CHARTER OF BUDGET HONESTY

POLICY COSTING GUIDELINES

GUIDELINES ISSUED JOINTLY BY THE SECRETARIES
TO THE TREASURY
AND THE DEPARTMENT OF FINANCE AND DEREGULATION
2012

ISBN 978 0 642 74829 4

Printed by Canprint Communications Pty Ltd

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INTRODUCTION

The *Charter of Budget Honesty Act 1998* (the Charter) outlines arrangements under which the Secretaries to the Treasury and the Department of Finance and Deregulation (the Secretaries) may be requested to cost election commitments during the Caretaker Period prior to a general election. The Charter also allows for the Secretaries to jointly issue written guidelines recommending approaches or methods to be used in the preparation of such costings.

Following the establishment of the Parliamentary Budget Office (PBO) and its ability to prepare policy costings, the Secretaries consider it timely to issue these updated guidelines. They reflect the PBO's mandate and functions, as well as details of the amendments that were made to the Charter when establishing the PBO (Part 2), including allowing minority parties with at least five members to request election costings from Treasury and Finance. Parts 3 to 5 provide information relating to the processes and conventions used in preparing policy costings. These guidelines should assist in promoting consistency, transparency and comparability of the costings performed by the Departments and the PBO.

This document has six parts:

- Part 1 outlines the main statutory provisions for costing election commitments in the Charter;
- Part 2 provides details of the mandate and functions of the PBO, including information relating to the associated changes that were made to the Charter;
- Part 3 outlines the process by which Treasury and Finance update the economic and fiscal estimates;
- Part 4 outlines the aims of the Secretaries in undertaking policy costings and the broad methods to be followed;
- Part 5 specifies how requests for costings should be made, including the information required for a costing to proceed and the processes for dealing with requests; and
- Part 6 deals with issues relating to the content and timing of public reports on policy costings released by the Secretaries.

Appendices A and B provide further details on estimate updates and costing conventions. The methodology used to cost policies is under constant review to ensure it remains appropriate. The guidelines will be updated where the methodology significantly changes.

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Secretary to the Treasury

Mr David Tune PSM
Secretary of the Department of Finance and Deregulation

PART 1: STATUTORY PROVISIONS — SUMMARY

Part 8 of the Charter sets out the arrangements for the costing of election commitments.

Those provisions apply only during the Caretaker Period following the issuing of a writ for a general election. They relate to the costing of publicly announced policies of the Government, the Opposition and minority parties (a party with five members or more in the House of Representatives and/or the Senate). The ability of the minority parties to request costings from Treasury and Finance during the Caretaker Period follows an amendment to the Charter at the time of the establishment of the PBO. Some of the more significant amendments that were made to the Charter at that time are set out below.

The obligations of the Charter are independent of, but have precedence over, the Caretaker Conventions. The Charter makes no provision for costing publicly announced election commitments made by independent Senators or Members or parties with less than five members.

MAIN CHANGES TO THE CHARTER SINCE THE PREVIOUS GUIDELINES WERE ISSUED

As well as establishing the PBO, the changes to the *Parliamentary Service Act 1999* (the PS Act) also amended some provisions in the Charter. While many changes are intended to improve clarity or terminology, a summary of the more significant amendments are listed below.

Definition of Caretaker Period

The definition of 'Caretaker Period' for a general election begins when the House of Representatives expires or is dissolved ahead of that election, and ends when it is clear that the Government has been re-elected or, if there is a change of Government, when the new Government has been sworn in.

The revised definition ensures that the Caretaker Period in the Charter is consistent with the definition in the *Guidelines on Caretaker Conventions* (the current version can be found at www.dpmc.gov.au/guidelines/index.cfm).

The leader of a minority party may access election costings provisions

The Charter allows any parties with at least five members in the Parliament to request election costings from Treasury and Finance. In contrast, parties with fewer than five members in either House of Parliament and independent members of Parliament will only have access to the election costing provisions of the PS Act.

Should the Leader of a minority party (a party with five members or more in the House of Representatives and/or the Senate) wish to request the Secretaries to prepare costings of publicly-announced policies under the Charter, he or she will need to follow the standard process which is set out in the section below.

Prohibition against duplicate costings

There are provisions in both the Charter and the PS Act that are intended to preclude Parliamentary parties from seeking duplicate costings of the same, or a substantially similar, policy from both the PBO and Treasury and Finance during a particular Caretaker Period.

REQUESTS FOR THE COSTING OF ELECTION COMMITMENTS

The Charter, under Clause 29, details how requests for the costing of election commitments are to be made. It provides that, during the Caretaker Period, the Secretaries may be asked by the Prime Minister, the Leader of the Opposition or the Leader of a minority party, through the Prime Minister, to cost their publicly announced policies.

A request is to:

- be in writing;
- fully outline the policy to be costed, giving relevant details; and
- state the purpose or intent of the policy.

A request from the Leader of the Opposition or the Leader of a minority party is to be provided to the Prime Minister, who may then refer it to the responsible Secretary. Secretaries are not obliged or authorised to take action in relation to any request, unless the Prime Minister has referred the request to them. The Prime Minister, the Leader of the Opposition or a Leader of a minority party may withdraw a request at any time. A withdrawal by the Prime Minister must be in writing to the Secretaries. A written withdrawal by the Leader of the Opposition or a Leader of a minority party is to be given to the Prime Minister, who will then notify the Secretaries of the withdrawal.

HOW POLICY COSTINGS ARE PREPARED

The Charter, under Clause 30, details how the policy costings are to be prepared. It provides for the Secretaries to issue written guidelines (this booklet) recommending approaches or methods to be used in preparing costings (see Parts 3 and 4 and Appendices A and B). It also divides responsibility for costings between the Secretaries: the Secretary to the Treasury is responsible for costing policies affecting taxation revenue and taxation expenditure; while the Secretary of the Department of

Finance and Deregulation is responsible for costing policies that affect outlays and expenses and non-taxation revenue.

If necessary, in order to fully cost a policy, the relevant Secretary may request, in writing, more information from the Prime Minister, the Leader of the Opposition or the Leader of a minority party.

COMMONWEALTH BODIES' ASSISTANCE IN PREPARING COSTINGS

Clause 32 provides for Australian Government bodies to provide information to help prepare costings at the request of either Secretary.

PUBLIC RELEASE OF COSTINGS

The Charter, under Clauses 31 and 31A, outlines the requirements for the public release of policy costings. For requests made before polling day, Clause 31 of the Charter requires the relevant Secretary to publicly release the request and a costing as soon as practicable after the request is received and before polling day. If the costing cannot be undertaken before polling day, either due to insufficient information or time constraints, the relevant Secretary is to publicly release a statement to that effect, and the request is taken to have been withdrawn on that day. Secretaries are not obliged or authorised to take any further action in relation to a policy costing request on or after polling day.

For requests made after polling day, where the Caretaker Period extends after that day, Clause 31A of the Charter requires the relevant Secretary to publicly release a costing as soon as practicable after the request is received. If the costing cannot be undertaken before the end of the Caretaker Period, either due to insufficient information or time constraints, the relevant Secretary is to publicly release a statement to that effect, and the request is taken to have been withdrawn at the end of the Caretaker Period. Secretaries are not obliged or authorised to take any further action in relation to a policy costing request after the end of the Caretaker Period.

PART 2: THE MANDATE AND FUNCTIONS OF THE PARLIAMENTARY BUDGET OFFICE

The Parliamentary Budget Office (PBO) was established through amendments by the *Parliamentary Service Amendment (Parliamentary Budget Officer) Act 2011* (the PS Act) on 15 February 2012. Its creation followed a review by the Joint Select Committee on the Parliamentary Budget Office (the Committee), with the PBO's mandate and functions consistent with all of the Committee's recommendations.

These legislative amendments established the PBO as a separate Parliamentary Department and created the position of the Parliamentary Budget Officer (the Officer) as an independent statutory office holder. The PS Act also amended the Charter to clarify the responsibilities of the Secretaries, change the definition of Caretaker Period, allow the Leader of a minority party to have that party's election policies costed and prohibit duplicate costings being undertaken by the PBO and the Secretaries.

MANDATE OF OPERATION

The role of the PBO, as set out in Clause 64B of the PS Act, is to inform the Parliament by providing independent and non-partisan analysis of the Budget cycle (that is, policies and proposals developed throughout the Budget year, as well as the evolution of estimates and the fiscal outlook publicly released during the year), fiscal policy and the financial implications of proposals.

To facilitate these activities, the PS Act allows for the development of working arrangements between the Officer and Australian Government bodies in the form of a Memorandum of Understanding (MOU). This would establish a framework for the exchange of data and information between the PBO and Government bodies, including the use and disclosure of that information.

