

STATES' EXPENDITURE FORECASTS

**EVIDENCE SUBMITTED
BY THE COMPTROLLER & AUDITOR GENERAL
TO THE FINANCE SUB-PANEL OF THE CORPORATE SERVICES
SCRUTINY PANEL**

APRIL 2009

*States' Expenditure Forecasts
Evidence submitted by the Comptroller & Auditor General
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SECTION ONE ~ INTRODUCTION

1. I have been invited by the Finance Sub-Panel of the Corporate Services Scrutiny Panel to submit evidence to the Sub-Panel in connection with an enquiry that it is undertaking into the effectiveness of the States' forecasting of expenditure. The issues which I understand are covered by the terms of reference of the enquiry are set out in Appendix One to this paper.
2. To a large extent, the evidence that was requested from me involved refreshing and confirming information that I have set out in a number of reports published during the past two years and concerned:
 - (1) What is States' expenditure and, importantly, how does the total amount of actual expenditure relate to the States' forecasts of expenditure which are published Annually?
 - (2) On what basis are the States' annual expenditure forecasts prepared?
 - (3) What are the principal components of the annual forecasts of expenditure?
3. In the following sections of this paper I will deal with each of these subjects in turn.

SECTION TWO ~ WHAT IS STATES' EXPENDITURE?

Net Expenditure

4. Each year, the States publish forecasts of Net Expenditure in the annual Budget Statement¹.
5. Net Expenditure comprises two elements:
 - (1) Net Revenue Expenditure of ministerial and non-ministerial departments; and
 - (2) Net Capital Expenditure Allocation.

Net Revenue Expenditure

6. Net Revenue Expenditure includes the annual running costs of States' departments. It takes account of income received directly by departments which consist largely of charges made by departments for their services. The effect is that Net Revenue Expenditure is not the total amount of expenditure expected to be incurred by individual departments or by the States overall.
7. In addition, Net Revenue Expenditure does not take account of expenditure incurred by the States but charged against special funds such as the Criminal Offences Confiscation Fund and the Drug Trafficking Confiscation Fund.
8. Thus, to examine the total running cost of the States, one must:
 - (1) look at Net Revenue Expenditure;
 - (2) add the amount of departmental income; and
 - (3) add the amount of expenditure charged to special funds.

Net Capital Expenditure

9. Net Capital Expenditure includes the cost of acquiring capital assets which will be used by the States for a number of years. It takes account of capital receipts such as the sale of properties by the States including the sale of housing assets.

¹ The most recent such statement was published by the Minister for Treasury and Resources early in December 2008 as the Budget Statement 2009.

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Disclosure

10. This information is not readily available in all statements published by the Treasury and Resources Department.
11. The annual Budget Statement includes forecasts of Net Revenue Expenditure which are analysed by department. It does not however include forecasts of departmental income or of expenditure to be charged to special funds. As a result, the annual Budget Statement does not disclose forecasts of the total running costs to be incurred by the States.
12. The annual Budget Statement includes forecasts of Net Capital Expenditure and of the capital receipts that have been taken into account. As a result, the annual Budget Statement does not disclose forecasts of the total capital expenditure to be incurred by the States.
13. The annual accounts published by the States report Net Revenue Expenditure in detail, departmental income in total and also the principal elements of expenditure charged to special funds. Thus information concerning both net and gross expenditure is disclosed albeit in different places.

Most recent forecasts

14. The forecasts published in the Budget Statement 2009² are as follows:

<i>Probable Out-turn 2008 £m</i>		<i>2009 £m</i>	<i>2010 £m</i>	<i>2011 £m</i>	<i>2012 £m</i>	<i>2013 £m</i>
526	Net Revenue Expenditure	546	563	581	598	616
143	Net Capital Expenditure Allocation	38	40	37	35	16
669	Total States Net Expenditure	584	603	618	633	632

15. The analysis of Net Capital Expenditure Allocation³ published in the Budget Statement 2009 is as follows:

² Shown on page 15 of the Budget Statement 2009.

