:

- make sure that agencies explicitly identify their least valuable 1 per cent of spending
- make agencies identify measures to achieve their 1 per cent savings before it considers any bids for additional funding
- determine whether agencies can include savings arising from policy decisions of government towards their 1 per cent savings targets
- ensure productivity gains are pursued.

The third point raises difficult issues. Savings opportunities identified elsewhere in this Report could be included as savings in the 1 per cent savings target. Alternatively, the Government could make other savings opportunities separate from the general 1 per cent saving. The Budget Committee of Cabinet would need to determine whether to count savings arising from an explicit reduction in services towards an agency's 1 per cent per annum savings target.

The Government will need to tell agencies the types of saving measures expected to be incorporated in agencies' advice to the Budget Committee of Cabinet. For example, in the *2005-06 Half-Yearly Budget Review* the Premier and Treasurer announced that the Government expected agencies to target non-essential services, and in particular, efficiencies in back-office costs, as part of their current savings requirements. Improving the productivity of front-line services will also be a necessary part of a continuing requirement to achieve 1 per cent across-the-board savings.

# 8. Government employees

At 30 June 2005, the NSW public sector had 360,880 employees, accounting for over 11 per cent of total employment in the state, or 290,057 full-time equivalent employees. Eighty per cent of full-time equivalent staff from June 2004 to March 2005 were classified as front-line staff. The remaining 20 per cent provided essential support (8 per cent), corporate services (10.4 per cent) and policy (1.4 per cent).

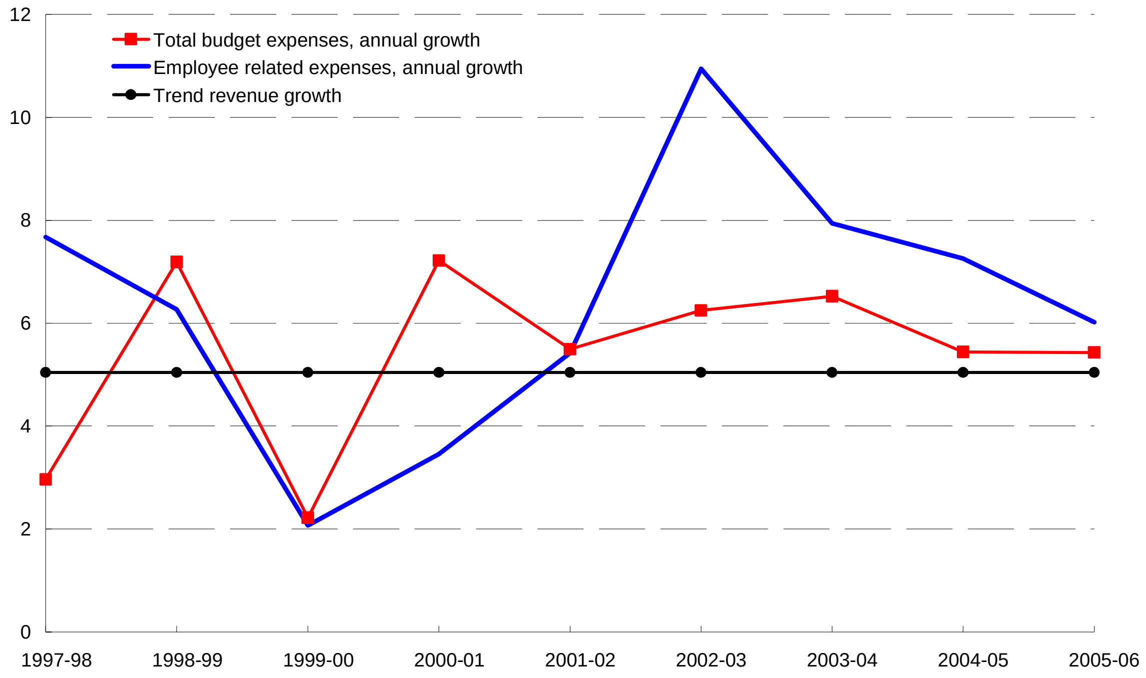
### Table 6: Analysis of front-line staff

| | Front-line agencies | Central agencies | State Owned Corps | Regulatory | Other | TOTAL |
|---|---|---|---|---|---|---|
| | % | % | % | % | % | % |
| Front-line staff | 80.94 | 0 | 51.13 | 46.61 | 54.52 | 77.59 |
| Front-line managers | 2.66 | 0 | 0.93 | 2.44 | 4.15 | 2.6 |
| *Total front-line* | *83.6* | *0* | *52.06* | *49.06* | *58.67* | *80.19* |
| Essential support | 5.55 | 2.06 | 30.42 | 20.07 | 14.06 | 7.5 |
| Essential support managers | 0.34 | 0 | 1.56 | 3.74 | 2.15 | 0.51 |
| *Total essential support* | *5.89* | *2.06* | *31.98* | *23.81* | *16.22* | *8.01* |
| Policy & research | 0.8 | 62.49 | 1.04 | 8.08 | 2.56 | 1.12 |
| Policy & research managers | 0.17 | 17 | 0.27 | 2.56 | 1.4 | 0.29 |
| *Total policy and research* | *0.97* | *79.49* | *1.31* | *10.64* | *3.96* | *1.41* |
| Corporate services | 9.02 | 11.38 | 13.63 | 12.77 | 13.34 | 9.5 |
| Corporate services for other agencies | 0.23 | 5.96 | 0.07 | 2.02 | 6.43 | 0.49 |
| Corporate services managers | 0.3 | 1.12 | 0.95 | 1.71 | 1.39 | 0.39 |
| *Total corporate services* | *9.55* | *18.46* | *14.65* | *16.5* | *21.16* | *10.39* |
| **Total FTE %** | **100** | **100** | **100** | **100** | **100** | **100** |
| **Total FTE (number)** | **257,980** | **805** | **17,501** | **2,633** | **11,135** | **290,057** |

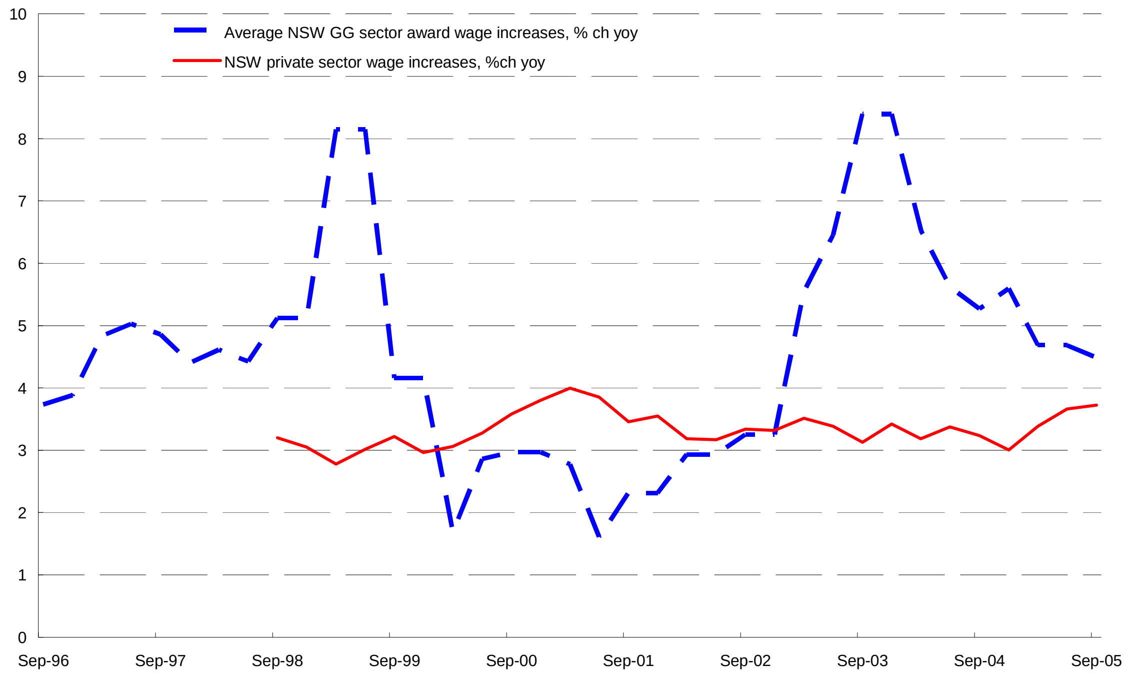
Front-line staff are employees directly providing services to the public (e.g. train drivers) and employees having contact with the public in the delivery of government services. Essential support staff are employees directly managing or supporting front-line staff.

