Department of Treasury and Finance
Government of Western Australia

Accrual Appropriations and Capital User Charge

A User Manual

Second Edition

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FOREWORD

This revised edition of the user manual provides guidance to officers at all levels and is intended to assist agencies operate within the accrual appropriations and capital user charge regime. This edition reflects the results of a departmental review and incorporates feedback from key stakeholders.

Accrual appropriations and the capital user charge were introduced as part of the 2001–02 budget and have been important milestones in Western Australia's financial management reform agenda.

These initiatives have made the costing of government services far more accurate and transparent, encouraging agencies to take responsibility for the full cost of their services, better aligning their financial management processes and making appropriations by Parliament more meaningful.

The manual has been prepared by the Western Australian Department of Treasury and Finance. Further information may be obtained from the Department's web page at www.dtf.wa.gov.au or by contacting the Department's Financial Policy Division on (08) 9222 9358.

J L Langoulant

UNDER TREASURER

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1 BACKGROUND

1.1 FINANCIAL MANAGEMENT REFORM AGENDA

Accrual appropriations and the capital user charge form an integral part of Western Australia's financial management framework and complement the suite of financial initiatives implemented to date. These initiatives include accrual financial reporting, net appropriations, agency operating trust accounts, Government Financial Responsibility Legislation and Output Based Management (OBM). Each of these initiatives encourages greater responsibility for the management of resources at an agency and whole of government level.

Accrual appropriations and the capital user charge assist to make the full cost of delivering services transparent as well as encouraging managers to assess the full cost of future proposals. Accrual appropriations enable budget funded agencies (departments and statutory authorities) to better align all their financial management processes – planning, resourcing, monitoring and reporting – on a consistent basis.

The introduction of accrual appropriations is consistent with the direction of reforms that have been implemented in other jurisdictions throughout Australia and overseas.

1.2 FEEDBACK AND FURTHER ADVICE

Comments on this publication and accrual appropriations generally are welcomed and encouraged. Such comments should be directed to the Financial Policy Division of the Department of Treasury and Finance.

Within the Department of Treasury and Finance, advice on accrual appropriations policy matters can be obtained by contacting the Financial Policy Division. Matters specific to agencies should be referred to Agency Resources. A list of frequently asked questions and answers on accrual appropriations and the capital user charge, can also be accessed online at: www.dtf.wa.gov.au/cms/tre_content.asp?id=613

2 WHAT ARE ACCRUAL APPROPRIATIONS?

2.1 DEFINING ACCRUAL APPROPRIATIONS

An accrual appropriation is a mechanism of parliamentary control over the total amount of resources to be made available for a particular purpose, and in a particular period. Unlike previous cash based appropriations, an accrual appropriation recognises the full annual cash and non-cash cost components of services, including expenses that are incurred in the year of appropriation but paid at a later date. The non-cash component of an agency's appropriation provides for accrued employee leave entitlements and asset depreciation.

There are three types of appropriations under the current regime. These provide for:

- the delivery of outputs;
- capital contributions to expand the asset base of agencies; and
- administered grants, subsidies and transfer payments.

Appropriations for the delivery of outputs are paid partly in the form of cash and partly as an asset (receivable) that agencies may draw, subject to government approval, at some future date.

Appropriations are made at agency level rather than at the level of individual outputs, in order to maintain the flexibility for agencies to adapt to changing circumstances.

Amounts authorised by other statutes (or 'standing appropriations') are paid in cash.

It is important to note that accrual appropriations do not provide an additional cash funding source for agencies.

2.2 PURPOSE OF ACCRUAL APPROPRIATIONS

By structuring appropriations on an accrual basis, annual appropriations approved by Parliament reflect the full cost of services provided by government. This enhances the transparency of government finances, providing a truer picture to Parliament of the expenditure it is approving and of an agency's operating result.

At the agency level, accrual appropriations promote consideration of the full cost of services when making decisions that have financial implications, and enhance balance sheet management. All of this helps to ensure consistency and alignment between planning, resourcing, monitoring and reporting.

2.3 ACCRUAL APPROPRIATIONS AND THE *FINANCIAL ADMINISTRATION AND AUDIT ACT (FAAA)*

The *Financial Administration and Audit Act (FAAA)* provides the legal basis for accrual appropriations. Section 27 of the *FAAA* enables the Treasurer to:

> *'direct that an appropriation for a financial year may, to the extent necessary to meet any relevant commitment, be transferred to a suspense account, and any such transfer is to be regarded as a payment correctly chargeable against that appropriation for that financial year'.*

The suspense account established under section 27 may receive the non-cash components of an appropriation related to depreciation and accrued leave entitlements.

2.3.1 ACCRUED SALARIES (27TH PAY)

Existing arrangements for 'accrued salaries' remain unchanged. Departments continue to transfer accrued salaries expense to the existing suspense accounts held at the Department of Treasury and Finance and statutory authorities continue to hold cash for accrued salaries in their operating accounts. This arrangement will be reviewed during the year in which 27 fortnightly pays occur (for most agencies this will be 2004–05).

3 CREDITS TO THE HOLDING ACCOUNT

3.1 INTRODUCTION

The Department of Treasury and Finance maintains a holding account for each agency, to receive credits for the non-cash component of its appropriation (i.e. depreciation and accrued leave entitlements) as a provision for the future replacement of assets and leave liability reduction.

The holding account is an essential element of the accrual appropriations regime in Western Australia. It is not backed by cash – credits to the holding account reflect the non-cash component of appropriations. It is the mechanism by which the non-cash component of appropriations approved by Parliament are recorded and reported, enabling the amount due to each agency to be transparent. When drawdowns from the holding account are required, the cash is sourced through a reduction in other funding sources, such as capital contribution appropriations in the case of asset replacement.

Credits to the holding account are reflected in the agency's disbursement profile. As agencies draw down their appropriation, the cash component is credited to their bank account while the non-cash component is credited to the holding account. The balance of the holding account is reported as a controlled (although restricted) asset on the agency's Statement of Financial Position.

Retrospective adjustment of previous years credits to the holding account to reflect the actual level of depreciation or accrued leave expense is not practical, given the potential impact on appropriations.

Where control of an asset, including responsibility for its replacement, is transferred to another agency under section 25 of the *FAAA*, consideration will need to be given as to whether any part of the balance held in the holding account should also be transferred. The level of credits to be transferred however will need to be determined and agreed to between both agencies affected by the transfer.

3.2 CREDITS FOR DEPRECIATION

Agencies are credited for the depreciation of assets used to deliver services. Depreciation credits are based on estimates provided by agencies. As part of the ongoing process of managing total expenses, agencies should monitor depreciation on a regular basis with a view to minimising credit variations to the holding account and impacts on the government's financial targets.

The effect of acquisition and disposal of assets should also be incorporated into budget estimates. If an asset only exists for part of a year, depreciation with respect to that asset will only be credited to the holding account for that part of the year.

If the level of depreciation is expected to exceed the approved budget provision, an increase in the amount credited to the holding account can only be accommodated if offsetting savings are achieved or the Treasurer approves supplementary funding.

3.2.1 EXTERNAL FUNDING OF ASSET REPLACEMENT AND NON-REPLACEMENT OF AN ASSET

Credits to the holding account may need to be modified where an agency also receives funding from an external source/s for replacement of an asset. This external funding may be realised from a number of sources including the Commonwealth, local government, private organisations or fees and charges.

Where these funding arrangements are likely to exist and are material in relation to the agency's depreciation estimate, the Department of Treasury and Finance may, after consultation with the agency, recommend that the non-cash component of an agency's recurrent appropriation be reduced by the commensurate level of revenue expected to be received from the external source/s.

Should the situation arise where an asset is currently being depreciated and is not expected to be replaced at a future date, consideration may also be given to reducing the agency's recurrent appropriation by the equivalent level of depreciation relating to that asset.

If an agency considers that these funding scenarios apply, it should contact its Agency Resources analyst for further information and advice.

Where an agency receives an external contribution towards the cost of replacing an asset, and no commensurate adjustment is considered necessary to the non-cash component of its appropriation, the drawdown from the holding account is calculated taking into consideration, in the first instance, the revenue received from external sources.

3.3 CREDITS FOR LEAVE ENTITLEMENTS

The only leave entitlements to be accommodated in the holding account are annual and long service leave. Sick leave and other forms of leave are not provided for in the holding account.

Agencies are not required to monitor changes in leave entitlements for individual employees for holding account purposes. However, agencies do need to distinguish between credits that are attributed to leave entitlements and those that are attributed to depreciation costs.

When an agency's budget includes an estimate that leave liability is expected to increase, its holding account would generally be credited with that agreed amount. The associated level of salary expense must, however, be approved as part of the annual budget process.

Credits may be varied in light of revisions to the estimated outturn of the agency's leave liability/salary expenses, but increases to estimates can only be accommodated if offsetting savings are achieved or supplementary funding is approved by the Treasurer.

3.4 TRACKING OF CREDITS AND DRAWDOWNS

The Treasury Information Management System (TIMS) tracks credits to, and drawdowns from, the holding account for each agency. At this time, however, TIMS does not distinguish between the portion of the holding account balance that relates to depreciation (future asset replacement) and accrued leave entitlements (leave liability reduction). To assist agencies, the Department of Treasury and Finance is working towards improving this situation by modifying TIMS to distinguish between credits for depreciation and accrued leave entitlements.

Details of the composition of credits and agreed drawdowns for depreciation and accrued leave entitlements need to be maintained by both agencies and the Department of Treasury and Finance outside the TIMS environment. The Department of Treasury and Finance requires that appropriate records be maintained to ensure that the amounts credited to, or drawn down from, the holding account for depreciation/asset replacement, can be identified and managed by asset class/sub-asset class. For further information on holding account asset classes, see section 4.3.