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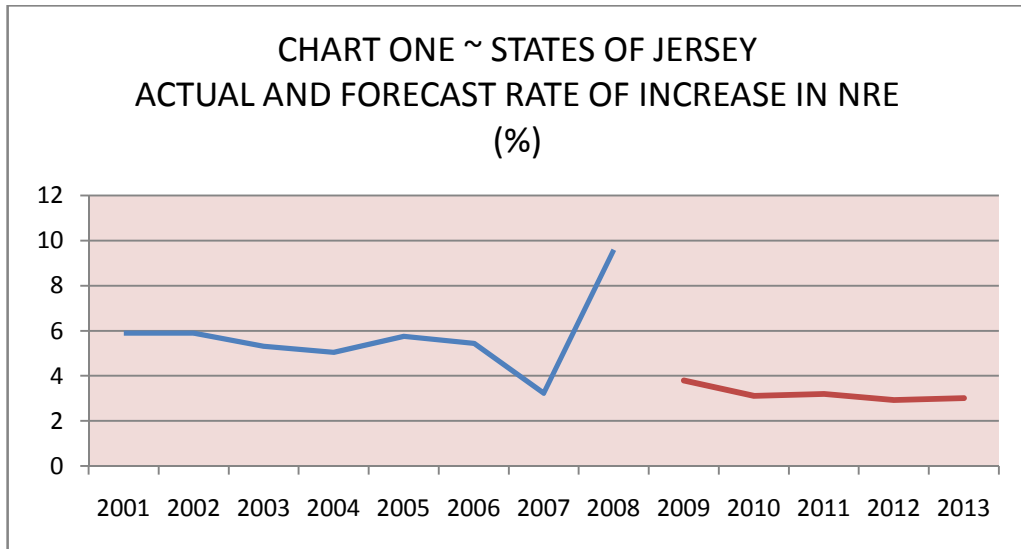
	<i>2009</i>	<i>2010</i>	<i>2011</i>	<i>2012</i>	<i>2013</i>
	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>	<i>£m</i>
Capital expenditure allocation	55	61	52	62	35
Property capital receipts	-4	-4	-4	-4	-4
Housing capital receipts	-13	-18	-11	-23	-15
Net Capital Expenditure Allocation	38	39	37	35	16

³ Shown on page 34 of the Budget Statement 2009.

SECTION THREE ~ PAST FORECASTS

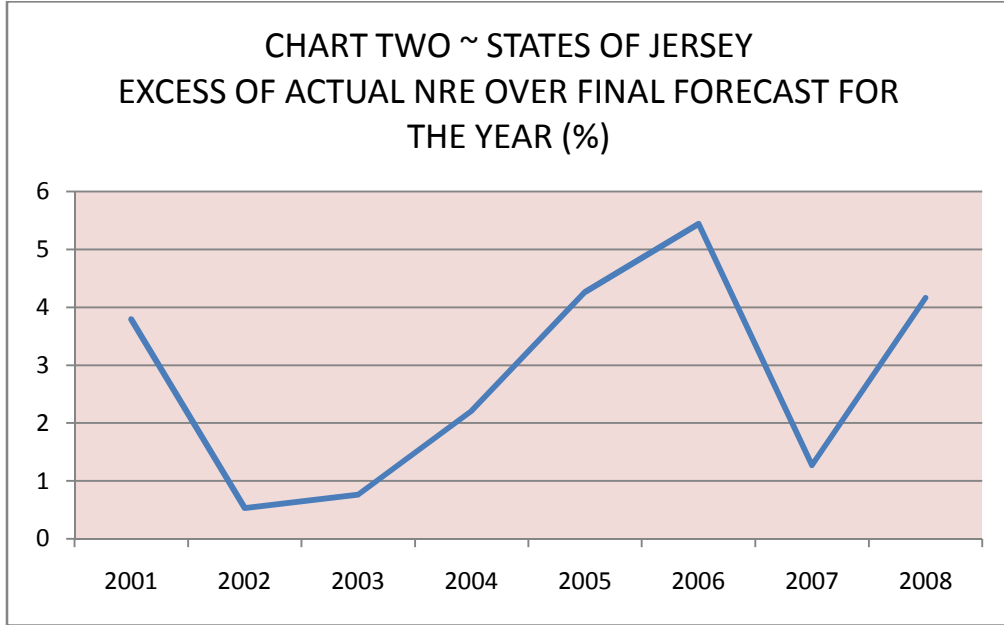
Past forecasts of Net Revenue Expenditure

