

Audit Report No. 28, 2005-06, Management of Net Appropriation Agreements

Background

- 10.1 An appropriation is an authorisation by the Parliament to spend an amount from the Consolidated Revenue Fund (CRF) for a particular purpose. Section 83 of the Constitution provides that no money shall be drawn from the Treasury of the Commonwealth¹ except under an appropriation made by law.²
- 10.2 In this context, net appropriation arrangements are a longstanding feature of the Commonwealth's financial framework. They provide a means by which an agency's appropriation item in the annual Appropriation Acts can be increased for amounts received from non-appropriation sources. This may include payments from the public, employees, private sector entities, other agencies or other governments – for example, through user charging fees. A net appropriation agreement provides the agency with the appropriation authority to retain and spend those amounts.
- 10.3 Net appropriation agreements are made under Section 31 of the *Financial Management and Accountability Act 1997* (FMA Act). The FMA Act requires that an agreement be made between the Finance Minister and the Minister responsible for the appropriation item or, in the case of items for which

1 In this context, the Treasury of the Commonwealth refers to the CRF.

2 Australian National Audit Office, Audit Report No. 28 2005-06, *Management of Net Appropriation Agreements*, Commonwealth of Australia, January 2006.

the Finance Minister is responsible, with the Chief Executive of the agency for which the appropriation is made.

Audit objective and scope

- 10.4 The objective of the performance audit was to assess agencies' financial management of, and accountability for, the use of net appropriation agreements to increase their appropriations.
- 10.5 Six FMA Act agencies were selected for detailed examination: Australian Agency for International Development (AusAID); Bureau of Meteorology (BoM); Department of Defence; Department of Industry, Tourism and Resources (DITR); Department of Immigration and Multicultural and Indigenous Affairs (DIMIA);³ and Department of Finance and Administration (Finance).
- 10.6 The ANAO also examined 231 agreements made in respect of FMA Act agencies between 1 January 1998 and 30 June 2005,⁴ and agencies' financial reporting of the use of Section 31 to increase their appropriations.

Overall conclusion

- 10.7 Overall, the audit revealed widespread shortcomings in the administration of net appropriation arrangements. In particular, there had been inadequate attention by a number of agencies to their responsibility to have Section 31 agreements in place. Other agencies were found to have agreements in place, but some of these agreements were found to be 'ineffective' or 'in doubt' because agencies could not demonstrate that the signatories to the agreements had the appropriate delegation from the Minister. The ANAO found that given the fundamental importance of appropriations to Parliamentary control over expenditure, improvements are necessary to secure proper management of net appropriation arrangements.
- 10.8 The ANAO believed that two recent Finance Circulars issued by the Department of Finance and Administration would assist in improving management of net appropriation agreements, as would changes to Finance's practices in negotiating and executing agreements on behalf of

3 Following changes announced by the Prime Minister on 24 January 2006, the Department of Immigration, Multicultural and Indigenous Affairs (DIMIA) was altered to form the new Department of Immigration and Multicultural Affairs (DIMA). DIMIA will continue to be used in this section as that was the departmental name at the time of the audit.

4 These agreements had been made in respect to 79 agencies. The least number of agreements made in respect to an individual agency in that period was one (including five agencies that had been created since 1 July 2003) and the most was eight (for Finance).

the Finance Minister. Nevertheless, in terms of appropriation management, individual agencies are directly responsible for ensuring that an appropriation is available before spending funds from the CRF.

- 10.9 Accountability to the Parliament for the use of Section 31 arrangements is expected to occur through reporting in budget papers and agency financial statements. However, the ANAO found that the current presentation of budget estimates does not assist readers of agency Portfolio Budget Statements (PBS) with a clear understanding of how much 'extra' money will be available to the agency through amounts collected under net appropriation agreements.⁵ Further, the ANAO found that agency financial statements have not accurately reflected the use of Section 31 arrangements.
- 10.10 The ANAO found that a measure implemented by Finance to require agency Chief Executives to provide an annual statement of compliance with the legislative and policy elements of the financial management framework, introduced in 2006–07, should assist in ensuring a stronger agency focus on compliance issues.

Committee inquiry

- 10.11 The Committee held a public hearing on Audit Report No. 28, 2005-06 on 29 May 2006. Submissions were received from the Clerk of the Senate and from the Department of Finance and Administration (in answer to questions on notice arising from the public hearing).

5 The Portfolio Budget Statements are targeted towards providing the Parliament with information regarding the proposed allocation of resources to Government outcomes. Information is provided to Parliament regarding 'Other receipts available to be used', which is the estimated amount of receipts that are available to the agency for expenditure to contribute to the relevant outcome.

ANAO recommendations

Table 10.1 ANAO recommendations, Audit Report No. 28, 2005-06- Net Appropriation Agreements

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1. In order to provide certainty as to the capacity of amounts debited from internally managed Special Accounts to be captured by agencies' Section 31 agreements, ANAO *recommends* that the Department of Finance and Administration take the necessary steps to align the provisions relating to notional transactions in the annual Appropriation Acts with those set out in Section 6 of the *Financial Management and Accountability Act 1997*.
Finance agreed with qualification. All other agencies that responded to this recommendation agreed.

