

## **THE FINANCIAL MANAGEMENT LEGISLATION**

### **The aims of the legislation**

- 2.1 The second reading speech provides an important insight into the Government's aims for any new piece of legislation. Both the FMA Act and the CAC Act were reintroduced to the Parliament in December 1996 by the Minister for Finance, the Hon John Fahey MP. In his second reading speech to the FMA Bill the Minister identified the aims of the legislation as providing:

... a legislative framework for effective and accountable financial management that is not only matched to the public sector environment of today, but a framework that will also be flexible enough to meet the evolutionary changes to Commonwealth financial management practices that the future will inevitably bring.<sup>1</sup>

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1 The Hon John Fahey MP, Minister for Finance, FMA Bill Second Reading Speech, House of Representatives Hansard, 12 December 1996, p. 8345.

- 2.2 As well, the legislation specified the ‘responsibilities and powers necessary for the efficient, effective and ethical use of the resources lawfully available to the Commonwealth’, and provided ‘appropriate mechanisms to ensure that the stewardship and management performance’ was visible and therefore accountable.<sup>2</sup>
- 2.3 The submission from DoFA added that the FMA Act had shed much of the prescriptive procedural content of the *Audit Act 1901* and instead focussed on the fundamental principles of financial management. It had facilitated the devolution of financial management to Commonwealth agencies.<sup>3</sup>
- 2.4 The aims of the CAC Bill identified in the second reading speech were to:
- replace the diverse accountability requirements of the CAC bodies with a single set of core requirements;
  - enable the accountability requirements to be viewed as a whole thereby significantly streamlining the focus of the Government’s and the Parliament’s interest;
  - model the provisions on comparable areas of Corporations Law and adopt best practice currently applying to individual authorities; and
  - bring the requirements for the Auditor-General’s audits of financial statements into line with those required by the Corporations Law.<sup>4</sup>
- 2.5 Similar comments were provided by Mr Maurie Kennedy, a former Senior Executive in DoFA who was involved with the development of the legislation. Mr Kennedy noted that in drafting the legislation, there was one fundamental specification, namely that it should comply with sections 81 and 83 of the Constitution—that ‘all revenues raised or received ... shall form one Consolidated Revenue Fund’, and that ‘no money shall be drawn from the Treasury ... except under appropriation made by law.’<sup>5</sup>

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2 The Hon John Fahey MP, Minister for Finance, FMA Bill Second Reading Speech, House of Representatives Hansard, 12 December 1996, pp. 8344–5.

3 DoFA, *Submission*, p. S106.

4 The Hon John Fahey MP, Minister for Finance, CAC Bill Second Reading Speech, House of Representatives Hansard, 12 December 1996, p. 8347.

5 Mr Kennedy, *Submission*, pp. S15, S18–19.

- 2.6 Mr Kennedy said that in coming to a view as to whether the legislation had been successful in meeting its aims, two questions needed to be asked:
- Is there any evidence to prove that the framework, itself, which asserted the promise of structural integrity for public sector financial management and accountability, no longer remains relevant and robust; and
  - Do the actions of the participants, operating within the framework, support that structural integrity.<sup>6</sup>
- 2.7 The Committee addresses the first question in the remainder of this chapter. (Chapter 3 discusses accountability mechanisms which impact on the second question.)

## The new accrual framework

- 2.8 There is a major division within the Commonwealth public sector between government agencies which are covered by the FMA Act and CAC Act bodies. The latter type of entity has always had a more commercial focus and more readily adopted accrual principles. Commonwealth agencies, on the other hand, have traditionally operated on a cash accounting basis. The impact of the new accrual framework, therefore, is felt more significantly by Commonwealth agencies.
- 2.9 The Committee has been a long time supporter of the move towards full accrual financial management by Commonwealth agencies. In its report into accrual accounting, tabled in August 1995, the Committee recommended:
- that the Government should commission a review to consider the merits or otherwise of a move to accrual budgets and appropriations;
  - the Government should make a statement supporting the value of accrual information for effective management; and
  - that agency heads should commit their agencies to implementing accrual financial management systems and practices.<sup>7</sup>

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<sup>6</sup> Mr Kennedy, *Submission*, pp. S20–1.

<sup>7</sup> JCPA, *Report 338, Accrual Accounting—A Cultural Change*, AGPS, Canberra, 1995, Recommendations 9, 10 and 11, pp. 72, 74.

- 2.10 In March 1996, the newly elected Government established the National Commission of Audit to investigate and report on the financial position of the Commonwealth Government. The Commission found that:
- A full accrual accounting framework [was] an essential complement to the structural and cultural change the Government [was] seeking by way of a more competitive, efficient and effective public sector.<sup>8</sup>
- 2.11 The Commission recommended that the Government should adopt ‘accrual principles as the basis for an integrated budgeting, resource management and financial reporting framework’.<sup>9</sup>
- 2.12 The Government subsequently decided in 1997 to move to an accruals-based framework with the first accrual Budget being for the 1999–2000 financial year. Appropriations would be based on the total financial resources needed to contribute to Government outcomes,<sup>10</sup> with funds being allocated for departmental items, administered items, and for equity injections.<sup>11</sup>
- 2.13 Other initiatives designed to reveal the full cost of government activities include:
- the levying of a capital use charge—to recognise the opportunity cost of capital and/or provide a rate of return to the Commonwealth on capital invested in agencies;
  - requiring agencies to insure for their operations with Comcover—superseding the practice of the Commonwealth ‘self-insuring’, ie absorbing the risk; and
  - devolved banking—requiring agencies to enter into direct arrangements with the banks.