Employee-related costs are the largest component of total expenses. In 2005-06 they amounted to 49.5 per cent of total general government expenses, up from 45.9 per cent in 1996-97. Each 1 per cent increase in employee-related costs permanently increases government expenses by around $200 million. Employee related expenses rose at an annual rate of 7.5 per cent per annum over the 5 years to 2005-06. Of the 7.5 per cent increase in employee related expenses, 4.7 per cent resulted from wage increases, 1 per cent from growth in employee numbers with the remaining 1.8 per cent resulting from other causes including changes in workforce composition and grade creep. Chart 5 shows that employee-related costs have been rising at a faster rate than total expenses in recent years.

### Chart 5: Employee-related costs



## Chart 6: Wages growth




## 8.1 Areas of investigation

The Audit looked at:

- employment growth in the NSW general government sector from the Workforce Profile, ABS data and annual reports
- wages growth in the general government sector compared with the NSW private sector and other states' general government sectors
- current and proposed policies for managing displaced employees
- corporate services overheads and relevant benchmarks
- occupational health and safety issues relating to workers compensation payments and premiums
- performance management
- trends in flex-time, annual leave, long-service leave and sick leave.

The investigations of public sector management issues revealed:

- While employee numbers have risen in recent years - by about 1 per cent per annum on a full-time equivalent basis - it is strong growth in NSW general government wages that has been the major driver in employee related expenses. Wage judgements by the Industrial Relations Commission and skill shortages in specific areas such as health have contributed to this strong growth. NSW general government sector employees have received wage increases in excess of private sector employees in NSW (see Chart 6). Over the five years to September 2005, NSW private sector wages rose by an average of 3.4 per cent per annum; the average general government sector wage increased by 4.7 per cent per annum.

- Implementation of a revised policy on managing displaced employees, including redundancies after a 12 month period of being displaced, will help reduce current employee costs and will be essential for any further restructuring.
- Although there have been considerable savings in corporate services delivery, there are still many agencies falling short of relevant benchmarks.
- Workers compensation costs above benchmarks are $66 million a year across the government. The Department of Health and Department of Corrective Services have reduced workers compensation costs to below benchmark levels.
- Agencies bear a significant administrative burden managing discipline and promotional appeals. Costs arise due to the complexity of Tribunal processes. In respect to discipline there is overlap between the Tribunals and the role of the NSW Industrial Relations Commission.
- Agencies could better manage the use of flex-time, annual leave, sick leave, overtime and the use of contractors and temporary staff. The amount of untaken recreation leave has increased recently, partly due to the use of block flex-time. The number of sick leave days per employee for many agencies is above the sector average of around eight per year. Some of the highest levels of sick leave occur in large agencies relying on rosters for the delivery of essential services. Total costs for overtime in 2004-2005 were $383 million. Total costs for contractors and short-term staff in 2004-2005 were $351 million.

## 8.2 Areas for review by the Government

### Future wage increases

When the current agreements expire from 2008, wage increases should be funded to agencies at the expected level of the annual CPI increase. This would maintain the significant real wage increases that NSW general government employees have gained over the last decade. Any increases in excess of this amount would be paid for through agency productivity savings. The Government announced this measure in the Half-Yearly Budget Review.

Where agencies experience difficulties with attraction and retention of staff, means other than across-the-board wage outcomes should be considered as possible solutions.

The Government should also review the Transferred Employees Compensation Arrangements that apply to staff relocating from one region to another. The reforms should restrict the overly broad entitlements to compensation. Currently, the provisions apply to all promotions as well as directed transfers and are not targeted at hard-to-fill locations. Entitlements are not time limited, in line with Australian Tax Office guidelines, and can incur additional FBT liabilities. The savings that could be generated could fund more flexible, enhanced attraction and retention allowances such as Living Away from Home Allowances. This should reduce recruitment costs in hard-to-fill locations and help isolate attraction and retention issues from future pay negotiations.

### Active management of employee issues

Agencies should be required to actively manage ongoing employee-cost drivers such as overtime – for example, through improved rostering practices – sick leave, flex time, annual leave accrual, performance management and management of displaced employees.

The principal requirement is for chief executive officers and Ministers to give these areas priority and support.

- The sector average for **sick leave** is around eight days per full-time employee per year. A **reduction** in average sick leave of one day across the sector would save around $45 million in direct replacement costs for front-line workers.
- A 5 per cent **reduction in overtime** costs across the sector would save around $20 million.
- **Offices sector-wide should close for the two-week period including Christmas and the first week of January**, except for essential front-line services. This is generally when the public sector is least productive, and will help reduce the level of untaken recreation leave.
- The Government should implement a policy of redundancy after one year of an officer being displaced. The initial benefit of this policy with existing employees identified as redundant would be a $12 million saving each year after redundancy payments were made. Given that further restructuring of government service delivery agencies is likely, the savings could be larger. For example, the cost of keeping 100 displaced employees on the payroll would be around $8 million each year.
- Agencies should review their industrial instruments to identify restrictive practices and encourage new and innovative employment practices and rostering strategies. The Department of Corrective Services, for example, has recently succeeded in better linking its staff rostering practice to its needs.

### Occupational Health and Safety

Agencies are currently performing below the benchmark for workers compensation by $66 million per annum. This expenditure is met from agencies' recurrent budgets.

In December 2005, the Cabinet approved WorkCover's strategy *Working Together: the Public Sector OH&S and Injury Management Strategy 2005-08*. WorkCover expects that if agencies implement this strategy it should significantly reduce workers compensation costs. These savings will not be realised until 2008-09. In implementing this policy the Government is also meeting its commitment under the *National Occupational Health and Safety Strategy 2002* to reduce injuries by 40 per cent by 2012.

### Corporate services reform

A program of corporate services reform has been underway over the past five years. The Government could save around $170 million each year if all agencies above the median performance benchmark for the delivery of corporate services met the median.

Agencies would need to meet the Council on Cost and Quality of Government's full time equivalent employee benchmarks, and best practice benchmarking in areas such as accounts payable, payroll processing, recruitment and procurement.

One way to achieve this would be to require agencies to meet the benchmarks over a given period with corresponding reductions to their budget allocation.

### Public service appeal processes

Abolishing the Government and Related Employees Appeals Tribunal (GREAT) and the Transport Appeal Board (TAB) and transferring functions to the Industrial Relations Commission would save $1 million each year, which is the current cost of the tribunals and staff. The streamlining of processes and removal of promotional appeals work will reduce agencies' workload and staff numbers, and allow significant further savings. These savings are difficult to estimate as different agencies experience different volumes of promotional appeals.

The process now is cumbersome, resource-hungry and overly legalistic. The promotional appeals provisions are also inequitable because only internal public sector applicants can appeal promotional decisions to GREAT.

Other jurisdictions have far less formal appeal processes, which they have reformed while still achieving appropriate standards and performance, and still providing employees with a mechanism to review decisions. In Victoria and Western Australia, employees can seek a review of promotional and disciplinary matters with the Public Sector Standards Commissioner. The Australian Public Service has a Merit Protection Commissioner. The process in these jurisdictions is informal and non-legalistic with the commissioners making recommendations rather than the NSW approach of giving directions.