4 DRAWDOWNS FROM THE HOLDING ACCOUNT

4.1 INTRODUCTION

Requests for drawdowns from the holding account are assessed by the Department of Treasury and Finance as part of the annual budget process.

Two critical points about drawdowns from the holding account are:

1. they may only be used for the purposes prescribed by legislation (section 27 of the *FAAA*), that is, asset replacement and leave liability reduction; and
2. they are not a source of additional cash funds (budget neutral). All drawdowns are matched by equivalent reductions in appropriation funding.

Holding account balances are not available for managing trade creditors or other minor movements in current assets and current liabilities from year to year. Agencies are expected to manage these within existing resources.

4.2 HOLDING ACCOUNT BALANCES

An agency's holding account balance comprises credits to that account less drawdowns from it. The account becomes a funding source, in lieu of cash appropriations, to meet the cost of asset replacement and reductions in leave liability.

The holding account does not earn interest and may not go into overdraft. Drawdowns are reported in agency cash flow statements as published in the budget papers, reflected in their disbursement profile and subsequently reported in the financial statements in agency annual reports.

Recognising that circumstances may change over time, drawdowns from the holding account do not necessarily need to have a direct relationship to the components making up the balance. For example, an asset that has been depreciated may not be replaced at a future time because it is no longer required to support service delivery or is surplus to requirements.

In such circumstances the agency may provide justification to the Department of Treasury and Finance for alternative use of that portion of the account balance towards:

1. the replacement of an agency's asset in another holding account asset class (i.e. not the asset class in which the depreciation credits initially accrued); or
2. a leave liability reduction plan, where applicable.

All proposals for drawdowns from the holding account require government endorsement prior to the funds being made available to agencies. This endorsement forms part of the budget process.

4.3 ASSET REPLACEMENT

Drawdowns from the holding account for asset replacement are only approved where government has endorsed the replacement of those assets as part of the agency's approved capital works program.

Drawdowns with respect to depreciation may not be applied to increasing an agency's total capital stock. Increases in capital stock are more appropriately funded by appropriations in the form of capital contributions.

In some cases the distinction between these may not be clear, for example when a new asset both replaces and improves an existing asset.

In such circumstances drawdowns from the holding account may be supplemented by appropriations in the form of capital contributions.

In other cases drawdowns from the holding account may not be sufficient to fund replacement of assets simply because the balance in the holding account is insufficient at a particular time. The balance of the holding account is not intended to limit expenditure decisions of government and in such circumstances replacement of an asset may be partly funded through the holding account and partly from a capital contribution.

The capital contributions required in the above circumstances however, are subject to approval as part of the budget process.

Drawdowns from the holding account are calculated and applied against asset classes (referred to as a holding account asset class). The number of holding account asset classes identified by agencies for tracking credits to, and drawdowns from, the holding account should be kept to a manageable level. The Department of Treasury and Finance recommends that a minimum of two holding account asset classes be identified. That is, general asset replacement (e.g. plant and equipment; furniture and fittings; and minor computer equipment) and major capital infrastructure (e.g. buildings) where the useful life of the asset could be up to forty years.

In the case of the major capital infrastructure asset class, sub-asset classes may also exist. This will depend on the diversity of assets that the agency utilises to deliver services.

4.3.1 CALCULATION OF DRAWDOWNS

For general asset replacement, the level of funding to be drawn down is based on, and subject to, the availability of sufficient funding within that holding account asset class, in the financial year that the asset is to be replaced. Refer to Appendix 1.1 for an example of a drawdown calculation for general asset replacement.

For major capital infrastructure replacement, the level of drawdown from the holding account is based on the availability of sufficient funding, within the appropriate sub-asset class, in the financial year that the asset is to be replaced. Credits accumulated against a particular sub-asset class (e.g. buildings) are generally not available for funding asset replacement in another sub-asset class (e.g. major IT equipment). Refer to Appendix 1.2 for an example of a drawdown calculation for major capital infrastructure replacement.

In some instances an agency may determine that an alternative methodology for calculating drawdowns from the holding account for asset replacement is more appropriate. Agencies should consult with the Department of Treasury and Finance to reach agreement before adopting an alternative methodology.

It should be noted that credits to the holding account in the year of asset replacement are generally not available for drawdown until subsequent financial years.

4.4 LEAVE LIABILITY REDUCTION

Agencies are required to provide justification to the Department of Treasury and Finance in support of a request for drawdowns from the holding account to reduce leave liability during the budget year and in the forward estimates period. This justification could take the form of a leave management plan.

If there are insufficient credits in the holding account to achieve an agreed reduction in leave liability, the balance of funds required may be provided through re-prioritisation of existing agency cash resources.

As previously noted, drawdowns from the holding account are not a source of additional cash funds.

Refer to Appendix 1.3 for an example of how to calculate holding account drawdowns to meet employee leave entitlements.

4.5 RESPONSIBILITIES

Agencies' responsibilities in managing the holding account are to:

- ensure that the components of expenditure that form the basis of credits to the account (depreciation and accrued leave entitlements) are accurately forecast;
- ensure drawdowns are applied to agreed asset replacement or a reduction in leave liability;
- provide justification for proposed drawdowns from the account;
- estimate the timing of agreed drawdowns via the disbursement profile; and
- monitor depreciation and leave liability expense during the year and if forecasts materially change, advise Agency Resources at the Department of Treasury and Finance.

The Department of Treasury and Finance is responsible for:

- reviewing forecast expenditure for depreciation and accrued leave entitlements;
- ensuring that drawdowns for asset replacement form part of the agency's approved capital works program;
- assessing and advising government on the justification provided by agencies for drawing from the holding account;
- reviewing and monitoring the disbursement profile; and
- administering holding account transactions.

5 BUDGET STATEMENTS

Holding account related transactions are reflected in the following tables of Budget Paper No. 2 (see Appendix 4):

- **Appropriation and Forward Estimates (Table 1)**

  The amount appropriated for delivery of outputs is inclusive of credits to the holding account.

- **Output and Appropriation Summary (Table 2)**

  Table 2 outlines the amount to be appropriated from the Consolidated Fund to fund the delivery of outputs. The cost of each output is recorded separately in the Table, and is inclusive of credits to the holding account.

- **Outcomes, Outputs and Performance Information (Table 3)**

  This table provides detailed information concerning each agency's outputs. Accrual costs are included in the line 'Total Cost of Output'.

- **Capital Contribution (Table 4)**

  The drawdown from the holding account for asset replacement is shown against the heading 'Holding Account'.

- **Statement of Financial Performance (Controlled) (Table 5)**

  Credits to the holding account for depreciation will normally correspond to the depreciation figure reported as part of 'Cost of Services'. Holding account credits for accruing leave entitlements form part of the expenditure item 'Employee Expenses' which is also under 'Cost of Services'.

- **Statement of Financial Position (Controlled) (Table 6)**

  The balance of the holding account will be reported as an asset under the heading 'Amounts receivable for outputs'. This asset may be reported as both a current asset, i.e. an amount to be drawn down in the following year, and the remaining balance as a non-current asset.

  Growth in leave liabilities will influence changes in 'Provision for employee entitlements' (under 'Current Liabilities' and 'Non-current Liabilities'). Agreed growth in estimated leave liabilities will be reflected in credits to the holding account.

- **Statement of Cash Flows (Controlled) (Table 7)**

  This table shows the total agreed annual drawdown for the year against the heading 'Holding Account' under 'Cash Flows from State Government'. Any difference between the drawdown amounts in Tables 4 and 7 reflects drawdowns for reducing leave liability.

6 SUPERANNUATION

6.1 INTRODUCTION

Superannuation arrangements between departments and budget funded statutory authorities are more consistent since the introduction of accrual appropriations as from 1 July 2001.

A strategy is currently being developed to eliminate all remaining differences, which will ensure that the accounting and reporting arrangements in relation to superannuation payments and liabilities for budget funded statutory authorities are identical to that of departments.

6.2 WEST STATE AND GOLD STATE SUPERANNUATION SCHEMES

Appropriations for outputs include the cost of agencies making employer contributions to the Government Employees Superannuation Board (GESB) for the West State and Gold State superannuation schemes.

Under existing arrangements, agencies send employee data to GESB, along with payment of the employers' contribution to the West State scheme, each fortnight.

The calculation of employer contributions for Gold State is determined by GESB based on submitted employee data that in turn generates invoices for payment by agencies.

Emerging superannuation liabilities for both these schemes continue to be met centrally for departments. The Department of Treasury and Finance administers a standing appropriation for this purpose.

6.3 PENSIONS AND PRE-TRANSFER BENEFITS

Departmental arrangements for the scheme remain unchanged. That is, expenditure reflecting actuarial movements in liability balances continues to be reported in the agency's Statement of Financial Performance and matched by notional revenue in the form of liabilities assumed by the Treasurer.

Budget funded statutory authorities currently report liabilities associated with these schemes on their Statement of Financial Position, although a strategy is being developed to transfer such liabilities to the Treasurer. The strategy also includes a proposal for pension recoups and pre-transfer benefit payments to be met centrally, as is currently the practice for departments.

Statutory authorities affected by the proposed initiatives will be advised of any future agreed outcomes.

6.4 SUPPLEMENTARY FUNDING

As with all expense types, in the first instance, agencies are expected to manage superannuation variations from within existing resources.

If appropriations are materially less than revised expenditure forecasts, supplementary funding will be considered on a case-by-case basis. Similarly, if approved budget expenses are forecast to be materially less than the approved budget, downward adjustments to funding will be considered.