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8 National Commission of Audit, *Report to the Commonwealth Government*, AGPS, Canberra June 1996, p. 211.

9 National Commission of Audit, *Report to the Commonwealth Government*, p. 211.

10 This includes salaries and operational expenses including depreciation and accruing employee entitlements such as long service leave.

11 DoFA, Scoping studies, guidance and publications, *Accrual Appropriation Framework*, p. 1 [<http://www.dofa.gov.au/abp/reading%5Froom/publications/Appropriations.html>], DoFA, 1999.

- 2.14 The framework would 'support competitive pricing and facilitate Government choice' and also increase flexibility to agencies because, as the guidance provided from DoFA noted:

Departmental resources will be appropriated for each agency as a single amount. Agencies will therefore be able to shift resources between outputs and outcomes. Subject to agreement by their Minister, agency managers may respecify or replace outputs with others that are more cost-effective in achieving desired outcomes. Any such changes would need to be noted in the annual report.<sup>12</sup>

- 2.15 The framework is completed by the agency annual report. Dr Peter Boxall, Secretary to DoFA told the Committee:

... there will be a read across from the appropriation bills to the portfolio budget statements through to the annual report where agencies will be reporting on their performance against key indicators. Probably for the first time we will have systematic reporting of outputs and outcomes by agencies against performance indicators, and agencies will be able to discuss where they succeeded and where they did not ...<sup>13</sup>

## Does the legislation meet the needs of the accrual framework?

- 2.16 There have recently been two pieces of legislation which have impacted on the FMA and CAC Acts:

- the *Corporate Law Economic Reform Program Act 1999* (the CLERP Act) ;  
and
- the *Financial Management Legislation Amendment Act 1999* (the FMLA Act).

- 2.17 The amendments to the CAC Act arising from the CLERP Act relate to the duties of directors. The CAC Act changes were necessary if the Act was to remain aligned with corporations law after the changes introduced by the CLERP Act.<sup>14</sup>

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12 DoFA, *Accrual Resourcing Framework*, pp. 1, 2. [[http://www.dofa.gov.au/budgetgroup/training\\_materials/accrual\\_financ.../Res\\_frwk.html](http://www.dofa.gov.au/budgetgroup/training_materials/accrual_financ.../Res_frwk.html)], DoFA, 2000

13 Dr Boxall, DoFA, *Transcript*, pp. 4-5.

14 DoFA, *Submission*, p. S109.

- 2.18 The FMLA Act directly arose from the need to accommodate the new accrual framework.<sup>15</sup> Consequently, the Committee concludes that the FMA Act as first enacted apparently did not meet the needs of the new accrual framework. The issue arising is whether the legislation as amended remains robust, whether risks remain, or whether new risks have been introduced.

### The elimination of Fund accounting

- 2.19 The FMLA Act introduced amendments to the FMA Act which took effect on 1 July 1999. The Loan Fund, Reserved Money Fund and Commercial Activities Fund were merged with the Consolidated Revenue Fund (CRF) to eliminate the need to maintain a multiple fund accounting system.
- 2.20 Fund accounting was a form of cash accounting whereby separate pools of money were set aside for specific purposes. The *Explanatory Memorandum* to the FMLA Bill argued that maintaining the system in the accrual framework would have required a dual set of accounts—one dealing with cash transactions by fund—the other dealing with accrual revenues, expenses, assets and liabilities. In addition, the new arrangements:
- would enable the use of non-lapsing accrual appropriations;
  - would not require the transfer of moneys outside the CRF to meet accrued costs; and
  - would remove the need for a central ledger and allow agencies to process and record transactions in their own accounting systems, thus facilitating the move to devolved accounting and banking arrangements.<sup>16</sup>
- 2.21 The *Explanatory Memorandum* concluded that the FMLA legislation would:
- ... eliminate obsolete accounting processes and facilitate the introduction of modern, businesslike approaches. This [was] expected to translate into more efficient and effective use of the Commonwealth's resources.<sup>17</sup>

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15 FMLA Bill, *Explanatory Memorandum*, p. 1.

16 FMLA Bill, *Explanatory Memorandum*, pp. 1–2.

17 FMLA Bill, *Explanatory Memorandum*, p. 2.

### Concerns with the elimination of Fund accounting

2.22 Mr Kennedy who assisted with the drafting of the FMA Act raised two concerns about the elimination of Fund accounting in his submission to the inquiry. These were:

- that the Commonwealth would be exposed to the provisions of Section 99 of the Constitution; and
- that the abolition of the concept of 'Received Money' and 'Drawn Money' could lead to problems.

DoFA responded to these concerns in a supplementary submission to the Committee (see paragraphs 2.27–2.28 and 2.31–2.32 below).

### Exposure to Section 94 of the Constitution

2.23 Section 94 of the Constitution states as follows:

After five years from the imposition of uniform duties of customs, the Parliament may provide, on such basis as it deems fair, for the monthly payment to the several States of all surplus revenue of the Commonwealth.