 2. ANAO *recommends* that, before entering into future Section 31 agreements:
all signatories establish the capacity in which they may legitimately sign the agreement, and correctly identify that capacity in the agreement;
where it is intended that an official will be entering into the agreement, rather than the holder of the statutory power, agencies take steps to obtain written authorisations or delegations (where available) from the responsible Minister (or, for Finance portfolio agencies, Chief Executive); and
delegates of the Finance Minister satisfy themselves that the agreement has been signed by the responsible Minister or an agency official who holds a current authorisation or delegation, as appropriate, from the responsible Minister (or, for Finance portfolio agencies, Chief Executive).
All agencies that responded to this recommendation agreed to relevant parts.

 3. In the interests of an effective and accountable financial framework for the management of appropriations, ANAO *recommends* that:
as part of their financial controls and in accordance with Commonwealth recordkeeping requirements, all agencies maintain adequate records of Section 31 authorisations and delegations provided by Ministers (and, where relevant, Chief Executives), together with records of which official(s) held the power when Section 31 agreements were signed; and
the Department of Finance and Administration examine possible administrative and/or legislative changes that could limit the opportunity for agencies to rely upon a 'presumption of regularity' when increasing their appropriations through Section 31 arrangements.
All agencies that responded to this recommendation agreed to relevant parts.

 4. ANAO *recommends* that, as part of its responsibilities for developing and maintaining the Commonwealth financial framework, the Department of Finance and Administration consider the merits of including greater specificity in the relevant legislative provisions regarding the conditions under which net appropriation agreements may be applied retrospectively to amounts previously received by an agency.
BoM agreed with qualification. All other agencies that responded to this recommendation agreed.

 5. ANAO *recommends* that, as part of its current work examining opportunities to simplify the financial framework, the Department of Finance and Administration examine options to improve the framework for net appropriation arrangements, including the merits of specifying the relevant terms and conditions (including common eligible receipts) in the annual Appropriation Acts, rather than through delegated legislation (Section 31 agreements).
All agencies that responded to this recommendation agreed.
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Audit findings on net appropriation agreements

Pre-requisites for retaining and spending from non-appropriation sources

10.12 The ANAO report explained that for an agency to receive an appropriation authorising it to retain and spend amounts received from non-appropriation sources, each of the following arrangements must be in place:

- there must be a relevant appropriation item for the agency in an annual Appropriation Act that has been marked 'net appropriation';
- there must be an effectively executed Section 31 Agreement in place that applies to that appropriation item; and
- the amount received must be of a kind that is specified as being an eligible receipt for the purposes of the agreement, and therefore, for the purposes of the annual Appropriation Acts.

10.13 In its examination of net appropriation agreements, the ANAO found problems in each of the above areas.

Increasing use of net appropriation agreements

10.14 The extent to which agencies have used net appropriation arrangements to increase their available appropriation has grown considerably over time. During the course of the 1990s, net appropriation agreements became more widespread amongst agencies, in part reflecting public sector management reforms introduced at the time, such as an increased use of user charging and cost-recovery.⁶

10.15 On 1 January 1998, the Audit Act was replaced with the FMA Act and associated legislation. Under the revised arrangements, it is Section 31 of the FMA Act that provides the power for Ministers to enter into net appropriation agreements. Further, the annual Appropriation Acts no longer specify the types of receipts that can be retained as net appropriations. Instead the relevant sections of the annual Appropriation Acts provide that the amount specified in an appropriation item is taken to be increased in accordance with, and on the conditions set out in, the Section 31 agreement applying to that item.⁷

6 Department of Finance and Administration Submission to ANAO, *Management of Net Appropriation agreements*, 10 February 2005.

7 This and following three paragraphs taken from ANAO Audit Report No.28, 2005-06, pp. 39-40.

- 10.16 A further significant change was that an agreement made under Section 31 need not relate to a particular Appropriation Act and could be made for any period, including a period longer than a financial year.
- 10.17 There has continued to be growth in the use of net appropriations since the commencement of the FMA Act. In 1996-97, the last full financial year prior to the Act commencing, agencies reported net appropriation receipts totalling \$831 million. In 2003-04, 68 FMA Act agencies collectively reported receipts totalling \$1.55 billion as having been added to their respective annual appropriations by operation of Section 31 agreements. In 2004-05, 67 agencies reported Section 31 receipts totalling \$1.46 billion.⁸
- 10.18 However, while the total dollar amount has increased, the amount of net appropriation revenue as a proportion of departments' (running costs) appropriations has decreased, from 6.1 percent in 1996-97 to 4.4 percent in 2004-05.