PBO FUNCTIONS

Clause 64E of the PS Act specifies that the Officer will:

- outside of the Caretaker Period — prepare policy costings upon request of individual Senators and Members of Parliament;

- within the Caretaker Period —consistent with the Charter, prepare election policy costings upon request from a Parliamentary party or a sitting independent member of Parliament seeking re-election;

  : confer with Treasury and Finance to avoid duplication of costings of the same policy proposal during the Caretaker Period;

- prepare responses to budget-related requests of individual Senators and Members in line with the PBO's mandate;
- provide submissions to relevant Parliamentary Committee inquiries; and
- initiate its own work in anticipation of client interests, including general research and analysis of the budget and fiscal policy settings.

While the PBO may undertake analysis of the Government's forecasts and estimates by examining methodologies and assumptions underpinning these figures, its mandate does not include the production of economic or budget forecasts or estimates, either at the whole-of-government or program level. This means that the PBO's analysis and costings will incorporate the latest published economic forecasts and fiscal estimates produced consistent with the Charter (that is, the Budget, the Mid-year Economic and Fiscal Outlook (MYEFO) or the Pre-election Economic and Fiscal Outlook (PEFO)). Further information is provided on this aspect of the Officer's role in Part 3.

PREPARATION OF POLICY COSTINGS

Under Clause 64G of the PS Act, the Officer must prepare policy costings using approaches and costing conventions recommended in the most recent guidelines issued under the Charter. With the agreement of the Secretaries, however, the Officer can issue alternate written principles; these must then be made publicly available.

In the absence of this alternative approach being sought by the Officer, the guidelines in this document constitute the basis for the preparation of policy costings. In particular, Part 4 sets out the requisite costing protocols and methods to be used, and Appendix B summarises the costing conventions that the Officer will be expected to follow.

CONFIDENTIALITY ARRANGEMENTS

The PS Act allows for a request for a costing initiated by a Senator or Member of Parliament *outside the Caretaker Period* to be treated as confidential. In contrast, requests to the PBO seeking election policy costings *within the Caretaker Period* must be made publicly available, consistent with the Charter and with the current publication arrangements employed by Treasury and Finance.

As noted above, it is expected that a MOU entered into by Commonwealth Heads with the Officer will establish a framework for Commonwealth bodies to handle confidential costing requests lodged with the PBO.

Public release of requests and costings — requests made *before* polling day

In terms of the public release of costings, the PS Act distinguishes between policy costing requests that are made before polling day for a general election and requests that are made on or after polling day during the Caretaker Period.

Where a policy costing is requested before polling day, but the responsible Secretary has not had sufficient time or information to prepare and publicly release the policy costing, the request is deemed to have been withdrawn on polling day.

Where policy costing requests are deemed to have been withdrawn and the Caretaker Period for that general election extends beyond the polling day, should those parties wish to have those particular policies costed, the requests must be formally re-submitted to either the Officer or under the Charter, so that the costing may be completed and released after polling day.

Public release of requests and costings — requests made *on or after* polling day

The Charter now makes provision for policy costing requests that are made after polling day where the Caretaker Period continues beyond polling day.

These amendments recognise that, on such occasions, it will be necessary to distinguish between pre- and post-polling day costing requests and to establish processes that the Secretaries must follow in responding to these requests. The provisions relating to post-polling day costing requests will be similar to those relating to pre-polling day requests in that, as soon as practicable after the request has been made, the responsible Secretary is to prepare and publicly release a costing of that policy.

Should the responsible Secretary have insufficient information or time to prepare and publicly release the policy costing before the end of the Caretaker Period, then they will be required to release a statement to that effect as soon as practicable after the end of the Caretaker Period. In addition, the costing request will be deemed to have been withdrawn at the end of that Caretaker Period, and the responsible Secretary will not be obliged or authorised to take any further action in relation to the request.

PART 3: PREPARATION OF THE PRE-ELECTION ECONOMIC AND FISCAL OUTLOOK

PRE-ELECTION ECONOMIC AND FISCAL OUTLOOK

The Secretaries of Treasury and Finance must jointly release a PEFO within 10 days of the issue of a writ for a general election. The PEFO is to include updated fiscal estimates for the Australian Government general government sector[1] over the forward estimates period, as well as the economic and other assumptions that have been used in preparing these fiscal estimates. The information in the PEFO report is to take into account, to the fullest extent possible, all Government decisions made before the issue of the writ and all other circumstances that may have a material effect on the fiscal and economic outlook. The PEFO also includes sensitivity analysis and an updated statement of risks.

The procedures for updating the economic and fiscal forecasts are similar to those used by successive Governments to develop the Budget and the MYEFO, with the main differences being the more limited amount of time available to prepare the PEFO.

In recognition of this fact, the Charter provides that information which is unchanged from that provided in an earlier economic and fiscal report may be summarised in the PEFO. As the Parliamentary Budget Officer must use the economic forecasts and parameters and fiscal estimates contained in the most recent relevant report released under the Charter to undertake the PBO's functions — including costings — this section has been included as a useful guide to the procedures and conventions used in developing these documents.

ESTIMATES UPDATES

The Government employs a medium–term estimates framework made up of rolling estimates for the Budget year and the three subsequent years (collectively known as the forward years). The rolling four-year estimates are regularly reviewed and an extra 'out year' is added when the Budget is prepared.

Further information on particular aspects of estimates updates can be found at Appendix A.

1 The general government sector comprises of Government departments and agencies that provide non-market public services and are funded mainly through taxes (for example, the Australian Broadcasting Corporation).

ECONOMIC FORECASTS

Treasury generally has two major economic forecasting rounds in the year. One is used as the basis for the government's forecasts published in the Budget each May, and the other forms the basis for the revised forecasts published in the MYEFO. Two other rounds are also held, around June and December following the publication of the quarterly national accounts.

In years where a PEFO is being prepared outside of this cycle, an additional forecasting round will be held. Compared with typical forecasting rounds, a PEFO forecasting round will be more condensed, as the PEFO report must be released within a 10 day timeframe.

The major data inputs into the forecasting process are from the Australian Bureau of Statistics (ABS), supplemented by data from other providers, and business and consumer survey data. This quantitative information is tested against information from Treasury's business liaison program and other contacts. The quarterly national accounts are an integral part of the process, as the national accounts form the framework for the forecasting exercise.

At the start of a forecasting round, the technical assumptions about interest rates, exchange rates and oil prices are reset in the light of recent developments. The usual assumption is that exchange rates and oil prices will remain around recent average levels, and that interest rates will evolve in line with market expectations. These assumptions are not always applied mechanically — for example, if the path for interest rates implied by market yields is diverging from the forecasts made by market economists, then weight may be given to both sources of information in arriving at a technical assumption. The assumptions are revisited throughout the round if there are significant movements in any of the variables.

Treasury's forecasts are subject to an external quality test through the Joint Economic Forecasting Group (JEFG), which meets three times a year. At these meetings, the forecasts are discussed with representatives from the Reserve Bank of Australia, the Department of the Prime Minister and Cabinet, the Department of Finance and Deregulation and the ABS. The JEFG process also benefits from extensive input and consultation with other economic agencies through meetings of two JEFG sub-committees. These are: the Balance of Payments JEFG sub-committee (which includes officials from the RBA, ABS and the Bureau of Resources and Energy Economics) and the Public sector JEFG sub-committee (which includes the RBA, ABS and Department of Finance and Deregulation). Due to the time constraints during a PEFO forecasting round, there is no JEFG committee meeting although the Treasury conducts informal discussions with other JEFG partners as part of the forecasting process.

Forecasts are usually generated for the budget year and the next year, and projections for an extra two years. Forecasts take into account cyclical variation in economic activity, whereas projections are based on long-term average growth rates and assumptions (for example, the annual growth in the Consumer Price Index (CPI) is assumed to be 2½ per cent in the projection years, in line with the mid-point of the Reserve Bank's inflation target).

The forecasts and projections for the major economic parameters (such as real Gross Domestic Product growth, employment growth, and CPI growth) are published in the PEFO. These published macroeconomic aggregates are underpinned by the more detailed, disaggregated sectoral estimates, some of which are published in the Budget and MYEFO.

The forecasts and projections for the economic variables that influence the revenue, capital and expenses estimates are sent to the Commonwealth bodies that prepare these estimates. This process is discussed below.

