

Budget Controls – Net Cost of Services

All general government agencies are required to manage budgets within net cost of services limits. There is no tolerance limit but agencies may carry forward unspent limits to future years in certain circumstances. This Circular replaces Treasury Circular TC 06/19.

Summary:

This circular updates and replaces NSW Treasury Circular 06/19 and applies to all general government agencies.

It confirms net cost of services as a key Budget control mechanisms for the 2012-13 Budget. This is consistent with the new Enhanced Framework for Budget Compliance. That framework was communicated to all Ministers by the members of the Expenditure Review Committee of Cabinet on 8 September 2011.

The principal elements of the policy in this circular are:

- net cost of services limits apply to all general government agencies.
- net cost of services limits apply to the current year, budget year and each forward estimate year.
- there is no tolerance limit i.e. agencies must manage to or below the net cost of services limit.

The Coordinating Minister of a cluster, supported by the Director-General of the principal department, is required to:

- Ensure that net cost of services for each agency within a cluster is managed within limits for that agency.
- Meet any additional expenditure needs by reprioritising net cost of services limits between agencies in a cluster.

The primary means by which net cost of service limits can be adjusted is through the Budget process. This means approval must be sought for:

- any proposed increase in net cost of services limits for the cluster in aggregate.
- the carry forward of unspent net cost of services limits from the current financial year to a future financial year in the circumstances set out in this circular.

Mark Ronsisvalle
Deputy Secretary

Further Information: Your Agency's Treasury Analyst

NSW Treasury Internet: www.treasury.nsw.gov.au

Budget Controls - Net Cost of Services

1. Background

The Circular supports the implementation of financial management improvements which aim to strengthen budget control. This circular updates the control framework and is also consistent with the Government's commitment to devolve financial management responsibilities for clusters to Coordinating Ministers and the Directors-General of principal departments.

2. Net Cost of Services Limits

All general government agencies (including principal departments and all other departments and statutory bodies in Budget Paper 3) must operate within approved net cost of services control limits for the current year, Budget year and three forward years. Agencies are advised of approved limits by the final allocation schedules issued at the end of each Budget cycle with any variations to this being advised through specific correspondence issued by the Treasurer or Treasury.

The financial reporting formats now adopted in Budget Paper No. 3 and the Financial Reporting Code for general government agencies will no longer specifically highlight the net cost of services. A single reporting format, highlighting total expenses and total revenues (including recurrent and capital appropriations), has been adopted to accommodate all general government agencies. This includes those agencies funded directly by appropriations, those funded by grants from a principal department and those funded through their own revenue sources.

The individual components of net cost of services will still be identifiable in financial statements. Net cost of services comprises:

- Expenses
- Less: Revenues*
 - Sale of goods and services
 - Investment revenue
 - Retained taxes, fees and fines
 - Grants and contributions
 - Other revenue
- Less: Gain/(loss) on disposal
- Less: Other gains/(losses)

* Excludes direct Appropriations and crown accepted revenue items

3. No Tolerance Limits

The net cost of services tolerance limits that previously existed have now been removed. This reflects the Government's commitment to rigorous Budget control and the expectation that budget variances will be managed within individual clusters.

4. Setting Net Cost of Services limits in the Budget Process

Agency net cost of services limits are set during the Budget process or through approved adjustments during the year. These variations are approved by either the Treasurer (in consultation where necessary with the Expenditure Review Committee of Cabinet) or Treasury under delegation.

5. Applying Net Cost of Services limits during the current year

Clusters are expected to manage their finances within net cost of services limits. Any additional expenditure needs and cost pressures should be managed through re-prioritisation within the cluster.

The Coordinating Minister, supported by the Director-General of the principal department in the cluster, has the flexibility to meet any additional expenditure needs and cost pressures through reprioritisation of resources within the cluster.

Coordinating Ministers can exercise this flexibility by increasing the net cost of services limit of one agency in a cluster with an offsetting reduction in the net cost of services limit in another cluster entity. The principal department must write to Treasury to advise that the Coordinating Minister has exercised this discretion providing details (including reasons) for the change concurrently with the submission of monthly monitoring data.