Roles and responsibilities

- 10.19 Under the FMA Act, responsibility for the financial management and accountability of government agencies is devolved to chief executives. Each agency is accountable to their minister and to the parliament, through the chief executive, for their financial management. Finance defines its role as to 'develop, implement, train and advise on a framework that allows [agencies] to ensure that the framework does allow them to do that.'⁹
- 10.20 Specifically in regard to net appropriation agreements, Finance advised the ANAO that its role comprises:
- negotiating all agreements with the relevant agency;
 - signing each agreement as the delegate of the Finance Minister. Finance advised ANAO that, as a signatory to Section 31 agreements, it is responsible for assessing the types of receipts identified by agencies in the proposed agreement, to ensure that they are appropriate; and

8 The \$99 million reduction in Section 31 receipts reported in 2004-05 compared to 2003-04 is consistent with increased actual Section 31 receipts, combined with corrections made by agencies in 2004-05, in response to issues raised in the ANAO performance audit, to exclude amounts previously incorrectly disclosed as Section 31 receipts. See Audit Report 28, 2005-06, footnote 40 and paragraphs 4.45 to 4.54 for more detail regarding those issues.

9 Ms Kathryn Campbell, Finance, *Transcript of Evidence*, 29 May 2006, p. 12.

- providing guidance and advice to agencies on appropriation management generally and more specifically on Section 31 agreements.¹⁰
- 10.21 In its 2004-05 Annual Report, Finance noted that a number of audit reports have identified scope for improvements in the financial framework, predominantly in agencies' application of the framework.¹¹ In this context, Finance undertook an examination of Section 31 of the FMA Act. The culmination of this work was the issuing, on 11 August 2004, of Finance Circular No. 2004/09, *Net appropriation agreements (Section 31 Agreements)*.
- 10.22 Finance Circular 2004/09 included a revised template for the preparation of Section 31 agreements. Associated with the Circular, Finance required all agencies to make a new agreement. By 30 June 2005, all agencies had executed a revised agreement using the new template.
- 10.23 The template was further revised on 30 June 2005, when Finance Circular No. 2004/09 was replaced by Finance Circular No. 2005/07, *Net appropriation agreements (Section 31 Agreements)*. This Circular, including the agreement template, can be found at:
http://www.finance.gov.au/finframework/docs/FC_2005.07_attachments.pdf

Requirements for an effective net appropriation agreement

- 10.24 In order to comply with the provisions of the FMA Act, a net appropriation agreement must be made between the Finance Minister (as the whole-of-government representative) and the Minister responsible for the relevant agency or, for most Finance portfolio agencies, the agency Chief Executive. Accordingly, there are two signatories to a Section 31 agreement. Both signatories must have the necessary authority in order for an agreement to be effectively executed in accordance with the legislative requirements.
- 10.25 In almost all instances, a Finance official signs the whole-of-government side of Section 31 agreements, as delegate of the Finance Minister. Finance officials must hold a written delegation from the Finance Minister in order to enter into these agreements.¹²

10 ANAO Audit Report No. 28, 2005-06, p. 44.

11 Department of Finance and Administration, *2004-05 Annual Report*, October 2005, pp. 22 and 34

12 In accordance with the requirements of Sections 62 and 53 of the FMA Act.

- 10.26 Similarly, the significant majority of agreements made to 30 June 2005 were signed by an official of the relevant agency, rather than the responsible Minister or, for Finance portfolio agencies, Chief Executive.¹³

ANAO findings on net appropriation agreements

- 10.27 The ANAO examined 231 Section 31 agreements made between the commencement of the FMA Act on 1 January 1998, and 30 June 2005. The ANAO was looking for evidence from Finance and each agency to prove that the agreements had been effectively executed by both signatories. The assessment was conducted using a decision tree that reflected a series of legal advices provided to Finance and ANAO by the Australian Government Solicitor (AGS) regarding assessment of Section 31 agreements, including the application of a 'presumption of regularity'.
- 10.28 Of the agreements examined, 157 (68 percent) were assessed as having been effectively executed. The remainder (32 percent) of agreements were assessed as 'ineffective'; 'in doubt'; or having 'no agreement'. These findings are briefly outlined below.

Effective agreements

- 10.29 Where the agencies could demonstrate that the Section 31 agreements were signed by the responsible Minister or their Chief Executive (or an official acting in that capacity), they were deemed to have an effective agreement. In a number of cases, officials at levels below the Chief Executive had signed the agency side of the agreement. The ANAO deemed these agreements to be effective if the agencies could provide evidence to show that the official had been expressly authorised or delegated by the responsible Minister or Chief Executive to carry out this function. The ANAO also found that Finance was able to demonstrate appropriate delegations from the Finance Minister for all their officers who had signed Section 31 agreements.¹⁴

Ineffective agreements

- 10.30 In total, the ANAO found that 42 agreements (18 percent) across 23 agencies were 'ineffective'. The agencies could not provide sufficient evidence to prove that the signatories to the agreements had the appropriate delegation from their Minister. A finding that an agreement was ineffective meant that the affected agencies had not obtained the appropriation authority for the amounts collected under those
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13 ANAO Audit Report No. 28, 2005-06, p. 17.

14 ANAO Audit Report No. 28, 2005-06, p. 21.

agreements. Any money spent had been in breach of Section 83 of the Constitution.¹⁵

10.31 To address the issue of 'ineffective' agreements, on 24 June 2005 the Finance Secretary made two instruments under subsection 31(4) of the FMA Act. They were:

- an instrument to cancel all agreements made on or before 30 June 2004; and
- an instrument (the Variation Instrument) to vary all agreements made between 1 July 2004 and 30 June 2005 to include, as eligible receipts, amounts retained by the agency in reliance on prior, 'ineffective' agreements.