## 9. Information, communications and technology

Government expenditure on information, communications and technology (ICT), excluding public trading enterprises, is at least $1.3 billion annually.

### Table 7: ICT expenditure

| | | |
|---|---|---|
| Capital (ICT projects) | $500m pa | Capital |
| Telecommunications | $300m pa | Recurrent |
| Staff salaries (approx 2,500 staff) | $250m pa | Recurrent |
| Agency recurrent ICT Budget | $250m pa | Recurrent |

Most areas of government service delivery are underpinned by ICT which has become increasingly pervasive and embedded within government's business and service delivery processes. Disruption to ICT services is not just an inconvenience but affects most, if not all, areas of service delivery.

All governments face the same pressure to better use technology to improve the efficiency and effectiveness of government service delivery. Governments must also use technology as a strategic asset.

The Department of Commerce, through its Government Chief Information Officer (GCIO), is the lead agency for ICT issues. The Chief Information Officers' Executive Council is the principal forum to provide executive leadership and decision-making, and to develop a NSW Government ICT Strategic Executive Plan.

The CIO Executive Council has agreed on the ICT strategies and projects outlined in Table 8.

### Table 8: ICT strategies and projects agreed to by CIO Executive Council

| ICT strategy | Projects | Budget opportunities |
|---|---|---|
| Authentication & security | Authentication | Cost avoidance |
| | Security | |
| Channels & access | Electronic response management system | Cost reduction |
| | Channels & access infrastructure | Cost reduction |
| Front-line service & delivery | Back-end systems consolidation | Cost reduction |
| | Front-line services delivery – agency responsibility | |
| Emergency information management | Emergency information management | Cost avoidance |
| Telecommunications | Telecommunications convergence | Cost reduction |
| ICT infrastructure | Standard Internet & email filtering and access | |
| | Agency infrastructure consolidation | Cost reduction |
| | Windows Vista & Office 12 (SOE) | |
| ICT procurement | ICT procurement/strategic sourcing | Cost reduction |
| Strategic governance framework | Strategic governance | |

## 9.1 Areas of investigation

The investigation drew on the Department of Commerce existing plans. Figures come from estimates that the department compiled from:

- Budget Papers
- estimates of agencies' staff and ongoing recurrent costs, such as software maintenance, contractors and other ICT operating costs.

The Department of Commerce has reviewed ICT strategies, budgets and expenditures, leadership and decision-making structures, purchasing arrangements, and arrangements for staff and contractors.

The Department identified key challenges for ICT:

- Expected savings from ICT projects in the past have often not been delivered.
- The community is increasingly using technology, and will require more of this from government – for instance 24-hour service delivery and seamless access to government services.
- Clients have differing expectations from government and the services it delivers.
- Rising business demands on and for ICT is increasing ICT costs and the need to replace ageing technologies at a time of increasing Budget constraints.
- Seamless access to government services needs appropriate authentication measures to verify the identity of individuals and agencies, taking account of privacy and confidentiality provisions.
- The diversity and scale of ICT systems are unique to government.
- Some technologies are exclusive to government where there is no ready market solution available.
- There is poor perception of ICT projects. They are often seen as reactive rather than proactive or have unrealistic expectations and can result in delivery delays.
- Integration is needed to minimise duplication, overlap, redundancy and the cost of ICT between NSW agencies and with other state, Commonwealth and local government jurisdictions.
- In some circumstances, ICT expenditure is not linked to government priorities, nor focused on core agency business systems that support front-line services.

## 9.2 Areas for review by the Government

The Department of Commerce proposal for a new approach to ICT was reviewed. It represents an opportunity for significant savings and better value for money (see Table 9). The Audit notes that measures of this type were included in the *2005-06 Half-Yearly Budget Review*.

A new approach to ICT can occur through:

- developing a NSW Government ICT Strategic Executive Plan
- implementing a global capital ICT Budget
- consolidating telecommunications purchasing
- amalgamating ICT between agencies
- re-directing agency ICT savings to agency expenditure on core business information systems.

### Table 9: Estimated ICT savings ($m)

| Strategy | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Total |
|---|---|---|---|---|---|---|
| Capital funding | 50 | 75 | 100 | 125 | 125 | 475 |
| Telecommunications | 10 | 25 | 35 | 45 | 50 | 165 |
| Staff | 5 | 10 | 15 | 15 | 20 | 65 |
| Contractors | 5 | 10 | 20 | 20 | 20 | 75 |
| **Total saving ($m)** | **70** | **120** | **170** | **205** | **215** | **780** |
| **Total saving (%)** | **5.4** | **9.2** | **13.1** | **15.8** | **16.5** | **12.0** |

The Department of Commerce believes these savings are possible, as technology is highly scaleable and access to broadband, including the Government's new broadband network, is relatively inexpensive. This allows amalgamation of systems whilst delivering cross-agency services to the public. Also, both agencies and vendors are now more willing to work together on statewide procurement initiatives.

The Department of Commerce proposes four strategies:

### An ICT strategic executive plan

Agencies and the GCIO will develop an ICT strategic executive plan. The strategy will ensure government priorities are implemented, and it will direct procurement by providing a strategic, consolidated enterprise perspective. This will allow ICT investment to be leveraged across all agencies, reducing ICT costs and unnecessary expenditure.

### Global capital ICT Budget mechanism

Supporting the plan will be a budget mechanism ensuring expenditure matches government service delivery priorities. A global budget will encourage aggregation of ICT, maximising the use of common applications, infrastructure and processes. This will increase integration, better manage common business functions, and reduce costs. As the use of common applications and infrastructure increases, the need for ICT support staff and contractors will fall.

### Consolidated purchasing of telecommunications

Data services aggregation, through the Government's broadband service program, has saved from $10 million to $15 million each year.

The ICT strategic executive plan will include an ICT procurement strategy, which will address aggregated purchasing arrangements for telecommunications services.

The GCIO and the CIO Executive Council will define the procurement and technical plans to aggregate purchasing of telecommunications services and make any associated savings. Government, where appropriate, will mandate aggregated telecommunications purchasing arrangements.

As well as lowering telecommunications expenditure, this strategy will also ensure the coordination of telecommunication technologies to underpin emergency management information and service delivery.

### Amalgamating ICT between agencies

Strategically amalgamating ICT between agencies, and lessening the necessary ICT support, will cut staff and contractor costs. Maximising the use of common applications and infrastructure and increased integration will provide flow-on effects on agency ICT salary costs and general recurrent expenditure.

As more common or shared services are amalgamated in non-core areas, such as finance, payroll, email, disaster recovery or web serving, there will be a natural corresponding fall in associated ICT support staff.

## 10. Centralised procurement policy

Government agencies, including state-owned corporations (SOCs), spend close to $12 billion a year procuring goods and services, excluding construction. Purchases range from pencils to helicopters. Existing whole-of-government policy gives many agencies significant autonomy in their goods and services procurement activities. Whole-of-government policy and practice guidelines issued by Treasury are high level. The guidelines apply to all non-SOC agencies, with state-owned corporations being encouraged to adopt policies and practices that support their corporate intentions.

Existing policy directives include a requirement that agencies:

- prepare annual procurement plans linked to their service delivery objectives
- prepare business cases
- undertake 'gateway reviews' – the standard procurement review process – for major procurements.

These directives do not restrict agencies' freedom to:

- develop their own procurement management structures
- determine the skill levels of procurement practitioners
- determine the financial, contractual and administrative delegations
- deal with the market place and on what to procure.

The Public Sector Management (Goods and Services) Regulation requires approximately half of non-SOC agencies identified in Schedule 1 of the *Public Sector Employment and Management Act 2002* to procure goods and services through the State Contracts Control Board (SCCB). The Board has extended a general delegation to all Schedule 1 agencies to procure goods and services up to $150,000 with the exception of goods and services from Board panel contracts. The Board engages the NSW Procurement Unit in the Department of Commerce as its agent to establish panel contracts, and to procure on behalf of Schedule 1 agencies major items outside their delegation. Other non-SOC agencies are only subject to the Treasury whole-of-government procurement framework.