REVENUE ESTIMATES

Revenue estimates are underpinned by the economic forecasts developed by Treasury, as well as tax collections information from the Australian Taxation Office and the Australian Customs and Border Protection Service. Data relating to oil and gas production from the Department of Resources, Energy and Tourism are also incorporated. The forecasts also account for new policy, results of court cases, variations in the tax collection due dates from year to year and other relevant information.

Final revenue forecasts are entered into CBMS for consolidation into fiscal aggregates.

A reconciliation table is published in the relevant Budget documents, detailing how the revenue estimates have changed in the current round, abstracting from policy decisions.

EXPENSE ESTIMATES

Expense estimates are also updated before publishing the PEFO report, as required under the Charter.

Expense estimates of the Commonwealth bodies which comprise the Australian Government general government sector are prepared and bodies enter any revised estimates into the Government's estimates system, the Central Budget Management System (CBMS).

These must reflect: government decisions or measures since the previous estimates update; approved movement of funds (changes of estimates between years without any overall increase in program costs); parameter updates (changes in economic parameters or program specific parameters); and up-to-date departmental and administered program estimates for all years. The estimates prepared by bodies are reviewed by Finance and validated in CBMS if agreed.

In a compressed PEFO update, Finance and Commonwealth bodies will first focus on incorporating any movements in the larger demand-driven programs in the estimates update. Further information on the processes for updating expense estimates is included in Appendix A.

PART 4: COSTING PROTOCOLS AND METHODS

SECRETARIES' OBLIGATIONS IN COSTING POLICIES: CLARITY AND TIMELINESS

The Secretaries will aim to be clear, transparent and timely in costing policies. In undertaking policy costings, the Secretaries will:

- endeavour to provide their best estimate of the full cost of a policy (including departmental expenses where requested and feasible);
- endeavour to complete the costing in the shortest time possible, generally within five business days (noting that where additional information is required, the five days will exclude the time taken to obtain the additional information);
- cost policies in a manner consistent with methodologies used to prepare the Budget statements and fiscal reports required under the Charter;
- cost Government, Opposition and minority party policies in a consistent manner;
- only provide financial costings, and not provide policy advice or assessments of the economic impact of policies; and
- produce a self-contained written report on the costing that fully justifies the published costings.

COSTING VARIABLES

In costing policies, the Secretaries will use standard approaches and conventions that are consistent with normal Budget costing methodologies. Key approaches and conventions are set out in more detail below. A list of costing conventions is at Appendix B**.**

Costing estimates will be provided for the current financial year plus the following three years. Where a revenue/expense cost is likely to be significantly different beyond this forward estimates period — for example, because the measure is not scheduled to commence or reach 'maturity' until after the forward estimates period — it may be necessary to include a statement about the financial impact of the policy in the relevant years beyond the forward estimates. For instance, where a measure is terminating after the four forward estimates years (for example, after a 10 year period), the Secretaries will endeavour to provide their best estimate of the cost of the policy in the relevant years beyond the forward estimates.

Policies will be costed in accrual and cash terms, with both the impact on the fiscal balance and the underlying cash balance reported as well as the impact on the headline cash balance as appropriate. It is expected that most costings will involve revenue elements only or expense elements only. However, where relevant, the revenue and expense components of a policy will be identified separately.

As with existing arrangements, individual costings may take account of direct behavioural responses, but will generally not incorporate second round effects. The costing will focus on first round effects and the direct budgetary consequences of policies. Similarly, costings will generally not account for the impact on Public Debt Interest (PDI) payments, unless it is an explicit policy objective to affect the level of interest payments, or the policy involves transactions of financial assets (such as loan schemes). PDI costings will normally assume no change to the debt management strategy.

In the case of costing a policy package, both the cost of individual components and the overall cost of the package will be undertaken and, where feasible to do so, the effect of one component of a package on another will be taken into account and reported.

Where there is a difference between a costing request and the publicly released policy, an effort will be made to clarify the difference. If that is not possible, the costing will be based on information provided in the costing request.

COSTING ASSUMPTIONS

Consistency and transparency of costing assumptions

Assumptions used in costings (for example, the numbers of people making use of a particular rebate or estimates of taxable incomes) will be the most appropriate available, based on the best professional judgment of the Secretaries. As noted in Part 6, the nature of assumptions used will be made clear by the Secretaries when publicly releasing costings and any caveats associated with the assumptions will be outlined. To maintain consistency, assumptions used in one policy costing will generally be used again for costing similar policies.

The Charter allows the Secretaries to request an Australian Government body (for example, other government departments or agencies) to provide information to assist in the costing. An Australian Government body is required by the Charter to comply with such a request in time to allow the information to be taken into account in the preparation of the policy costing, unless it is not practicable for the body to do so, or where providing the information would contravene another law of the Commonwealth. The Secretaries will ensure consultations take place with other relevant departments or agencies, at senior management level, as a matter of course in producing a costing, so as to help ensure the assumptions chosen are the most appropriate. However, the final responsibility for the assumptions used will remain with the Secretaries.

Any economic data or forecasts used in costings will be consistent with the most recent publicly released estimates. The PEFO will be the basis of the economic parameters to be used in costing election commitments.

Assumptions regarding behavioural responses of the people affected by policies will be taken into account where it is normal practice to do so. In some instances, behavioural effects will be a significant element of the costing. Where there are significant behavioural effects, the assumptions used in the costing will be clearly identified in the publicly released costing report. In some cases, behavioural responses will be highly uncertain, ambiguous, difficult to quantify or of small magnitude. In these situations, the treatment of behavioural effects, if any, will be made clear in the costing report. The inclusion of behavioural effects in costings will reflect the best professional judgment of the Secretaries and will be decided on a case by case basis. Where appropriate, sensitivity analysis will be undertaken to demonstrate the impact of different assumptions regarding behavioural responses.

While costings will generally be the Secretaries' best assessment of the cost of a policy, in cases where assumptions are particularly uncertain, Secretaries may choose to publish costings as a range of possible outcomes.

Variations in assumptions from those specified by parties

Where a Treasury/Finance or a joint costing uses different assumptions to those specified in a party costing request, the costing advice will explain the reason for using those different assumptions.

PART 5: REQUESTS FOR COSTINGS AND PROCESSING

REQUESTS FOR COSTINGS — PROCEDURES AND STANDARDS

Further to Part 1, requests for costings can be made during the Caretaker Period prior to a general election. They must be made by the Prime Minister, or the Leader of the Opposition or the Leader of a minority party through the Prime Minister. The Secretaries are not obliged to take any action on requests unless they are received through the Prime Minister.

The provision of full information to the Secretaries at the outset will help to minimise unnecessary delays. Requests for costings are to: be in writing; fully outline the policy to be costed, giving relevant details, including any underlying assumptions; and state the purpose or intention of the policy. Appendix C contains a pro-forma indicating the information normally required for a costing to be prepared.

A request should fully outline the design features of the policy. It will assist in the preparation of costings if detailed information is provided on the assumptions that parties may have used in making their own assessments regarding the cost of policies. However, it should be noted that all assumptions used in the costing will be those of the Secretaries. Where there is an inconsistency between the stated intention of the policy and its design features, the policy will be costed on the basis of its design features.

Departmental expenses will be included in costings where analysis of the policy shows that these are material. In undertaking the costing of departmental expenses, existing programs/policies of a similar nature will be used as a guide.

RESPECTIVE RESPONSIBILITIES OF THE DEPARTMENT OF THE TREASURY AND THE DEPARTMENT OF FINANCE AND DEREGULATION

Under the Charter, the Secretary to the Treasury is responsible for costing aspects of policies affecting taxation revenue and taxation expenditure, while the Secretary of the Department of Finance and Deregulation is responsible for costing aspects of policies that affect government outlays and expenses, and non-taxation revenue.

Policies that have implications for both taxation revenue and expenses will be jointly costed by the Secretaries. Costing requests received will be divided between the Secretaries on a case-by-case basis. In some cases, it may not be clear if a policy will affect only revenue or expenses. It is therefore suggested that, to facilitate timely and accurate costings, costing requests should be forwarded to both Secretaries simultaneously. In such cases, the Secretaries will ensure close consultation between their Departments in administering the costing process in order to minimise delays.

It is also expected that the Departments will liaise closely with the PBO to ensure that similar policies are not costed by both organisations.

Upon receiving a request from — or through — the Prime Minister, the relevant Secretary (or Secretaries jointly) will issue a press release to inform the public they have been asked to cost a policy. The press release will broadly outline the policy to be costed.

