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Regional Development and Local Government

Reference: New regional development funding program

ANSWER TO WRITTEN QUESTION - USE OF A SPECIAL ACCOUNT FOR
THE RLCIP

Australian National Audit Office

Background

Grants made under the former Regional Partnerships Program were funded through an annual administered appropriation. The appropriations for administered items are expected to represent the amounts required to meet the total estimated expenses for the administered outcome for the relevant financial year.

Annual administered appropriations not expensed in the relevant financial year generally lapse and are not available to departments in subsequent financial years. This is achieved through processes provided in the annual Appropriation Acts.

At the time of ANAO's performance audit of the Regional Partnerships Program, section 8 of the annual Appropriation Acts appropriated amounts for administered items and provided for the amount able to be issued from the Consolidated Revenue Fund (CRF) for each item to be limited to either the amount of the appropriation item or a lesser amount determined by the Finance Minister, based on the expenses incurred in relation to the item in the financial year. This process aimed to ensure that administered amounts not required in a financial year were not available to be spent in a later year.¹ Determinations made under section 8 limited the amount of annual appropriation available, but did not reduce the amount of the appropriation.²

A process also existed whereby agencies could seek to have their Minister request the Finance Minister's agreement to some or all of unexpensed administered appropriations being re-phased—that is, added to an appropriation for a future financial year in forthcoming annual Appropriation Acts. However, such re-phasing requests were generally subject to consideration and agreement, or otherwise, in the Budget context.

The 2008-09 annual Appropriation Acts provide a revised process for the reduction of annual administered appropriation items. The provision relating to the Finance Minister limiting the amount that may be issued out of the CRF for an administered item has been removed.³ Instead, a new provision at subsection 11(1) of *Appropriation Act (No. 1) 2008-2009* provides that, where the actual expenses reported against an administered item in the tabled annual report of the relevant agency are less than the amount of the item as set out in the annual Appropriation Acts (as adjusted in accordance with relevant provisions of the Appropriation Acts and *Financial Management and Accountability Act 1997* (FMA Act)), the appropriation item will be taken to be reduced to the amount reported as actually being

¹ Department of Finance and Administration, Estimates Memorandum 2003/27, *Refresher on Appropriation Framework – Rules*, 23 August 2003, p. 4.

² The Parliament of the Commonwealth of Australia, House of Representatives, *Appropriation Bill (No. 1) 2008-2009*, Explanatory Memorandum, Circulated by the authority of the Minister for Finance and Deregulation, the Honourable Lindsay Tanner, MP, p. 12.

³ This was on the basis that the Finance Minister manages the payment from appropriation items by agencies through the issuing of drawing rights in accordance with sections 26 and 27 of the *Financial Management and Accountability Act 1997* (FMA Act)—drawing rights control who may spend money from appropriations, and allow for conditions and limits to be set by the Finance Minister (or delegate) in relation to those activities. On this basis, it was determined that it was no longer necessary for the Finance Minister to issue amounts out of the CRF (*ibid.*, pp. 6-8).

required in that year. The Explanatory Memorandum to the *Appropriation Bill (No. 1) 2008-2009* advised that this provision is intended to provide a streamlined process for amounts of administered items not required in later years to be extinguished.⁴ If the Government then decides that amounts should be spent in a later financial year, the Government must request Parliament to appropriate these amounts in future Appropriation Bills.⁵

Subsection 11(2)(a) of *Appropriation Act (No. 1) 2008-09* retains a power to the Finance Minister to determine that subsection 11(1) does not apply in relation to an administered appropriation item. In that case, any unexpensed appropriation under that item would still be available to the relevant agency, in the same way that unexpensed departmental annual appropriations continue to be available to agencies.

Using an annual administered appropriation

Administered expenses are administered by an agency on behalf of the Government, with payments usually being made pursuant to eligibility rules and conditions established by the Government or Parliament.⁶ Annual administered appropriations are made at the agency outcome level—that is, the appropriation is tied to the specified outcome for which it was made, but, for the purposes of the Appropriation Acts, may be expensed against any activity that contributes to that administered outcome. In practice, the allocation of annual administered appropriations across activities (or programs) that contribute to the relevant outcome is specified through the Budget process and reflected in agency Portfolio Budget Statements (PBSs).

