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May 2001

The Secretary
Joint Committee of Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

JCPAA REVIEW OF ACCRUAL BUDGETDOCUMENTATION

Thank you for your letter of 3 April 2001, inviting me to make a written submission to the Committee in connection with its Review.

My submission is attached.

Maurie Kennedy

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT'S REVIEW OF ACCRUAL BUDGET DOCUMENTATION

Submission form Maurie Kennedy
(May 2001)

This submission confines itself to just one of the Committee's Terms of Reference in this review –

- the level of aggregation of appropriations within portfolio agencies and in particular for administered items

It would not be surprising if the 12 matters listed in the Terms of Reference, described as being of particular concern to the Committee, were a reflection of a broader uncertainty, confusion, or even disquiet that some Members and Senators might feel about the seemingly different approach that Parliament is now expected to adopt in dealing with the Executive's accrual budgetary framework and supporting documentation.

The reason I have chosen to address myself to only that one particular item in the Terms of Reference is because I believe it is central to the exercise of Parliament's power over the Executive, around which the other 11 matters, though important in themselves, are largely peripheral or consequential.

In its Report 374 –*Review of the Financial Management and Accountability Act 1997 and the Commonwealth Authorities Act 1997* – in paragraphs 3.5 to 3.19, the Committee addressed some of the emerging concerns about Parliament's scrutiny of appropriations.

At paragraph 21 of my written submission to the Committee in connection with that Review I had stated:

> *"Within the totality of legislation, Appropriation Acts, because they are commonplace, run the risk of being regarded by some as merely routine or procedural. Yet they are the most important of all laws, because they are the ultimate instruments of Parliament's control over the Executive: in authorising the Executive to spend money on staffing and equipping itself, [these Acts] set and control the limits within which the Executive may legitimately function. The true assessment of the value of any legislation, but especially so for appropriation law, is not to see it working in the best of times, but, rather, to imagine how it would perform when it is under pressure from the most adverse of circumstances – say, exploited by a hypothetical bad and unscrupulous Executive. Applying that test to the now accepted form of Appropriation Acts, I cannot help but wonder whether Parliament fully realises what it has surrendered."*

Since making that submission, I have thought further about the issues that were then troubling me. The conclusions I have reached, if they can be shown to possess legal substance (I am not a lawyer), should be of *profound* concern to Parliament.

- The annual Appropriation Acts **do not lapse** on 30 June

The Executive would, it appears, be entitled to utilize amounts unspent in an ever-growing number of non-lapsed appropriations of former years. This raises a significant question:

> ***Does this dilute Parliament's ultimate power – the power to prevent the Executive from continuing to function when denied supply?***

While the answer to this question might seem to be of primary interest to Senators, given the Senate's role in the events of 1975, it must also be of direct interest to Members, since there is always the potential for an Executive to be formed in future with Independents holding the balance of power in the House of Representatives; or even where the Executive governs in coalition, there is always the potential for partners to fall out.

And from the experience of the events of 1975, there is the interesting consequential issue involving the reserve powers of the Head of State: if the answer to the question, above, is "yes", then, with the dynamics between the Executive and the Parliament changed in such a way, it would, presumably, serve to delay the circumstances in which the Head of State might otherwise act to dismiss an incumbent Executive which has been unable to secure timely supply.

My thoughts and conclusions on this question are set out as Attachment 1 to this Paper.

- The annual Appropriation Bills introduced for 1999-2000, were the first to be structured to provide appropriations according to agency 'outcomes', rather than as dissected line-items. Those outcomes, describing the purposes of each appropriation, are couched in very broad terms.

  - ***Could the broadness of the descriptions used in the appropriation laws make it possible for the Executive to accommodate, during the currency of an appropriation, totally new activities that Parliament may not have contemplated at the time it was considering the Bills?***

  - ***Does the broadness of the descriptions diminish the meaningfulness of Senate's rights, under section 53 of the Constitution, to amend, or request amendments to, this category of proposed laws appropriating money?***

My thoughts and conclusions on these questions are set out as Attachment 2 to this Paper.

ATTACHMENT 1

Does the non-lapsing of annual Appropriation Acts dilute Parliament's ultimate power – the power to prevent the Executive from continuing to function when denied supply?

The culmination of the Executive's move to a full accrual financial management framework, from 1 July 1999, came with Parliament's acceptance and passage of the 1999-2000 Appropriation Bills that were radically restructured to reflect accruals principles.