TIMELINES FOR SUBMITTING COSTING REQUESTS

Costing requests should desirably be submitted to the relevant Secretary during business hours, preferably by 5.30 pm on a weekday. Business hours for the purpose of these guidelines are the weekday hours from 8.30 am to 5.30 pm. Requests received by Secretaries outside of these hours will be taken as having been received the next business day, unless otherwise specifically agreed in advance with the relevant Secretaries. These timing conventions will apply to both the public release of information regarding the request, as well as the commencement of work on the costing.

Election costing requests should be received by the responsible Secretaries no later than 5.30 pm on the sixth business day prior to polling day for the election (that is, Thursday in the penultimate week before the election), to enable the public release of the policy costings by 5.30 pm on the Thursday before polling day for the election. This will allow time for costings to be publicly scrutinised before polling day. Should requests be received later than the specified time, the Secretaries will endeavour to cost the policy and release the costing. However, it may not be possible to complete the costing in time for release on the Thursday before polling day for the election. The Secretaries will send a letter and issue a press release early in the campaign reminding both parties of the submission deadline.

TIMELINES FOR THE PROVISION OF COSTINGS

As noted in Part 4, the Secretaries will endeavour to complete and release a costing within five business days of receiving a request. However, this may not be possible in the case of complex costing requests where data is difficult to obtain, or where more detailed information needs to be provided by the party. In such cases, a public statement to that effect will be made by the relevant Secretary at the outset, or when it becomes clear that the costing cannot be completed within the time frame. Where additional information is required, the five days will exclude the time taken to obtain the additional information.

FURTHER INFORMATION REQUIRED FOR THE COMPLETION OF COSTINGS

If the Secretaries consider that further information is required, they may request information from the Prime Minister, or from the Leader of the Opposition, or the Leader of the relevant minority party, as appropriate, in writing. Secretaries will endeavour to ask for such additional information within two business days of receiving the costing request. Further discussion between Treasury and/or Finance officials and advisers in the offices of the Prime Minister or the Leader of the Opposition or the Leader of the relevant minority party may be necessary as part of that process. Additional information provided in such discussions should be followed up in writing and forwarded to the Secretaries.

Officials may seek clarification of points relating to the costing request from the requesting party. Such requests may be by email or telephone. The officer seeking additional information will make a note of the information sought and responses received, and seek confirmation from the costing party of the accuracy of the note. Such requests for clarification will be noted in the final costings advice where the information materially affects the costing outcome.

WITHDRAWAL OF A COSTING REQUEST

As noted in Part 1, the withdrawal of a request for a costing may be made at any time. A withdrawal by the Prime Minister must be in writing to the Secretaries and a withdrawal by the Leader of the Opposition or a Leader of a minority party must be in writing to the Prime Minister, permitting the Prime Minister to notify the Secretaries of the withdrawal in writing.

SECURITY ARRANGEMENTS

Security arrangements will be similar to those applied at Budget time and the confidentiality of the costings will be protected until they are publicly released.

PART 6: REPORTING — PUBLIC RELEASE OF POLICY COSTINGS

As noted in Part 1, the Charter requires that costings be publicly released as soon as practicable after a costing request has been made. Costing requests made before polling day are to be released prior to polling day and, where the Caretaker Period extends past polling day, requests made after this day are to be released before the end of the Caretaker Period.

REASONS FOR NON-RELEASE OF POLICY COSTINGS

Where a policy costing is not possible, the Secretaries will issue a press release, no later than the close of business on the last business day before polling day, stating reasons why the policy cannot be costed.

Where the Caretaker Period extends past polling day, and where costing requests made after polling day cannot be completed, a similar press release will be issued as soon as practicable after the end of the Caretaker Period.

The non-release of a policy costing may be due to:

- time constraints that prevent the policy being costed before polling day or the end of a Caretaker Period;
- the withdrawal of the request for a costing by the Prime Minister or the Leader of the Opposition or a Leader of a minority party;
- insufficient information about the policy to allow the Secretaries to cost it properly; or
- insufficient data available to cost the policy reliably.

PUBLISHED POLICY COSTING REPORT: CONTENTS AND PROTOCOLS

When a policy costing is published, the final report will include the request submitted under Clause 29(2) of the Charter; any request for further information made by the Secretaries; and any further information forwarded to the Secretaries or obtained in discussions with parties.

The report will also include the following:

- an outline of the specific costing methodology and assumptions used (including any economic and behavioural assumptions) in sufficient detail to allow an understanding as to how the costing was determined;

- a table setting out the annual Budget cost against the current financial year and the following three financial years (where assumptions are particularly uncertain, the Secretaries may choose to report costings as a range of likely outcomes);

- an explanation detailing any significant differences between the assumptions specified in a party costing request and those used in a Treasury/Finance costing; and

- where the Secretaries consider it appropriate, a sensitivity analysis which shows the extent to which changes in assumptions could produce different costing estimates.

Appendix D outlines the pro-forma that will be used by the Secretaries when releasing a policy costing.

INFORMING PARTIES OF THE PUBLIC RELEASE OF A COSTING AND THE DELIVERY OF COSTING REPORTS

The offices of the Prime Minister, the Leader of the Opposition or the Leader of a minority party will be advised at least four business hours in advance of the expected public release time of all costings, but not of the content of the reports. The requesting party will also be informed of the hand delivery arrangements and public release approximately one hour prior to the release.

When a costing is to be released, hard copy costing reports will be provided to the Parliament House offices of the Prime Minister, the Leader of the Opposition and the Leader of a minority party at approximately the same time, with the costing provided to the requesting party first. Shortly after the delivery of the document, costings will be publicly released to the press and on the joint Treasury/Finance election costings website. As noted in Part 4, the Secretaries will aim to produce a written report that provides a full explanation of the costing. However, a further statement may be issued if the Secretaries judge that further clarification of a costing and the methods used is required.

Summary of key protocols, processes and timelines

- the Secretaries will aim to ensure that all costings are provided in a timely manner and are clear, consistent and transparent and follow a list of costing conventions outlined in Appendix B;
- all requests for costings must be made through the Prime Minister;
- requests for costings must be in writing and fully outline the policy to be costed, giving relevant details and underlying assumptions (format provided at Appendix C);
- a Parliamentary Party cannot request a costing for the same, or substantially similar, policy from both the Parliamentary Budget Officer and the Secretaries of Treasury and Finance;
- costings for policies affecting taxation revenue will be conducted by the Treasury Secretary; and costings regarding government outlays, expenses and non-taxation revenue will be costed by the Finance and Deregulation Secretary; or policies may be costed jointly;
- upon receipt of a costing request, the relevant Secretary will issue a press release which broadly outlines the policy to be costed;
- costing requests should be submitted to relevant Secretaries during business hours (8.30 am to 5.30 pm on a weekday) or will be recorded as having been received the next business day;
- costing requests should be submitted on the sixth business day prior to polling day for the election (to allow five working days for the costing to be completed and allow public release on the Thursday before polling day). This will allow time for published costings to be publicly scrutinised before polling day. Should requests be received later than the specified time, the Secretaries will endeavour to cost the policy and release the costing. However it may not be possible to complete the costing in time for release on the Thursday before polling day for the election;
- the Secretaries will send letters to parties reminding them of the submission deadlines;
- the Secretaries will endeavour to complete the costings in the shortest time possible, generally within five business days of receiving a costing request;
- should the Secretaries require more details for the costing, they may seek further information in writing and/or officials may hold discussions with the relevant parties (any time taken to obtain further information will not count towards the five business days). All follow-up information must be provided in writing to the Secretaries;

Summary of key protocols, processes and timelines (continued)

- withdrawal of a request for a costing can be made at any time, in writing, through the Prime Minister;
- security arrangements will be similar to those applied at Budget time;
- where the Secretaries are unable to complete a costing due to time constraints, lack of information or other reasons, they will issue a press release outlining reasons for non-completion; and
- the Secretaries will publish completed costings, detailing methodology and other relevant factors. The offices of the Prime Minister, the Leader of the Opposition and the Leaders of minority parties will be advised in advance (by at least four business hours) of the expected public release time of a costing, but not of the content of the report.

APPENDIX A: COSTING OF MEASURES AND UPDATING ESTIMATES

The following provides further information on certain aspects of costing new measures and updating Budget estimates. The methodology used to cost policies is under constant review to ensure it remains appropriate.

MEASURES

Measures are defined as decisions of the Government that have a real or potential impact on the fiscal and underlying cash balances in the current year, forward estimates period, or beyond. Measures can comprise:

- new policy decisions;
- changes to, or the extension of, existing policy; and
- alterations to eligibility criteria or assistance rates (other than by legislated indexation).