6.5 RESPONSIBILITIES

Agencies are responsible for:

- estimating their superannuation expense for the budget year and forward estimates, separately identifying Gold State and West State employer contributions;
- providing fortnightly employee data to GESB; and
- paying employer contributions to GESB for Gold State and West State schemes.

The Department of Treasury and Finance is responsible for:

- reviewing forecast expenditure for superannuation; and
- continuing to incorporate the cost of Gold State and West State employer contributions into appropriations, which are recommended to government.

GESB is responsible for:

- receiving fortnightly data from agencies;
- invoicing agencies each fortnight for Gold State employer contributions;
- receiving West State and Gold State employer contributions; and
- arranging for Gold State employer contributions, paid by departments, to be paid into the Consolidated Fund.

Queries on superannuation arrangements should be made to GESB on (08) 9263 4111.

7 OTHER ISSUES

7.1 CASH AND EXPENSE MANAGEMENT

Accrual appropriations help to increase the focus on elements that impact on the government's financial targets. In order to achieve these targets, agencies should be managing expenses and monitoring cash levels in line with approved budget estimates and their resource agreements.

Prudent expense and cash management will also assist agencies to maintain efficient levels of cash, reduce the likelihood of carryovers and maintain the integrity and efficiency of the budgeting process.

Agencies carrying unnecessarily high cash balances will incur a higher capital user charge for which supplementary funding will generally not be supported.

Expense carryovers represent deferral of an expense in relation to an issue that was budgeted for in a previous year. These impact on the government's financial targets, namely:

- real per capita expenses;
- operating surplus;
- net worth; and
- net debt to revenue.

As part of the process of managing expense carryovers, agencies are required to raise specific adjustments in TIMS to reflect such occurrences. Adjustment titles and descriptions should commence with 'Carryover' and then the relevant details (e.g. Carryover – Old Growth Forests). All carryovers are assessed on a case-by-case basis by the Department of Treasury and Finance and recommendations are made to government for its consideration.

Agencies should also consider whether they are likely to have similar carryovers in the following budget year. This will assist agencies to provide advice at bilateral meetings on carryover history and the probability of large carryovers continuing.

The Department of Treasury and Finance is currently developing a strategy to reduce the risk to government's financial targets posed by large variations between budget estimates and actuals.

7.2 CAPITAL

Capital budgets are developed and managed at a whole of government level, and the capital works program is developed on the basis of whole of government objectives. For agencies this means that all capital expenditure including amounts funded from drawdowns from the holding account to fund asset replacement must be considered in terms of the effect of this expenditure on government's financial targets (these are listed in section 7.1).

An agency's capital works program will normally be funded by sources specifically intended for capital purchases. These sources are:

- capital contributions;
- the holding account;
- asset sales;
- specific external contributions;
- internal funds and balances; and
- borrowings.

However, there may be cases where the correct accounting treatment for a capital works project is to expense the outlays (e.g. a capital grant to the private sector for infrastructure development). In such cases agencies should consult with their Agency Resources analyst to determine the appropriate funding source.

7.3 ACCOUNTING TREATMENT

As agencies draw down appropriation money on a fortnightly basis, the total amount drawn is recorded as appropriation revenues from government. The revenue, however, has two components, namely cash and a receivable (asset).

The accounting entries to record this transaction are:

Dr. Cash at bank

Dr. Amount receivable for outputs

Cr. Revenue from State Government appropriation

When drawdowns from the holding account occur, accounting entries are:

Dr. Cash at bank

Cr. Amount receivable for outputs

These accounting entries result in the following disclosures on the face of the financial statements (as shown in Appendix 4).

Statement of Financial Performance (Table 5)

Appropriations in the 'Revenues from State Government' section are inclusive of both the cash and non-cash components.

Statement of Financial Position (Table 6)

The balance (credits less drawdowns) of the holding account is reported as an asset – 'Amounts receivable for outputs'. This balance is separated between current assets (the portion that will be drawn down in the following year) and non-current assets. Cash drawn down but not spent is reported as a current asset.

Statement of Cash Flows (Table 7)

The cash component of appropriations for outputs, drawdowns from the holding account and appropriations in the form of capital contributions are individually disclosed in the 'Cash Flows from State Government' section.

1 WHAT IS THE CAPITAL USER CHARGE?

1.1 DEFINING THE CAPITAL USER CHARGE

In the simplest of terms, a capital user charge is a levy on capital employed in the delivery of services to the public.

In Western Australia, the capital user charge is a levy, currently set at 8%, on the net assets of budget funded agencies, as expressed in their Statement of Financial Position. In some instances the capital user charge is adjusted to take account of exempt assets.

The underlying theory of the capital user charge is that there is a cost associated with holding assets. The purpose of the capital user charge is to acknowledge this cost. Indeed, the assets provided to agencies over the years by central government are not 'free'. For every asset held by an agency there exists an opportunity cost – that is, something that is foregone as a consequence of holding an asset.

For the purposes of the capital user charge, the opportunity cost is deemed to be the rate of return which could be achieved if the funds which are tied up in an asset could be realised and placed in a comparable investment. This deemed return is generally described as the cost of capital.

1.2 PURPOSE OF THE CAPITAL USER CHARGE

The primary aim of the capital user charge is to assist in determining the full cost of services delivered by agencies. The capital user charge also has asset management benefits, but is not aimed at divesting assets.

Cost of Services

There is a cost associated with holding an asset that contributes to the delivery of services. This is a cost in addition to the original purchase price. However, until the introduction of the capital user charge, this cost had never been formally recognised in agency accounts.

The financial management framework applying in the Western Australian public sector requires that agencies report the full cost of the services they produce. These services contribute to government's desired outcomes. This overall framework is now referred to as Output Based Management (OBM).

It therefore makes sense to include the cost of capital in the calculation of the total cost of delivering services.

By including the cost of capital in the cost of services, the full cost of delivering services to the community can be established. As well as improving the rigour of the government's financial management, this step also improves the transparency of the government's financial reporting. In essence, the community has a much better insight into the costs associated with delivering public services through the inclusion of the capital user charge in amounts appropriated in the budget each year.

A capital user charge also allows for more meaningful service delivery cost comparisons to be made between government and non-government organisations. This helps with the establishment of best practice benchmarks.

Including the cost of capital in the cost of services is not a practice confined to the Western Australian Government. Capital user charges currently apply in Queensland, Victoria, New Zealand, the United Kingdom and Singapore. In addition, the production costs of private businesses include a component for capital, which is reflected in the prices charged for goods and services.

Asset Management

The capital user charge also serves as a catalyst for better asset management. However, it is not targeted at divesting assets.

Agencies are able to reduce their output costs per unit of service delivery by making more efficient use of the assets they hold. This could, for example, involve delivering the same level of service with a smaller asset base, or delivering a higher level of service without increasing the asset base.

The process of improving the efficiency of assets brings into play the principles of Strategic Asset Management (SAM).

Under SAM, an agency should have in place an ongoing process of asset review. The purpose of asset review is to ensure that all assets are contributing to the delivery of core services. Assets that are considered to be surplus to requirements may then, in appropriate circumstances, be sold.

In situations where assets are sold, the proceeds of sale could be reinvested in assets that improve the level of service delivery. Hence, the asset position remains unchanged, service delivery levels increase and per unit output cost has fallen.

Alternatively, the sale proceeds could be returned to central government. In this situation, the service delivery levels would remain unchanged, but the reduced asset base would result in lower per unit output costs.

In Western Australia, there are adequate safeguards to ensure that 'social' assets are protected under the capital user charge arrangements:

- disposal of assets requires government approval as part of the capital works program;
- given that the purpose of agencies is to provide goods and services to the community, it is not in agencies' interests to dispose of assets used in producing services, as this would compromise service delivery;
- agency management is subject to performance appraisals and accountability measures which more than neutralise any incentive to dispose of required assets in an attempt to make gains from the capital user charge; and
- the capital user charge is funded to avoid any disincentive to retain 'social' assets.

1.3 SETTING THE CAPITAL USER CHARGE RATE

The capital of an entity is made up of a combination of its debt and equity.

Debt is represented by the interest bearing liabilities contained in the Statement of Financial Position.

Equity is the residual amount after subtracting debt and other liabilities from the total assets recorded in the Statement of Financial Position.

The capital user charge rate is determined by calculating a weighted average of the cost of debt and the cost of equity, based on their proportions in the whole of government Statement of Financial Position. The calculated figure represents the Weighted Average Cost of Capital for the State, and becomes the capital user charge rate.

The actual calculation involves some complex analysis. The cost of debt component reflects the Western Australian Treasury Corporation's 10-year bond yield as at the date of calculation. The cost of equity is calculated using the Capital Asset Pricing Model (CAPM). The Department of Treasury and Finance's CAPM assumptions have taken into account research in other jurisdictions on the cost of public sector equity.

Through these calculations, for the three years up to and including 2003–04, a rate of 8% has been established.

The capital user charge rate is reviewed annually. In the event of material changes in market rates, the Department of Treasury and Finance may recommend to government that the capital user charge rate be adjusted.

1.4 BASIC PROCESS PRINCIPLES

The following chapters of this manual provide a detailed description of the capital user charge process.

However, in very simple terms:

- agencies are to pay central government a charge of 8% on their net asset position;
- payments are made to the Department of Treasury and Finance in quarterly instalments;
- subject to the necessary budget approval, agencies are fully funded for the capital user charge; and
- the funding, which is included in the annual budget, is based on the estimated net asset position for the year.

1.5 FEEDBACK AND FURTHER ADVICE

The Department of Treasury and Finance welcomes and encourages comments on this publication and the capital user charge process generally. Such comments should be directed to the Financial Policy Division of the Department.