10.32 The Variation Instrument provided a basis for agencies to capture retrospectively all receipts that were subject to an 'ineffective' agreement. An appropriation for the affected receipts was made available to agencies as at 30 June 2005, which would allow any unspent amounts to be lawfully spent. This action could not, however, remove past breaches of Section 83 of the Constitution that occurred due to agencies spending money collected under an 'ineffective' Section 31 agreement.¹⁶

10.33 The Variation Instrument applied in respect to receipts totalling \$1.76 billion across 19 agencies. Of those receipts, a total of \$1.16 billion was disclosed by the relevant agencies as having been spent without appropriation between 1997-98 and 2004-05, in contravention of Section 83 of the Constitution.¹⁷

'In doubt' agreements

10.34 A number of agencies were unable to provide evidence to demonstrate the effectiveness of their agreements – that is, there was no evidence that the official/s who signed the Section 31 agreements were authorised or delegated to do so. However, the agencies relied on advice from the AGS

15 The agencies found to have ineffective Section 31 agreements were: AusAID; Australian Bureau of Statistics; Australian Competition and Consumer Commission; Australian Electoral Commission; Australian Federal Police; Australian Radiation Protection and Nuclear Safety Agency; Australian Security Intelligence Organisation; Department of Family and Community Services; Department of Finance and Administration; Department of Health and Ageing; Department of Transport and Regional Services; Federal Court of Australia; National Competition Council; Office of Asset Sales and IT Outsourcing; Office of Film and Literature Classification; and Office of National Assessments.

16 ANAO Audit Report No. 28, 2005-06, p. 110.

17 ANAO Audit Report No. 28, p. 2005-06, p. 112.

regarding a 'presumption of regularity' to argue that the Section 31 agreements were valid.

10.35 The AGS advice was that:

It may be that an agreement signed by an official other than the Chief Executive is presumptively valid in circumstances where:

- the officer signed the agreement 'for and on behalf of the Minister' or in some other way which indicated that the officer understood himself or herself to be acting under an authorisation from the Minister; and
- there is no evidence to support the view that the officer was not expressly authorised to enter into Section 31 agreements on behalf of the Minister.¹⁸

10.36 The AGS further advised the ANAO and Finance that, where the two above requirements were satisfied, it was unlikely that a court would declare that expenditure in accordance with the agreement was invalid because of a breach of Section 83 of the Constitution.¹⁹

10.37 However, the ANAO sought its own legal advice on the matter. The ANAO's advice was that the 'presumption of regularity' is for the protection of those who are entitled to assume, because they cannot know, that the person with whom they deal has the authority that is claimed. For example, 'the person in the street' who cannot know whether a government official with whom he or she deals has the authority to undertake a particular function. Based on this advice, the ANAO argued:

Relying on a 'resumption of regularity' in this context inevitably leaves doubt as to the effectiveness of the agreement and, therefore, the amount of the appropriation that was legally available to the relevant agency. This does not reflect sound administrative practice, the ANAO's view.²⁰

10.38 The agencies which relied on the 'presumption of regularity' argument to demonstrate that their Section 31 agreements were valid disclosed this doubt in their 2004-05 statements. The ANAO reports that a total of \$4.8 billion was added to agencies' annual appropriations up to 30 June 2005, under 'in doubt' agreements. At 30 June 2005, \$2.86 billion had been spent.²¹

18 Australian Government Solicitor, quoted in ANAO Audit Report No. 28, 2005-06, p. 93.

19 ANAO Audit Report No. 28, 2005-06, p. 94.

20 ANAO Audit Report No. 28, 2005-06, p. 22.

21 ANAO Audit Report No. 28, 2005-06, p. 94. The eleven agencies which had 'in doubt' agreements were: Australian Greenhouse Office; Australian Public Service Commission; Australian Taxation Office; Department of Agriculture, Fisheries and Forestry; Department of

10.39 Following the ANAO findings on 'in doubt' agreements, the ANAO and Finance agreed that agencies should obtain a written authorisation from the responsible Minister before entering into Section 31 agreements on the Minister's behalf. The Circulars issued by Finance in August 2004 and June 2005 advocate this approach as best practice.²²

'No agreement'

10.40 The ANAO identified 14 agencies that had reported income that at no time was captured by a Section 31 agreement, or had spent income prior to having an agreement in place. These agencies were assessed as having 'no agreement' in place.²³

10.41 Where money had been spent without appropriation, Section 83 of the Constitution was contravened. This was disclosed by the relevant agencies in their financial statements. Where the Section 83 breach was a result of the agency signatory to an agreement not being authorised or the agency not having an agreement, a corresponding breach of Section 48 of the FMA Act was also required to be reported, given the specific obligations placed on agency Chief Executives under that Section to keep proper accounts and records.²⁴

10.42 To give the agencies found with 'no agreement' an appropriation authority in respect of any amounts still held, in October 2005 the Finance Secretary executed two further Variation Instruments under the FMA Act. As with the previous Variation Instrument, this would not remove past breaches of Section 83 of the Constitution that occurred due to agencies spending receipts not covered by a Section 31 agreement.