As discussed above, requests for the re-phasing of unexpensed administered appropriations are considered in the Budget context, in which a measure of the on-going performance of a particular administered program that may be considered is the extent to which the program has spent its available appropriations. As noted in the audit report, while significant underspends against the Regional Partnerships Program allocation were initially fully re-phased into later years, this was not agreed to by the Finance Minister in later years, with the re-phasings that did take place occurring over a longer period of time.⁷

In this respect, the use of annual appropriations to fund administered programs provides Government with the ability to moderate the funding that is to be made available to a program to reflect its priorities for each Budget and realistic spending expectations, within the context of sound administration. Equally, it provides the Parliament with the opportunity to scrutinise proposed expenditure through consideration of the annual Appropriation Acts and agency PBSs.

However, the use of lapsing, annual appropriations requires management to avoid the risk of unintended consequences for effective and efficient administration of the public money involved. In the case of Regional Partnerships, ANAO identified that the extent of underspends against the Program's appropriation allocation would have been significantly

⁴ *ibid.*, p. 12.

⁵ Subsection 11(2)(b) of *Appropriation Act (No. 1) 2008-09* retains a power to the Finance Minister to determine that an amount published in the financial statements of an agency is taken to be the amount specified in his or her determination. This power is provided to ensure that the expense amount published in the agency financial statements for the administered item can be corrected if, for example, the amount is erroneous or requires updating after the annual report is published (*ibid.*, p. 12).

⁶ *Appropriation Act (No. 1) 2008-09*, Explanatory Memorandum, *op. cit.*, p. 8.

⁷ ANAO Audit Report No. 14 2007-08, *Performance Audit of the Regional Partnerships Programme*, 15 November 2007, Volume 2—Main Report, p. 505.

greater had the Department not adopted various strategies to increase Program expenditure.⁸ These strategies included:

- seeking to reduce the time taken to undertake assessment processes in order to ensure there were sufficient approved projects to enable contracting and expenditure of allocated appropriations; and
- a practice of making payments of Regional Partnerships funds in advance of project needs, including through the payment of a significant proportion of approved funds upon execution of the Funding Agreement (regardless of expected project progress and expenditure profile).

As the actual progress of an increasing number of contracted projects fell behind the milestones included in Funding Agreements (on which the Program's monthly and annual expenditure projections were based), the incentive to make substantial up-front payments in relation to newly approved projects increased. In some cases, this also resulted in second and later instalment payments being made, notwithstanding that funding recipients had not acquitted earlier payments or met other contractual obligations.⁹

These practices had a cumulative, year-on-year effect in which it became increasingly necessary to bring forward project expenditure wherever possible so as to compensate for projects that were not progressing as expected and for which further payments could not be made. This was not conducive to appropriate cash-management and risk-management practices being applied to individual projects and the Program's overall administration.

The use of an annual administered appropriation as the funding mechanism for a discretionary grants program need not result, and for a range of other programs has not resulted, in the administrative issues identified by ANAO in relation to the Regional Partnerships Program. In this respect, ANAO's audit report noted that:

If the Government considers it important that the department take further steps to spend the annual budgeted allocation, rather than the department making payments in advance of project requirements as has previously occurred, DOTARS should seek to improve its information on Programme funding needs by obtaining better information on the forward funding expectations for each project from applications during the project assessment stage and, where funding is approved, updating this information as part of its project monitoring activities. Such an approach would provide more scope to fund additional applications under the Programme consistent with budget allocations.¹⁰

Benefits and risks of establishing a Special Account

As the Committee noted in its Interim Report¹¹, an alternative approach to addressing these issues may be the use of a Special Account. The use of a Special Account for the new regional grants program may provide an opportunity to enhance transparency, accountability and the efficient use of funds. However, there are also issues to be managed in such an approach.