Measures are classified as expense, capital or revenue, and can include both spending and saving components. In the case of costing a policy package, both the cost of individual components and the overall cost of the package will be undertaken. Where feasible to do so, the effect of one component of a package on another will be taken into account and reported. It should be noted that a saving only occurs to the extent that the original policy is included in the estimates.

Costings of measures are prepared by relevant bodies and agreed with Finance (or Treasury, if the measure includes taxation revenue or taxation expenditure components), based on current parameters.

Example 1: Identifying the different components of a measure

In the 2012 13 Budget, the Government provided $52.6 million over five years for two new diplomatic posts. This measure included both an expense and capital component and was recorded in the fiscal balance in the following manner.

Expense ($m)

	2011-12	2012-13	2013-14	2014-15	2015-16
Department of Foreign Affairs and Trade	0.3	1.9	9.0	8.8	8.5
Related capital	–	5.0	14.9	4.3	–
Department of Foreign Affairs and Trade					

UPDATING THE ESTIMATES

Estimates are generally updated on a program basis and the processes for updating expense estimates differ between different types of spending. Large demand driven programs will typically be determined by individual program models, which incorporate all relevant factors that impact on the expenditure under each program. These factors generally include relevant economic parameters (such as forecasts of inflation or wage growth), and program-specific parameters that, depending on the program type, may include forecasts of changes in eligibility and rates of payment.

Estimates for most cash-limited programs are generally updated using specific knowledge of the program. The estimates typically involve a joint assessment between Finance and the relevant spending body as to whether a program is on track to meets its delivery timetable.

All estimates for the Australian Government are consolidated to produce a set of whole-of-government financial statements for each sector. These include, an operating statement, balance sheet and cash flow statement for the general government sector (GGS), the public non-financial corporations sector (PNFC) and the total non-financial public sector (NFPS). Consolidation involves aggregating controlled entity financial statements while eliminating inter-entity transactions.

THE COSTING PROCESS

Policies are costed in accrual and cash terms, with both the impact on the fiscal balance and the underlying cash balance reported, as well as the impact on the headline cash balance as appropriate.

Estimates are provided for the current financial year plus the forward estimates period using the most recent set of published estimates under the Charter (the Budget or MYEFO) as the benchmark. For election costings, these will be the forward estimates published in the PEFO.

Where a revenue/expense cost is likely to be significantly different beyond the forward estimates period — for example, because the measure is not scheduled to commence or reach 'maturity' until after the forward estimates period — the Secretaries may consider it appropriate to include a statement about the financial impact of the policy in the relevant years beyond the forward estimates.

Example 2: Costing process

Most costings provided to Treasury or Finance will be addressed by application of the *Cost (or Revenue)* = *Quantity* × *Price* principle. Total cost or revenue can be determined by reducing a costing into a suitable number of cost elements (for example, materials, salaries etc), performing a thorough price- and quantity-based analysis of each particular element, and then pulling all the derived cost subtotals together to produce an overall estimate.

An illustrative example is to cost a proposal to introduce a new screening process for passengers and checked baggage in Australian airports.

The first steps would be to determine the number of airports affected that did not have the requisite security screening procedures in place, as well as the price and installation costs of each piece of equipment required to implement the screening (for example, Explosive Detection System Capable X-ray machines (checked baggage), Explosive Trace Detection machines, Walkthrough Metal Detectors (passengers), X-ray machines (passengers' carry-on baggage) and other items, including hand wands, divest tables, tensa barriers, etc).

The costs of operating the equipment would also need to be assessed. These would include costs associated with communicating new procedures to travellers (the cost of this would vary depending upon the type of communication — such as printed flyers, posters, language cards, and so on — multiplied by the cost and the quantity required), the cost of employees with the technical expertise to assist the airports in implementing this form of screening (this would be based on the number and type of employees required, their pay rates and the length of time required), consultative forums between the administering agency and the affected airports (this would include travel and meeting expenses such as flights and venue hire), as well as the cost of ongoing audit and compliance activities (this would be calculated on the estimated number of officers, their pay rates, the number of visits and the length of time required to undertake these activities).

The total cost estimate could then be constructed from the two components, that is, the equipment together with the program delivery costs for the Department. It should also be noted that a costing may also consider the most cost-effective way of achieving the policy objective; this could examine options such as whether it is more cost-effective to hire rather than purchase the equipment or to use consultants or departmental officers for some or all of the activities.

BEHAVIOURAL ASSUMPTIONS

Wherever possible, costings will take into account the impact of a change in policy on the behaviour of certain groups, where this impacts on the cost of a measure. For example, a new taxation concession will advantage an activity receiving the concession over those which do not. This is likely to result in resources (capital and labour) moving to activities which receive the concession from those which do not. The movement of resources will affect the likely response to a policy change and can affect the costing.

Costings will therefore consider the impact of resource constraints and where the resources for an expected policy response will come from. For example, resource constraints will be particularly apparent in an economy near full employment, but can still exist in a less than fully employed economy. Failure to take account of resource constraints is likely to result in an overestimate of the impact of the behavioural response on the costing. However, reliable information on the effects of a particular policy change is often unavailable. As such, estimates of behavioural responses are the element of costings which require the greatest exercise of judgment.

Behavioural responses may be estimated from previous experience with similar changes; academic and other studies of response effects or price elasticities; input from consultations or submissions; econometric modelling and studies; and sensitivity analysis estimating the scope for variations and taking a point estimate within the range.

An assumption of no behavioural change may be necessary where the impacts of policy changes cannot be estimated due to a lack of information.

Costings documentation will make clear what behavioural assumptions are used, including one of no behavioural change.

DIRECT (FIRST-ROUND) EFFECTS ONLY

While costings will take into account behavioural effects, they will generally only take into account the direct behavioural effects of a policy change, and not reflect so–called 'second-round' or indirect effects.

Direct effects include changes in demand for particular goods and services; investments or assets affected by a policy change; changes in prices or supply of goods and services affected by a policy change; and offsets involving switching resources between a particular activity affected by the policy change and other activities.

Second-round effects occur where a policy measure affecting one market has flow-on effects to broader markets, sometimes even to the macroeconomic level. This may include: potential changes in industry structure; a change in aggregate employment; or changes in investment or saving.

Second-round effects are generally not included in costings for a range of reasons, including uncertainty in estimating the magnitude and timing of the effects and because second-round effects are likely to be small relative to the direct financial impact of a measure. Second-round effects are also likely to take longer to arise than the immediate costs of a new policy proposal, and often may not occur within the forward estimates' timeline.

Second-round effects have been included in costings rarely. The few occasions were: the 1994 Working Nation policy; the 1999 Review of Business Taxation; the 2000 New Tax System; the 2005 Welfare to Work package; and the 2010 Stronger, Fairer, Simpler package. These packages included estimates of second-round effects because the broadly based nature of the packages meant that they were expected to produce unambiguous second-round benefits for the whole economy rather than shifting resources from one activity to another. Moreover, the magnitude of the reforms meant that the second-round effects were likely to be measurable over the forward estimates timeframe.

Example 3: Second round effects and costings (hypothetical)

A costing is sought for developing a program to reduce excessive alcohol consumption. The objective of the program is to educate people on the health risks of excessive alcohol consumption through an education campaign and funding for Occupational Health and Safety therapists to run programs in work places. It is suggested that the program has the potential to lower health costs and benefit the economy through fewer sick days. The costing for this proposal would only include the costs of the campaign and the therapists as well as any associated costs of running the program. The potential benefits to the health budget and the economy would not be included as it would be difficult to quantify the benefits or the period over which any benefits would occur.

PUBLIC DEBT INTEREST

Public Debt Interest (PDI) is the cost of servicing the stock of Australian Government debt incurred to meet budget financing and other borrowing requirements. Costings will generally not account for the impact on PDI payments. This does not apply where there is an explicit policy objective to affect the level of interest payments, or the policy involves transactions of financial assets (such as loan schemes). PDI costings will normally assume no change to the debt management strategy.

Nevertheless, where a proposal affects the borrowing requirements of the Commonwealth, it will have an effect on PDI. Such effects are usually costed towards the end of the estimates update process, as this enables consideration of the cumulative policy and parameter changes on the budget.

Estimates of interest costs are prepared by the Australian Office of Financial Management at each published estimates update, taking account of the Government's entire financing task. The interest rate assumption used in PDI calculations considers the overall average cost of funds for Commonwealth debt, including the outstanding stock of Commonwealth Government Securities (CGS) on issue and any new issuance of securities. It therefore reflects the actual profile of maturity and the cost of debt across the Commonwealth's portfolio. Public debt interest estimates are calculated using the contract interest rates incurred on existing CGS when issued and technical assumptions, based on prevailing market interest rates across the yield curve, for yields on future CGS issuance.