Annual expenditure on State Contracts Control Board arranged contracts is approximately $3 billion. As well as Schedule 1 agencies, this includes other non-SOCs, SOCs, local government and non-government education facilities and charities that are eligible to purchase goods and services from the Board's panel contracts.

## 10.1 Areas of investigation

A range of government procurement activities were reviewed. These included:

- Past reform initiatives, particularly the *Smarter Buying for Government* strategy released in March 2002. This strategy identified potential savings through better procurement practice, more aggregated buying, and wider take-up of e-procurement.

- The annual agency procurement planning program, including a 2003-04 Treasury report on agency plans.

- The current reform initiatives implemented in 2004 when Treasury was given responsibility for whole-of-government procurement policy.

- Recent initiatives implemented by the Roads and Traffic Authority which realised savings of 2 per cent in the first year and predicted annual savings of up to 8 per cent after three years.

- The Department of Commerce 'strategic sourcing' initiative being applied to its procurement activities and that of client agencies such as RailCorp. The department claims potential savings of up to 5 per cent on typical agency expenditure on goods and services.

The investigation found uneven agency performance in procurement, with effective procurement reform in only two cases, and inconsistent policy applying to different agencies for no obvious reason.

- There is uneven take-up by agencies in treating procurement as a strategic management function. More effective procurement planning is required with relevant management structures and clear linkages to service delivery needs.

- The Roads and Traffic Authority procurement reform initiatives and the Department of Commerce strategic sourcing initiatives are both very similar in structure and reflect best practice. These initiatives can generate real and significant savings. Major gains can occur by better matching goods and services to service delivery objectives rather than just through cheaper prices.

- Agency take-up of e-procurement is uneven, resulting in the Department of Commerce whole-of-government Smartbuy electronic marketplace and electronic tendering systems being underused. This is despite significant government investment in systems which reduce costs and improve procurement processes.

- The current policy regime requires further development. While the whole-of-government Treasury policy framework applies to all agencies apart from SOCs, the coverage of the State Contracts Control Board mandate is limited to Schedule 1 agencies. This causes anomalies such as the Department of Health being subject to the Board, but not Area Health Services.

- Inconsistent practices can occur despite recent procurement reforms such as ‘gateway reviews’ that have produced quality business cases. Construction procurement uses an agency accreditation scheme that requires non-accredited agencies to use expert assistance when doing procurement. The use of such a scheme should be considered for the procurement of other goods and services.

## 10.2 Areas for review by the Government

Opportunities exist to enhance the procurement skills and systems in agencies to generate savings.

- The Government could introduce an accreditation scheme for goods and services procurement for all agencies other than SOCs. Agencies would be accredited after their procurement policies, skills and systems have been assessed. Agencies with best practice would be delegated greater procurement freedom. The State Contracts Control Board would then oversee agencies without such accreditation.

- All agencies, other than SOCs, could be required to use the State Contracts Control Board panel contracts to maximise benefits from the scale of government procurement.

- The Government could develop and implement strategies to accelerate agency uptake of whole-of-government e-procurement tools such as Smartbuy and e-tendering.

The Audit notes that measures of this type were included in the 2005-06 Half-Yearly Budget Review.

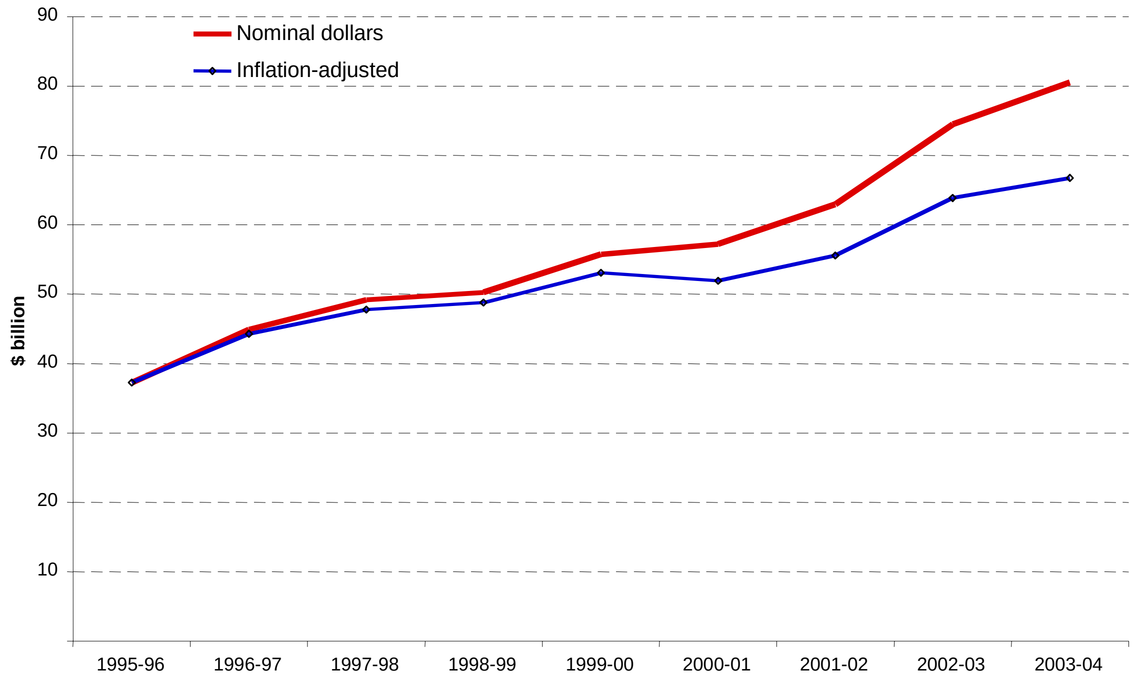
# 11. Property management

A recent initiative within the NSW Treasury has been to review the management of government property. In December 2005, the Premier announced the Government will implement the key recommendation of this review to establish a new Property Authority to centrally manage some government property assets. This audit has reviewed this work and supports the proposal.

The Government has, for many years, followed a policy of decentralised ownership and management of property assets. Service delivery agencies manage the assets provided to them, as well as acquisitions and disposals.

Over the eight years to June 2004, the value of government property assets has increased by about 80 per cent, after adjusting for inflation (see Chart 7).

**Chart 7: Value of government property assets**




Some, but not all, of this asset growth is because of recent increases in property values. Ongoing net property expenditures (net of disposals) have added over $1 billion to capital Budget outlays in each of the last five years. Property assets have been rising faster than expenditures on the government services that they support. As a result, the services yield of these property assets has been falling.

In contrast to the decentralised management of property, the Crown Property Portfolio centrally manages the leasing of major office accommodation. Leasing costs have risen at a more moderate rate and, as a result, the services yield of these assets has not fallen.

## 11.1 Areas of investigation

From a sample of the utilisation of government property assets, part of the Treasury review found that around 60 per cent of government owned properties are generic – for example depots, car parks, offices and unused land. Any number of agencies could use these assets. The remaining 40 per cent of sites are specialised – tightly linked to the service delivery processes of a particular agency, such as hospitals, schools or correctional facilities.

Many of these generic assets are under-performing or non-performing. The most common feature of non-performing assets was poorly used land and/or buildings.

These trends reflect inefficiencies in the current system of managing property assets rather than management errors. Agencies' top priority is service delivery, with property management not a major priority.

Current budgetary arrangements also hamper agencies prioritising their property needs by not explicitly pricing the resources absorbed into these assets. One unintended result is that agencies may view property assets as 'free'. Not surprisingly, they classify few assets as surplus when they see the cost of those assets, in a budgetary sense, to be zero.

There are important measures in place to promote better asset management. For example, Treasury's Total Asset Management process compares the property purchases of agencies to their service delivery strategies. There are also several initiatives to help them dispose of surplus property. Improved property management is required to improve asset productivity trends.