The narrative in Budget Paper No. 4, circulated to Members with the introduction of the Bills, stated (in part):

> *With the introduction of accrual budgeting there have been some revisions to the structure of the Appropriation Bills.*
>
> *First, the Senate has agreed to a change in the 1965 Compact between the Senate and the Government on the content of Appropriation Bills No. 1 and No. 2. In essence, that change will result in:*
>
> - *inclusion in Appropriation Bill (No. 1) of the full costs of the price of outputs for departmental expenses, including employee entitlements such as long service leave as it accrues and depreciation (or the cost of consumption of assets);*
> - *inclusion of all equity injections and loans in Appropriation Bill (No. 2); and*
> - *inclusion of all appropriations for administered expenses for new outcomes in Appropriation Bill (No. 2), mirroring the past arrangements for new appropriations.*
>
> *Second, Appropriation Bills will be focussed on agency outcomes. The aim of this change is to allow a clear linkage through Portfolio Budget Statements to agency annual reports and financial statements.*
>
> *Third, in recognition of the funding for long term commitments, the Appropriation Bills, while related to activity in a specific year, will not lapse at 30 June each year.*

The appropriations for departmental expenses will be open ended, while the appropriations for administered expenses will be limited to expenses incurred in that year.

Ostensibly, the non-lapsing of the annual Appropriation Acts is to permit the Executive to finance its accrued expenses (such as provisions for employee leave entitlements and depreciation of assets etc.) included in the amounts for a current year's appropriation, but for which no actual payment is required until some event in a future year (the employee separates from the Service and receives a payment in lieu of leave; or the asset is replaced and the accumulated depreciation funds are applied to purchase the new asset etc.).

In practice, however, it will probably be recognised as impracticable for agencies to accurately reconcile these payments to a growing 'tail' – a multitude of previous years' annual Appropriation Acts' unspent appropriations. For example, if an employee takes leave, using some part of their long service leave entitlements that had accrued over many years, which particular previous years' appropriations should be applied to the employee's salary cost while they are on leave?

The following paragraphs develop the issue in a '**worst case**' context that could well have the potential to do the greatest possible harm to that fundamental balance between the Executive and the Parliament, which the Constitution's financial provisions are intended to maintain.

Keeping track of a vast array of accrued expenses, across and within agencies, soon emerges as an administrative and accounting nightmare. It seems that the only practical way around this problem is for each agency to transfer all accrued expense provisions, *each year*, to the credit of its own Special Account within the Consolidated Revenue Fund, established for the purpose of meeting those expenses when they eventually fall due. [Members of the Committee will recall that the concept of the "Special Account" within the CRF was the mechanism devised, when Fund accounting was abandoned, so as to account for money that was earmarked to be spent on specific purposes at some future date] This solution means that, when the provision for an accrued expense had to be drawn on, at any time in the future, the Special Account will be the only source of appropriation that the agency needs to access.

Helpfully, both the annual Appropriation Acts contain identical enabling sections for this to occur:

Crediting amounts to Special Accounts

If any of the purposes of a Special Account is a purpose that is covered by an item (whether or not the item expressly refers to the Special Account), then amounts may be debited against the appropriation for that item and credited to that Special Account.

The Acts define "item" as an administered item [an amount set out in the Schedule opposite an outcome of an entity under the heading "Administered Expenses"]; or a departmental item [the total set out in the Schedule in relation to an entity under the heading "Departmental Outputs"].

Since "item" encompasses the *whole amount* of each appropriation described in the definition, it should be possible to credit these Special Accounts not only with accrued expenses requiring payments in future years, but also with *all of the unspent balances of each appropriation.* Since merely an intra-Consolidated Revenue Fund transfer would be involved, the transaction would not be in contravention of the sections of the Act that apply certain constraints on amounts being *issued out of* the Fund. In a relatively short time, these Special Account credits amount to a very considerable sum, the expenditure of which is now no longer governed by the terms of the Appropriation Acts , but rather, by the purposes clause of the Special Account and the standing appropriation of the Consolidated Revenue Fund, in s.20 of the FMA Act, that permits spending up to the credit balance of any Special Account for those purposes.

- For this to occur, all that is required is for Parliament to not disallow the Finance Minister's determinations establishing Special Accounts whose purposes are innocuously or ambiguously described as, say, "… for expenditure by [the agency] to meet accrued *and other* expenses in respect of those outcomes for which appropriations had been made in former years …"

In this way, the Executive establishes what are, in effect, 'hollow logs' of "appropriations made by law" (section 83 of the Constitution); and Parliament has unwittingly surrendered its most sacred power – the power to prevent the Executive from continuing to function when denied supply for the ordinary annual services of the Government

Any future stand-off between the Senate and the House of Representatives over the passage of the annual Appropriation Bills – such as that which occurred in 1975 – or any confrontation within the House of Representatives with a minority Government, must now have a very different outcome. Depending on the size of the 'reserves' accumulated in its Special Accounts, an Executive could continue functioning, not indefinitely, but for a time, notwithstanding the denial of the current year's supply to it.

To allow any potential for such a 'worst case' pattern of events to unfold, would mean tolerating a significant shift in the political dynamics within the Parliament and between the Parliament and the Executive. An Opposition and Members or Senators on the Cross-benches would no doubt recognise the pointlessness of taking that final step in the exercise of ultimate parliamentary power – the power to deny the Executive's annual appropriations – when the Executive is protected by a reservoir of accessible funds.