10.43 A further two agencies, the Bureau of Meteorology (BoM) and Centrelink, were identified as having spent amounts totalling \$1.59 billion prior to having a Section 31 agreement (and, for BoM, other necessary

Defence, Department of Education, Science and Training; Department of the Environment and Heritage; Department of Industry, Tourism and Resources; Department of the Treasury; Office of the Commonwealth Ombudsman; and the Productivity Commission.

22 ANAO Audit Report No. 28, 2005-06, p. 22.

23 The agencies found to have 'no agreement' for appropriations received were: Australia-Japan Foundation; Australian Bureau of Statistics; Department of Education, Science and Training; Department of Foreign Affairs and Trade; Department of the Parliamentary Library; Federal Court of Australia; Joint House Department; National Oceans Office; and Office of the Renewable Energy Regulator. The following five agencies relied on an inoperative agreement (ie the agreement had expired on 1 July 1999): Administrative Appeals Tribunal; AUSTRAC; National Native Title Tribunal; Office of Parliamentary Counsel; and Office of the Commonwealth Director of Public Prosecutions.

24 ANAO Audit Report No. 28, 2005-06, pp. 19-20.

arrangements relating to appropriations) in place to provide them with appropriation authority.²⁵ Consequently, each contravened Section 83 of the Constitution and Section 48 of the FMA Act. The agreements subsequently executed for both agencies provided for the retrospective capture of all receipts collected during the period each did not have an agreement. Accordingly, neither agency was included in Variation Instruments 2 & 3 relating to 'no agreement' periods. Both agencies disclosed this issue in their 2004–05 financial statements.²⁶

ANAO Recommendations

- 10.44 The ANAO recommended that for future Section 31 Agreements, agencies should ensure that signatories are able to legitimately sign the agreement, by obtaining written authorisations or delegations from their Minister, and that Finance should verify that the agency signatories are appropriately authorised or delegated to sign the agreement (ANAO recommendation 2). All agencies agreed to the recommendation.
- 10.45 The ANAO also recommended that agencies ensure that their record-keeping for Section 31 agreements is adequate (recommendation 3).
- 10.46 The Committee asked Finance if, as a result of the audit, FMA agencies are now taking the requirements for effective net appropriation agreements more seriously. Finance responded:

The Section 31 Agreements...are taken far more seriously. We in Finance have implemented a number of procedures to ensure that the agreements are appropriately signed. We sight the delegation from the other party, for want of a better term, before it is signed off. Internally we ensure that the appropriate delegate only is able to sign off. We do not encourage, if that delegate were on leave, the person stepping into that position to sign off; we ask for it to be escalated to the general manager of budget group, for example. The Financial Management Group checks these agreements to ensure that they have been executed in an appropriate manner.²⁷

25 The bulk of the funds spent without appropriation relates to \$1.56 billion received by Centrelink in 1998–99 from other Commonwealth agencies for the delivery of services.

26 ANAO Audit Report No. 28, 2005–06, p. 25.

27 Ms Kathryn Campbell, Finance, Transcript of Evidence 29 May 2006, p. 8.

Committee comment

- 10.47 The Committee was disappointed to learn that the audit revealed many agencies did not have effective net appropriation agreements in place, primarily because they had not covered the basic requirement of ensuring that signatories to the agreements had the proper delegation or authorisation to sign the document.
- 10.48 The Committee accepts that most or all of these 'ineffective' and 'in doubt' agreements have now been cancelled and replaced with effective agreements. However, the lack of attention to the legislative requirements for proper delegation of authority is a worrying issue. This is an issue that agency audit committees should be paying attention to, not just for net appropriation agreements but for all delegated signatories.

Eligible receipts

- 10.49 The FMA Act does not provide guidance as to the type of receipts that may be included in Section 31 agreements. This was a change from the Audit Act, which specified the type of receipts allowable.
- 10.50 Legal advice to agencies has been that the only express restrictions on the terms and operation of an agreement in relation to the amounts that may be applied to increase an appropriation item are:
- that the agreement must specify the receipts that are eligible receipts for the purposes of the agreement; and
 - the increase in the appropriation item cannot be greater than the amount of those specified receipts that is received.²⁸
- 10.51 However, the ANAO argued that the extent to which agencies' adherence to these requirements could be monitored was limited by the broad and inclusive manner in which eligible receipts were defined in individual agreements, using a category based approach. This issue was resolved when Finance issued the two Finance Circulars in 2004 and 2005, which more specifically defined the receipts that an agency is entitled to retain.²⁹

28 ANAO Audit Report No. 28, 2005-06, p. 25.

29 The template provided in Finance Circular 2005-07 details the types of receipts eligible for inclusion in Section 31 Agreements:
http://www.finance.gov.au/finframework/docs/FC_2005.07_Att_A.pdf, accessed August 2006.