2.24 Mr Kennedy commented that in drafting the FMA Act the prospect of an accruals framework was well known, but the Reserved Money Fund, because it was not subject to annual lapsing, was seen to be able to serve as a 'holding fund' for any accrual components agencies might require.<sup>18</sup>

2.25 Mr Kennedy suggested that the Trust Fund was created in 1906 'in apparent response to the "danger" to Commonwealth finances'.<sup>19</sup> The *Surplus Revenue Case* was unsuccessfully pursued by New South Wales in 1908, and the ability of the Commonwealth to appropriate surplus amounts from the CRF to the Trust fund 'was seen as a useful mechanism'.<sup>20</sup>

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18 Mr Kennedy, *Submission*, p. S21.

19 The introduction of the FMA Act saw 'the balances of existing Trust accounts and Heads of the Trust Fund transferred to the Reserved Money Fund and the Commercial Activities Fund.' FMA Bill 1996, *Explanatory Memorandum*, p. 6.

20 Mr Kennedy, *Submission*, pp. S21–2.

2.26 In drafting the FMA Act, it had been ‘considered prudent to continue with a Fund Accounting structure.’ Mr Kennedy concluded:

With the 1999 amendments to the FMA Act resulting in there now being only the CRF, standing alone (since even the concept of Special Accounts are, themselves, regarded as part of the CRF), perhaps it will only be a matter of time, especially in a period of Commonwealth Budget surpluses, before one or more of the States seeks to raise the Section 94 issue again.<sup>21</sup>

2.27 DoFA’s response to this issue was that under the old provisions the cash balances of the funds had to be monitored daily to ensure that temporary shortfalls in particular funds were met by ‘borrowing’ from funds in surplus. To have maintained the fund accounting system in the environment of the new framework:

... would have been expensive and wasteful because the information derived from the system underpinning the fund accounting structure would not have been used for decision-making either in relation to the Budget or financial management.<sup>22</sup>

2.28 Regarding the abolition of the funds structure and the risks imposed through the operation of Section 94 of the Constitution, DoFA advised that it had been aware of the *Surplus Revenue Case* and had given the issue ‘very serious and comprehensive consideration.’ Both the Australian Government Solicitor and the Solicitor-General had been consulted and their firmly held view was that:

... the existence of current accrual appropriations in excess of the balance of the Consolidated Revenue Fund will prevent the latter from being characterised as ‘surplus revenue’ for the purposes of section 94 of the Constitution.<sup>23</sup>

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21 Mr Kennedy, *Submission*, p. S23.

22 DoFA, *Submission*, p. S283.

23 DoFA, *Submission*, p. S283.



### Elimination of the categories of 'Received Money' and 'Drawn Money'

- 2.29 'Received Money' and 'Drawn Money' are defined, respectively, as:
- money received by the Commonwealth but which had not been transmitted by an agency to the central bank account to be a credit to the CRF; and
  - money drawn down against a particular Fund but which was still in the Commonwealth's possession, for example advances held by agencies or amounts in bank accounts representing the unrepresented cheque float.<sup>24</sup>
- 2.30 Mr Kennedy raised two concerns regarding the abolition of these categories through the recent amendments to the FMA Act. These were:
- agencies could draw against appropriations to accumulate 'hollow logs' of surplus cash in the guise of advances—the FMA Act had stipulated that uncommitted advances would lapse when their originating appropriation lapsed and the money would be recredited to the CRF as Received Money; and
  - the lack of distinction of received and drawn money would allow agencies to pool money and then 'inadvertently or deliberately,' use Received Money for expenditure, heightening the 'risk of spending that is unsupported by an appropriation.'<sup>25</sup>
- 2.31 DoFA responded that its tight system of controls on agency and Commonwealth authority bank accounts would result in the immediate identification of accumulating hollow logs. The system:
- regulated the flow of cash in line with the delivery of outputs and the timing of administered payments;
  - swept surplus cash in departmental or administered bank accounts to the Commonwealth's central account overnight;
  - ensured that departmental payments accorded to a drawdown schedule agreed to by DoFA;
  - provided incentives for money received as accrued costs to be placed on term deposit with the Reserve Bank; and
  - where agencies had private sector bankers, core protocols required daily reports on the balance of every official bank account, enabling

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<sup>24</sup> Mr Kennedy, *Submission*, p. S22.

<sup>25</sup> Mr Kennedy, *Submission*, p. S22.

identification of excessive balances which may be due to excessive rates of drawdown.<sup>26</sup>

- 2.32 Regarding the possible inadvertent mixing and using received money for expenditure, DoFA added that this would be prevented because:
- the newly prescribed bank account structures required separation of departmental money, drawn administered money, and administered receipts; and
  - the Finance Minister's Orders ensured accounts and records are kept in such a way that moneys were 'only expended for the purpose for which they [were] appropriated and that the limit on any appropriation [was] not exceeded.'<sup>27</sup>

#### The Committee's conclusion

- 2.33 The Committee is satisfied with DoFA's response to Mr Kennedy's concerns about section 94 of the Constitution. However, there still remains a risk, albeit minimal according to DoFA's advice, that the increased incidence of future Commonwealth surpluses will tempt the states to revisit the issue.
- 2.34 From July 1999, agencies are able to bank with the Reserve Bank of Australia or use the service of private banks. DoFA claims its system of controls outlined in its submission and underpinned by its *Agency Banking Framework—Guidance Manual*<sup>28</sup> are robust. The Committee notes the core requirements to be entered into with private banks appended to the manual are detailed and comprehensive. Nevertheless, as increasing numbers of agencies enter into banking agreements, DoFA will need to maintain its vigilance to ensure protocols are entered into and adhered to. The Committee also draws the attention of the Auditor-General to the possibility that monies could be spent without an appropriation and to the need to ensure that the departmental systems in place are effective.
- 2.35 Notwithstanding DoFA's controls, the Committee notes that accumulating hollow logs may be difficult to detect in the new accrual budgeting environment where money is appropriated for high level outcomes and there is flexibility to reallocate money between outputs.