16. In previous reports, I have compared forecasts of NRE published by the States. To respond to the Sub-Panel's invitation, I have refreshed those comparisons. The result is shown in the table set out in Appendix Two.
17. The rate of growth in NRE (both actual and forecast) shown in that table is shown in the table set out in Appendix Three and in the graph below:

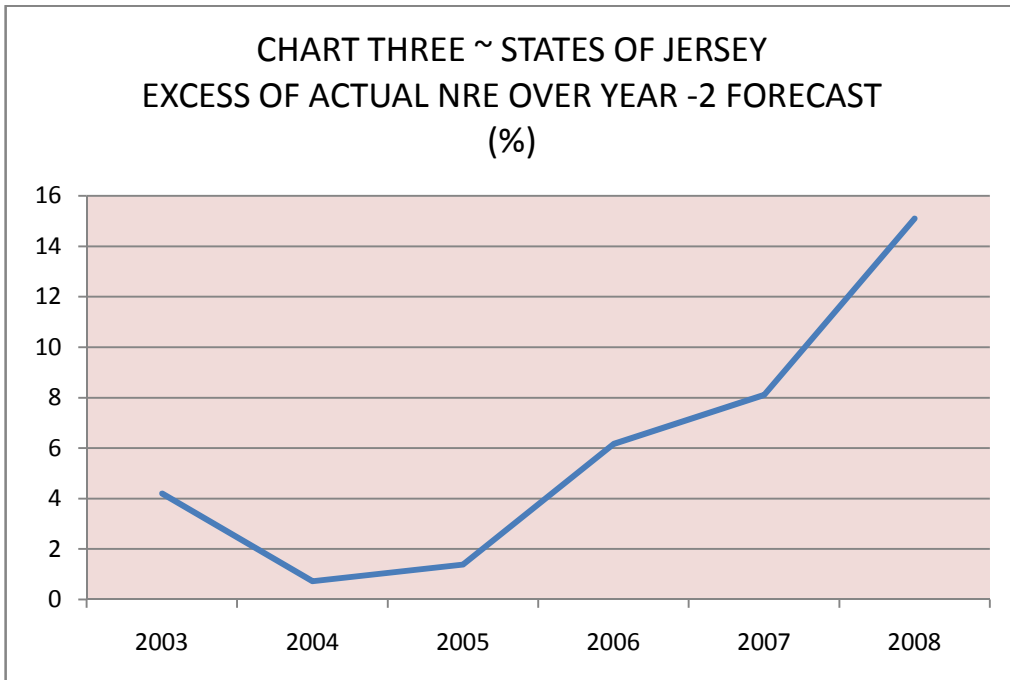


18. As can be seen, the annual percentage increase of NRE shown in the 2009 Budget's forecasts for the years 2009-2013 appear to have assumed a common rate of annual increase with relatively little variation. That appears to have been the States' normal practice as shown by the Table set out in Appendix Four.
19. I have also compared the actual NRE of the States with the forecasts and the result is set out in Appendix Five.
20. The result of a comparison between actual NRE and the last forecast for each year (i.e the forecast published immediately before the commencement of the year in question is shown in the graph below:

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21. The result of a comparison between actual NRE and the forecast published two years before the year in question is shown in the graph below:



SECTION FOUR ~ COMPOSITION OF NRE

Departmental forecasts

22. The States' forecasts of NRE comprise a series of more detailed forecasts for individual States' departments. These detailed forecasts (as published in the 2009 Budget Statement) are summarised in Appendix Six which also shows the proportion of the total forecast for NRE which is represented by each department.
23. It is evident from the Table set out in Appendix Six that during the period covered by the most recently published forecast, the proportion of the total forecast NRE represented by each individual department remains largely unchanged.