Another factor contributing to lower-asset productivity is that agencies rarely share property assets. The Government Asset Management Committee is the key means of coordinating property needs across agencies. While the committee watches high-level trends in property assets, and is very active on whole-of-government issues, it does not have enough resources to find opportunities to better use individual properties.

## 11.2 Areas for review by the Government

### Reduce net property acquisitions

Reforms to improve performance in this area must be designed to help, not hinder, agencies in meeting their service delivery responsibilities. Three objectives are important:

- improving the accuracy and completeness of government property information
- centralising more property management to improve asset utilisation
- highlighting the cost of tying-up capital in property assets.

Records on government-owned property are incomplete and contain some inaccuracies. As such the Government's property register is not a viable management tool. Steps are being taken to improve the information flow from agencies to the Government's central property register.

The key element of the reform package, recently announced by the Premier, is the creation of a central Property Authority to hold and manage property assets. The Authority will focus on the generic assets, which include offices, car parks, depots and unused land. It will benefit agencies by:

- allowing faster and cheaper property transactions
- better handling of maintenance processes
- better management of property leasing
- helping agencies to swap and share property assets.

Most specialised assets will stay in the hands of their respective service delivery agencies.

The Authority would levy rental charges on the properties which agencies use and recommend to Treasury whether it should fund these charges, agency by agency and asset by asset.

Estimates of savings will be affected by which particular assets are vested to the Authority at what times. In broad terms, recurrent savings from improved leasing and maintenance arrangements should be about $80 million per annum in five years time. Proceeds from asset sales should reach $100 million per annum after five years. Finally, there will be savings from programs such as depot-sharing or office-space sharing, which will reduce future purchases of property.

Treasury is handling the implementation planning for the new Authority, and will make proposals for the Government to consider later in 2006.

## 12. Government grants

Grants expenditure, listed as ‘Grants and subsidies’ in the Budget papers, covers a range of payments to non-government organisations (NGOs) and individuals so they can deliver a service, receive a subsidy or concession, or carry out a community project. Grants and subsidies also include transfer payments between agencies to cover operating costs, such as between the Ministry of Transport and the State Rail Authority and State Transit Authority, or between the Ministry for the Arts and the Sydney Opera House.

The 2005-06 Budget allocated $7,900 million for grants and subsidies, or 19 per cent of total Budget expenses of $40,557 billion. The allocation has increased by 56 per cent since 1999-2000.

## Table 10: Categories of grants and subsidies programs

| % of total allocation | 2005-06 ($m) | Categories of grants and subsidies programs |
|---|---|---|
| **36%** | **2,800** | **Programs meeting significant policy commitments to provide subsidies, concessions and services.** These are the major funding programs which the Government controls. They include subsidies to non-government schools; acute overnight inpatient services in private hospitals; drug and alcohol and AIDS services; family and children's services; school student transport; and the Sydney Opera House operating subsidy. |
| **31%** | **2,450** | **Programs with initial funding sources from outside the NSW Government Consolidated Fund.** These are usually either fully funded Commonwealth or joint NSW/Commonwealth programs, and the NSW Government has limited or no influence over these. They include Home and Community Care, Supported Accommodation Assistance Program, Disability and Housing programs, the First Home-Owner Grants Scheme, and petroleum products subsidies. They also include three-way funded programs between the state, Commonwealth and external sources for fire-fighting equipment and community legal services. |
| **29%** | **2,300** | **Programs with statutory requirements.** These include operating subsidies made through the Ministry of Transport to State Rail, Rail Infrastructure Corporation and State Transit. |
| **2%** | **200** | **Programs providing community grants.** The Government's contribution to these is usually only a proportion of the total cost of projects which they fund. They distribute small amounts to a large number of groups through many programs, for example Arts and Cultural grants; Sport and Recreation athletes and sporting facilities grants; the Families First Program; the Area Assistance Scheme; community education; heritage; natural resources, energy and water savings; Community Relations Commission; and women's community grant schemes. |
| **2%** | **150** | **Programs where legislation sets the level and manner of funding.** These include public libraries' grants, the Environment Trust, pensioner rate rebates, and the Waste Fund. |
| **100%** | **7,900** | |

Grants and subsidies payments are managed through what is generally termed grants or funding programs and administered by various government agencies (see Table 10).

## 12.1 Areas of investigation

The investigation looked at:

- recent and current moves to reform the management of grants, particularly those of the NSW Grants Administration Review and the Human Services CEOs Group
- grants and subsidies for community grants and services programs
- grants management practices in NSW compared with Victoria and New Zealand.

### Recent reforms

The Government signed the *Working Together for NSW* agreement with the Forum of Non-Government Associations in December 2004. The agreement provides a framework to build and improve the relationships between the Government and NGOs.

The Human Services CEOs Group has begun to review development and support services to NGOs so they can improve sustainability and performance across their human services grants and funding programs.

The Premier's Department Grants Administration Review has also streamlined the administration of grants resulting in:

- improved public access to all information on funding programs through the website **www.communitybuilders.nsw.gov.au**
- simpler processes and models to reduce the paperwork for grant recipients and funding agencies.

### Administration of grants programs in 2002-03

The Grants Administration review survey in 2003 found that there were 11,000 recipients of nearly 700 grants and subsidies programs administered by 42 government agencies.

The cost of administering these programs was about $69.5 million. Agency operating budgets covered 73 per cent of these costs, while the rest came out of the grants and subsidies themselves.

### Community grants programs

The 2005-06 allocation for community grants programs is nearly $200 million (Table 11).

### Table 11: Significant community grants programs ($m)

| | 1998-99 | 1999-00 | 2000-01 | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 |
|---|---|---|---|---|---|---|---|---|
| Energy & Water Savings Fund ***** | - | - | - | - | - | - | - | 70.0 |
| Arts & culture | 26.5 | 28.9 | 30.7 | 50.4 | 44.0 | 54.0 | 27.3 | 29.5 |
| Sport & recreation | 11.7 | 16.6 | 15.5 | 16.1 | 17.0 | 15.2 | 17.0 | 19.6 |
| Area Assistance Scheme | - | 8.1 | 9.8 | 10.0 | 10.4 | 9.8 | 9.5 | 9.6 |
| Heritage Incentives Program | 4.7 | 5.0 | 1.5 | 3.6 | 2.5 | 2.4 | 2.3 | 2.4 |
| Community Relations Commission Grants Program | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 |
| **Total** | **44.4** | **60.1** | **5.9** | **81.6** | **75.4** | **82.9** | **57.6** | **132.6** |

Sources: Overview of NSW Government Services 1986-2003; NSW Budget papers (Budget Paper 3, 2003-04 & 2005-06).
***** New program: $70 million allocation each year for five years.

A comparison with other jurisdictions highlights the importance of understanding and managing the administration costs of grant programs. Victoria and New Zealand separate their grants programs into either community grants programs or services funding programs. All their respective community grants programs are handled by a single agency, removing duplication and multi-funding, and reducing the cost of administration.

## Services funding programs

Each year nearly $2.5 billion goes towards services funding programs undertaken by NGOs through direct state or joint state and Commonwealth funding programs.

The significant service delivery funding programs managed by the human services agencies accounted for over $1.6 billion of the services funding (see Table 12).

During the past decade, governments world-wide have been outsourcing and working with NGOs to deliver these services, particularly those human services previously delivered wholly by government.

A strong and viable NGO sector, that delivers effective and efficient services, with sound governance arrangements and mature business relationships with the Government, is crucial to ensuring that funding creates a steady supply of the best services.