10.52 The ANAO also raised concerns about some agencies' use of Section 31 agreements to increase their annual appropriation for amounts debited from internally managed Special Accounts. For example, the Department of Environment and Heritage told the ANAO that the majority of its Section 31 receipts for 1998-99 (estimated at \$11.7 million) related to payments from the Natural Heritage Trust.³⁰

10.53 The ANAO argued that there had been an absence of clarity about if and how this can occur. The ANAO also found that there was ongoing uncertainty as to whether these internal transactions were relevant receipts for the purposes of the net appropriation provisions of the annual Appropriation Acts:

The uncertainty in respect to these transactions does not contribute to the orderly management and governance of appropriations. This is particularly the case in light of the significant amounts that are involved in some agencies.³¹

10.54 Accordingly, the ANAO recommended that Finance take the necessary steps to remove such uncertainty.³² Finance responded that it would give policy consideration to the recommendation and to whether such transactions should be included in Section 31 Agreements. The Committee notes that a Finance Circular released in August 2006, addressing this issue, states:

If an agency is receiving a notional payment, which it intends to retain and spend, including from a Special Account, the agency should seek advice from Finance as to whether that kind of payment should be listed in the agreement as a relevant receipt.³³

Accountability to the Government and the Parliament

10.55 The financial framework requires accountability for agency use of net appropriation arrangements in three primary ways, as follows:

- since 1 January 2005, Section 31 agreements have been required to be registered on a publicly available register, Federal Register of

30 ANAO, Audit Report No. 28, 2005-06, p. 67 (footnote 79). Other agencies identified as transferring funds from Special Accounts into appropriation accounts include: Australia-Japan Foundation; DAFF; DCITA; DoTaRS; Treasury; PM&C; and Finance.

31 ANAO Audit Report No. 28, 2005-06, p. 72.

32 ANAO Audit Report No. 28, 2005-06, p. 25

33 Finance Circular 2006/04, p. 4.

Legislative Instruments, enabling the Parliament to be aware of what agreements have been made since that date and their terms and conditions;

- disclosure in PBS and Portfolio Additional Estimates Statements (PAES) of receipts estimated to be collected by the relevant agency under authority of a Section 31 agreement; and
- disclosure in annual financial statements of the actual increase in the agency's annual appropriation under authority of Section 31.

10.56 The ANAO found that improvements could be made in respect of each of these accountability mechanisms, to assist in providing the Parliament with a complete and accurate record of the use of Section 31 arrangements.

Registration of legislative instruments

10.57 The *Legislative Instruments Act 2003* established a comprehensive regime for the registration, tabling, scrutiny and sunseting (or automatic repeal) of Commonwealth legislative instruments. Under the Act, instruments made on or after 1 January 2005 must be lodged in electronic form with the Attorney-General's Department as soon as practicable. Members of the public can view the Federal Register of Legislative Instruments (FRLI) on the internet at www.comlaw.gov.au.³⁴

10.58 The ANAO found that there had been delays of some months between the signing of Section 31 agreements and their registration on the FRLI. The ANAO argued that to improve the benefits obtained from the registration of Section 31 agreements on FRLI, such registration should be timely.³⁵

Reporting on the use of Section 31 agreements

PBS/PAES

10.59 As part of their annual Portfolio Budget Statement (PBS) and Portfolio Additional Estimates Statements (PAES) reporting, agencies are required to disclose estimates of the receipts from non-appropriation sources that will be available for expenditure in the coming year.

10.60 The ANAO found that the current presentation of those estimates for Section 31 agreements is not clear enough. Specifically, agencies may bundle Section 31 receipts under a heading which also includes receipts from any CAC Act bodies within the portfolio, receipts to Special

34 Attorney-General's Department website: www.comlaw.gov.au; accessed August 2006.

35 ANAO Audit Report No. 28, 2005-06, p. 26.

Accounts from non-appropriation sources, and resources received free of charge. Finance advised the ANAO:

...Specific receipt items are identified by agencies where they are considered significant. Less significant items, which in some cases may include Section 31 receipts, are aggregated in 'other' to achieve a balance between the level of detail and significance in presentation.³⁶

Financial statements

- 10.61 As part of their annual financial reporting to the Parliament, FMA agencies are required to account for the appropriations available to them; the extent to which payments were made from the CRF under authority of those appropriations; and for appropriations with a financial limit, the amount of appropriation still available as at 30 June.³⁷
- 10.62 The ANAO identified a number of cases where agencies had mis-reported their Section 31 receipts in their annual financial statements. In particular, the Department of Industry, Tourism and Resources, (DITR), Department of Health and Ageing, the Australian Radiation Protection and Nuclear Safety Agency (ARPANSA) and the Australian Centre for International Agricultural Research (ACIAR) had incorrectly consolidated debits, credits and balances of departmental Special Accounts into their Section 31 agreement amount.³⁸ There were also problems with reporting on repaid amounts, and in calculating the actual amounts of appropriations received under Section 31 Agreements.³⁹
- 10.63 The ANAO noted that accurate reporting is one of the responsibilities of agency chief executives, under Section 48 of the FMA Act. In this context, the ANAO argued, there is a need for improvement in agencies' reporting of Section 31 appropriations, both PBS, PAES, and financial statements. The ANAO did note that number of agencies had made changes in their 2004-05 financial statements to address reporting problems that were identified by the ANAO during the course of the audit.