Within the Department of Treasury and Finance, advice on general capital user charge policy matters can be obtained by contacting the Financial Policy Division. Matters specific to agencies should be referred to Agency Resources. A list of frequently asked questions and answers on the capital user charge can also be accessed online at: www.dtf.wa.gov.au/cms/tre_content.asp?id=613

2 ESTIMATING THE CAPITAL USER CHARGE

2.1 INTRODUCTION

This section deals with the activities associated with estimating the capital user charge. These are:

- the estimation of an agency's average net asset position for the year;
- making adjustments to the net asset position to take account of exempt assets;
- calculating the estimated capital user charge;
- incorporating the calculated capital user charge into the cost of agency services; and
- the appropriation of funds to agencies, inclusive of a component for the capital user charge.

2.2 ESTIMATING THE AVERAGE NET ASSET POSITION

The first step in estimating the capital user charge process is for the agency to calculate its estimated average net asset position for the forthcoming financial year.

Net assets are determined by subtracting total assets from total liabilities, as expressed in the agency's Statement of Financial Position.

It is important to note that only controlled assets and liabilities form part of the capital charge calculation. This is because only controlled assets are, as a general rule, used by an agency as an input to the delivery of services.

NET ASSETS
equals
TOTAL CONTROLLED ASSETS
less
TOTAL CONTROLLED LIABILITIES

Information for total controlled assets and total controlled liabilities is obtained from the agency's Statement of Financial Position

The formula for estimated average net assets is simply the average of the opening and closing estimated net asset positions for the forthcoming financial year.

AVERAGE NET ASSETS
equals
ESTIMATED NET ASSETS AT 1 JULY
plus
ESTIMATED NET ASSETS AT 30 JUNE
Divided by 2

2.3 ADJUSTMENTS TO EXCLUDE EXEMPT ASSETS

Government has determined that certain types of assets should be exempt from the capital user charge.

The value of these assets should be excluded when calculating the average net asset position.

The following categories of assets are exempt from the capital user charge.

Asset Revaluations

Asset revaluations are exempt in any year for which they are not included in the budget papers. For example, for asset revaluations brought to account in 2003–04 the capital user charge is not payable until the year in which they are incorporated in the budget papers – generally the following year. As part of the budget process the appropriation for the capital user charge will be adjusted accordingly.

Administered Assets

Administered assets are excluded from the capital user charge.

Such assets are usually not an input into the delivery of services by agencies. Their cost is therefore not relevant when determining the cost of an agency's services.

Heritage Assets

As a general rule heritage assets are included in the capital user charge base. However, where a heritage asset (defined as an asset to be preserved for cultural, historical or environmental reasons) is held solely for community purposes, and the value of the asset can be readily identified, an exemption may be granted.

For the purpose of this exercise, the suggested definition of heritage refers to assets identified on the State's heritage register.

Road Reserves and Land Beneath Roads

The value of roads and land within road reserves is exempt from the net asset calculation. This exclusion relates to Main Roads Western Australia.

Conservation and Land Management (CALM) Land Holdings

The government has agreed that CALM land held for conservation or related purposes is exempt from the capital user charge. The department is abnormally capital intensive with a substantial proportion of community purpose assets.

Consequently, application of the capital user charge across all land holdings would distort output costs.

Department for Environmental Protection

The department holds land that is not related to service delivery, in a similar manner to land held for conservation purposes by CALM.

State Fleet Facility of the State Supply Commission

The facility is a commercial undertaking, paying interest on borrowings and receiving interest on surplus cash. As a consequence it is outside the scope of the capital user charge which is intended to apply to capital that has been provided free of charge to agencies by government.

Department of Education Services Low Interest Loan Scheme

Under the Low Interest Loan Scheme the department borrows from the Western Australian Treasury Corporation (WATC) and advances loans to non-government schools, receiving repayments of these loans and making repayments to WATC. Interest is paid on the money borrowed from WATC and the schools pay interest (although at a subsidised rate) on the loans to them. Collectively this interest already acts as a charge on this capital. Consequently the capital user charge is not applied in these circumstances

Western Australian State Planning Commission

An exemption from the capital user charge applies to land that is designated for roads, parks and recreation, special uses and redevelopment schemes.

National Trust of WA

The total land and buildings of the National Trust of Western Australia consist of heritage land and buildings that are mainly for community purposes, have little operational use and have been determined as exempt from the capital user charge.

Restricted Cash

Cash that is restricted in its use, is readily identifiable and held under the following circumstances is exempt from the capital user charge:

- restrictions on the purpose for which the cash can be used are imposed by a third party (e.g. donations and bequests), or such restrictions are imposed by the agency holding the cash in seeking donations from third parties;
- interest earned from that cash held is not available for any purpose other than the purpose of the principal sum;
- no matching liability is recorded in the Statement of Financial Position of the agency holding the cash; and
- a trust account under section 9(2)(c)(iii) of the Financial Administration and Audit Act or under other legislation exists. The purpose of the account is specified as holding amounts that are restricted in use and that the amount of cash held is credited to that account.

Full details are provided to the Department of Treasury and Finance with each quarterly assessment of the capital user charge.

Other Exempt assets

Assets held by the Rural Business Development Corporation, as well as the assets held by agencies that are not divisions of the Consolidated Fund Estimates (other than TAFE colleges) are exempt from the capital user charge.

In the case of the Rural Business Development Corporation, the principal asset is cash provided under various assistance schemes pending distribution to eligible recipients, and application of the charge is therefore not appropriate. For non-budget funded agencies, the government has other options for ensuring full output costing and improved asset management.

2.4 CALCULATING THE CAPITAL USER CHARGE

Before calculating the estimated capital user charge the agency should have:

- calculated its estimated net asset position for the opening and close of the forthcoming financial year;
- adjusted the net asset position to take account of any exempt assets; and
- calculated the estimated average net asset position based on the above information.

The final figure, which has been derived from these calculations, can now be used to calculate the estimated capital user charge for the forthcoming financial year. This simply involves multiplying the adjusted estimated average net asset figure by the capital user charge rate of 8%.

ESTIMATED CAPITAL USER CHARGE

equals

ESTIMATED AVERAGE NET ASSETS

(Adjusted to exclude exempt assets)

multiplied by 8%

The calculated estimate for the agency's capital user charge for the forthcoming financial year can now be used to:

- determine the full cost of agency services; and
- determine, along with other expenses and outlays, the total resources required by the agency.

2.5 INCORPORATING THE CAPITAL USER CHARGE INTO THE COST OF AGENCY SERVICES

There are no set rules for attributing the capital user charge to specific services. The actual method adopted is likely to depend on the sophistication of an agency's cost accounting systems.

Some suggested approaches are outlined below, although the final decision on which method to adopt rests with the agency.

Attributing Specific Assets to Specific Services

With well developed cost accounting systems in place an agency may be in a position to directly attribute specific assets to specific services.

This requires a knowledge of which assets, or portions of assets, contribute to certain services.

Hence, services that are capital intensive in their delivery would have a higher capital user charge component in their cost structure than those that are not.

Apportionment of Depreciation Expenses

Agencies are already required to attribute depreciation expenses to the cost of their services. The method adopted by an agency can serve as a basis for apportioning the capital user charge. This is because the presence of a depreciation expense ordinarily indicates the presence of a capital input.

Apportionment of Overhead Expenses

Another possible approach is to apportion the capital user charge to specific services in a manner consistent with the apportionment of overheads.

2.6 BUDGET STATEMENTS

Agencies are funded for the capital user charge. The capital user charge funding is included with the appropriation of funds by Parliament, as part of the annual budget process.

The presence of the capital user charge is recognised in a number of ways in the Budget Statements. The specific points of recognition are:

- **Appropriation and Forward Estimates (Table 1)**

  The amount appropriated for the delivery of outputs is inclusive of the capital user charge.

- **Output and Appropriation Summary (Table 2)**

  Table 2 outlines the amount to be appropriated from the Consolidated Fund to fund the delivery of outputs. The cost of each output is recorded separately in the table and is inclusive of the capital user charge.

- **Outcomes, Outputs and Performance Information (Table 3)**

  This table provides detailed information concerning each of the agency's outputs. The cost of the capital user charge is included in the line 'Total Cost of Output'.

- **Statement of Financial Performance (Controlled) (Table 5)**

  The capital user charge is recognised as a separate item under the 'Expenses from ordinary activities' heading.

- **Statement of Cash Flows (Controlled) (Table 7)**

  The capital user charge is recognised as a separate item under the heading 'Cash Flows from Operating Activities'.

Examples of how the capital user charge is incorporated into agency financial statements are provided in Appendix 4.

2.7 VARIATIONS FROM BUDGET

There are a number of reasons as to why the final capital user charge may be greater than or less than budgeted. In many instances there will not be one single reason but a combination of reasons. This will require analysis of the final audited result for the financial year and determination of the amounts attributable to each.

Decisions on variations to appropriation funding for the initial capital user charge amount budgeted, as a result of movements in the capital user charge, depend firstly upon whether the variation meets the materiality threshold. Currently this threshold is the lesser of $100,000 or 10% of the capital user charge estimate. Assessment of variations under $10,000 will not be initiated by the Department of Treasury and Finance.

2.8 AMENDMENTS TO THE BUDGET AND FORWARD ESTIMATES

As a general rule supplementary funding requests from agencies are likely to be supported where it can be demonstrated that the reasons for the increased capital user charge expense are in relation to:

- an error, transfer of assets or accounting policy change; or
- reasons outside the agency's control (e.g. the receipt of Commonwealth funds on June 30).

Requests for supplementary funding should be netted against, or added to, other approved budget variations.

In the event that an agency has realised savings in relation to the capital user charge, retention of these funds will be subject to the approval of government. Agencies will need to clearly demonstrate that the associated reasons are not fortuitous or in relation to an error, transfer of assets or accounting policy change.

