

Treasury Report: 2008 Budget Bilateral Briefing for Vote Revenue

Date:	11 February 2008	Report No:	T2008/145
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Dr Michael Cullen)	Read the attached briefing and use it as a basis for making decisions in your bilateral with Hon Peter Dunne.	13 th February 2008

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[deleted – privacy]	Graduate Analyst, Tax Strategy	[deleted – privacy]	[deleted – privacy]	✓
[deleted – privacy]	Senior Analyst, Tax Strategy	[deleted – privacy]	[deleted – privacy]	

Minister of Finance's Office Actions (if required)

None.

Enclosure: No

Treasury Report: Bilateral Briefing for Vote Revenue

Attached is a briefing for the bilateral between the Minister of Finance and the Minister of Revenue at 4.30 p.m. on Wednesday 13th February 2008 to discuss the budget initiatives for Vote Revenue.

The bilateral briefing is structured as follows:

Recommendations	p. 4
Analysis by Vote	p. 8
One-page initiative summaries	p. 14

We expect the key issue for discussion will be the *Student Loans Redesign* bid. The Treasury, States Services Commission and PricewaterhouseCoopers (providing independent quality assurance) agree that Inland Revenue has developed a robust stage 2 business case. However, the funding requirements do not fit within Budget 2008 capital constraints. The Treasury considers that reduced funding should be provided to allow the project to continue pending Ministerial consideration of the proposal in Budget 2009. The outcome of that Ministerial consideration will determine whether Inland Revenue and the Ministry of Social Development proceed to a Request for Proposal process.

Inland Revenue has begun a process of looking at the medium- to long-term investment required to better deliver its business, aligning with the processes required by the Capital Asset Management framework. This work takes into account work already underway to address potential areas of immediate risk (such as the *Student Loans Redesign* and *Transforming Employer Information and Payments*) as well as taking a wider view across Inland Revenue's business. *[information deleted in order to enable the Crown to carry out commercial activities without disadvantage or prejudice].*

Annex one (p.13) provides, for your information, high-level costings of tax policy proposals intended for the 2008 tax bill (expected to be introduced in May 2008). These high-level costings are being built into Treasury's reporting on the overall fiscal position of Budget 2008. The costings will be firmed up as Ministers receive more detailed briefing on the proposals and Cabinet decisions are sought.

You previously agreed that the Vote Revenue bilateral discussion would include consideration of any KiwiSaver bids (T2007/2153). One such bid has been put forward by the Ministry of Social Development on behalf of the Retirement Commission.

Recommended Action

We recommend that you **read** the attached briefing and use it as the basis for making decisions in your bilateral with the Minister of Revenue at 4.30 p.m. on Wednesday 13th February 2008.

Bill Moran
Manager, Tax Strategy
for Secretary to the Treasury

Hon Dr Michael Cullen
Minister of Finance

Recommendations

VOTE REVENUE

a Student Loans Redesign

analysis p. 8

- Inland Revenue (IRD), jointly with the Ministry of Social Development (MSD) seek additional funding for a new IRD/MSD Student Loan IT system to deliver increased alignment of services between agencies, seamless provision of services for students/borrowers across agencies, timely sharing of information between agencies and enhanced loan management capabilities through a new cross agency interface.
- The Treasury, State Services Commission (SSC) and PricewaterhouseCoopers (providing independent project quality assurance) agree that this is a robust business case. However, the funding required for the proposal as set out in the stage 2 business case (option 1) does not fit within Budget 2008 capital constraints.
- Instead, reduced funding could be provided to IRD and MSD to allow the project to continue, pending Ministerial consideration of the proposal in Budget 2009 (option 2). This would allow IRD to work with prospective vendors to discuss system configuration and should lead to less uncertainty in the final fiscal costs. The outcome of Ministerial consideration of the proposal in Budget 2009 will determine whether IRD process to a Request for Proposal (RFP) process. The Treasury supports this option proceeds.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 & Outyears</i>
<i>Operating (GST excl)</i>					
Department (Option 1)	[deleted – commercial position]				
Department (Option 2)	-	5.067	-	-	-
Treasury	-	5.067	-	-	-
<i>Capital (GST excl)</i>					
Department (Option 1)	[deleted – commercial position]				
Department (Option 2)	-	-	-	-	-
Treasury	-	-	-	-	-

b Transforming Employer Information and Payments (TEIP)