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26 DoFA, *Submission*, p. S284.

27 DoFA, *Submission*, p. S284.

28 DoFA, *Agency Banking Framework—Guidance Manual*, [[http://www.dofa.gov.au/budgetgroup/policies/guidance\\_and\\_manuals/agency\\_banking\\_framework/agency\\_banking\\_framework.doc](http://www.dofa.gov.au/budgetgroup/policies/guidance_and_manuals/agency_banking_framework/agency_banking_framework.doc)], DoFA, 2000.

## Does the legislation meet the needs of the public sector?

- 2.36 In coming to a view as to whether the Commonwealth's financial management legislation has met the needs of the public sector the Committee notes that the provisions have been in place for a relatively short period of time. However, the Committee has received a significant number of submissions and has also been provided with a summary of the results of the DoFA survey of the legislation.<sup>29</sup>
- 2.37 Dr Diana Wright, General Manager, Resource Management Framework, DoFA, told the Committee that the DoFA survey results indicated that the Acts were working well, but that it was too soon for more strategic, longer term issues to arise.<sup>30</sup>
- 2.38 From the comments in the submissions provided to the inquiry, the Committee agrees that in general the Acts are working well. However, several specific issues were raised with the Committee at the public hearing relating to the operations of the CAC Act and have broader implications. The issues, which are discussed below, are:
- the definition of officers;
  - the indemnification of officers and employees;
  - the use of insider information by directors; and
  - restrictions on investments of research and development corporations.
- 2.39 Other issues which were raised in evidence are presented in Appendix D together with the response from DoFA.

### The definition of officers

- 2.40 Section 5 of the CAC Act defines an officer of an authority as:
- a) a director of the authority; or
  - b) any other person who is concerned in, or takes part in, the management of the authority.
- 2.41 The submission from CSIRO referred to legal advice from the Attorney-General's Office of General Counsel which indicated that the definition could capture more than the limited range of senior officers within CSIRO.

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<sup>29</sup> DoFA, *Submission*, pp. S335–58.

<sup>30</sup> Dr Wright, DoFA, *Transcript*, p. 9.

- Those possibly falling within the CAC Act were the advisers on CSIRO's sector advisory committees.<sup>31</sup>
- 2.42 Ms Michelle Narracott, Manager Legal Affairs, CSIRO, told the Committee that the advisory committees included some 200 people from industry and the community who assisted CSIRO with its strategic research direction. She believed that it was not the intention of the legislation's explanatory memorandum for these people to fall within the definition of CSIRO officer.<sup>32</sup>
- 2.43 There were two consequences of this broad definition of officer:
- the knowledge that they could be subject to the criminal and civil sections of the CAC Act could deter potential members of the advisory committees from accepting appointment; and
  - arranging indemnity insurance for each of these potential officers was an 'expensive and intensive exercise.'<sup>33</sup>
- 2.44 After the public hearing, CSIRO provided to the Committee, as confidential exhibits, the original legal advice and subsequent confirmatory advice sought after the hearing from the Office of General Council.
- 2.45 In its supplementary submission, DoFA stated that the CAC Act placed high level advisers to CSIRO in exactly the same position as advisers to any Australian company. DoFA noted that the penalty regime in the CAC Act relating to conduct replicated the penalty regime in the Corporations Law and related to conflicts of interests, acting honestly, exercising care and diligence and using insider information.<sup>34</sup>
- 2.46 The Committee notes that the explanatory memorandum to the CAC Act comments that the:
- ... definition of "officer" is intended to align the meaning of the term with its meaning in the provisions of the Corporations Law relating to conduct.<sup>35</sup>
- 2.47 Section 232 of the Corporations Law concerning the 'duty and liability of officer of corporation' defines officer to be 'a director, secretary or executive officer of the corporation.' Section 9 defines executive officer as:

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31 CSIRO, *Submission*, p. S213.

32 Ms Narracott, CSIRO, *Transcript*, p. 111.

33 CSIRO, *Submission*, p. S213.

34 DoFA, *Submission*, p. S305.

35 CAC Bill 1996, *Explanatory Memorandum*, p. 3.

... a person, by whatever name called and whether or not a director of the body or entity, who is concerned, or takes part, in the management of the body or entity.

- 2.48 The Committee agrees that the provisions of the CAC Act are aligned with those of Corporations Law and notes that many Australian companies have high level advisers who, it appears, may be captured by the legislation. The Committee is unaware whether or not Australian companies have difficulty with this provision so has not formed a view on this issue.
- 2.49 The recent amendments to the Corporations Law have resulted in a substantial consequential expansion of the sections in the CAC Act dealing with the conduct of officers. The Committee believes the greater detail concerning what is expected of officers will provide reassurance to those asked to become advisers to CSIRO.

### **Indemnifying officers and employees**

- 2.50 Section 26 of the CAC Act contains various provisions dealing with the indemnification of serving or past officers of a Commonwealth authority or its subsidiary against liability arising from their actions performed in their capacity as an officer of the authority or subsidiary. Witnesses from the ABC and CSIRO elaborated on two concerns when they appeared before the Committee:
- the inability to indemnify ABC officers against adverse ‘in good faith’ findings in defamation proceedings; and
  - possible inconsistency with legislation in three states which allows employers to indemnify employees.