Forecasts of categories of expenditure

24. The States' NRE forecasts do not show the composition of forecast NRE analysed by reference to the type or category of expenditure which the States incur. This can however be shown by reference to information published in the States' accounts for past years.
25. An analysis of NRE by reference to category of expenditure is set out in Appendix Seven based on information published with the States' accounts for 2006.
26. This shows that the three largest components of NRE are:
- (1) Manpower costs: 46.2% of total NRE.
 - (2) Administrative costs: 12.6% of total NRE.
 - (3) Grants to Social Security and Health Insurance Funds: 10.3% of total NRE.
27. These three categories of expenditure 69.1% of total NRE.

SECTION FIVE ~ OBSERVATIONS

28. A number of observations seem appropriate in the light of the information set out in this paper and in the Appendices to this paper:

(1) *Annual rate of increase in NRE*

The annual rate of increase in NRE appears to have increased markedly in 2008 (see Chart One And Appendix Three).

(2) *Extent of the unreliability of forecasts*

The reliability of forecasts as a guide to actual NRE appears to have been increasing. As one would expect this is most marked for earlier forecasts (see Chart Three which shows the excess of actual NRE over the forecast published two years before the year in question).

(3) *Assumed percentage increases in expenditure*

The States' normal practice appears to be to prepare forecasts on the basis of assumed annual increases in NRE (see Appendix Four and Chart One).

(4) *Departmental allocations of forecast expenditure*

The effect of this practice is that each department's NRE as a proportion of total states' NRE remains stable (see Appendix Seven).

(5) *Manageable and unmanageable expenditure*

States' expenditure includes costs that respond directly to external economic drivers. Such costs (e.g. the States' contributions to social security funds⁴) can only be managed by way of variation of the policy by which they are determined and

⁴ Certain benefits are paid from the Social Security and Health Insurance Funds and thus do not form a part of States' expenditure. The Funds are sustained by contributions paid by employers and employees together with a contribution paid by the States (known as 'supplementation') which does form a part of States' expenditure.. The amount of the States' contribution to the Funds is calculated according to a formula and is broadly similar to the amount of contributions payable by employers and employees which are themselves calculated by reference to earnings. The effect is that the total amount of the States' contribution is determined by economic conditions. The purpose of the Funds is not to provide complete financial security in the sense of their being sufficient to meet the whole of the expected future cost of the benefits which are met from them, .Rather it is 'to smooth' the impact of the cost of the benefits over a period of years. Further information on these Funds can be obtained from the annual accounts of the Funds and from the periodic actuarial valuations by the Government Actuary's Department.

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not be day to day management control exercised by the Chief Officers. Thus departmental budgets which include expenditure which is affected by facts outside the control of the States may enjoy a particular advantage if that expenditure happens to fall or particular disadvantage if that expenditure happens to increase at a faster rate than the percentage increase in expenditure assumed in the States' expenditure forecasts.. Examples of this include the States' contributions to the Social security and Health Insurance Funds (which are determined by reference to general economic variables such as average earnings and unemployment levels), school pupil numbers (determined by demographic factors not controlled by the States), court and case costs (determined by prosecution decisions) and the Jersey Field Squadron (determined by the Ministry of Defence in London).

(6) *Effect of unmanageable expenditure on departmental forecasts*

Departments faced with significant elements of expenditure determined by economic factors not within the Chief Officers' control but with budgets determined by general percentage increases will face particular difficulty. Departments which do not have such elements of expenditure will have a correspondingly easier challenge in controlling expenditure.

(7) *Locus of control of certain categories of expenditure*

Certain major categories of expenditure are not within the control of individual Chief Officers. For example, as shown in Appendix Seven, manpower costs represent 46.2% of total NRE. Rates of pay are determined centrally by the States so that an individual Chief Officer has no control over the amount of pay to any employee. The published forecasts of expenditure appear to assume that increases in rates of pay can be restrained within the overall assumed increases in expenditure.

(8) *Chief Officers' difficulty in controlling expenditure*

The effect is that individual Chief Officers may face considerable difficulty in ensuring that departmental expenditure is lower than forecast: a difficulty that is magnified by the States' current policy with regard to reducing the number of employees through redundancy.