### Table 12: Significant services funding programs in 2002-03

| Agency/programs | 2002-03 $m |
|---|---|
| **Department of Ageing Disability and Home Care** | |
| Commonwealth, State, Territories Disability Agreement | 433.5 |
| Home and Community Care | 289.9 |
| Ageing Program | 5.6 |
| **Department of Community Services** | |
| Supported Accommodation Assistance Program | 108.2 |
| Community Services Grants Program: community development; child protection; youth services; and family & individual support | 57.8 |
| Out of Home Care: intensive and post-contract services | 33.7 |
| Children's Services Program: pre-school & day-care centres; early childhood | 99.2 |
| **Department of Health** | |
| Overnight acute inpatient services | 349.7 |
| Rehabilitation & extended care services | 87.8 |
| Primary & community based services: health promotion; AIDS; rural doctors services; aged and disabled; community services; dental services; drug and alcohol; and extension health | 98.2 |
| **Department of Education and Training** | |
| Handicapped conveyancing | 43.1 |
| Apprenticeship and Traineeship Training Program | 41.0 |
| Adult and Community Education | 16.0 |
| **Total** | **1,663.7** |

Source: Review of Grants and Subsidies Payments 2002-03, NSW Premier's Department 2003.

## Monitoring the effectiveness of all grants and funding programs

The Government should regularly and rigorously examine how effective grants and funding programs are for both community projects and NGO services.

A lack of detailed and consistent data on grants and programs does not easily allow the Government to see if they are effective. Better information would help inform resource allocation, allow the Government to move away from often out-dated funding systems, and to re-allocate funds from existing to emerging initiatives.

The Department of Commerce and the Premier's Department are reviewing the need for a framework to collect data that will identify and report on grants and funding programs, and give the Government better information on grants expenditure. A framework should include an agreed common data set and a system of review to measure how effectively current programs deliver on policy and services.

The framework should also include agencies' plans for grants management systems that record funding distribution and track outcomes. Central data collection will require a small capital investment.

### 12.2 Areas for review by the Government

Rationalising grants programs could achieve long-term efficiencies and cost savings opportunities.

- **Fewer agencies administering community grants** could reduce administrative costs, duplication and multi-funding,
- Progressively move to **contracted service delivery for** grants aimed at specified outcomes. Such service delivery should be founded on sound performance-based contracts, longer-term funding and a focus on results for clients.
- D**evelop a framework to collect data**, to identify and report on the full range of grants expenditure, and to monitor its effectiveness.

## 13. Concessions

A concession is when part of the community receives a government service at no charge or at less than the standard price. The Government provides over 60 separate concessions valued at around $1.5 billion a year. This does not include a number of similar tax expenditures which are treated differently for Budget purposes (see Section 10) but which are of essentially the same character.

Concessions are usually means or disability tested. Most state governments limit concessions to people holding cards from either Centrelink or the Commonwealth Department of Veterans Affairs, which apply a means or a disability test before issuing a card.

There are around 1.15 million pensioner concession card holders in NSW, including about 20,700 war veterans and war widows.

Since the late 1980s, 'Seniors' – people 60 years of age and more, working less than 20 hours a week – have received certain transport and other concessions in NSW. There is no means or disability test for this.

Due to the ageing of the population, the numbers of pensioners and seniors are likely to increase faster than general population growth. There will be an increasing impact on the Budget.

Current government concessions fall into three categories:

- means-tested and disability-tested concessions based on a Commonwealth Centrelink or Commonwealth Department of Veterans Affairs card
- concessions for senior citizens based on the non-means-tested 'Seniors' card issued by the NSW Department of Ageing, Disability and Home Care
- other concessions.

## 13.1 Areas of investigation

Information on concessions came from Budget Papers, RailCorp's 'Passes and Concessions Guide', and Seniors' and pensioners' internet sites.

The investigation looked at:

- anomalies in the way concessions are provided; the extent to which some are free while others require differing payment contributions; and how this varies across the state
- concessions available on the basis of entitlement rather than need
- ways to reduce costs through relatively simple and sensible changes
- ways to improve benefits for a given outlay.

Where anomalies exist, the approach has been to suggest standardising at the level of concession that would reduce the overall cost to the Budget and slow the rate of growth.

### Transport concessions

Transport concessions are available to means and disability-tested Centrelink and Department of Veterans Affairs cardholders as well as seniors cardholders.

Seniors cardholders receive concessions on transport services, but not on other major areas of household expenditure such as water, sewerage or energy.

Seniors' use of transport could be affecting full-fare patronage. Transport concessions for seniors started in the late 1980s. Since then, concession travel has been extended to the morning peak, and crowding on both daily peaks can be a problem.

Concession travellers now form the majority of travellers on many CountryLink and regional services. The ageing of the population suggests this growth is set to continue.

The Pensioner Excursion Ticket (PET) more recently became available to private bus areas in Sydney and Newcastle, widening its usage. In addition the reforms addressed years of imbalance when the PET was available only in areas covered by public buses. The price of the PET ticket was raised for the first time in 15 years in 2005.

Given the breadth of the metropolitan public transport networks, the PET is an extremely costly concession, recognised as being the most generous in Australia. Many Seniors are more financially secure than pensioners.

The net cost to the Budget of extending concessions beyond Commonwealth benefit recipients is estimated to be around $25 million per annum.

### Cost of major concessions

Although many concessions already require the user to pay part of the cost of the service, the Government provides many services to sections of the community for free. These include car registration, driver licence renewal, motor vehicle tax for pensioners, TAFE courses for some pensioner concession card holders, school student travel, ambulance services for pensioners, and exemption from the environment improvement charge in the Hunter region.

The concessions above cost around $800 million a year. Tax expenditures, would add to this figure.

### Water and sewerage concessions

Pensioners in the Sydney Water service area can collect a 100 per cent rebate on their fixed water charge. They also receive 77 per cent back from their sewerage charge, and this is set to increase over the next three years. Pensioners in the rest of the state receive 50 per cent.

There is no cap on the amount of rebate pensioner customers can claim from Sydney Water bills but those in the rest of the state are limited to a fixed $175 cap. For energy, there is a standard pensioner rebate statewide of $112 a year.

Water and sewerage concessions for pensioners are higher in NSW than in Victoria and Queensland. Victoria provides a statewide concession of 50 per cent on both water and sewerage charges, both capped at $67.50. Queensland allows a statewide 20 per cent concession on the gross rates and charges levied by a local government which includes water and sewerage, as well as general rates and the fire service levy, capped at $180 a year.

### The School Student Transport Scheme

Sixty per cent of students travel for free, more than twice the proportion of students in Victoria (22 per cent) and Queensland (23 per cent). The scheme works unevenly, with non-government school students benefiting disproportionately.

Following the Unsworth Review of Bus Services in NSW, the Government introduced measures to deal with ‘phantom riders’ and introduce transparent contracting arrangements with private bus operators.

The School Student Transport Scheme costs around $500 million a year, most in contract arrangements with the private bus sector. Average growth over the last five years has been 5.3 per cent per annum.

## 13.2 Areas for review by the Government

### Centralise contractual arrangements

There are around 40 different concessions for pensioners and seniors, and this does not include a range of tax expenditure benefits. The unwieldy number leads to an uneven and possibly unintended distribution of benefits.

Centralisation should make the costing and reporting of concession benefits more accurate. With consultation between the Minister and welfare groups, it should see a redirection of funding and changes in the range of concessions that optimise the benefits to recipients. (See Part B section 6).

This is an opportunity for greater effectiveness.

### Index the $2.50 Pensioner Excursion Ticket

The PET is unique in not being indexed. Concessions in Victoria and Queensland comprise a discount on standard fares and are effectively indexed to annual fare adjustments.

Indexing the PET would not increase the real cost to users but would absorb future cost pressures and would avoid revenue leakage before the inevitable need for catch-up.

Without indexing, the $2.50 per ticket revenue is unlikely to be enough to fund payments to private operators that would keep them viable. Ultimately, taxpayers would have to meet the shortfall.

Annual PET revenue on government public transport is about $41 million. Ticket increases would need to be rounded to minimum 10-cent increases, so some years may see no increases and other years disproportionate catch-ups. The initial saving would be around $1.2 million, cumulating annually.