### **Indemnity of ABC officers to adverse ‘in good faith’ findings**

- 2.51 Subsection 26(1)(b) of the CAC Act prevents a Commonwealth authority from indemnifying an officer for a liability to another person ‘arising out of conduct involving a lack of good faith.’
- 2.52 The ABC advised the Committee that it indemnifies its employees in relation to defamation actions brought against them because of their involvement in preparing broadcast materials.<sup>36</sup> Defamation defences involve the concept of ‘good faith’ which is defined:

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<sup>36</sup> ABC, *Submission*, p. S83.

... in terms of whether the matter was relevant to the discussion, the manner and extent of publication, the motivation of the person making the publication and the belief in the truth or otherwise of the matter.<sup>37</sup>

- 2.53 Ms Judith Walker, General Manager, Legal and Copyright, ABC, told the Committee that if the defence failed and the tribunal found there was a 'lack of good faith' it was not necessarily because of dishonesty or a lack of belief in what was published. Such findings, which would only become apparent at the end of the case, would invalidate the indemnity and the employee could incur substantial damages.<sup>38</sup> The issue was whether the lack of good faith in the CAC Act was identical to that envisaged in defamation cases.<sup>39</sup>
- 2.54 Ms Walker added that the ABC had corresponded with the Attorney-General's Department on the issue, but she felt Attorney-General's had difficulty in appreciating the problem which the legislation posed to the ABC. While it was not a 'big issue in the scheme of things' it could easily be remedied by a simple exemption.<sup>40</sup>
- 2.55 In its submission to the Committee, DoFA responded that:
- ... the [CAC] Act's provisions relating to indemnity and insurance, replicate equivalent provisions in the Corporations Law. Accordingly, officers of the ABC are placed in the same position as officers of media companies in the private sector with respect to the laws of defamation.<sup>41</sup>
- 2.56 With respect to indemnification, the Committee does not believe that the ABC should be given an advantage in relation to private sector media companies. However, the issue of possible inconsistency remains and the Committee believes that legislative clarification is more desirable than awaiting future litigation to determine the issue. The Committee returns to this issue later in this chapter.

### **Inconsistency with state legislation allowing indemnification of employees**

- 2.57 Ms Michelle Narracott, Manager Legal Affairs CSIRO, told the Committee that indemnification had become an issue for CSIRO because it wished to ensure that all classes of its staff, CAC Act officers and general staff, were
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37 Ms Walker, ABC, *Transcript*, p. 83.

38 Ms Walker, ABC, *Transcript*, p. 83.

39 ABC, *Submission*, p. S83.

40 Ms Walker, ABC, *Transcript*, p. 84.

41 DoFA, *Submission*, p. S314.

indemnified in the event they were sued as a result of their duties. A consequent review of CSIRO's indemnification arrangements had uncovered a possible anomaly between the CAC Act and legislation in three other Australian jurisdictions.<sup>42</sup>

2.58 CSIRO advised that the common law had been modified in three jurisdictions to allow employers to indemnify employees except where the employee was guilty of serious, willful or gross misconduct.<sup>43</sup> The CAC Act allowed indemnification of **officers** to third parties while acting in good faith, but it was unclear whether this impacted on the legal right afforded to all **employees**, other than CAC Act officers, in these three jurisdictions. The uncertainty arose because section 109 of the Constitution stipulates that where inconsistency exists, Commonwealth laws override state laws.<sup>44</sup>

2.59 CSIRO advocated that:

... staff of an authority should be governed on the same or similar terms and conditions and should be governed by the same laws regardless of the State or Territory in which they are employed or reside ...

and recommended that:

... the Attorney-General provide advice on the uncertainty which has resulted from the introduction of special indemnification provisions for some classes of Commonwealth officers, with a view to clarifying through legislation the position of all officers.<sup>45</sup>

2.60 DoFA responded in its submission that the definition of 'officer' in the CAC Act and provisions relating to indemnity and insurance replicated the Corporations Law and that CSIRO officers were placed in the same position as officers of any large private sector company which had operations extending throughout the country.<sup>46</sup>

2.61 The Committee notes that the recent amendments to the CAC Act have added to the section relating to indemnification. Subsection 27M(1) provides the power to indemnify officers but makes no reference to employees.

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42 Ms Narracott, CSIRO, *Transcript*, pp. 111, 113.

43 The three jurisdictions are New South Wales, South Australia, and the Northern Territory.

44 CSIRO, *Submission*, p. S214.

45 CSIRO, *Submission*, p. S214.

46 DoFA, *Submission*, p. S314.

- 2.62 The Committee concludes that DoFA's comment has not advanced resolution of the issue and that there may, as CSIRO has suggested, be a possible inconsistency between Commonwealth and state laws.