Transfers of functions between agencies that also involve the transfer of assets and/or liabilities will in most instances require adjustments to funding for changes to the capital user charge.

Revalued assets are exempt from the capital user charge if they are not reflected in the agency's budget statements. Future years' budget provisions are to be adjusted for the impact of asset revaluations.

Excluding the above reasons, adjustments to agency output appropriations for the capital user charge should only occur when:

- the new out year is rolled into the forward estimates; or
- capital contributions in existing forward estimate years are amended.

This is illustrated in the following example.

At the time the 2007–08 financial year is incorporated into the forward estimates, an agency is provided with a $1 million capital contribution appropriation and is estimated to receive $1 million in external grants (e.g. Commonwealth) for capital purposes. This will cause net assets to increase by $2 million.

The capital user charge payable will increase by $80,000 in 2007–08 ($2 million x 8% divided by 2). The amount is divided by two because the capital user charge payable is an average between the opening and closing net asset positions for the year.

When 2008–09 is rolled into the forward estimates, a further $80,000 is to be added to the output appropriation, representing the full year impact of the previous year's capital contribution. Also, the 2008–09 capital user charge impact of the new 2008–09 capital contribution is to be added to the agency's output appropriation, calculated in the same way as illustrated in the previous paragraph.

Agencies are to manage the capital user charge expense in the same manner as all other expenses. As such, other than for the above instances, adjustments to output appropriations for the capital user charge will not be considered.

2.8.1 MECHANISM FOR REDUCING OR INCREASING AN APPROPRIATION

Where a material variation in the capital user charge arises, the mechanism to correct any imbalance (if appropriate) is through an adjustment to either the current year or subsequent year's appropriation drawdowns.

Over-provision of the capital user charge

When it is determined during the budget year that an agency's budget has been over-provided, current year appropriations equivalent to the amount over-provided, should not be drawn down. If, in this instance, the full appropriation has already been drawn, the amount overdrawn should be repaid before the end of the financial year.

When an over-provision is determined after the completion of the budget, an adjustment will be made to the subsequent years appropriation as a 'once off' adjustment.

Under-provisions of the capital user charge

Where it is determined during the budget year that an agency's budget has been under-provided, supplementary funding may be sought in the year in question.

When an under-provision is determined after the completion of the budget year in which the agency has been under-provided, supplementary funding should be sought in the subsequent years appropriation as a 'once off' adjustment.

2.9 DISBURSEMENT PROFILES

Throughout the financial year, agencies receive their cash funding through a process of drawdowns from the Department of Treasury and Finance.

Prior to the commencement of the financial year, the agency should, as part of its normal planning process, prepare a disbursement profile. This profile will need to include the amounts required to cover the capital user charge. These amounts should be drawn down in the fortnight before the capital user charge instalment due date.

From 1 July 2004 disbursement profiles should reflect capital user charge instalments made by the end of September, December, March and June. The first three capital user charge instalments should sum to three quarters of the estimated capital user charge payment published in the budget papers. The final June quarter instalment of the capital user charge is self-assessed by agencies, based on the estimated average net assets for the year. Payment of the budgeted balance owed will continue to be made before the end of June and any adjustments, where necessary, are to be applied to the next quarterly payment (September).

2.10 RESPONSIBILITIES

The Department of Treasury and Finance is responsible for:

- assessing the budget estimates provided by agencies as part of the budget formulation process; and
- incorporating the capital user charge into output costs as reflected in the budget papers.

Agencies are responsible for estimating the capital user charge for the budget and determining the method for attributing the capital user charge to specific services.

3 PAYING THE CAPITAL USER CHARGE

3.1 INTRODUCTION

The process of calculating and paying the capital user charge is carried out by agencies on a quarterly basis. A standard process applies to the first three quarters of the financial year, with a slightly different process applying to the final quarter.

The key steps for agencies in this process are:

- calculating the quarterly capital user charge;
- drawing down capital user charge funds; and
- payment of the capital user charge to the Department of Treasury and Finance.

Further detail on each of these steps, and of the role played by the Department of Treasury and Finance is provided in section 3.3.

3.2 DRAWING DOWN FUNDS FOR THE CAPITAL USER CHARGE

Throughout the year an agency will draw down funds on a fortnightly basis to cover its various operating costs.

An amount will need to be drawn down as close as practicable to the capital user charge payment due date, to cover the capital user charge expense. The drawdown immediately prior to the capital user charge payment due date is the best time for this to occur.

Agencies should not be drawing down the additional capital user charge funding any earlier than absolutely necessary.

As discussed in section 2.9, the actual timing of the drawdowns for the capital user charge should be planned prior to the commencement of the financial year.

3.3 MAKING PAYMENTS

The method of levying the capital user charge is for agencies to pay one quarter of the budgeted estimate of the capital user charge for the first three quarters of the financial year – this is the amount published under the heading 'Expenses from ordinary activities' in the Statement of Financial Performance of the budget statements.

From 1 July 2004 this equates to payments made by the end of September, December and March. In the June quarter the capital user charge is self-assessed by agencies, based on the estimated average net assets for the year. Payment of the budgeted balance owed will continue to be made as close as possible to and no later than June 30. Apart from adjustment notices referred to below, no invoice or payment advice will be issued by the Department of Treasury and Finance.

These arrangements are illustrated in the table on the following page.

Any adjustments, where necessary, will be made by the end of the following September. On occasion, payment of adjustments may fall into the next quarter. This is likely to arise when the Accounting Operations Branch of the Department of Treasury and Finance does not receive actuals in time to audit an agency for a September adjustment payment. This must be agreed in advance with the Department of Treasury and Finance.

	$
Annual estimate for capital user charge	1,000
Amount payable for September quarter ($1,000/4)	250
Amount payable for December quarter ($1,000/4)	250
Amount payable for March quarter ($1,000/4)	250
Actual opening net asset position @ 1 July	12,000
Estimated closing net asset position @ 30 June	12,800
Amount payable for June quarter (($12,400 x 8%) – $750)	242

Payments are made to the Department of Treasury and Finance through an electronic transfer of funds. The Department has established a receivable account for the capital user charge for each agency. In addition to making the payment, agencies should also provide a remittance advice to the Department of Treasury and Finance that quotes the relevant capital user charge account number (dept. abbrev. 721300).

3.4 RESPONSIBILITIES

The Department of Treasury and Finance has a number of roles associated with the quarterly capital user charge process. These roles are divided according to the following parts of the Department of Treasury and Finance.

State Financial Reporting Branch

Agencies enter monthly and/or quarterly capital user charge actuals data into the Treasury Information Management System (TIMS). State Financial Reporting verifies this data against other Department of Treasury and Finance (administered) records.

Accounting Operations Branch

The Accounting Operations Branch is the area of the Department of Treasury and Finance that receives and records the capital user charge payments.

The Accounting Operations Branch ensures the first three quarterly payments made by an agency in the financial year sum to three quarters of the capital user charge estimate published in the budget statements.

At the end of the financial year and upon availability of the actual capital user charge amount for that year, Accounting Operations will issue agencies with an adjustment notice. As noted in section 3.3 any adjustment amount is to be paid by the end of September.

Payments which are not received by the due date, or which are incorrect, are subject to recovery action by Accounting Operations.

Similarly, Accounting Operations will arrange the reimbursement of overpayments to agencies.

Agency Resources

The role of Agency Resources is to manage the relationship between the Department of Treasury and Finance and individual agencies.

Agency Resources provides a liaison service between State Financial Reporting, Accounting Operations and individual agencies. In particular Agency Resources analyses the reasons underlying the outturn of the previous year.

Each agency is assigned an individual analyst within Agency Resources, who is a useful first point of contact when dealing with capital user charge process issues.

Agencies have three primary responsibilities. These are:

- calculating capital user charge in accordance with the budget process, and using this estimate to pay the first three quarterly instalments of the capital user charge;
- from 1 July 2004, make capital user charge payments to the Department of Treasury and Finance by the end of September, December and March, and as close to June 30 as possible for the last quarter of the year; and
- calculating the actual capital user charge for the financial year based on the final audited net asset position and paying any adjustment by the end of September.

4 OTHER ISSUES

4.1 POLICY DECISIONS OF GOVERNMENT

There may be occasions when a policy decision of government has a substantial impact upon the net asset position of an agency.

The types of instances can include the merger of two or more agencies, an expansion in the scope of activity of an agency, or the transfer of a function and its associated assets to another agency.

In these circumstances, the Department of Treasury and Finance will ensure that agencies are not unfairly penalised with respect to the capital user charge.

The *Financial Administration and Audit Act* contains provisions that permit the Treasurer to authorise the transfer of appropriations from one agency to another in the event of a transfer of function.

In situations where additional and new functions are taken on by an agency, and this results in an increase in net assets, then the Department of Treasury and Finance may also consider supplementary funding and budget adjustments to cover the additional capital user charge expense. This is most likely to occur when the functions taken on are completely new to government.

The Department of Treasury and Finance is also mindful that agencies should not receive a windfall benefit from surplus capital user charge funds as a result of a policy decision. This could conceivably occur if, through a policy decision, an agency loses a number of functions and is required to divest itself of assets of substantial value.

In this situation the Department may seek the Treasurer's approval to adjust an agency's approved budget to reflect a reduced capital user charge.

4.2 GRANTS OR DONATIONS OF ASSETS FROM EXTERNAL BODIES

The primary purpose of the capital user charge is to take account of the cost of capital held by an agency. As discussed in Chapter 1, this reflects the opportunity cost to government of holding assets.

Because the emphasis of the capital user charge is on the cost of holding the asset rather than purchasing the asset, it is entirely appropriate to include the value of assets that have not been 'purchased' by the agency in the net asset calculation. Such assets may include grants from Commonwealth agencies or local government organisations. Such assets should be valued, accounted for in the agency's Statement of Financial Position and be subject to the capital user charge.

