

ADDITIONAL SUBMISSION TO SENATE SELECT COMMITTEE ON STATE GOVERNMENT FINANCIAL MANAGEMENT

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As requested at my appearance before the Senate Select Committee in Melbourne on 19 May 2008, I am providing additional information on the various budget balance (surplus/deficit) measures reported in the 2008-09 Victorian State government budget. Parallel Commonwealth figures are shown for comparative purposes. Forward estimate figures for the Victorian budget balance measures are also presented, and a discussion of the basis for the alternative budget balance measures completes the submission.

1. Summary of major alternative Commonwealth and Victorian 2008-09 budget balance (surplus/deficit) measures.

The table below indicates that the Commonwealth, adopting a cash-based measure (*underlying cash balance*), has budgeted for a cash surplus of \$21,703m (ie \$21.7b) for the coming financial year (2008-09). The Victorian government, adopting an accruals based *net operating balance* basis for its budget balance, has announced a budget surplus of \$827.5m. However, if the Commonwealth's underlying cash balance measure had been used, a surplus of only \$10.2m would have been announced. Further, if the *fiscal balance*, the accrual-based equivalent to the cash-based underlying cash balance, had been adopted, a *deficit* of \$441.7m would have been announced.

Budget Balance Measure	2008-09 Budget Balance	
	Commonwealth	Victoria
Cash Measure:		
Underlying Cash Balance	\$21,703m surplus	\$10.2m surplus
Accrual Measures:		
Net operating balance	\$26,994m surplus	\$827.5m surplus
Fiscal Balance	\$23,122m surplus	\$441.7m deficit

Figures in bold denote budget balance measure used in government announcement.

The major difference between the accruals-based net operating balance method on the one hand and the accruals-based fiscal balance and the cash-based underlying cash balance on the other is that the former (net operating balance) is a measure of recurrent revenues less expenses. In contrast, the latter two (fiscal balance and underlying cash balance) take into account the effect of net capital investment (also referred to as the net acquisition of non-financial assets).

A further understanding of Victoria's budget position can be obtained by examining the *forward estimates* of the three budget balance measures disclosed in the 2008-09 budget. The table on the following page summarises these.

	Forward Budget Estimates		
	2009-10 (\$m)	2010-11 (\$m)	2011-12 (\$m)
Net operating balance	851.1	906.0	962.6
Underlying cash balance	(450.7)	(580.9)	(979.9)
Fiscal balance	(351.9)	(626.8)	(1,836.2)

Figures in parentheses denote a deficit.

The table above indicates healthy Victorian budget surpluses on the net operating balance measure for the three forward estimate years (2009-10, 2010-11 and 2011-12). However, the underlying cash balance measures indicate increasing deficits over the forward estimates period, and the fiscal balance shows even larger deficits in the latter two years. Taken together, the alternate budget balance measures indicate an increasing level of capital expenditure being budgeted for by the Victorian government, with these expenditures being financed by increased borrowings.

A brief summary of the basis for the alternate budget balance measures is provided in the following section.

2. Basis for alternative budget balance measures.

A number of major financial statements are produced pursuant to financial reporting (accounting) requirements. These are an operating statement, a cash flow statement and a balance sheet. Alternative budget balance (surplus/deficit) measures can be drawn from the first two of these financial statements. Accrual-based measures are derived from the operating statement, while cash-based measures are derived from the cash flow statement.

The accrual-based operating statement presents details of (a) revenue and expense transactions, and (b) the net acquisition of non-financial assets (net capital investment) for an accounting period. The format of the operating statement results in two measures that represent alternative budget balances. The first section of the operating statement comprises revenues less expenses, these essentially being recurrent items arising from transactions. The balance of revenues less expenses represents the *net operating balance*. The revenues and expenses are calculated on an accruals basis, with depreciation included as an expense. The net operating balance represents the change in net worth due to transactions.

The second section of the operating statement deducts the net acquisition of non-financial assets (net capital investment) from the net operating balance. Depreciation expense is added back to avoid double counting, and this results in the fiscal balance (also referred to as the *net lending/borrowing balance*). Hence, the fiscal balance comprises the net operating balance plus depreciation expense less net capital investment.

Also prepared pursuant to the accounting frameworks is a cash flow statement, indicating the budgeted net increase or decrease in cash held. The cash flow statement presents cash flows dissected between operating, investment and financing activities, with cash flows from investment activities further dissected according to whether they are investments in a) non-financial assets, b) financial assets for policy purposes, or c) financial assets for liquidity management purposes. Accordingly, from the cash flow statement, a cash based measure of the budget balance can be derived. The Commonwealth government's underlying cash balance is calculated as net cash flows from operating activities (essentially recurrent receipts and expenditures) less expenditures for the net acquisition of non-financial assets.