The PDI estimate is important when considering the effect of financing decisions for the budget. A budget deficit can be financed by liquidating financial assets, where available, or by increasing the issuance of debt. A surplus can be used to retire debt or invest in financial assets. These transactions are disclosed as a change in the composition of the government's balance sheet and are not themselves reflected in the fiscal or underlying cash balances (which measure the cost of government operations including fixed investments and determine the deficit or surplus).

The impact of any spending on the fiscal or underlying cash balances remains the same regardless of whether that spending is financed through the sale of, or drawdown on, a financial asset or through the increased issuance of debt. However, changes in the government's issuance of debt or its holdings of financial assets feed back into the fiscal and underlying cash balances through the resulting changes in the cost of servicing its debt or in the return generated by its financial assets.

Example 4: Costing the purchase or sale of a financial asset (hypothetical)

The same interest rate assumptions are used for the costing of the sale of a financial asset as for the costing of the purchase of a financial asset.

The interest cost associated with a financial transaction is sensitive to the assumption about the timing of that transaction within years. The interest paid on a transaction at the start of a year is greater than that of a transaction near the end of a year. Where the timing of a transaction is unknown, interest costings are normally prepared using a simplifying assumption that a transaction will occur halfway through the year.

The rule of thumb methodology can be illustrated using the following hypothetical example of the sale of a $1 billion financial asset in 2012-13. The interest savings from the sale of the asset are calculated:

- assuming the sale proceeds of $1 billion are received half way through 2012-13;
- using a weighted average cost of funds for new borrowing of, say, 5 per cent; and
- with interest savings compounding across the forward estimates.

The calculations are summarised in the table below, showing total interest savings of $187 million over the forward estimates.

	2012-13 $m	2013-14 $m	2014-15 $m	2015-16 $m
Profile for asset sale	1,000	0	0	0
Weighted average cost of funds (%)[a]	5.0	5.0	5.0	5.0
Compound interest on principal[b]	25	51	54	57
Impact of asset sale on the fiscal balance/underlying cash balance	25	51	54	57

a) Weighted average interest rate paid on new issuance of debt (illustrative rates only).

b) Interest impact in the first year assumes that the sale proceeds are received halfway through the year.

The costing would also include the costs of selling the assets and any forgone interest or dividends generated by the financial asset which would offset — partially or wholly — the impact of the interest savings on the fiscal and underlying cash balances.

CONTINGENCY RESERVE

The Contingency Reserve (CR) is an allowance, included in aggregate expenses, principally to reflect anticipated events that cannot be assigned to individual programs in the preparation of the budget estimates. The CR is designed to ensure that aggregate budget estimates are based on the best information available, and are as close as possible to expected outcomes at the time of the release of an economic and fiscal outlook. The CR is not a general policy reserve.

Allowances included in the CR are not appropriated and can only be drawn upon once the relevant appropriation legislation has been passed by Parliament. These allowances are removed from the CR and allocated to specific agencies for appropriation closer to the time when the anticipated events eventuate.

In addition to allowances for anticipated events, the CR may also include measures that reflect Government decisions that were either made too late in the estimates process for inclusion against individual agency estimates, or are commercial-in-confidence or national-security-in-confidence and therefore cannot be disclosed explicitly in portfolio estimates.

Conservative Bias Allowance

One of the largest components of the CR is the conservative bias allowance (CBA). This is an allowance for the tendency for estimates of expenses for existing Government policy to be revised upwards over time. This is of particular importance for demand driven programs where precise cost estimates are difficult.

The allowance is set as a percentage of total general government sector expenses (excluding GST payments to the States). The rates applied across the Budget and forward estimates are reviewed periodically by Treasury and Finance. The CBA is reduced for earlier forward estimate years as program estimates are progressively updated, thereby decreasing the bias.

Drawdowns (which are reflected as reductions) of the conservative bias allowance are treated as parameter variations and are consistent with long standing practice. Such adjustments do not realise any actual budgetary savings, nor offset Government spending measures, as the CBA is always reduced to zero prior to the commencement of the budget year. That is, the CBA does not affect the accrual level of government spending — it is only a device to improve the accuracy of the forward estimates.

Other allowances that may be included in the CR

Allowances may also be made for other anticipated events including:

- a provision for underspends in the current financial year reflecting the tendency of budgeted expenses for some bodies or functions not to be met; and
- provisions for events and pressures that are reasonably expected to affect the budget estimates.

Example 5: Calculating the conservative bias allowance

The following percentages are used to determine the amount to be included in the CBA over the forward estimates. The reduction in the percentage over time reflects the fact that program estimates are progressively updated by bodies and the bias decreases accordingly. The allowance for a particular year is unwound at each estimates update until it is backed out completely when that year becomes the budget year.

CBA summary	Rate	2012-13	Rate	2013-14	Rate	2014-15	Rate	2015-16
	% of expenses	$m	% of expenses	$m	% of expenses	$m	% of expenses	$m
Expenses used in calculating CBA		328,000		347,600		362,413		383,495
2011-12 MYEFO								
CBA provision in Contingency Reserve	0.25	820	0.75	2,607	1.5	5,436		
2012-13 Budget								
Drawdown, as scheduled	0.25	820	0.25	869	0.5	1,812		
Effective new rate	0.0		0.5		1.0		2.0	7,679
2012-13 MYEFO								
Drawdown, as scheduled			0.25	869	0.25	906	0.5	1,917
New rate in Reserve	–		0.25	869	0.75	2,718	1.5	5,753

Based on the current rates, at the 2011-12 MYEFO the allowance was set at 0.25 per cent in 2012-13, 0.75 per cent in 2013-14, and 1.5 per cent in 2014-15. As per normal practice, the CBA was drawn down by 0.25 per cent, 0.25 per cent and 0.5 per cent for each of the forward years in the 2012-13 Budget, respectively. The CBA is progressively unwound until it is backed out completely when that year becomes the budget year — that is, the remaining balance currently in the first forward estimate year (2012-13) is zero in the current Budget. Similarly, the CBA in the other forward years will be further drawn down at the 2012-13 MYEFO to the prevailing rates appropriate for each forward year (currently 0.25 per cent, 0.75 per cent and 1.5 per cent, respectively).

DRAWDOWN OF THE NATION-BUILDING FUNDS

Nation-Building Funds consist of three separate funds — the Building Australia Fund (BAF), the Education Investment Fund (EIF) and the Health and Hospitals Fund (HHF). The totals that make up the balances of the funds are reported on the Government's balance sheet as financial assets consisting of cash and investments.

These Funds do not adversely impact on the fiscal or underlying cash balance until a decision is made to make a non–equity payment outside the General Government Sector from the specific fund. Earnings from the Funds have a positive impact on both the fiscal and underlying cash balance. Payments from the Funds that are classified as equity do not impact on underlying cash balance.

This is consistent with the budgetary treatment of other grant payments. A decision to close one or more of the funds would not therefore result in a reduction in the underlying cash balance or fiscal balance for the Budget as the relevant cash and investments would still be reported as assets on the balance sheet, except to the extent that any reduction in PDI does not match a reduction in earnings from the Funds.

Where a decision is taken to close a fund, or reprioritise expenditure from a fund, the costing would consider the viability of effectively revoking grant payments that have been publicly committed or those set out in contractual arrangements. These projects are often very difficult and/or expensive to unwind and this may affect the quantum available, if any, as a save from the closure of the relevant fund.

Example 6: Implications for the Budget of a Nation-Building fund (hypothetical)

The Government decides to use part of its Budget surplus to set up a $1 billion Community Assets Fund to invest in a variety of projects across the country. The fund is treated on the balance sheet as a distinct financial asset instead of being aggregated into cash reserves or other financial assets. There is no impact on the fiscal or underlying cash balance as no payment or flow of receipts results from this decision.

Any costs associated with setting up the management of the fund would be recorded as an expense and any interest earnings on the funds would be recorded as revenue/receipt inflows (noting that any borrowings required to establish a fund's balance would lead to an increase in public debt interest outlays). Both would therefore impact on the fiscal and underlying cash balance.

The next year the Government decides to spend $600 million over two years on projects. These grants will be recorded as an expense/payment in the relevant years, and will impact on the fiscal and underlying cash balance. The following year the Government decides to spend $300 million over three years on additional projects. These grants will also affect the fiscal and underlying cash balance.

The Government decides to close the fund with $100 million remaining. The $100 million will continue to be reported as a financial asset, with no impact on the fiscal and underlying cash balance other than adjustments across the forward estimates to reflect a reduction in PDI and a reduction in the earnings of the Fund.