36 Finance advice to ANAO, Audit Report No. 28, 2005-06, p. 123.

37 ANAO Audit Report No. 28, 2005-06, p. 126. These requirements are spelt out under the Financial Management Orders made under Section 63 of the FMA Act and Section 48 of the CAC Act.

38 ANAO Audit Report No. 28, 2005-06, p. 129.

39 ANAO Audit Report No. 28, 2005-06, pp. 130 and 132.

Compliance certificate

10.64 At the hearing, Finance noted that the Government had introduced a compliance certificate, to be signed off by each FMA agency's chief executive at the end of each financial year and submitted to their Minister. The compliance certificate will state that the chief executive has put in place controls and mechanisms to ensure compliance with the FMA Act.⁴⁰ Each agency's compliance certificate will also be copied to the Finance Minister for review. Finance stated:

We believe those compliance certificates will allow us to identify where there are either systematic problems or agency specific problems and be able to assist the agency in overcoming those problems.⁴¹

10.65 Since the hearing Finance has altered the status of the Compliance Certificates. They were introduced on a 'trial basis' for 2005-06, with completion and lodgement with each agency's Minister to be compulsory in 2006-07.⁴²

Financial framework enhancement opportunities

10.66 Many of the findings of this performance audit relate to agencies' understanding of, and compliance with, the financial framework. Clearly agencies need to focus more clearly on their responsibilities under the FMA Act (discussed further below). As well as identifying problems with the current system for making and reporting on net appropriation agreements, the ANAO identified scope for enhancing certain aspects of the financial framework as it operates in respect to net appropriations.

Retrospective application of Section 31 agreements

10.67 It has been a common practice for agencies to enter into Section 31 agreements some time after the commencement of the period to which the agreement is then purported to apply. The ANAO found that nearly half of the agreements made to 30 June 2005 had been applied retrospectively to amounts received by the agency prior to the agreement being executed.⁴³

40 Ms Kathryn Campbell, Finance, Transcript of Evidence 29 May 2006, p. 7.

41 Ms Kathryn Campbell, Finance, Transcript of Evidence 29 May 2006, p. 13.

42 Discussions between Committee Secretariat and Finance, 23 August 2006.

43 ANAO Audit Report No. 28, 2005-06, p. 134.

- 10.68 In several pieces of legal advice to Finance, the AGS has stated that while there is a general presumption against the powers of Acts being applied retrospectively, the language of Section 31 of the FMA Act is broad, and there seems to be no compelling reason to read it as preventing the capture of previous receipts if the Finance Minister considers it appropriate.⁴⁴ However, the ANAO notes, the AGS has consistently advised agencies that it is not possible to retrospectively provide an appropriation to cover moneys already spent.
- 10.69 The ANAO expressed concern that while retrospective net appropriation agreements may be legal, they do not represent best practice:
- While administratively convenient, applying net appropriation agreements to amounts received at some earlier time does not promote discipline by agencies in complying with their financial management requirements and Constitutional obligations.⁴⁵
- 10.70 Therefore the ANAO recommended a tightening in the legislation to limit the circumstances in which past receipts can be captured by Section 31 agreements. The ANAO noted that the Government had other authority through which it could provide agencies with appropriation authority to spend amounts received into the CRF, if required.
- 10.71 Finance agreed with this recommendation and stated that it had developed a policy setting out the circumstances in which agreements can be applied to past receipts of an agency. Finance also agreed to examine the issue further in its review of the operation of Section 31 of the FMA Act, in accordance with its response to the ANAO's recommendation number five of the audit report.

Role of Section 31 agreements

- 10.72 As outlined earlier, prior to the implementation of the FMA Act, the annual Appropriation Acts specified the sources from which net appropriations could be received. The agreements made under those arrangements identified, in a Schedule, the types of receipts an agency would be able to collect under the broad sources specified in the Appropriation Acts, and the quantum of such receipts expected to be collected in the relevant financial year. Under the FMA Act, the receipts each agency may use to increase its annual appropriation are established by the terms of its particular Section 31 agreement.⁴⁶

44 ANAO Audit Report No. 28, 2005-06, p. 136.

45 ANAO Audit Report No. 28, 2005-06, p. 140.

46 ANAO Audit Report No. 28, 2005-06, p. 142.

- 10.73 As has been demonstrated in this audit, many agencies have had difficulties in managing this new responsibility under the FMA Act. Many agencies did not ensure that the signatories to Section 31 Agreements were correctly authorised or delegated to sign the document. Many agencies also did not ensure that appropriate Section 31 agreements were in place for monies received and spent.
- 10.74 Because of these difficulties, the ANAO has raised the option of returning the central role in net appropriations from individual agency agreements back to the annual Appropriation Acts. Under this approach, the annual Appropriation Acts would list all the types of receipts that would be eligible for all agencies for the purposes of net appropriations. The ANAO states that this would allow for the removal of individual agency agreements in all or most circumstances.⁴⁷
- 10.75 The ANAO pointed out that most agencies follow the template provided by Finance in 2005, which has a standard list of eligible receipts for inclusion in net appropriation agreements. Therefore this list could easily be included in the annual Appropriation Acts, capturing most agencies' needs. Individual agreements could be made on an exception basis, where an agency required an agreement for a specific receipt which was not included in the generic list.
- 10.76 The submission from the Department of the Senate criticised the financial framework to the extent that it may allow large amounts of money to be expended with little or no Parliamentary oversight. The Senate suggests that
- ...the problems identified [in this and previous ANAO audit reports], which might be described as neglect of legal requirements and unsatisfactory management and accounting, have arisen partly from a system which encourages those attributes by having those multiple jam jars and hollow logs and complex flows of funds. While this system may give maximum flexibility to agencies, it is not conducive to respect for legality and good management and accounting, nor to parliamentary accountability.⁴⁸
- 10.77 At the hearing the Clerk of the Senate acknowledged that to go back to a more centralised system of financial management would be a reversal of the system of decentralisation of financial management introduced a decade ago –