⁸ *ibid.*, p. 502.

⁹ *ibid.*, Volume 1—Summary and Recommendations, p. 25. Also see, for example, *ibid.*, Volume 2—Main Report pp, 507-533.

¹⁰ *ibid.*, Volume 1—Summary and Recommendations, p. 26.

¹¹ The Parliament of the Commonwealth of Australia, House of Representatives Standing Committee on Infrastructure, Transport, Regional Development & Local Government, *Funding regional and local community infrastructure: Proposals for the new Regional and Local Community Infrastructure Program, Interim Report*, November 2008, p. 35.

Crediting amounts to a Special Account

A Special Account is a mechanism used to record amounts in the CRF that are appropriated for specified purposes. Special Accounts can be created through either a determination by the Finance Minister (section 20 of the FMA Act), which is a disallowable instrument, or through an Act of the Parliament (section 21 of the FMA Act). A Special Account enables money to be earmarked within the CRF for the purposes for which the Account has been established. Guidelines issued by the (now) Department of Finance and Deregulation (Finance) state that a purpose of a Special Account is generally expressed in specific terms that distinguish the Special Account from other purposes for which money may be appropriated by the Parliament.¹²

The determination or legislation establishing a Special Account provides the legal authority for amounts to be credited to the Account. In this context, the annual Appropriation Acts provide that if any of the purposes of a Special Account is a purpose that is covered by an appropriation 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.¹³ Accordingly, funding may continue to be provided for a program such as the RLCIP through annual administered appropriations set out in the annual Appropriation Acts, but with relevant amounts then being debited from the annual appropriation and credited to the Special Account.

However, amounts credited to the Special Account would not be subject to annual appropriation reduction provisions, such as those set out in Clause 11 of *Appropriation Act No. 1 2008-09*. Instead, unspent amounts would continue to be available for expenditure in subsequent financial years for the purposes of the Program. This is because Special Accounts represent a type of special appropriation, with a standing appropriation being provided through sections 20(4) and 21(1) of the FMA Act for the purposes of each Account, up to the balance of the Account.

Accordingly, the use of a Special Account would provide certainty as to the funding available for a program involving infrastructure projects, which can be expected to often extend across financial years. It would also assist in addressing the cash management issues identified in the audit report of the Regional Partnerships Program, by removing the incentive for the administering department to maximise expenditure in a given financial year, regardless of the actual cash requirements and progress achievement of approved projects.

Debiting amounts from a Special Account

A determination made under Section 20 of the FMA Act establishing a Special Account must specify the purposes for which amounts may be debited from the balance of the Special Account (and therefore expended from the standing appropriation provided by s20(4) of the FMA Act). This provides an opportunity to enhance transparency and accountability for the use of the funds appropriated for a discretionary grants program, which could be enhanced further by tying the stated purpose of the Special Account to the program's approved guidelines. In this context, amounts may only be debited from a Special Account in accordance with the specified purposes of the Account.¹⁴ Accordingly,

¹² Department of Finance and Administration, *Guidelines for the Management of Special Accounts*, Financial Management Guidance No.7, October 2003, p. 13.

¹³ See, for example, section 18 of *Appropriation Act (No. 1) 2008-09*.

¹⁴ Amounts may also be debited from the balance of a Special for the purpose of correcting clerical errors; and to reverse a credit when the crediting of an Account occurred through the exercise of a discretion by an official, and the exercise of that discretion was actuated by a fundamental mistake of fact or law.

if the purposes of the Special Account were to be tied to the program guidelines, debiting a RLCIP Special Account for purposes that lie outside the program guidelines would not be authorised. This would enhance the obligation on Ministers and departments to demonstrate that all grant approvals were made within the terms of the program's approved guidelines.

The disallowance provisions under Section 22 of the FMA Act would provide a level of transparency and accountability to the Parliament of the purposes for which it is proposed that the funding will be expended.