### Ensure consistency in handling overdue bills

The Department of Energy, Utilities and Sustainability pays out around $9 million each year through the Energy Accounts Payments Assistance Scheme to help people having trouble paying their energy bills.

Government could reduce this direct cost by adopting a more corporate approach to bad debt management, as practiced in the water utilities. The self-funding of bad debts in the energy businesses could reduce their dividends initially, but the use of extended payment plans could more than offset this and produce a benefit for the Budget.

The savings for the Budget would be a proportion of $9 million.

# 14. Tax expenditures

Tax expenditure is the cost of giving favourable tax treatment to certain taxpayers. It can take the form of:

- exempting certain taxpayers from a tax
- applying a lower rate of tax, a rebate or a deduction to certain taxpayers
- deferring payment of a tax for certain taxpayers.

This discussion of tax expenditures only covers concessions that can be characterised as preferential – those available to a limited set of taxpayers. Tax-free thresholds and taxation rates that apply to taxpayers in general are a structural feature of the underlying taxation system.

Tax concessions are not costless. They have a similar policy and fiscal impact as direct expenditure. Without these concessions, and assuming the underlying economic activity is unaffected, the Government could reduce current tax rates, support a higher level of public spending, reduce net debt, or fund future liabilities.

Quantifiable tax expenditures are about $4 billion in 2005-06. This is around 25 per cent of total tax revenue, or about 10 per cent of total expenditures (excluding financing costs). Tax expenditures are spread across all major tax bases. By value, tax expenditures in 2005-06 are highest in transfer duty, payroll tax, and general and life insurance duty. Together these account for over 53 per cent of total measurable expenditures.

## 14.1 Areas of investigation

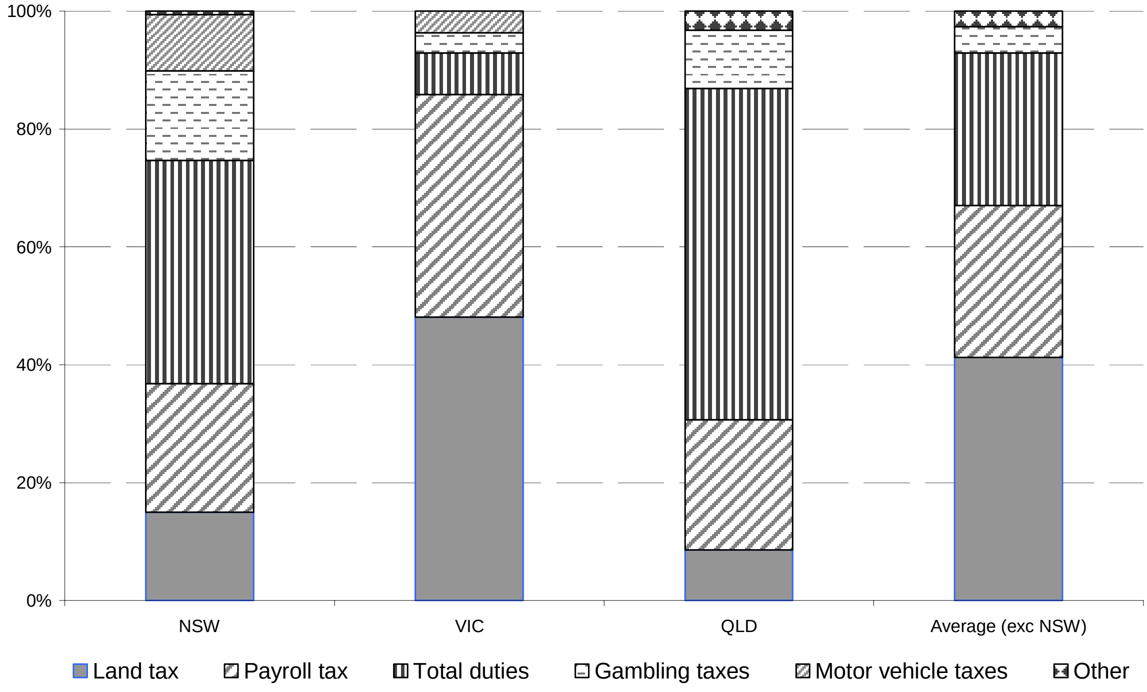
### Interstate comparisons

Care should be taken when commenting on the scope of tax expenditures in NSW compared with other jurisdictions. A comparison with other jurisdictions' tax expenditures must remove any differences in the rates of tax from the NSW benchmark. When comparing with other states, it is also important to bear in mind that NSW lists all tax expenditures whether a cost can be assigned or not. Other jurisdictions only appear to list tax expenditures they can cost. Note that these figures also exclude vendor duty.

New South Wales tax expenditures are spread across the four major tax bases of payroll tax, stamp duties, land tax and gambling taxes (see Chart 8). With the exception of Queensland, tax expenditures in most other jurisdictions are generally concentrated on just the first three of these.

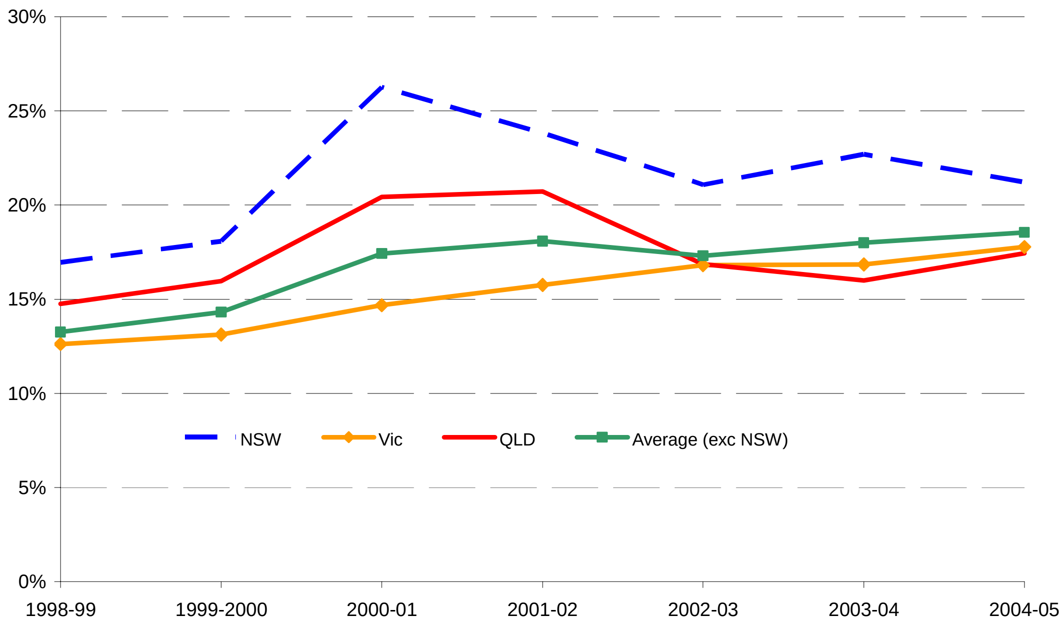
When compared with other jurisdictions and the all-state average in 2004-05, NSW tax expenditures were highest in the areas of gambling and motor vehicle taxes. It had the second highest tax expenditure for total stamp duties, behind Queensland, and well above the all-state average.

**Chart 8: Interstate composition of tax expenditures, 2004-05**




Based on Budget paper reported figures, NSW tax expenditure at the aggregate level appears relatively more generous than in other jurisdictions. Over the six year period to 2004-05, NSW tax expenditure as a proportion of tax revenue was consistently above Victoria, Queensland and the all-state average (see Chart 9).