47 ANAO Audit Report No. 28, 2005-06, p. 144.

48 Department of the Senate, submission No. 1, p. 2.

That, from a parliamentary perspective, would be no bad thing. If you know that the central department has a greater role in laying down compulsory procedures which must be complied with from the point of view of financial control, then probably you would get fewer audit reports of the kind that you are looking at now, and few problems that you have to inquire into later.⁴⁹

10.78 At the hearing Finance told the Committee:

...we are currently considering whether the FMA Act is a little too complex; whether, for example, with Section 31 there are easier ways in which to achieve the objectives without setting up a mechanism such as agreement making, which, in this case, has clearly identified a number of issues in the late nineties.⁵⁰

10.79 The Committee encourages this re-examination of the best management practice for net appropriation agreements, and notes major reviews of the appropriations system more generally conducted subsequent to this review, including an inquiry by the Senate Finance and Public Administration Committee and a review being conducted by former Senator (and JCPAA member) Andrew Murray, under the auspices of the Government's "Operation Sunlight".

Committee comment: financial management in APS agencies

10.80 This audit report on *Management of Net Appropriation Agreements* was the fourth performance audit on financial management in FMA Act agencies examined by the Committee in three years.⁵¹ As in the previous three reports, this audit revealed systemic problems in accountability and transparency in expenditure of taxpayers' money. The ANAO has found that a number of agencies have breached the Constitution and sections of the FMA Act. Monies have been spent without the correct Parliamentary appropriation, and legislated reporting requirements have not been met,

49 Mr Harry Evans, Clerk of the Senate, Transcript of Evidence 29 May 2006, p. 9.

50 Ms Kathryn Campbell, Finance, Transcript of Evidence 29 May 2006, p. 5.

51 Audit Report No. 24, 2003-04: *Agency Management of Special Accounts*; was reviewed in JCPAA Report 402, tabled August 2004. Audit Report No. 15, 2004-05: *Financial Management of Special Appropriations*; was reviewed in JCPAA Report 404, tabled in November 2005. Audit Report No. 22, 2004-05: *Investment of Public Funds*, was reviewed in JCPAA Report 407, tabled September 2006.

or reporting could be significantly improved. Alarming, many of these faults have only come to light during an audit by the ANAO.

- 10.81 In evidence to the Committee the ANAO stated its concern about the pattern emerging from its audits on FMA management issues within APS agencies:

...we are already covering off a rather large portion of the outlays that come through appropriations, and we have found shortcomings in each of those audits. It would be fair to say that we do not have a great deal of confidence that agencies have actually been discharging their responsibilities, in the broad, across how they are spending money from the consolidated revenue fund.⁵²

- 10.82 At the hearing, the Clerk of the Senate also commented that the ANAO has uncovered an ongoing pattern of problems with financial management:

You have had a series of reports by the Audit Office saying there has been non-compliance, illegalities and problems of that sort. You have an underlying problem, and the Audit Office cannot report on everything all the time.⁵³

- 10.83 Finance acknowledged the series of audit reports which have found problems in financial management and compliance with the FMA Act. Finance argued that the compliance certificate, which will require agency chief executives to formally assure their Minister and the Finance Minister that they have complied with the appropriate legislation, will assist in improving compliance with the Act.⁵⁴ The Committee acknowledges that agencies have made improvements to their management of net appropriation agreements as a result of the ANAO audit findings.

- 10.84 In the Audit Report, the ANAO flagged that it will take an increased focus on legislative compliance in its future financial statement audit coverage. This will involve confirming the presence of key documents or authorities, and sample testing of relevant transactions to confirm agencies' compliance with the legislative requirements on annual appropriations, special appropriations, annotated appropriations (through Section 31 agreements) and special accounts.⁵⁵

52 Mr Brian Boyd, ANAO, Transcript of Evidence 29 May 2006, p. 14.

53 Mr Harry Evans, Clerk of the Senate, Transcript of Evidence 29 May 2006, p. 12.

54 Ms Kathryn Campbell, Finance, Transcript of Evidence, 29 May 2006, p. 13.

55 ANAO Audit Report No. 28, 2005-06, p. 133.

- 10.85 The Committee strongly supports this approach by the Audit Office and hopes that agencies have taken heed of the Audit Office's warning that compliance on these matters will be audited. This Committee will be reviewing the Audit Office's findings on this matter and may decide to pursue individual agencies further if financial statements audits or performance audits reveal ongoing compliance issues.