To the extent that donated assets have a material impact on net assets, agencies may approach the Department of Treasury and Finance to seek additional funding for the capital user charge.

4.3 ASSET VALUATION POLICIES

A meaningful capital user charge relies on an agency maintaining a meaningful and relevant asset valuation policy. This applies particularly in the case of real property assets.

The most meaningful valuation approach is that which provides for 'fair value' of assets.

This means that assets are valued in a way that balances considerations of current use, encumbrances and restrictive covenants, community expectations, and a realistic assessment of future use.

Notably, a fair value approach can mean that historical cost and residual current value valuations may not always be suitable.

Agencies are encouraged to discuss their asset valuation policies with the Valuer General's Office, and should also value assets in a manner consistent with Australian Accounting Standards Board Standard AASB 1041 and Treasurer's Instruction TI954.

4.4 TREATMENT OF ASSETS LISTED FOR SALE

Assets that have been placed on the market for sale remain an asset of the agency and should continue to be reported in the agency's Statement of Financial Position until settlement takes place.

It is important to note that the Department of Land Information, in its capacity as a sales agent, neither administers nor controls an asset that it is marketing on behalf of an agency. For this reason, the capital user charge remains payable on an asset until settlement.

4.5 ASSET REVALUATIONS

The upward revaluation of agency assets during the year will naturally cause the capital user charge to increase.

To avoid unfavourable budget variations, asset revaluations are exempt from the capital user charge in any year in which they are not included in the budget papers. For example, for asset revaluations brought to account in 2003–04, the capital user charge is not payable until the year in which they are published in the budget papers – generally the following year.

Future budgets will be adjusted for the impact of asset revaluations.

4.6 GOODS AND SERVICES TAX (GST)

The Australian Taxation Office has confirmed that the capital user charges applied by various Australian governments do not represent a taxable supply and are therefore not liable for GST.

APPENDICES

APPENDIX 1

CALCULATION OF DRAWDOWNS FROM THE HOLDING ACCOUNT

APPENDIX 1.1

GENERAL ASSET REPLACEMENT

For general asset replacement, the level of funding to be drawn down is based on, and subject to, the availability of sufficient funding within that holding account asset class (general asset replacement), in the financial year that the asset is to be replaced.

This is illustrated in the following example.

> *An agency intends to replace an existing photocopier in 2008-09 at an estimated cost of $5,000. Depreciation credits accumulated against the holding account class 'general asset replacement' at year-end 2007–08 total $3,500. The total balance of $3,500 may be drawn down from the holding account for partial funding of the photocopier replacement. The remaining $1,500 is funded through a capital contribution.*

The table below illustrates the calculation of the drawdown from the holding account for this example.

Holding Account - General Asset Replacement

	2001–02 to 2003–04 Accumulated Balance $	2004–05 $	2005–06 $	2006–07 $	2007–08 $	2001–02 to 2007–08 Accumulated Balance $
Furniture and Fittings	250	250	250			750
Computer Upgrades	750	500				1,250
Photocopier	0	0	500	500	500	1,500
Total	1,000	750	750	500	500	3,500

APPENDIX 1.2

MAJOR CAPITAL INFRASTRUCTURE REPLACEMENT

For major capital infrastructure replacement, the level of drawdown from the holding account is based on the availability of sufficient funding, within the appropriate sub-asset class, in the financial year that the asset is to be replaced. Credits accumulated within a particular sub-asset class (e.g. buildings) are generally not available for funding asset replacement in another sub-asset class (e.g. major IT equipment).

This is illustrated in the following example.

> *An agency intends to replace a building at the end of 2008-09 at an estimated cost of $100 million. Credits for depreciation of assets in the sub-asset class 'buildings' (within the holding account asset class 'major capital infrastructure') at year-end 2007–08 total $27.3 million. Although the total balance of the holding account asset class 'major capital infrastructure' is $35 million, $7.7 million of this total balance relates to another holding account sub-asset class (IT System) and therefore should not be drawn down in this instance. To fund the building replacement, $27.3 million may be drawn down from the holding account, with the remaining $72.7 million funded through a capital contribution.*

The table below illustrates this calculation of the drawdown from the holding account.

Holding Account - Major Capital Infrastructure

	2001–02 to 2003–04 Accumulated Balance $	2004–05 $	2005–06 $	2006–07 $	2007–08 $	2001–02 to 2007–08 Accumulated Balance $
Buildings	11,700	3,900	3,900	3,900	3,900	27,300
IT System	3,300	1,100	1,100	1,100	1,100	7,700
Total	15,000	5,000	5,000	5,000	5,000	35,000

APPENDIX 1.3

LEAVE LIABILITY REDUCTION

Drawdowns for leave liability reduction are contingent on the level of funding available within the holding account. The following example illustrates the calculation of drawdowns from the holding account for leave liability reduction.

Holding Account - Leave Liability

	2003–04 $’000	2004–05 $’000	2005–06 $’000	2006–07 $’000	2007–08 $’000
Leave Liability Balance	10,000	11,000	9,000	11,100	10,000
Growth/Reduction (-)		1,000	-2,000	2,100	-1,100
Transfer to Holding Account		1,000		2,100	
Drawdowns from Holding Account			1,000		1,100
Holding Account Balance - Leave Liability	0	1,000	0	2,100	1,000
Amendment to:					
Output Appropriation		1,000	-1,000	2,100	-1,100
Output Appropriation - Receipts		0	-1,000	0	-1,100
Proceeds from Holding Account		0	1,000	0	1,100

An agency's leave liability is forecast to increase from $10 million in 2003–04 to $11 million in 2004–05. The increase of $1 million results in a corresponding increase to the agency's output appropriation, which is credited to its holding account.

In 2005–06, the agency's leave liability is forecast to reduce by $2 million (from $11 million in 2004–05 to $9 million in 2005–06). The $1 million balance of the leave liability portion of the holding account can be drawn down by the agency in 2005–06. A corresponding reduction of $1 million will also occur against the agency's output appropriation in 2005–06, consistent with budget neutrality. The remaining $1 million reduction in leave liability is to be met from within existing agency cash resources.

With leave liability expected to increase from $9 million in 2005–06 to $11.1 million in 2006–07, the agency's output appropriation is increased by $2.1 million, which is credited to the holding account.

Leave liability estimates in the final forward estimate year are forecast to decrease from $11.1 million in 2006–07 to $10 million in 2007–08. As there is a sufficient balance in the holding account ($2.1 million), the leave liability reduction of $1.1 million can be fully funded from the holding account.

A corresponding reduction of $1.1 million will also occur against the agency's output appropriation in 2007–08.

APPENDIX 2

HOLDING ACCOUNT: SUMMARY OF MAJOR POINTS

THE HOLDING ACCOUNT

A holding account is maintained by the Department of Treasury and Finance for the non-cash component of each agency's appropriation – namely depreciation and accrued leave entitlements:

- requests for drawdowns from the holding account will be assessed by the Department of Treasury and Finance as part of the annual budget process;
- an agency may only drawdown funds from the holding account for asset replacement and leave liability reduction;
- credits to, and drawdowns from, the holding account are reflected in the disbursement profile of each agency;
- each agency needs to maintain a record of the components of holding account credits attributable to depreciation and leave, as the Treasury Information Management System (TIMS) does not distinguish between the two;
- the Statement of Financial Position of each agency reports the balance of the holding account as a controlled but restricted asset;
- the Statement of Cash Flows of each agency reports drawdowns from the holding account;
- the amount of holding account credits transferred to an agency with respect to the transfer of control of an asset, must be agreed between the agencies involved; and
- there are no retrospective adjustments of previous years credits to the holding account.

CREDITS FOR DEPRECIATION COSTS

An agency is credited for the depreciation of assets used to deliver services:

- credits are based on estimates provided by agencies;
- where an asset exists for part of the year, credits to the holding account for depreciation will also reflect a part year impact;
- where the level of depreciation is expected to exceed the approved budget provision, an increase in the amount credited to the holding account can only be accommodated if offsetting savings are achieved or the Treasurer approves supplementary funding; and
- where an agency receives both a non-cash component of an appropriation to cover depreciation and funding from an external source for asset replacement, the Department of Treasury and Finance may recommend, after consultation with the agency, that the non-cash component of the agency's recurrent appropriation be reduced by the equivalent level of revenue received from external sources.

CREDITS FOR LEAVE LIABILITY

An agency may be credited for agreed increases in annual and long service leave liability:

- the associated level of salary expense must be approved as part of the annual budget process; and
- where the level of leave liability is expected to exceed the approved budget provision, an increase in the amount credited to the holding account can only be accommodated if offsetting savings are achieved or the Treasurer approves supplementary funding.

DRAWDOWNS FOR ASSET REPLACEMENT

An agency may use holding account depreciation credits to replace existing assets:

- the assets being replaced must form part of the agency's approved capital works program;
- drawdowns will be matched by a commensurate reduction in the agency's capital contribution (budget neutrality);
- drawdowns for the replacement of an asset should correspond to the holding account asset class or sub-asset class applicable;
- a drawdown from the holding account for asset replacement may be supplemented by a capital contribution when:
  - a new asset both replaces and improves an existing asset; or
  - the balance in the holding account is insufficient;
- the capital contribution, as with all other funding issues, is subject to the necessary budget approval process; and
- increases in capital stock are generally funded through a capital contribution.