But even if those opposing the Government did choose to pursue that path, the practical consequences for the welfare of the people, where the Executive cannot secure timely supply, may be so minimal that a Head of State would not *need* (at least for a time) to contemplate taking profound action to break the impasse. This could be seen (at least in practical terms) as tantamount to narrowing the Head of State's 'reserve powers' under the Constitution.

If there is even the remotest possibility of this 'worst case' (or something like it) materialising, then a bipartisan approach by the Parliament, and a genuinely supportive commitment by the Executive, would be urgently needed to find a way to restore the constitutional balance.

Fortunately, a convergence of the sorts of circumstances that give rise to Parliament's seeking to deny supply to the Government tend not to happen often within the span of our parliamentary history. But the fact that **it is within the power** of the Parliament to do so, is one of the great moderating influences on the way Governments behave and, for that reason, it deserves to be seen as one of the more important protective cornerstones of our Australian Democracy.

Risking it for the sake of an accounting concept somehow just doesn't seem to rate.

ATACHMENT 2

Could the broadness of the descriptions used in the annual Appropriation Acts make it possible for the Executive to accommodate, during the currency of an appropriation, totally new activities that Parliament may not have contemplated at the time it was considering the Appropriation Bills?

Does the broadness of the descriptions of 'Outcomes' as the appropriation purposes included in annual Appropriation Bills diminish the meaningfulness of Senate's powers, under section 53 of the Constitution, to amend, or request amendments to, this category of proposed laws appropriating money?

Using, for the purposes of illustration (because of its brevity in having only one described outcome), the 1999-2000 appropriations for the ordinary annual services for the Department of Transport and Regional Services, the new form that the Schedule to the Appropriation Bill took was:

	Departmental Outputs $'000	Administered Expenses $'000	Total $'000
Outcome 1 – Linking Australia through transport and regional services	181992	114171	296163
Total: Department of Transport and Regional Services	**181992**	**114171**	**296163**

The activities which the entity proposes to undertake in achieving its outcome, are set out in its "Portfolio Budget Statements" (PBS) which provide comprehensive data about the intended financial operations of the entity. A PBS for each portfolio was tabled in Parliament as a 'Budget Related Paper' with the introduction of the Bills. [Access to a PBS is necessary in order to comprehend an entity's appropriations.]

Although mention is made of them in the Appropriation Acts, the PBSs are not part of the Acts. Since PBSs are not law, the Executive is not constrained by what is, or is not, in them.

- The Acts impose particular restrictions against switching appropriation provisions between outcomes – at least as far as the provisions for Administered Expenses is concerned – and link those provisions to activities that had actually been foreshadowed in the PBSs.

- However, there seems to be no legal impediment to the Executive's undertaking, during the course of a financial year, *totally new or expanded activities* which had not been foreshadowed to Parliament in the PBSs.

- Provided the new or expanded activities were, in some way, related to the achievement of a currently-described outcome, and their costs could be accommodated within the total appropriation provision for that outcome, Parliament may not be formally made aware of the matter until details of those activities were later revealed in the entity's annual report and financial statements.

Consider a hypothetical '**worst case**': At a time which just happens to coincide with the lead up to a crucial rural by-election, an incumbent Government cynically seeks to win the hearts and minds of the residents of this depressed, isolated region, by offering those with a motor vehicle over 10 years old, a subsidy to purchase a new car.

There appears to be nothing to prevent the Government from funding such a program with spare Administered Expenses capacity within the appropriation for the expansively-titled "Linking Australia through transport and regional services" outcome. On the face of it, Parliament would be powerless to intervene in the use of an existing appropriation.

In relation to the second question posed at the commencement of this Attachment, consider this not-so-hypothetical '**worst case**': Imagine that the present form of appropriation structure was in place in 1995. In the 1995-96 Budget, the then Labor Government had included, in Appropriation Bill (No. 2), an item in the Attorney-General's Department's votes for the Commonwealth to pay the legal costs of the Hon. Dr Carmen Lawrence MP, in connection with her involvement with the Easton Royal Commission. The non-Labor Senators had indicated that they would amend the Bill in the Senate to exclude that portion of the costs which related to Dr Lawrence's appeals to the courts. The Government amended its own Bill in the House of Representatives to reduce the item's provision by some $300,000 and, thereby, avoid the threatened conflict between the Houses that would have delayed passage of the whole Bill.

What would be achieved, under the current appropriation structure, if the Attorney-General's Department's appropriation provision of $58,945,000 for "Other Administered Expenses" in Appropriation Bill (No. 2), against the outcome "An equitable and accessible system of federal law and justice", were reduced to $58,942,000? The Government would still be legally able to fund Dr Lawrence's court appeal costs out of that total.

By any measure, adoption of the new structure of the Appropriation Acts has significantly weakened Parliament's capacity for control over the Executive's financial activities.