$ million	FB/UCB Yr 1	FB/UCB Yr 2	FB/UCB Yr 3	FB/UCB Yr 4	FB/UCB Yr 5	Total FB/UCB impact	Financial assets total
Fund established — recorded as distinct asset	0.0	0.0	0.0	0.0	N/A	0.0	1,000.0
Commit to $600m of projects / 2yrs	N/A	-300.0	-300.0	0.0	0.0	-600.0	400.0
Commit to $300m of projects / 3yrs	N/A	N/A	-100.0	-100.0	-100.0	-300.0	100.0
Abolish fund — assets will still be reported in total assets but not separately	N/A	N/A	N/A	0.0	0.0	0.0	100.0

Note: Depending on the timing of payments, fiscal balance and underlying cash balance may or may not be equivalent in individual years. This example does not include the costs of setting up the fund or any interest earnings in the fiscal and underlying cash balance numbers.

FUTURE FUND

The general principles applying to the Nation-Building funds also apply to the Future Fund. The total balance of the Future Fund is reported on the Government's balance sheet as financial assets consisting of cash and investments.

In terms of the Government's financial statements, it should be noted that Future Fund earnings are excluded from the underlying cash balance on the basis that the earnings are reinvested to meet future superannuation payments and are therefore not available for current spending. The earnings are, however, included in the headline cash balance and fiscal balance.

The operational costs of the Future Fund are met from the Fund and treated as payments for the purposes of calculating the fiscal and underlying cash balance. [2]

LOANS

Loans, as financial assets, do not have a direct impact on the underlying cash balance. However, there will be an impact on the underlying cash balance and fiscal balance as a result of net interest costs.

The repayment of loan principal will have no direct net impact on the underlying cash balance as it is replacing one financial asset (a loan) with another (cash).

Interest repayments on loans have a positive impact on the underlying cash balance and fiscal balance, which will either be partially, wholly or more than (depending on the relative interest rates of the loan and Commonwealth financing costs) offset by the PDI costs associated with raising debt to fund the proposal.

Commercial loans

If loans are made by the Government on terms equivalent to those that the borrower could obtain in the marketplace then these loans would be treated as commercial loans.

Such loans will typically have an overall positive impact on the underlying cash balance and fiscal balance as the PDI costs would be less than the interest repayments. Both the borrowing, or reduction in financial assets, and loan are included in the calculation of net debt so the measure of net debt is not affected.

As the loan is a financial asset transaction, the direct effect on the level of PDI will be costed with the proposal. The second round effects of such loans on public debt interest rates as a result of increasing risk on the Commonwealth's balance sheet would not normally be costed.

Concessional loans

If loans are made by the Government at more favourable terms than the borrower could obtain in the marketplace, then these loans would be treated as concessional loans. The concession provided may be in the form of lower market interest rates, longer loan maturity or grace periods before the payment of the principal and/or interest.

2 The Government announced in the 2012–13 Budget that it has decided to review the budget treatment of the Future Fund. Treasury and Finance will consult on the appropriate treatment of Future Fund costs in the underlying cash balance.

The concessional component of these loans (that is, the opportunity cost of the value forgone in providing the loan at a discounted rate) will have an upfront negative impact on fiscal balance and net debt. These impacts are unwound over the life of the loan.

Whether or not such loans have an overall positive impact on the underlying cash balance, fiscal balance and net debt will depend on the extent of the concession. In some cases, the PDI costs (or reduction in interest earnings) associated with the financing of these proposals will exceed the total amount of the interest repayments.

The non-concessional component of the loan will be treated as a financial asset on the Government's balance sheet. Both the borrowing, or reduction in financial assets, and loan are included in the calculation of net debt and net debt will be increased by the concessional component of the loan. As with commercial loans, the effect the concessional loan has on the level of PDI would be included in the costing.

INVESTMENTS IN ENTITIES OUTSIDE THE GENERAL GOVERNMENT SECTOR

The Government may also make investments in entities outside the general government sector. Corporations that produce goods and services are referred to as a Public Non-Financial Corporations while corporations mainly engaged in financial intermediation and provision of auxiliary financial services are referred to as Public Financial Corporations.

An entity is a corporation if it meets all of the following criteria:

- It operates under the Government's control. Control is defined by the ability to determine general corporate policy by appointing appropriate directors. This is generally determined by holding more than 50 per cent of the shares of the entity. However, the Commonwealth may also obtain control of an entity with less than a 50 per cent holding by way of legislative or regulatory powers;

- it produces goods and services or provides financial services for sale in the market; and

- it provides such goods and services on a commercial basis, and is funded largely by the sale of these goods and services.

Investments into these corporations can take the form of an equity injection or a loan.

An investment would be regarded as an equity injection if the Government exercises control over the investment, such as being able to sell its investment without unreasonable impediments and there is reasonable expectation of recovery of the investment. Therefore, the entity must be able to generate a revenue stream that at least covers its costs and generates a positive rate of return.

An equity injection from the Government to a corporation would have no direct impact on the underlying cash and fiscal balances. There would be an ongoing indirect impact on the underlying cash and fiscal balances reflecting the difference between dividends received from the corporation and the interest paid by the Government on borrowings to finance the equity injection (or forgone interest if financed from an asset). The equity injection would be treated as a financial asset on the Government's balance sheet. As equity is not a net debt asset, net debt will increase reflecting borrowings or lower cash reserves.

A loan would be treated in the way as discussed above. A payment to a corporation would only classify funding as a loan where there is a reasonably expectation that the funds would be repaid and the corporation can service the loan, otherwise it will be classified as a grant. A grant from the Government to the corporation would reduce fiscal balance and the underlying cash balance directly when paid.

SENSITIVITY ANALYSIS

The estimates contained in the Budget and PEFO documents represent forecasts of the economic outlook. Changes to the economic assumptions underlying the estimates will impact on receipts and payments, and hence the size of the underlying cash balance. To assist readers in analysing the impact of variation in these assumptions, the Budget papers and PEFO contain a section that examines the effects on receipts and payments of altering some of the key economic assumptions.

The economic scenarios are intended to provide a rule of thumb indication of the impact on receipts, payments and the underlying cash balance of changes in the economic outlook. They represent a partial economic analysis only and do not attempt to capture all the economic feedback and other policy responses related to changed economic conditions. In particular, the analysis assumes no change in the exchange rate, interest rates or discretionary policy over the forecast period.

Two economic scenarios are considered in the sensitivity analysis: a fall in nominal GDP due to changes in the terms of trade; and an increase in real GDP driven by changes in labour productivity and labour force participation, with each contributing equally. The economic scenarios illustrate the impact on key economic variables (including employment and unemployment, wages, prices, incomes and consumer spending) and the resulting flow-on effects on budget receipts, payments and the underlying cash balance.

Payments are generally affected largely through indexation arrangements (for example, the indexation of income support payments to movements in the Consumer Price Index or particular average earnings measures) and fluctuations in the number of unemployment benefit recipients. On the revenue side, changes in the economy will lead to movements in taxation revenue — for example through changes in profits or employment and wages leading to shifts in income tax.

STATEMENT OF RISKS

The Charter requires that any factors that may have a material impact on the fiscal outlook in the future, but which are not included in the fiscal estimates, be disclosed in a Statement of Risks in each economic and fiscal outlook report. The purpose of their disclosure is to increase the transparency of the fiscal projections.

Events that could affect fiscal outcomes include: changes in economic and other parameters (which are examined as part of the sensitivity analysis mentioned above); matters not included in the fiscal forecasts because of uncertainty about their timing; magnitude or likelihood; and the realisation of contingent liabilities or assets. The Statement of Risks outlines general fiscal risks, as well as specific contingent liabilities and assets. In broad terms, contingent liabilities and assets represent possible costs or gains to the Australian Government arising from past events or decisions which will be confirmed or otherwise by the outcome of future events that are not within the Government's control. Contingent liabilities can include loan guarantees, non-loan guarantees, indemnities and uncalled capital.

The Statement of Risks would not normally include: expense and revenue pressures involving unannounced prospective or possible Government decisions; normal business risks — positive and negative — which are the responsibility of each body to manage (for example, the adequacy of insurance levels); a contingent liability or contingent asset where disclosure would seriously prejudice the position of the body, another Australian Government body or the Australian Government as a whole; and positive and negative risks already provided for in the Contingency Reserve.