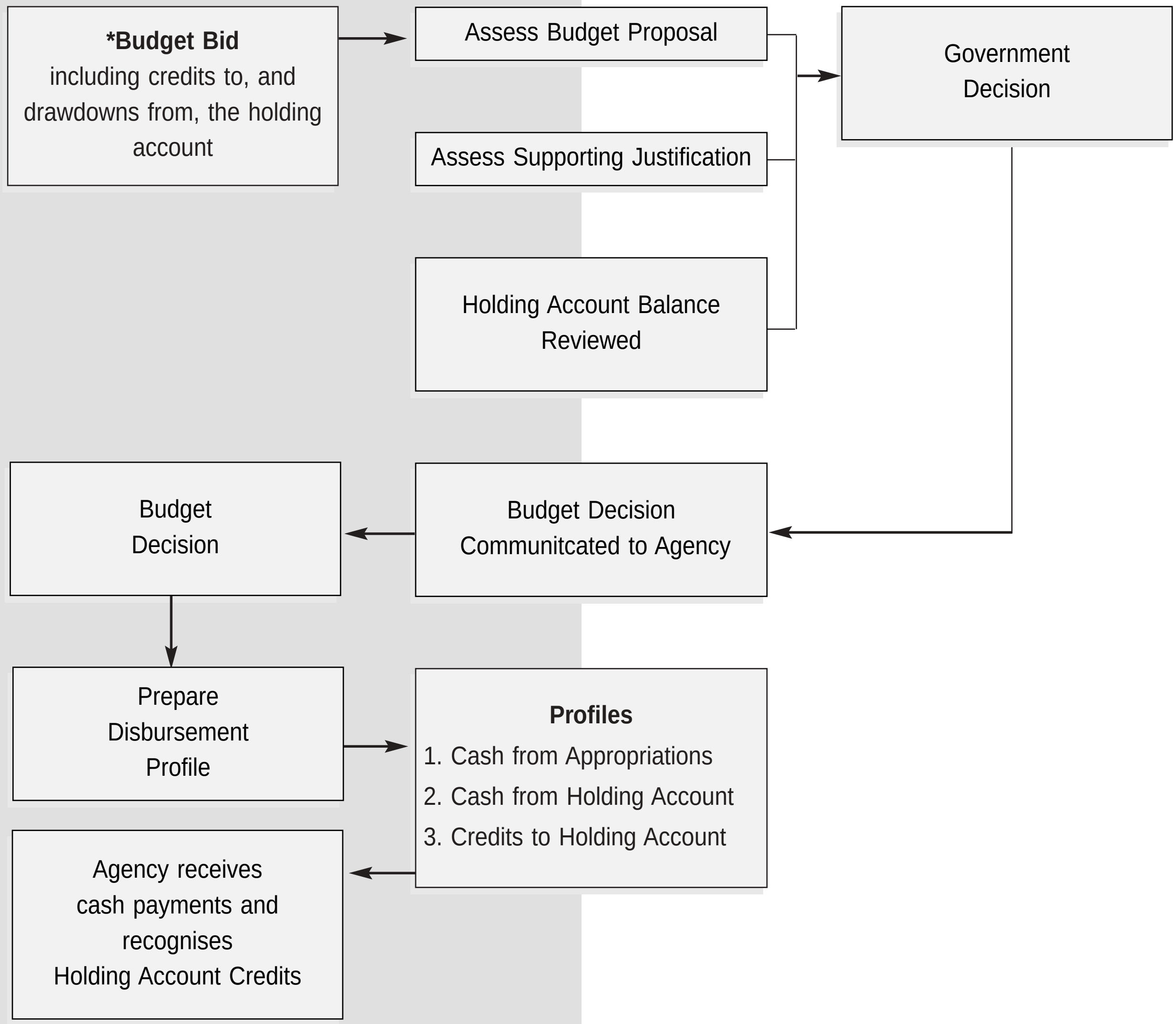
DRAWDOWNS TO REDUCE LEAVE LIABILITY

An agency is required to provide justification in support of any request for a drawdown from the holding account to fund leave liability reduction:

- drawdowns will be matched by a commensurate reduction in the agency's appropriation to deliver outputs (budget neutrality); and
- where the balance of the holding account is insufficient to meet the requested leave liability reduction, the balance may be supplemented through re-prioritisation of existing resources by the agency.

APPENDIX 3

HOLDING ACCOUNT ACCESS PROCESS MAP



* The Budget Bid assumes that government has already approved agencies' asset replacement proposals, which form part of the capital works program.

APPENDIX 4

BUDGET STATEMENTS*

TABLE 1

APPROPRIATION AND FORWARD ESTIMATES

	2002–03 Actual $'000	2003–04 Budget $'000	2003–04 Estimated Actual $'000	2004–05 Budget Estimate $'000	2005–06 Forward Estimate $'000	2006–07 Forward Estimate $'000	2007–08 Forward Estimate $'000
DELIVERY OF OUTPUTS							
Item 87 Net amount appropriated to deliver outputs				**54,696**			
Amount Authorised by Other Statutes							
- Salaries and Allowances Act 1975				**478**			
- Lotteries Commission Act 1990				**8,600**			
Total appropriations provided to deliver outputs				**63,774**			
ADMINISTERED TRANSACTIONS							
Item 88 Amount provided for Administered Grants, Subsidies and Other Transfer Payments				**600**			
CAPITAL							
Item 171 Capital Contribution				**7,959**			
GRAND TOTAL				**72,333**			

The appropriation for the delivery of outputs includes both credits to the holding account and provision for the capital user charge

* All tables in this appendix have been included for illustrative purposes.

example

TABLE 2

OUTPUT AND APPROPRIATION SUMMARY

	2002–03 Actual $'000	2003–04 Budget $'000	2003–04 Estimated Actual $'000	2004–05 Budget Estimate $'000	2005–06 Forward Estimate $'000	2006–07 Forward Estimate $'000	2007–08 Forward Estimate $'000
OUTPUTS							
Output 1:							
Creation of, and the provision of access to, a diverse range of knowledge, information, arts and cultural experiences				27,085			
Output 2:							
Development and management of the State's natural, cultural and documentary collections				26,383			
Output 3:							
Support to Western Australia's arts and cultural industries				26,440			
Total Cost of Outputs				79,908			
Less Operating revenues				16,134			
Net Cost of Outputs				63,774			
Adjustments [(a)]				–			
Appropriation provided to deliver Outputs				63,774			
ADMINISTERED TRANSACTIONS							
Appropriation for Administered Grants, Subsidies and Transfer Payments				600			
CAPITAL CONTRIBUTION TO MEET EQUITY NEEDS							
Appropriation for Capital Contribution to meet equity needs [(b)]				7,959			
TOTAL CONSOLIDATED FUND APPROPRIATIONS				72,333			

Each output may include provision for the capital user charge and accrual costs of depreciation and leave entitlements

(a) Adjustments are related to movements in cash balances and other accrual items such as receivables, payables and superannuation.

(b) Supporting details are disclosed in the Capital Contribution Statement.

example

TABLE 3

OUTCOMES, OUTPUTS AND PERFORMANCE INFORMATION

***Outcome:* A community that is informed of, and has access to, a diverse range of innovative ideas, knowledge and cultural experiences.**

***Output 1:* Creation of, and the provision of access to, a diverse range of knowledge, information, arts and cultural experiences**

Includes information, public library services and exhibition services provided by the Library and Information Service of WA (LISWA), the Art Gallery of WA and the WA Museum.

	2002–03 Actual $'000	2003–04 Budget $'000	2003–04 Estimated Actual $'000	2004–05 Budget Estimate $'000	Reason for Significant Variation
Total Cost of Output				27,085	
Less Operating Revenues [(a)]				5,265	
Net Cost of Output				21,820	
Adjustments [(b)]				-	
Appropriation for delivery of Output 1				21,820	

Total cost of output may include provision for the capital user charge and accrual costs of depreciation and leave entitlements

(a) Includes user charges and fees, net profit on asset disposal, other revenues and resources received free of charge.

(b) Adjustments are related to movements in cash balances and other accrual items such as receivables, payables and superannuation.

TABLE 4
CAPITAL CONTRIBUTION

	2002–03 Actual $'000	2003–04 Budget $'000	2003–04 Estimated Actual $'000	2004–05 Budget Estimate $'000	2005–06 Forward Estimate $'000	2006–07 Forward Estimate $'000	2007–08 Forward Estimate $'000
CAPITAL CONTRIBUTION TO MEET EQUITY NEEDS							
Total Cost of Capital Works Program				9,377			
Working capital requirement							
Loan repayments				912			
				10,289			
LESS							
Borrowings				2,130			
Funding included in output appropriations (a)				-			
Holding Account (b)				200			
Capital Contribution				7,959			

Drawdown from holding account for asset replacement

(a) Capital works expensed through the Statement of Financial Performance.

(b) Drawdown from holding account.

example

TABLE 5

STATEMENT OF FINANCIAL PERFORMANCE (Controlled)

	2002–03 Actual $'000	2003–04 Budget $'000	2003–04 Estimated Actual $'000	2004–05 Budget Estimate $'000	2005–06 Forward Estimate $'000	2006–07 Forward Estimate $'000	2007–08 Forward Estimate $'000
COST OF SERVICES							
Expenses from ordinary activities							
Employee expenses [(a)]				25,114			
Superannuation				1,280			
Supplies and services				12,869			
Administration expenses				8,310			
Accommodation expenses				3,000			
Depreciation				6,056			
Net loss on disposal of non-current assets				-			
Borrowing costs				3,073			
Capital User Charge				5,000			
Grants and subsidies				15,206			
TOTAL COST OF SERVICES				79,908			
Revenues from ordinary activities							
User charges and fees [(b)]				10,244			
Interest				890			
Net profit on disposal of non-current assets				-			
Grants and subsidies				2,000			
Other				3,000			
Total Revenues from Ordinary Activities				16,134			
NET COST OF SERVICES				63,774			
REVENUES FROM STATE GOVERNMENT							
Appropriations				63,774			
TOTAL REVENUES FROM STATE GOVERNMENT				63,774			
CHANGE IN EQUITY RESULTING FROM OPERATIONS				-			
Change in Equity arising from transfer of assets/liabilities				-			
CHANGE IN EQUITY AFTER EXTRAOARDINARY ITEMS				-			

May include leave credits to the holding account. The level of credits is based on the provision for employee entitlements in Table 6

Normally represents credits to the holding account

The capital user charge is explicitly recognised as a cost of service

(a) The Full Time Equivalents (FTE's) for 2003-04 Estimated Actual and 2004-05 Estimate are 630 and 635 respectively.