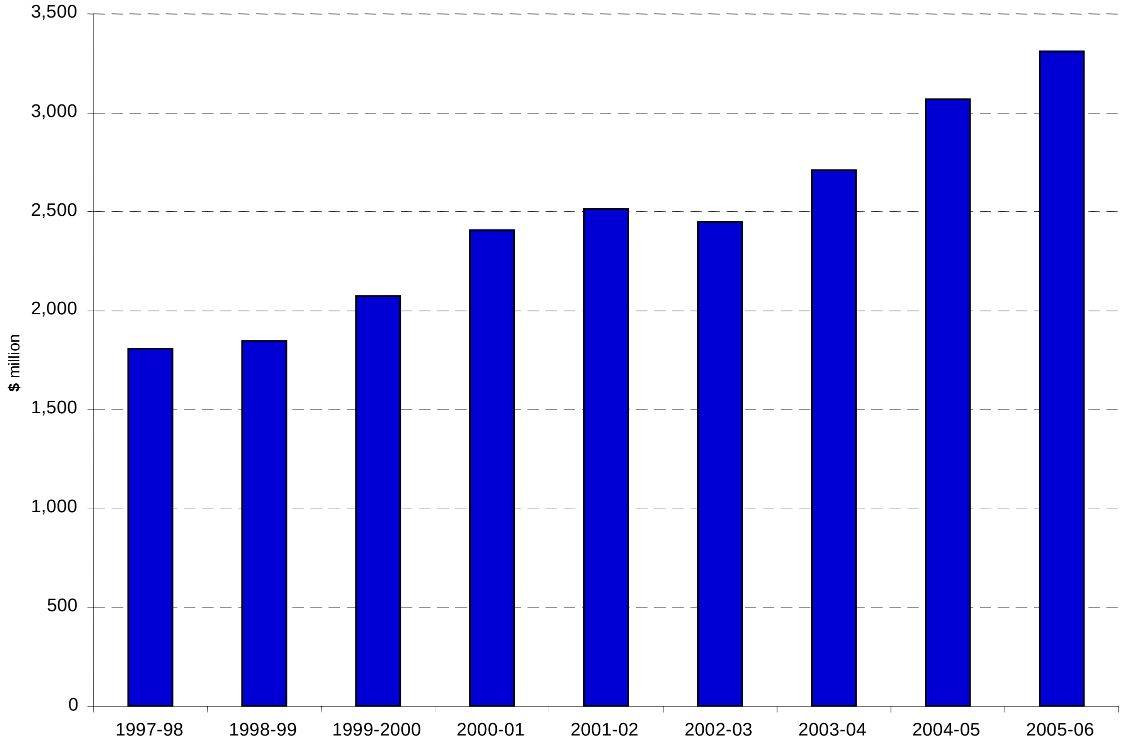
**Chart 9: Interstate comparison of tax expenditures to tax revenues**



## Growth trend

Tax expenditures have grown at an annual average rate of about 7 per cent from 2000-01 to 2005-06 (see Chart 10).

### Chart 10: Adjusted tax expenditures 1997-98 to 2005-06




When comparing NSW tax expenditures over time, it is important to bear in mind that the cost of tax expenditures can vary due to changes in the underlying tax, as well as changes in the tax concession itself. Also, improvements over time may be made in the coverage of tax expenditures costed and the costing of individual tax expenditures, which can affect the aggregate costing of tax expenditures.

To examine the extent of growth in tax expenditures, in the absence of tax policy decisions, the tax expenditures series has been standardised for the period 1997-98 to 2005-06. Policy decisions that did not directly affect tax expenditures, such as rate increases, have been removed from these figures. Tax expenditures relating to taxes abolished under National Tax Reform have also been removed, as well as tax expenditures relating to vendor duty and corporate reconstructions under purchaser transfer duty because of the lumpy nature of the concession.

### Anomalies in the NSW tax system

Tax concessions may impede the overall aim of building a tax system that is equitable, efficient and simple.

- **Equity:** state tax concessions for social welfare objectives may be more effectively addressed by other means including Commonwealth income tax concessions and social security payments.
- **Efficiency:** By narrowing the tax base, tax concessions impose higher costs on the economy and mean higher taxes for the remaining taxpayers.
- **Simplicity:** The additional legislation needed to define the preferential tax treatment makes the tax system more complex and adds to compliance costs.

It would be better to avoid duplicating Commonwealth responsibility, or making the tax system more complex or fragmented through preferential tax rates, exemptions and concessions.

The following table lists some of the major tax concessions. A full list is contained in Budget Paper Number 2 (2005-06), Appendix B.

| Tax Concession | Revenue Foregone |
|---|---|
| **Land tax exemption for land used for primary production**<br><br>Land qualifies for this exemption if it is zoned rural and its dominant use is primary production. For land that is not rural, an exemption depends on whether the use of the land:<br>• has a significant and substantial commercial purpose or character; and<br>• is engaged in for the purpose of profit on a continuous and repetitive basis (whether or not a profit is made). | $300 million. |
| **Land tax-free threshold for companies and trusts**<br><br>Most companies that own land are entitled to the tax-free threshold when assessing their tax liability. Some trusts – mainly superannuation trusts – also receive the concession. | $150 million. |
| **Land tax exemption for land used by racing clubs, retirement villages, and child care centres**<br><br>The Government exempts land owned or held in trust for any club promoting or controlling horse racing, trotting or greyhound racing and which is primarily used for such race meetings.<br><br>Land owned and used by retirement villages or residential parks that are predominantly occupied by retired persons are exempt from land tax.<br><br>Land qualifies for a land tax exemption if it used as a residential child care centre licensed under the *Children (Care and Protection) Act 1987 (NSW)* or a school registered under the *Education Reform Act 1900 (NSW).* | $97 million |
| **Motor vehicle tax exemptions for social security recipients**<br><br>Holders of a Pensioner Concession Card, Department of Veterans Affairs TPI or Gold War Widows card receive a full exemption on motor vehicle weight tax, registration fees and drivers' licence fees. | $180 million |

| Tax Concession | Revenue Foregone |
|---|---|
| **Petrol subsidies for areas around the Queensland border**<br><br>The petrol subsidy scheme applies five rates ranging from 1.67 cents per litre in areas furthest from the Queensland border to 8.35 cents closer to the border. | $40 million |
| **Clubs gaming machine GST rebate**<br><br>Clubs receive a rebate for GST paid on the first $200,000 of gaming machine income. | $20 million |
| **Payroll tax exemption for private schools**<br><br>Schools or colleges are exempt from payroll tax if they are not run by or on behalf of the state, are not for profit, and provide primary or secondary level education. | $105 million |
| **Payroll tax exemption for local councils**<br><br>Wages paid by a council or county council are exempt from payroll tax. The exemption does not extend to trade undertakings of local councils. | $150 million |
| **Insurance duty exemptions for compulsory third-party motor vehicle personal injury insurance and WorkCover premiums**<br><br>These premiums are exempt from the normal insurance duties. | $395 million |

## 14.2 Areas for review by the Government

As noted in Part A, NSW taxation powers are generally limited to narrow tax bases. These tax bases have been further eroded over time by the many exemptions, concessions and thresholds provided to certain taxpayers. Limiting growth of tax expenditures would strengthen the Budget position.

While acknowledging the difficulty of limiting long established tax expenditures, the Government should regularly review all tax expenditures to ensure that the specific situation, for which the concession was initially given, still warrants government assistance.

# Audit terms of reference

The terms of reference for Audit of Expenditure and Assets are to:

- advise on the overall cost impacts facing government funded programs arising from legislative, regulatory, policy, demographic and economic trends
- advise on options to reduce the cost of government services by improving efficiency through changes to administrative structures and by eliminating duplication and overlap between government agencies
- review the costs and benefits of government service delivery and provide advice on programs which may no longer represent value for money and whether improved outcomes are possible at lower or similar cost
- provide advice on options to reduce net government expenditure (now and in the future) including through use of non-tax options
- review the alignment of agency capital programs with government priorities
- examine existing property management practices across government and provide options to reduce costs and improve efficiency and co-ordination across agencies
- review government asset holdings
- examine existing non-property management across government and provide options to reduce costs and improve efficiency.

The Audit should provide progressive reports to the Minister for Finance on a monthly basis and a final report by 31 January 2006.