(9) *Resulting pressure on costs controllable by Chief Officers*

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The consequence is that to restrain their departments' expenditure within forecast levels, Chief Officers must seek savings in the costs which they are able to control. Since these categories of costs may represent Small proportions of a department's total NRE, the effect is that drastic reductions may be necessary to achieve necessary reductions in overall NRE. For example, expenditure may be reduced by deferring maintenance expenditure (although this may increase the long term cost of maintenance)⁵, or delaying recruitment to replace staff who have left the States' employment (although this may affect the quality of promised services)⁶.

(10) *Effect of 'other funds'*

A further consequence is that the pressure on controlling costs can be relieved if a Chief Officer has access to 'other funds' which can be used to meet certain expenditure. For example, the Criminal Offences and Drug Trafficking Confiscation Funds have been used regularly to meet the court and case costs of the Law Officers' Department, and costs which would otherwise form part of the budget of the Home Affairs Department such as the costs of the drug education initiatives managed through the Building a Safer Society programme. Departments which do not have access to such funds do not enjoy similar relief from funding pressures.

⁵ Supported by evidence given by David Flowers, of Jersey Property Holdings to the Public Accounts Committee in 2008. The full financial effect of deferment of expenditure in this way is difficult to assess from the published accounts of the States. In a commercial environment, where published accounts would be based on Generally Accepted Accounting Practice, one might assume (as a crude rule of thumb) that annual maintenance expenditure would be of an order similar to that of the annual charge for depreciation of buildings and infrastructure assets. The States' accounts are not currently prepared on this basis so that this comparison cannot be made. It is evident however that there is a serious backlog of maintenance expenditure relating to assets such as: States' properties (as reported by Jersey Property Holdings); States' social housing (as reported in the Housing Plan); sea defences; and sewers (both as reported by the Chief Officer, Transport and Technical Services)

⁶ Supported by evidence of unfilled vacancies obtained by the Deputy of St Ouen by questions to ministers during 2007 and 2008.

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**APPENDIX ONE ~ ISSUES COVERED BY THE TERMS OF REFERENCE FOR THE
ENQUIRY BY THE FINANCE SUB-PANEL OF THE CORPORATE SERVICES
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1. To review the policies, directions and practices driving the States of Jersey financial forecasting.
2. To review the areas of responsibility for the control of the forecasting process.
3. To review the accuracy and timetable of the forecasting process.

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**APPENDIX TWO ~ COMPARISON OF EXPENDITURE FORECASTS PUBLISHED IN
ANNUAL BUDGET STATEMENTS 2001-2009**

<i>£ million</i>										
<i>Year of account</i>										<i>Budgets</i>
<u></u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2009</u>
2001	343									
2002	363	375								
2003	381	394	394							
2004	398	414	414	408						
2005			435	424	423					
2006				438	433	441				
2007				450	444	454	474			
2008				462	455	457	492	505		
2009					466	480	507	525	546	
2010					478	490	518	546	563	
2011							532	565	581	
2012								583	598	
2013										616

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APPENDIX THREE ~ ACTUAL AND FORECAST NRE ~ RATE OF INCREASE (%)

	<u>Actual</u> <u>NRE</u> <i>£m</i>	<u>Forecasts</u> <i>£m</i>	<u>Annual</u> <u>increase</u> <i>%</i>
2001	356		
2002	377		5.90
2003	397		5.31
2004	417		5.04
2005	441		5.76
2006	465		5.44
2007	480		3.23
2008	526		9.58
2009		546	3.80 <i>Forecast</i>
2010		563	3.11 <i>Forecast</i>
2011		581	3.20 <i>Forecast</i>
2012		598	2.93 <i>Forecast</i>
2013		616	3.01 <i>Forecast</i>

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**APPENDIX FOUR ~ ANNUAL RATES OF INCREASE OF NRE WITHIN BUDGET
FORECASTS (%)**