(b) Includes resources received free of charge. This treatment may differ from the agency's annual report.

example

TABLE 6

STATEMENT OF FINANCIAL POSITION (Controlled)

	2002–03 Actual $'000	2003–04 Budget $'000	2003–04 Estimated Actual $'000	2004–05 Budget Estimate $'000	2005–06 Forward Estimate $'000	2006–07 Forward Estimate $'000	2007–08 Forward Estimate $'000
CURRENT ASSETS							
Cash				15,857			
Other financial assets (Investments)				208			
Receivables				1,360			
Inventories				774			
Restricted cash				1,756			
Amounts receivable for outputs				182			
Prepayments				180			
Other				300			
Total current assets				20,617			
NON-CURRENT ASSETS							
Amounts receivable for outputs				7,000			
Land and buildings				76,689			
Other financial assets (Investments)				2,479			
Plant, equipment and vehicles				6,482			
Other				250			
Total non-current assets				92,900			
TOTAL ASSETS				113,517			
CURRENT LIABILITIES							
Provision for employee entitlements				1,506			
Payables				1,262			
Interest bearing liabilities (Borrowings)				1,221			
Interest payable				999			
Superannuation				3,331			
Other liabilities				7,101			
Total current liabilities				15,420			
NON-CURRENT LIABILITIES							
Provision for employee entitlements				2,920			
Interest bearing liabilities (Borrowings)				32,640			
Total non-current liabilities				35,560			
TOTAL LIABILITIES				50,980			
EQUITY							
Contributed equity				7,959			
Accumulated surplus/(deficit)				28,037			
Asset revaluation reserve				13,669			
Other reserves				12,872			
Total equity				62,537			
TOTAL LIABILITIES AND EQUITY				218,817			

Amounts sum to balance of holding account

Net Assets *equals* Total Assets *minus* Total Liabilities

example

TABLE 7

STATEMENT OF CASH FLOWS
(Controlled)

	2002–03 Actual $'000	2003–04 Budget $'000	2003–04 Estimated Actual $'000	2004–05 Budget Estimate $'000	2005–06 Forward Estimate $'000	2006–07 Forward Estimate $'000	2007–08 Forward Estimate $'000
CASH FLOWS FROM STATE GOVERNMENT							
Appropriations				56,392			
Capital Contribution				7,959			
Holding Account				200			
Net cash provided by State Government				64,551			
CASHFLOWS FROM OPERATING ACTIVITIES							
Payments							
Employee costs				(23,276)			
Superannuation				(1,280)			
Supplies and services				(15,079)			
Administration				(7,840)			
Accommodation				(3,000)			
Borrowing costs				(2,946)			
Capital User Charge				(5,000)			
Grants and subsidies				(14,519)			
Goods and Services Tax				(6,000)			
Receipts							
User charges and fees				10,080			
Interest				790			
Grants and subsidies				2,000			
Goods and Services Tax				6,000			
Other				4,427			
Net cash from operating activities				(55,643)			
CASH FLOWS FROM INVESTING ACTIVITIES							
Purchase of non-current assets				(8,617)			
Purchase of investments				(760)			
Proceeds from the sale of non-current assets				-			
Net cash from investing activities				(9,377)			
CASHFLOWS FROM FINANCING ACTIVITIES							
Proceeds from borrowings				2,130			
Repayment of borrowings				(912)			
Net cash from financing activities				1,218			
NET INCREASE/(DECREASE) IN CASH HELD				749			
Cash assets at the beginning of the reporting period				16,864			
Cash assets at the end of the reporting period				17,613			

Drawdown from holding account

The capital user charge is recognised under Cash Flows from Operating Activities

GLOSSARY

accrual accounting	Recognition of economic events and other transactions involving revenues, expenses, assets, liabilities and equity as they occur, rather than when a flow of cash occurs.
accrual appropriations	Appropriations that recognise the full annual cost of services, including expenses which are incurred in the year of the appropriation but paid in a later year, namely depreciation and accrued leave entitlements.
administered assets	Assets administered by an agency on behalf of government, that do not contribute to the services produced by an agency. These assets are not included on an agency's controlled Statement of Financial Position, and are therefore not attributable towards the capital user charge.
appropriation	The Parliamentary authorisation of expenditure by agencies. The budget process includes the passage of Appropriation Bills by Parliament.
asset	Future economic benefits controlled by an entity as a result of past transactions or other events. Assets may be tangible, and can include land, buildings and equipment. Assets may also be intangible, and can include legal claims and rights, such as accounts receivable.
average net assets	The average net assets figure for an agency is the average of the estimated net asset position as at the beginning and the end of each financial year.
balance sheet	see 'Statement of Financial Position'.
Capital Asset Pricing Model	A financial model used to calculate the cost of equity. The details of the CAPM formula can be found in most finance theory textbooks.
capital contributions	These are appropriations approved by Parliament mainly for the purchase of assets.
capital user charge	The opportunity cost of government's capital investment in agencies. This is represented by a levy charged by government on the net value of assets used by agencies in the delivery of services.
capital user charge rate	This is the rate applied to net assets to determine the capital user charge expense. It is currently set at 8%.

cash flow statement
See 'statement of cash flows'.

Consolidated Fund
The central account administered by the Treasurer from which appropriations are paid and into which revenues of the Crown, such as State taxes, royalties and Commonwealth grants, are credited.

controlled items
Assets, liabilities, revenues and expenses that are directly controlled by agencies, in that they relate directly to agencies' operational objectives. In particular, controlled assets are subject to the capital user charge. Technical guidance on what constitutes a controlled asset should be obtained from Australian Accounting Standards and Statements of Accounting Concepts.

cost accounting
Measures and reports financial and other information related to an organisation's acquisition or consumption of resources.

cost of capital
The expected return that is foregone by investing in an asset rather than in comparable financial securities. Also referred to as the opportunity cost of capital.

debt
An interest bearing liability that is held by an entity. The rate of interest on the debt is referred to as the cost of debt.

depreciation
The portion of the cost or value of an asset that is assigned to expenses by an entity. Depreciation recognises that assets generally have a limited life and that the declining life span of an asset is an expense to an entity.

equity
The residual interest in the assets of an entity after the deduction of liabilities.

exempt assets
Assets which are not included in the calculation to determine the capital user charge.

expense
Consumption or loss of future economic benefits in the form of reduction in liabilities of the entity, other than those relating to owners, that result in a decrease in equity during the reporting period.

fair value	The valuation approach that takes account of the current use of an asset and the various restrictions that may apply to its current and future use. Technical guidance should be obtained from Australian Accounting Standards Board Standard AASB 1041 and Treasurer's Instruction (TI) 954.
Financial Administration and Audit Act	Commonly referred to as the *FAAA*, this statute sets out the framework of financial administration for departments and statutory authorities in the Western Australian public sector.
historical cost	The recording of an asset in the Statement of Financial Position of an entity at a value that matches its purchase price.
holding account	An account, administered by the Department of Treasury and Finance on behalf of agencies, that holds credits for the non-cash component of an agency's appropriation (depreciation and accrued leave entitlements) as a provision for the future replacement of assets and reduction in leave liability.
liability	Future sacrifices of economic benefits that an entity is presently obliged to make to other entities as a result of past transactions or other events.
material	In the context of the capital user charge an amount is material if it represents 10% of the total capital user charge payment for a quarter or $100,000, whichever is the greater.
net assets	Equals total assets minus total liabilities. The capital user charge rate of 8% is levied on 'net assets'.
operating statement	See 'statement of financial performance'.
operating surplus/deficit	Difference between revenues and expenses for the year on the Statement of Financial Performance.
opportunity cost	That which is foregone by investing in an asset rather than an alternative investment, project or program.

outcomes	The effect, impact, result on or consequence for the community (or target clients) of the application of government services. In other words, what is planned to be achieved through the productive efforts of government departments and statutory authorities.
outputs	The services which are produced by government agencies to achieve desired outcomes.
output based management (OBM)	The process whereby agencies manage, are funded and have their performance assessed, according to the services they produce. Agencies aim to reduce the cost and improve the quality of their outputs.
overheads	The fixed and variable costs of an organisation which are not directly attributable to the production of services.
real rate	A rate of interest or charge that has been adjusted to take account of inflationary effects. The capital user charge rate is a real rate.
residual current value	The value of an asset minus its accumulated depreciation.
statement of cash flows	A statement containing information about an agency's cash inflows and outflows during a reporting period.
statement of financial performance	A record of expenses and revenues transacted (and their sources) during a reporting period.
statement of financial position	A report listing the assets, liabilities and equity of an agency as at a specific date.
strategic asset management	The strategy which involves planning the life cycle of asset use, from acquisition to disposal. It includes ensuring that all assets are accounted for and that they contribute towards the services of an agency.
supplementary funding	Additional funding approved by the Treasurer over and above funds previously approved by Parliament.
suspense account	see 'holding account'.
weighted average cost of capital	Formula for determining the cost of capital, based on a weighted average of the cost of equity and the cost of debt, as per the Statement of Financial Position.

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