analysis p. 9

- IRD bid for funding to deliver a stage 2 business case to identify a solution that will future proof IRD’s Employer Monthly Schedule (EMS) processes and related employer/employer information. Since submitting the bid the department has identified savings of \$2.000 million arising largely from lower ‘make good’ costs on IRD’s interim property relocations in the Wellington campus. IRD would like to apply these savings to fund the cost of the TEIP bid. [*There have been significant changes to the project to be undertaken since the Bilateral. IRD is now following the SSC’s Gateway programme and may evaluate broader systems changes.*]
- The Treasury supports this proposal.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 & Outyears</i>
<i>Operating (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-
<i>Capital (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-

c Implementation of Government Initiatives

analysis p. 9

- IRD seeks funding for the administrative costs associated with the implementation of the legislative programme included in the May 2008 tax bill.
- The Treasury supports funding for this bid at a reduced scale as we consider some of the costs included in the bid to be “business as usual” activity for IRD. We note that these costings are high-level and are based on an assumption that all policy proposals will be included in the May 2008 tax bill. Any administrative costs funded may need to be refined subject to Ministerial agreement of the proposals that will be included.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 & Outyears</i>
<i>Operating (GST excl)</i>					
Department	0.048	2.492	1.489	1.159	1.159

Treasury	-	0.651	0.220	0.220	0.220
<i>Capital (GST excl)</i>					
Department	-	5.618	0.178	-	-
Treasury	-	1.098	-	-	-

d People Capability - Remuneration

analysis p. 9

- IRD seeks part funding to maintain [deleted – negotiate without prejudice] to retain capability to deliver current and new business.
- The Treasury does not support funding for this bid. As part of the process of prioritising all Budget 2008 wage and capability bids, the Treasury and the SSC jointly assess this bid to be low priority/low risk when considered against recruitment and retention pressures across the wider public sector.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 & Outyears</i>
<i>Operating (GST excl)</i>					
Department	-	5.000	5.000	5.000	5.000
Treasury	-	-	-	-	-
<i>Capital (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-

e Improved Compliance and Customer Experience

analysis p. 10

- IRD seeks funding to ensure the continuation of its call handling platform, new technology to manage growth in the volume and complexity of calls, improved 0800 access for customers, and proactive calling functionality.
- The Treasury supports funding for this bid at a scaled level. The Treasury supports the replacement of critical call infrastructure and new technology to manage growth in the volume and complexity of calls. However, we view the other components of the proposal to be of low priority at this time.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 & Outyears</i>

<i>Operating (GST excl)</i>					
Department	-	6.325	6.250	5.330	4.030
Treasury	-	1.350	0.630	(0.405)	(1.755)
<i>Capital (GST excl)</i>					
Department	-	6.460	-	-	-
Treasury	-	3.630	-	-	-

VOTE SOCIAL DEVELOPMENT

f KiwiSaver Financial Education Programme

analysis p. 12

- MSD seek ongoing funding to continue and further develop the Retirement Commission's *Workplace Financial Education Programme*, a programme designed to inform KiwiSaver decision-making.
- The Treasury supports funding this proposal for the next three years (until 2010/11) as it supports the implementation of key government policy. However, the Treasury does not support an increase in ongoing baseline funding beyond 2010/11. The need for ongoing funding should be determined once KiwiSaver has bedded down and evidence of any ongoing requirements becomes available.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 & Outyears</i>
<i>Operating (GST excl)</i>					
Department	-	1.900	1.900	2.000	2.000
Treasury	-	1.900	1.900	1.900	-
<i>Capital (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-

Vote Revenue – Analysis

Analysis of Initiatives

1. Funding being sought for Vote Revenue through this bilateral is summarised in the table below:

	<i>\$million - increase/(decrease)</i>				
<i>Funding sought for Vote Revenue in Budget 2008</i>	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 & Outyears</i>
TOTAL OPERATING	[deleted – commercial activities]				
TOTAL CAPITAL	[deleted – commercial activities]				

Student Loans Redesign (recommendation a)

2. IRD, jointly with MSD, seeks additional funding for a new IRD/MSD Student Loan IT system to deliver increased alignment of services between agencies, seamless provision of services for students/borrowers across agencies, timely sharing of information between agencies and enhanced loan management capabilities through a new cross agency interface.
3. *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]*
4. Central agencies have reviewed the Student Loans Redesign stage 2 business case and Independent Quality Assurance (IQA) report. The IQA was conducted by PricewaterhouseCoopers who have commented positively on the high quality of the business case. The final business case reflects our detailed discussions with the project team, particularly relating to cost reductions from initial estimates, and we anticipate that there will be further opportunities to reduce costs during the procurement phase. Central agencies support the proposal presented in the business case on its merits.
5. However, the fiscal constraints in the Budget 2008 capital allocation are such that lower-cost options should be considered. IRD have submitted a fall back option at a cost of \$5.067 million in 2008/09 with the following features:
 - The project team will work with preferred vendors (from the Request for Interest) over the next year to discuss possible system configuration. This should lead to less uncertainty in the business case costings than currently proposed.
 - IRD will prepare an RFP ready to be sent to market subject to Cabinet’s full and final funding agreement throughout the Budget 2009 process.