Approval for additional funding and increases to the approved net cost of services limit for the cluster as a whole will be considered only in exceptional circumstances.

6. Carrying forward expenditure at the end of the financial year

In appropriate circumstances and subject to the approval process below, unspent net cost of services limits may be carried forward from the current financial year to a future financial year.

The need to carry forward expenditure can arise for a number of reasons. For operational efficiency, an agency may need to change the timing of expenditure from that originally planned.

Criteria for carrying forward expenditure

Any approved carried forward expenditure will need to be spent on either the purpose for which it was provided (i.e. the expense is just a timing adjustment), a core service need of the agency or an expenditure which will provide an ongoing benefit to the operations of an agency.

The expenditure must not be for activities that would lead to additional ongoing future costs over and above the agency's baseline forward estimates (for example, spending on employing any additional permanent staff).

Proposals to carry forward expenditure will be considered by Treasury under two categories:

- A. Unspent revenues and/or under expenditure on items that were budgeted to be funded from non-consolidated fund appropriations (e.g. to be funded from revenue or cash balances); and
- B. Unspent consolidated fund appropriations, including unspent Commonwealth funded programs.

The following types of variances cannot be carried forward:

- Protected Items that are demand driven
- A gain/loss on sale of assets that impacts on the operating statement
- Depreciation expense
- Non-cash long service leave expenses
- Other specific non-cash items (e.g. a non-cash revenue variation).

Process for approving carry forward of expenditure

The process for seeking approval to carry forward expenditure to the next financial year, or potentially into a forward year if that reflects a better resource allocation outcome, is as follows:

- Any timing adjustments that can be identified by February should be dealt with in the Budget process via a parameter and technical adjustment and, subject to approval, will be advised in the March/April allocation letters.
- For other timing adjustments, agencies should determine that the proposed carry forward expenditure will meet the required criteria and seek in-principle agreement from Treasury
- The final audited accounts will be used to determine the amount for any potential carry forwards consistent with the carry forward policy.
- Agencies will need to submit a formal request to Treasury indicating the category of proposed expenditure. It should be clear that the adjustment will not create any additional expenditure above the carry forward amounts.
- Category A items (unspent revenue/cash), if supported, will be approved by the Treasurer or Treasury.
- Category B items (unspent consolidated fund appropriations) will be assessed by Treasury to determine whether the amount can be met from the Treasurer's Advance or whether an additional Appropriation Bill is required.
- It is envisaged that these last two steps will be undertaken and completed around September/October each year.

7. Net Cost of Services and Consolidated Fund

The net cost of services limit is the principal mechanism used to ensure agencies operate broadly consistent with the accrual based Budget Result and that agencies are managing the full range of resources under their management.

Treasury's normal controls relating to appropriations and the processes determining the Liability to Consolidated Fund continue to apply. Agencies that receive a recurrent or capital appropriation will need to calculate a liability to Consolidated Fund at year end. In calculating the liability, principal departments that provide grant funding to other departments and statutory bodies in their cluster can treat these appropriations as spent when the grant is paid to the recipient agency.

Should you have any queries on this Circular, please contact your agency Treasury analyst.

New carry forward process – illustrative example

The following example illustrates the new carry forward process.

	Budget \$'000	Actual \$'000	Variance \$'000	Carry Forward \$'000
Core State funded programs	400,000	400,000	0	
Demand driven programs (protected)	100,000	98,000	(2,000)	
Expenditure from agency cash balances	10,000	9,500	(500)	500
Expenditure funded by agency revenue	60,000	56,000	(4,000)	4,000
Agency revenue funding expenses	(60,000)	(60,000)	0	
Commonwealth National Partnerships	50,000	45,000	(5,000)	5,000
Gain/loss on sale of assets	0	(200)	(200)	
Depreciation expense	5,000	5,150	150	
Long service leave (CTE accepted)	2,000	1,900	(100)	
TOTAL NCoS	567,000	555,350	(11,650)	9,500

The above example has resulted in a total carry forward amount of \$9.5 million. Of this amount:

- \$4.5 million is a category A amount (unspent revenue/cash)
- \$5 million is a category B amount (Consolidated Fund appropriation).