Administrative considerations in establishing a Special Account

Special Accounts are subject to particular reporting requirements in the PBS, Consolidated Financial Statements and financial statements included in agencies' annual reports. A performance audit of Agency Management of Special Accounts undertaken by ANAO in 2003-04 demonstrated that there was significant scope for agencies to improve their financial management and reporting practices in respect of their Special Accounts. Improvements to Special Account disclosure requirements introduced in response to the audit and the development and publication in October 2003 of Special Account Guidelines by Finance have provided a stronger platform for enhancing the financial management, reporting and transparency of Special Accounts. However, the audit report concluded that:

...further improvement in administration must also come from greater understanding of, and increased care and attention to, legislative requirements and appropriation management practices by agencies responsible for the management of individual Special Accounts.¹⁵

In respect to the creation of new Special Accounts, we are aware that, in its inquiry into transparency and accountability of Commonwealth public funding and expenditure, the Senate Standing Committee on Finance and Public Administration canvassed issues relating to the proliferation of Special Accounts and for improving the capacity of the Parliament to scrutinise the establishment of new Special Accounts.

There is now greater disclosure of the existence of Special Accounts and their transactions and balances (such as through a list of Special Accounts now being included in the Budget Papers together with each Account, its opening and closing balances and receipts and payments being reported in the Consolidated Financial Statements). However, it remains a requirement that relevant alternatives be considered before the establishment of a Special Account is proposed. In this respect, guidelines for the management of Special Accounts issued by Finance advise:

When considering an appropriation and accounting regime for an activity, an agency should start from the premise that an activity should be funded through the annual budget mechanism. That is, the initial position should be that an activity can be funded through annual appropriations. Where the activity necessitates the appropriation of a significant amount of funding, an agency could consider creating a new outcome.

...

Only when it is clear that other types of appropriations are not suitable should Special Accounts be considered.

At a minimum the establishment of a Special Account should promote the efficient, effective and ethical use of Commonwealth resources as required by FMA Act

¹⁵ ANAO Audit Report No. 24 2003-04, *Agency Management of Special Accounts*, Canberra, 30 January 2004, p. 19.

section 44. If, for example, the size of an activity managed through a Special Account is relatively small then it could well be that the Account's set up and ongoing management, accounting and reporting responsibilities will not be an efficient and effective use of Commonwealth funds. Therefore, alternative administrative and accounting arrangements should be explored to ensure that the appropriate financial arrangements are in place.

The following is a set of specific criteria that should be critically evaluated when the establishment of a Special Account is being considered.

- Will the management of an activity be enhanced by the establishment of a Special Account?
- Is there a requirement for increased transparency (e.g. through a Cabinet Decision)?
- Is the use of a Special Account essential to the effective implementation of an activity?
- Is the non-lapsing nature of a Special Account appropriation necessary?
- Can the purpose of the Special account be sufficiently bound within a written determination?

While it is difficult to make an *a priori* judgement of whether a Special Account is appropriate in a particular circumstance, as a broad rule of thumb it can be said that a successful proposal for a Special Account would satisfy one or a number of the above criteria while also being able to demonstrate that none of the other budget accounting mechanisms are satisfactory.¹⁶

[*Emphasis as per original*]

Summary

The establishment of a Special Account for use in the administration of a new regional development grants program may assist in promoting the efficient use of funds and enhancing program funding certainty across financial years. However, as discussed, there are also issues to be managed in such an approach. The relative advantages and disadvantages for Parliamentary scrutiny of executive expenditure associated with an increased use of Special Accounts have also attracted attention in recent years. The extent to which the perceived benefits will be considered to outweigh the additional reporting and administrative overheads associated with the proper maintenance of a Special Account can be expected to depend upon factors such as the ultimate size and nature of the funding program as determined by Government.

Regardless of the approach that is ultimately adopted, the underlying obligation on Chief Executives and their agencies, through section 44 of the FMA Act, is to manage their affairs so as to promote the efficient, effective and ethical use of the resources for which they are responsible. That obligation applies irrespective of the type of appropriation arrangements used in providing those resources.

¹⁶ Department of Finance and Administration, *op. cit.*, p. 9.