%	<i>Year on year % increase</i>				
	<u>Yr 2 on Yr 1</u>	<u>Yr 3 on Yr2</u>	<u>Yr 4 on Yr 3</u>	<u>Yr 5 on Yr 4</u>	<u>Yr 6 on Yr 5</u>
Budget 2001	5.8	5.0	4.5		
Budget 2002	5.1	5.1			
Budget 2003	5.1	5.1			
Budget 2004	3.9	3.3	2.7	2.7	
Budget 2005	2.4	2.5	2.5	2.4	2.6
Budget 2006	2.9	0.7	5.0	2.1	
Budget 2007	3.8	3.0	3.3	2.7	
Budget 2008	4.0	4.0	3.5	3.2	
Budget 2009	3.1	3.2	2.9	2.0	

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APPENDIX FIVE ~ COMPARISON OF ACTUAL NRE WITH FORECASTS

<i>Year of account</i>	<i>Actual NRE £m</i>	<i>Forecasts</i>		<i>Excess of actual over forecast</i>	
		<i>Final £m</i>	<i>Year -2 £m</i>	<i>Final %</i>	<i>Year -2 %</i>
2001	356	343		3.79	
2002	377	375		0.53	
2003	397	394	381	0.76	4.20
2004	417	408	414	2.21	0.72
2005	441	423	435	4.26	1.38
2006	465	441	438	5.44	6.16
2007	480	474	444	1.27	8.11
2008	526	505	457	4.16	15.10

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APPENDIX SIX ~ DEPARTMENTAL COMPOSITION OF NRE FORECASTS

	<u>2009</u>		<u>2010</u>		<u>2011</u>	
	£M	% of NRE	£M	% of NRE	£M	% of NRE
MINISTERIAL DEPARTMENTS						
Chief Minister's Department	15.8	2.7	16.4	2.7	16.9	2.7
Overseas Aid Commission	7.7	1.3	8.1	1.3	8.5	1.4
Economic Development	16.4	2.8	16.8	2.8	17.2	2.8
Education Sport and Culture	98.5	16.8	101.7	16.9	104.2	16.8
Health and Social services	153.6	26.2	160.2	26.6	167.5	27.0
Home Affairs	45.5	7.8	46.6	7.7	47.7	7.7
Housing	-22.3	-3.8	-22.9	-3.8	-23.5	-3.8
Planning and Environment	7.1	1.2	8.3	1.4	8.9	1.4
Social Security	157.1	26.8	159.2	26.4	164.1	26.4
Transport and Technical Services	23.7	4.0	24.9	4.1	26.6	4.3
Treasury and Resources	61.1	10.4	62.4	10.4	63.3	10.2
	<u>564.2</u>	<u>96.3</u>	<u>581.7</u>	<u>96.5</u>	<u>601.4</u>	<u>96.8</u>
NON MINISTERIAL BODIES						
Law Officers	5.9	1.0	6.3	1.0	6.4	1.0
Judicial Greffe	4	0.7	4.1	0.7	4.1	0.7
States Assembly	5.2	0.9	5.3	0.9	5.4	0.9
Other	6.6	1.1	5.3	0.9	3.9	0.6
NET REVENUE EXPENDITURE	<u><u>585.9</u></u>	<u><u>100.0</u></u>	<u><u>602.7</u></u>	<u><u>100.0</u></u>	<u><u>621.2</u></u>	<u><u>100.0</u></u>

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APPENDIX SEVEN ~ ANALYSIS OF NRE BY CATEGORY OF EXPENDITURE

	<u>2006</u>	
	<u>£M</u>	<u>% of NRE</u>
Manpower costs	258.6	46.2
Voluntary redundancy and early retirement	1.2	0.2
Supplies and services	70.7	12.6
Administrative costs	19.6	3.5
Premises and maintenance	44.6	8.0
Grants and subsidies		
Social Security and Health Insurance Funds	57.8	10.3
Community benefits	35.0	6.3
General (other grants)	24.0	4.3
Housing rent abatements	15.2	2.7
Student grants	9.9	1.8
Housing rent rebates	8.5	1.5
Overseas aid	5.7	1.0
Agricultural subsidies	<u>2.0</u>	0.4
	158.1	
Incidental expenses and charges	-0.5	-0.1
PECRS pre-1987 debt	5.2	0.9
States members' remuneration	2.0	0.4
	<u>559.5</u>	<u>100.0</u>