### The use of insider information by directors

- 2.63 Subsection 23(1) of the CAC Act stipulates that officers of an authority must not make **improper** use of inside information to gain an advantage for themselves or others or to cause detriment to the authority or another person. Subsection 23(2) provides that the actions of public servants in the normal discharge of their duties cannot be regarded as **improper**. The definition of public servant was the same as under the Public Service Act which excludes employees of CAC Act bodies.
- 2.64 CSIRO stated that its officers serving alongside departmental officers on Commonwealth boards would not receive the same protection as departmental officers, and that there seemed to be 'no valid reason for drawing this distinction.'<sup>47</sup> Ms Narracott told the Committee that CSIRO believed it was 'a mere technical hitch'. She added that although it was not of widespread concern because only a few CSIRO officers were involved, for those individuals it was 'quite an issue.'<sup>48</sup>
- 2.65 DoFA's response was that the CAC Act placed CSIRO officers who serve on Commonwealth authority boards in the same position as officers of companies who serve on the boards of other companies. Subsection 23(2) recognised that departmental officers were placed in a unique position. Such officers were:
- ... expected to have regard to the wider national interest, rather than the interests of the authority, when engaged in policy discussions within their department or providing advice to their Minister.<sup>49</sup>
- 2.66 DoFA also noted that the subsection did not exempt departmental officers from subsection 23(1), it merely protected them where there was a conflict between their role as a director and their role as a departmental officer.<sup>50</sup>
- 2.67 Recent amendments to the CAC Act have expanded and clarified the provisions concerned with the duty of officers. Subsection 27A(2) provides relief to public servants who become officers of an authority—if they act in

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47 CSIRO, *Submission*, p. S215.

48 Ms Narracott, CSIRO, *Transcript*, p. 113.

49 DoFA, *Submission*, p. S311.

50 DoFA, *Submission*, p. S311.



accordance with the duties expected of them as public servants, they do not contravene the sections of the CAC Act requiring them to act in the best interests of the authority.

- 2.68 In the Committee's view the provision is particularly clear in confirming that the primary allegiance of department officers serving as a directors of authorities is to their department. The Committee considers that the distinction between the corporate entity on the one hand and the individual on the other is valid.

### **Restrictions on the investments of research and development corporations**

- 2.69 Section 18 of the CAC Act limits the investment strategies allowed for authorities to bank deposits; securities of the Commonwealth, state or territory; or securities guaranteed by the Commonwealth, state or territory; or in any manner approved by the Treasurer. Section 19 concerns GBEs and statutory marketing authorities (SMAs) and, while it is similar to section 18, it allows them to invest in any manner 'consistent with sound commercial practice.'
- 2.70 The Grains Research and Development Corporation (GR&DC), which falls within section 18, argued that it should be permitted the flexibility of section 19 bodies.<sup>51</sup>
- 2.71 The GR&DC is jointly funded by grower levies and the Commonwealth and currently has reserves of about \$128 million. Mr Vincent Logan, Manager, Business and Finance, told the Committee that the investment policy of the GR&DC was fairly conservative to ensure funds were available for its forward commitments. However, the corporation felt its investment strategy was constrained by the legislation.<sup>52</sup>
- 2.72 DoFA's response was that the rationale for the greater flexibility provided to GBEs and SMAs was that they were not Budget dependent, and that research and development corporations 'are subject to section 18 on the basis that they are funded partially by levies on primary producers and partially by the Budget.'<sup>53</sup>

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51 GR&DC, *Submission*, p. S4.

52 Mr Logan, GR&DC, *Transcript*, pp. 91-2.

53 DoFA, *Submission*, p. S308.

- 2.73 The issue of sections 18 and 19 were first raised with the Committee when it reviewed the legislation in 1994. At that time the Committee concluded that Commonwealth authorities were not so commercially orientated as GBEs or SMAs and should be required to invest surplus money conservatively.<sup>54</sup>
- 2.74 The Committee has not changed its view on the matter and adds that a struggling primary producer being levied at one per cent net farm gate value would not be happy if the GR&DC lost money on risky investments. As well, the Committee notes that if the GR&DC was to substantially better the approximate \$7 million return in 1998–99 on the investment of its reserves, it would need to employ a high risk investment strategy.<sup>55</sup>

### Committee's conclusion

- 2.75 The Committee concludes that in general the legislation meets the needs of the Commonwealth public sector. Problems that do arise stem from the nature of the Acts themselves because they were constructed as generalised legislation designed to cover the two types of public sector entity.
- 2.76 For example, Mr Kennedy told the Committee that the FMA Act was 'principles based' legislation, with flexibility provided by the subsidiary legislation which could be amended to reflect further changes in circumstances.<sup>56</sup> As Mr Kennedy said:
- One of the essences of this legislation is that it enables one size not to fit all.<sup>57</sup>
- 2.77 The same applies to the CAC Act which focuses on establishing a 'set of uniform reporting and accountability requirements for financially separate Commonwealth authorities' and stipulates additional requirements for Commonwealth companies which were not applied by Corporations Law.<sup>58</sup>

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54 JCPA, *Report 331*, pp. 43–4.

55 *Transcript*, pp. 97, 109.

56 Mr Kennedy, *Submission*, p. S23.

57 Mr Kennedy, *Transcript*, p. 51.

58 Mr Kennedy, *Submission*, p. S19.

- 2.78 Unfortunately, as with all generalised legislation there will be exceptions—agencies and CAC Act bodies where aspects of the legislation will not meet their particular needs. The Committee comments that it is a credit to the drafters of the legislation that these exceptions, judging from evidence to the inquiry, are relatively few in number.
- 2.79 For particular entities, nevertheless, the issue can be significant. In several instances detailed in Appendix D, the solution offered by DoFA is for the concerned CAC Act body to raise the issue with its portfolio minister with a view to amending its enabling legislation. The Committee considers this an appropriate avenue because if the CAC Act was amended to accommodate concerns of particular entities, it would defeat the objective of the legislation to be broad and overarching.
- 2.80 However several concerns have raised the issue of consistency with other legislation. This is discussed further below.