The Secretaries may also decide to include in a PEFO a description of the treatment for estimates purposes of a government's public political commitments that have not yet been made a formal policy decision. The purpose of this is to remove any confusion in relation to the structure of the forward estimates included in the PEFO. An example of this is comments made in the 2004 PEFO relating to the Telstra asset sale. In that document, the statement of risks noted that, while the asset sale was factored into the forward estimates, the final sale would be contingent on prevailing market conditions at the time and the Government being satisfied that arrangements were in place to ensure continued service delivery, particularly in rural and regional Australia.

REPORTING STANDARDS

The Charter requires the budget and financial statements to be based on external reporting standards. Budget financial statements comply with AASB1049 that harmonises the Australian Bureau of Statistics' accrual Government Finance Statistics (GFS) framework and the Australian Accounting Standards (AAS), with any departures from the reporting standards disclosed. The Government's accounting policy is that the GFS remains the basis of budget accounting policy, except where the

Government applies AAS because it provides a better conceptual basis for presenting information of relevance to users of public sector financial reports.

The GFS framework has been developed to allow economic analysis of the public sector, particularly the effects of Government spending and revenue on the economy. Major budget aggregates, such as the fiscal balance and underlying cash balance, are based on the GFS framework. The AAS specify a range of accounting practices and the ways in which financial information should be reported. Government reporting under the AAS is intended to provide an overview of the Government's financial performance and position. The need for harmonisation was recognised and culminated in the development of AASB1049.

TAX EXPENDITURES

The Government publishes a Tax Expenditure Statement (TES) annually which provides estimates of the value of various tax concessions against a benchmark tax system which taxes all income at an individual's or body's tax rate. However, the TES does not necessarily give an estimate of the revenue that would be gained from removing concessions, as it does not take into account behavioural responses of the recipients of tax expenditures.

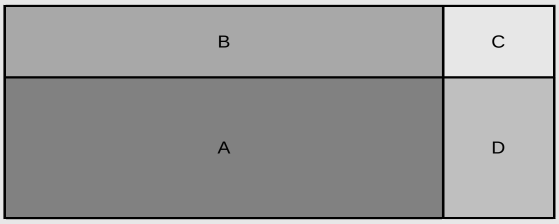
This 'no behavioural change' assumption means that tax expenditure estimates may differ substantially from budget revenue costings, which are measured relative to the government's forward estimates of revenue and take into account both current and prospective taxpayer behaviour.

Example 7: The difference between a budget costing and a tax expenditure

The diagram below shows the difference between a tax expenditures estimate and a revenue estimate for the budget. The axes of the chart are the tax base and the tax rate and the areas shown in the chart represent tax revenue. If in period 0 an activity is subject to a non concessional effective tax rate t0 and at that tax rate the tax base is b0 then revenue from this tax is equal to the area A + B. If a tax concession is provided for this activity that reduces the effective tax rate to t1 and as a result activity increases to a new level of b1, the total revenue collected will now be equal to area A + D.

In this example the budget impact of the measure would be the difference in revenue collected (A + D) — (A + B) = (D — B).

On the other hand, for measuring tax expenditures, the benchmark effective tax rate is t0, so before the tax change there is no tax expenditure. When the effective tax rate is reduced to t1, a tax expenditure is created equal to the difference between the benchmark tax rate and the new tax rate (that is, t0 — t1) times the new tax base (that is, b1). This is equal to area B + C in the diagram.



APPENDIX B: COSTING CONVENTIONS

The following are standard conventions for the preparation of fiscal costings:

- Costings will focus on the effect of a policy on the Australian Government's key Budget aggregates (both cash and accruals). They will be produced in a manner consistent with normal Budget costing methodologies.

- Economic data and forecasts used in the preparation of costings will be consistent with the pre-election economic and fiscal outlook report.

- Costings will be on a current price basis.

- Costs will be on a June financial year basis and costings will be provided for the current financial year and the following three financial years.

- Full year, part year and one off effects (the steady state full year cost will be made clear) will be distinguished.

- Costings will generally be best point estimates. However, in some cases the Secretaries may consider it appropriate to report ranges rather than point estimates.

- Costings will be prepared in accrual and cash terms. For each policy, the impact on the fiscal balance and underlying cash balance (and headline cash basis as appropriate) will be reported.

- Where relevant, the revenue and expense components of a policy costing will be identified separately (it is expected that most costings will typically involve revenue elements or expense elements only).

- In undertaking costings, departmental expenses will be included where analysis of the policy shows that these are material. Existing programs/policies of a similar nature will be used as a guide. Costings will not generally account for the impact on Public Debt Interest payments, except in those circumstances outlined in Part 4 of these guidelines.

- Assumptions used in costings will be based on the best professional judgment of the Secretaries.

APPENDIX C: REQUEST FOR COSTING AN ELECTION COMMITMENT — PRO-FORMA

Name of policy	
Person requesting costing (Prime Minister/Leader of the Opposition/Leader of a minority party):	
Date of public release of policy:	
Date of request to cost the policy:	
Summary of policy (please attach copies of relevant policy documents):	
Intention of policy:	
Certification that this, or a substantially similar costing request, has not been submitted to the Parliamentary Budget Office	
Description of policy (please note that, where the request to cost a proposal differs from the announced policy, the costing will be on the basis of information provided in the costing request) **What are the key assumptions that have been made in the policy including:**	
Is the policy part of a package? If yes, list and outline components and interactions with proposed or existing policies.	
Where relevant, is funding for the policy to be demand driven or a capped amount?	
Will third parties (for instance the States/Territories) have a role in funding or delivering the policy? If yes, is the Australian Government contribution capped, with additional costs to be met by third parties, or is another funding formula envisaged?	
Are there associated savings, offsets or expenses? If yes, please provide details.	

<table>
<tr><th colspan="2">Description of policy (please note that, where the request to cost a proposal differs from the announced policy, the costing will be on the basis of information provided in the costing request)

What are the key assumptions that have been made in the policy including:

(continued)</th></tr>
<tr><td>Does the policy relate to a previous budget measure?

If yes, which measure?</td><td></td></tr>
<tr><td>If the proposal would change an existing measure, are savings expected from the departmental costs of implementing the program? Will funding/cost require indexation?

If yes, list factors used.</td><td></td></tr>
<tr><td>What are the estimated costs each year? Are these provided on a cash or fiscal basis?</td><td></td></tr>
<tr><td>What assumptions have been made in deriving the expected financial impact in the party costing (please provide information on the data sources used to develop the policy)?</td><td></td></tr>
<tr><td>Has the policy been costed by a third party?

If yes, can you provide a copy of this costing and its assumptions?</td><td></td></tr>
<tr><td>What is the expected community impact of the policy?

How many people will be affected by the policy?

What is the likely take up?

What is the basis for these impact assessments/assumptions?</td><td></td></tr>
<tr><td colspan="2">NOTE: it will be up to the professional judgment of the relevant Secretary as to whether these assumptions are adopted in a Treasury or Finance costing of the policy.</td></tr>
</table>

Administration of policy	
Who will administer the policy (for example, Australian Government entity, the States, non-government organisation, etc)?	
Should departmental expenses associated with this policy be included in this costing? If no, will the Department be expected to absorb expenses associated with this policy? If yes, please specify the key assumptions, including whether departmental costs are expected with respect to program management (by policy agencies) and additional transactions/processing (by service delivery agencies).	
Intended date of implementation.	
Intended duration of policy.	
Are there transitional arrangements associated with policy implementation?	
List major data sources utilised to develop policy (for example, ABS cat. no. 3201.0).	
Are there any other assumptions that need to be considered?	

APPENDIX D: PUBLIC RELEASE OF COSTING — PRO-FORMA

Summary of costing:	
Person making the request:	
Date of request:	
Name of policy to be costed:	
Date of public release of policy:	
Costing request provided by the Prime Minister/Leader of the Opposition/Leader of a minority party:	
Additional information requested (including date):	
Additional information received (including date):	

Financial implications (outturn prices)[(a)]

Impact on	Current financial year	Current financial year + 1	Current financial year + 2	Current financial year + 3
Underlying cash balance ($m)				
Fiscal balance ($m)				

(a) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in revenue or a decrease in expenses or net capital investment in cash terms.

Where relevant, state that the proposal has been costed as a defined or specified amount.
Where relevant, include separate identification of revenue and expense components.
Where appropriate, include a range for the costing or sensitivity analysis.
Qualifications to the costing (including reasons for the costing not being comprehensive).
Where relevant, explain effects of departmental expenses.
Where relevant, explain the reason for any significant differences between the assumptions specified in a party costing request and those used in a Treasury or Finance costing.
Other comments *(including reasons for significant differences between the estimated impact on the fiscal and underlying cash balances)*.

Background information
Costing methodology used: Costing techniques. Policy parameters. Statistical data used. Behavioural assumptions used (as appropriate).