6. Agreeing to this approach now will not bind Cabinet to funding the proposal in full in Budget 2009 although expectations will be raised within the industry and the funding will be a sunk cost if the project does not go ahead. Central agencies are comfortable with this as there is widespread agreement that improvements to the system need to be addressed.

Inland Revenue Comment

7. *Due to the current risks identified around the stability and integrity of the system infrastructure and [deleted – free and frank] IRD recommends option 1, [deleted – confidentiality of advice].*
8. *[deleted – confidentiality of advice] option can not be funded then the Treasury preference of option 2 will allow IRD to progress with the detailed design phase with a [deleted – confidentiality of advice].*

Transforming Employer Information and Payments (recommendation b)

9. IRD bid for funding to deliver a stage 2 business case to identify a solution that will future proof IRD's EMS processes and related employer/employee information. The department has subsequently identified savings of \$2.000 million arising largely from lower 'make good' costs on IRD's interim property relocations in the Wellington campus. IRD would like to apply these savings to the costs of the TEIP bid. The Treasury supports this proposal. *[There have been significant changes to the project to be undertaken since the Bilateral. IRD is now following the SSC's Gateway programme and may evaluate broader systems changes.]*

Implementation of Government Initiatives (recommendation c)

10. IRD seeks capital and operating funding to implement around 11 policy initiatives that are expected to be included in the May 2008 tax bill (e.g., international tax, payroll giving and features of the life insurance review).
11. IRD's ability to implement any legislated initiatives is of high importance, however, the Treasury believes other funding options can be explored and supports funding at a reduced level. The Treasury is of the view that the costs associated with implementation of the majority of the initiatives fall into "business as usual" and, as such, should be met from within baselines. However, we acknowledge that some initiatives may require additional resources including, for example, payroll giving, tax simplification measures for small- and medium-sized enterprises, [deleted – confidentiality of advice]. For this reason the Treasury supports a reduced level of funding.

People Capability – Remuneration (recommendation d)

12. IRD seeks funding to update staff remuneration [deleted – negotiate without prejudice] as a means of retaining key staff.
13. As part of a process of prioritising all Budget 2008 wage and capability bids across the public service, the Treasury and SSC have assessed this bid as low priority/low risk and do not support funding for this bid.
14. The Treasury SSC prioritisation process assessed all wage and capability bids against three 'filters':
 - Turnover;
 - Difficulty in recruitment; and
 - Below average growth in personnel costs.

15. In terms of core unplanned turnover, we note that, at [deleted – confidentiality of advice] % turnover, IRD compares favourably with the public sector median of [deleted – confidentiality of advice] %. We understand that IRD faces particular pressures in call centre and some professional positions (such as investigators and auditors), however, we are of the view that these pressures do not present an unusual risk in a tight labour market.
16. In terms of real growth in personnel costs, we note that IRD has experienced [deleted – confidentiality of advice] % growth over 2000/01 to 2006/07, [deleted – confidentiality of advice] departments. Some of this growth can be attributed to the department taking on significant new responsibilities, such as the delivery of KiwiSaver.