## Consistency with other legislation

### Consistency with financial management legislation in the States

- 2.81 The various jurisdictions within Australia are moving to introduce accrual principles for public sector management. Consequently, a degree of consistency already exists in financial management requirements because of consistency of accounting standards, accrual measurements and charts of accounts.<sup>59</sup> However, the submission from DoFA advised that the details of the legislation vary significantly between jurisdictions.<sup>60</sup>
- 2.82 Arguments for introducing greater consistency put to the Committee included the following points:
- it would enable cross-jurisdictional comparisons between the government activities, provided there was a consistent set of principles to ensure consistent reporting;<sup>61</sup>
  - it would reduce confusion for national and international stakeholders;<sup>62</sup> and

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59 ATO, *Submission*, p. S46.

60 DoFA, *Submission*, p. S113.

61 Aboriginal and Torres Strait Islander Commission, *Submission*, p. S265.

62 Department of Health and Aged Care, *Submission*, p. S183.

- for entities with stakeholders comprising different jurisdictions, such as the Snowy Mountains Hydro-Electric Authority (SMHEA),<sup>63</sup> consistency between legislative frameworks would reduce administration, reporting and management costs.<sup>64</sup>
- 2.83 The submission from the ANAO commented that there were no compelling reasons or significant benefits to be gained from closer alignment across jurisdictions. Regarding CAC Act bodies, the ANAO considered it was appropriate that the CAC Act was consistent with Corporations Law.<sup>65</sup>
- 2.84 The submission from the Department of Education, Training and Youth Affairs pointed to practical impediments to achieving consistency, for example:
- the various jurisdictions being at different stages in implementing the accrual framework and outcomes budgeting; and
  - the different treatments chosen by the jurisdictions, for example devolved banking, and liability for employee entitlements.<sup>66</sup>
- 2.85 The submission from DoFA noted that the Commonwealth was at ‘the forefront of legislation both in relation to the devolution of decision making and accountability for results’, and that:
- At this stage in the evolution of public sector administration in Australia, any initiative aimed at achieving consistency with legislation of the States would have the potential to become a pedantic and time-consuming exercise.<sup>67</sup>
- 2.86 The Committee believes that there would be benefit in consistency in the financial management legislation across Australia as it would assist in the comparison of the performance of similar public sector bodies. Such comparisons would be useful to those wishing to identify best practice and set benchmarks for government performance.

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63 The SMHEA has a governance arrangement with the Commonwealth, New South Wales, and Victoria. SMHEA, *Submission*, p. S269.

64 Austrade, *Submission*, p. S228.

65 ANAO, *Submission*, p. S59.

66 DETYA, *Submission*, p. S142.

67 DoFA, *Submission*, p. S113.

- 2.87 For the CAC Act, consistency already exists to a certain extent because of alignment to Corporations Law. For the FMA Act closer cross-jurisdictional consistency might be of value. However, the Committee considers apparent benefits would be limited and probably would not warrant the likely costs of undertaking such an initiative at the present time.
- 2.88 In conclusion, the Committee notes that it is important when comparing the performance of government entities across jurisdictions to be aware of the implications of differences in the various pieces of legislation.

### Consistency with other Commonwealth and state legislation

- 2.89 Evidence to the Committee's inquiry has revealed that there may be inconsistency between the FMA and CAC Acts and other Commonwealth and state legislation. Three possible inconsistencies drawn to the Committee's attention were:
- the concept of a lack of good faith in the CAC Act which may differ from that applying to findings of a lack of good faith in defamation legislation (discussed above);
  - whether the ability to indemnify officers, rather than employees, under the CAC Act impacts on the indemnification of employees in three Australian jurisdictions (discussed above); and
  - the inconsistency in the terminology used in the FMA Act and CAC Act and the Public Service Act and Parliamentary Service Act (discussed below).

### Inconsistency in terminology

- 2.90 Submissions from the ANAO and the Parliamentary Departments cited examples where terminology in the FMA Act differed from terminology used in the then Public Service Bill.<sup>68,69</sup> The terms referred to included, 'official', 'employee', 'chief executive', 'secretary'.
- 2.91 The submission from the ANAO commented that it was desirable that the legislation covering financial and human resource management were consistent and complementary in order to promote effective public

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68 ANAO, *Submission*, p. S59; Parliamentary Departments, *Submission*, p. S151.

69 New legislation in the form of the *Public Service Act 1999* and the complementary *Parliamentary Service Act 1999* came into effect on 5 December 1999.

administration.<sup>70</sup> Mr Rob Johnston, Chair of the Senior Management Coordination Group, Parliamentary Departments, told the Committee:

We need to use consistent language not just to make it easier for bureaucrats to understand—because where you have inconsistent language you have to look up definitions to see whether there is any difference—but also for the application of legal principles. For instance, in one act there is a finding that a particular term means a particular thing, and consistency in language makes it easier to apply that term to the other act.<sup>71</sup>

2.92 Responding to the issue, DoFA supported the principle of more consistent terminology used to describe the corporate governance framework of the Commonwealth. DoFA's submission noted that an issue was whether the standard terminology should be the traditional public service terminology used in the public service legislation or whether the terminology of the private sector should be adopted, as represented by that used in the FMA and CAC Acts.

2.93 DoFA supported the retention of the private sector terminology used in the FMA and CAC Acts, adding that:

The broad alignment of the corporate governance framework of the Commonwealth sector with that of the private sector, as provided for in the Corporations Law and the Stock Exchange Listing Rules, facilitates a common understanding of roles and movement of skilled resources between the two sectors.<sup>72</sup>

2.94 Responding to DoFA's comment, PM&C stated that it also supported the application of common terminology where there was 'not a case for distinguishing between roles.' PM&C's submission added:

The Department considers that Secretaries have a distinctive and defined role under the Public Service Act that, while not conflicting in any way with the responsibilities of a Chief Executive Officer under the FMA Act, warrants the retention of the separate title.<sup>73</sup>

2.95 The Committee notes that the reforms to the public sector have been premised in part on the desire to encourage the public sector to adopt a more commercial focus. Consistent with this principle, when there are

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70 ANAO, *Submission*, p. S59.

71 Mr Johnston, Parliamentary Departments, *Transcript*, p. 66.

72 DoFA, *Submission*, p. S287.

73 PM&C, *Submission*, p. S360.

future amendments to the Public Service and Parliamentary Service Acts, opportunity should be taken to more closely align the terminology to that used by the financial management legislation.

### The Committee's conclusion

- 2.96 The Committee believes the inconsistencies that have been revealed in the evidence to the inquiry deserve to be addressed. Because the CAC Act is aligned with the Corporations Law (which falls within the Treasury portfolio), addressing the possible inconsistency with state legislation regarding defamation and indemnification of employees will involve consultations between Commonwealth and state agencies.
- 2.97 Reducing the inconsistency in terminology between the Commonwealth's financial management legislation and the public and parliamentary service legislation is an easier proposition involving just Commonwealth agencies.
- 2.98 In framing its recommendations the Committee notes that several pieces of legislation are new or have been recently amended, and acknowledges that the issues are not sufficiently urgent to warrant immediate attention. The Committee considers therefore that when the legislation is amended in the future, opportunity should be taken to address the issues of inconsistency that have been identified.

### Recommendation 1

- 2.99 **The Department of Finance and Administration and the Department of the Treasury, should consult with their equivalent state agencies with a view to addressing possible inconsistencies regarding defamation and indemnity legislation identified in this inquiry.**

### Recommendation 2

- 2.100 **The Department of Finance and Administration and the Department of Prime Minister and Cabinet should review the terminology of Commonwealth's financial management legislation and the public and parliamentary service legislation with a view to removing inconsistency and increasing consistency with the terminology used by the private sector.**

## The impact of devolution

- 2.101 Devolution has given FMA Act agency heads more responsibility for decision making and has removed some functions from central agencies. Two consequences of devolution put to the Committee by witnesses were that:
- the assumption of additional liabilities by chief executives may lead to an increase in a risk adverse attitude;<sup>74</sup> and
  - agencies have duplicated the creation of documentation and functions.<sup>75</sup>
- 2.102 The Committee comments on the first issue in the discussion of the accountability of chief executives in the next chapter.
- 2.103 The submission from the National Crime Authority (NCA) argued that the duplication due to devolution disproportionately affected smaller agencies. The issuing of instructions and procedural rules and the devolution of functions from central agencies such as banking, purchasing, central pay and accounting systems placed considerable resource pressure on small agencies. While strongly supporting accountability to the Parliament, the NCA's submission stated that:
- ... in a devolved environment there is a risk that some processes provide little real accountability while consuming significant resources and limiting primary activities.<sup>76</sup>
- 2.104 The NCA's submission also questioned the cost effectiveness for small agencies of the proposed devolved banking arrangements because small agencies would be unable to obtain the same fee structure as larger agencies. Seeking a whole of government tender from the private sector banks would have been the best strategy the submission concluded.<sup>77</sup>
- 2.105 A solution to the dilemmas faced by small agencies and others was presented by the Parliamentary Departments. Mr Johnston advised that the five departments had formed an alliance to increase their bargaining power when approaching goods and service providers. The departments jointly purchased personal computers and had a common travel contract.<sup>78</sup>

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74 Dr Boxall, DoFA, *Transcript*, p. 8.

75 Mr Broome, NCA, *Transcript*, p. 42.

76 NCA, *Submission*, p. S34.

77 NCA, *Submission*, p. S37.

78 Mr Johnston, Parliamentary Departments, *Transcript*, p. 68.



- 2.106 The sharing by non-competing agencies of scarce resources or expertise such as accountants was also advocated in the submission from the Australian Taxation Office.<sup>79</sup>
- 2.107 While the assessment of the merits or otherwise of the Government's policy of devolving responsibility to agencies is beyond its terms of reference, the Committee offers the following comments:
- devolution enables agencies to respond to their particular circumstances in a timely manner thus increasing their effectiveness and providing savings;
  - from a whole of government view, devolution may provide overall savings even though there may be increased costs for some agency activities;
  - the creation of duplicated functions within public sector agencies may spread the available expertise too thinly, thereby introducing future risks to the Commonwealth;<sup>80</sup> and
  - the forming of alliances by agencies to share information and increase leverage with suppliers may offer a way to overcome any of the disadvantages of devolution.

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<sup>79</sup> ATO, *Submission*, p. S47.

<sup>80</sup> The Committee is currently inquiring into contract management in the public sector, seeking to determine whether a lack of expertise in this area has increased the risks to the Commonwealth.