Inland Revenue Comment

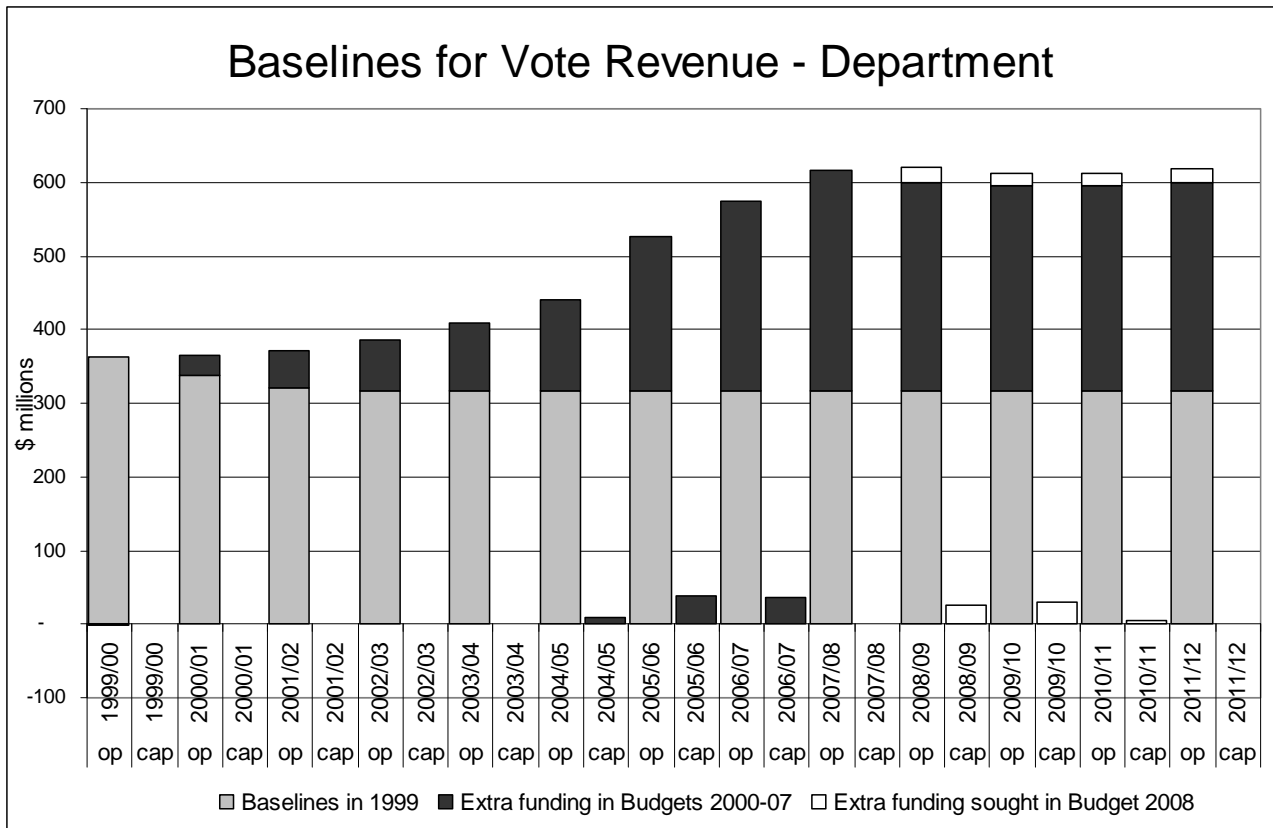
17. *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice].*
18. *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice].*
19. *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice].*

Improved Compliance and Customer Experience (recommendation e)

20. IRD seeks funding to provide a robust call handling platform that will replace the current system. The new system will manage growth in the volume and complexity of calls, provide improved access for customers (including toll-free calling from mobile phones and overseas), and proactive calling functionality.
21. The Treasury considers that elements of this proposal should be supported. The Treasury supports funding for the replacement of critical call infrastructure, *[information deleted in order to maintain the effective conduct of public affairs through the free and frank expression of opinions]*. We also support investment in speech recognition technology which would enable the department to realise cost savings as a result of more efficient call handling. However, we consider the other components of the proposal - 0800 access for calls for mobile and overseas calls, and proactive contact - to be of a low priority at this time.

Analysis of Vote

22. Vote Revenue departmental baselines are shown in the graph below. The vote has received significant increases in funding in the past four years due to increased responsibilities such as *KiwiSaver*, *Working for Families* and Student Loan scheme administration.



Vote Social Development – Analysis

KiwiSaver Financial Education Programme (recommendation f)

23. MSD seek ongoing funding to continue and further develop the Retirement Commission's *Workplace Financial Education Programme*, a programme designed to inform KiwiSaver decision-making.
24. The Treasury supports funding this proposal for the next three years (until 2010/11) as it supports the implementation of key government policy. However, the Treasury does not support an increase in ongoing baseline funding beyond 2010/11. Agreement of ongoing funding is deemed inappropriate at this time due to the likely diminishing effectiveness of the campaign, and because the goals of the campaign (to see 30% of New Zealanders using Sorted resources) could potentially be fulfilled by 2010/2011. We believe that the need for ongoing funding should be determined once KiwiSaver has bedded down and evidence of any ongoing requirements becomes available.

[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials].

One-page Initiative Summaries

One-page summaries of the initiatives for discussion at this bilateral are attached on subsequent pages.