



31 March 2005

Mr Alistair Sands
Secretary
Senate Finance and Public Administration
Legislation Committee
Parliament House
Canberra ACT 2600

Dear Mr Sands

Questions on Notice – Senator Sherry

The Australian National Audit Office (ANAO) has been requested by the Department of Prime Minister and Cabinet (PM&C) to respond to you in relation to question numbers PM 16, 17, 18 and 19.

The ANAO response is attached. Should you wish to discuss any aspect of this response, please contact Denzil Bourne on 02 6203 7661.

Yours sincerely

Warren Cochrane
Acting Deputy Auditor - General

Copy to: Department of Prime Minister and Cabinet (letter only)

Responses to Questions on Notice – PM16, 17 18 and 19, Senator Sherry, 14 February 2005

PM 16 Senator Sherry raised a question, in respect of the Department of Defence, regarding the items which were subject to a qualification in 2003-04, namely General Stores Inventory and Repairable Items. Senator Sherry asked the ANAO to provide the list.

Answer:

At the time of Senator Sherry's request for the ANAO to provide a list of items that were subject to qualification in 2003-04, the then Deputy Auditor-General undertook to provide the list but made the point that it may be preferable for Defence to provide it.

Having examined the request further, the ANAO, bearing in mind potential security issues, considers that Defence is best placed to provide the Committee with the list, which is attached to, and summarised in, separate but specific management letters for each site at which the ANAO conducted a stocktake. The following does however provide an overview of the specific categories of audit interest.

Background

The background to the audit findings associated with the financial statement audit of Defence is shown below.

The Australian National Audit Office (ANAO) is responsible for conducting the financial statement audit of the Department of Defence (Defence).

As part of the overall 2003-04 financial statement audit process, the ANAO performed audit procedures on the asset classes disclosed as Inventory and Specialist Military Equipment; the reported value of these asset classes at 30 June 2004 is \$4.4 billion and \$30.6 billion respectively. Specifically, *inter alia*, the ANAO conducted a series of stocktakes at a number of Defence establishments, focussing on:

- General Stores Inventory (a component of the Inventory asset class);
- Explosive Ordnance Inventory (a component of the Inventory asset class); and
- Repairable Items (a component of the Specialist Military Equipment class).

A stocktake program covering the above asset components is conducted on an annual basis. Specific Defence establishments at which the stocktakes are performed are chosen following the consideration of materiality and risk factors. Regarding the 2003-04 audit, an ANAO stocktake was performed at the following Defence establishments, covering the noted asset classes:

- Defence National Storage Distribution Centre (DNSDC) Moorebank (covering General Stores Inventory and Repairable Items);
- RAAF Base Amberley (covering General Stores Inventory and Repairable Items);
- RAAF Base Townsville (covering General Stores Inventory and Repairable Items);
- Defence Establishment Orchard Hills (covering Explosive Ordnance Inventory);
- Joint Ammunition Logistics Organisation (JALO) Depot Townsville (covering Explosive Ordnance Inventory); and

- Joint Ammunition Logistics Organisation (JALO) Depot Stirling (covering Explosive Ordnance Inventory).

The above Defence establishments account for approximately 41% of the reported balance of General Stores Inventory, 49% of the reported balance of Repairable Item's that are managed at Defence warehouses, and 47% of the reported balance of Explosive Ordnance Inventory.

The objective of the ANAO stocktake process is to determine the level of reliance that can be placed on the *quantity* information recorded in the Defence systems at a point in time, for financial reporting purposes. The stocktake review at the above Defence establishments included the following processes:

- A review and assessment of Defence management policies, systems and procedures surrounding the maintenance and reporting of General Stores Inventory, Explosive Ordnance Inventory and Repairable Item balances;
- A review of the causes underlying stock record inaccuracies; and
- A physical stocktake, based on a sample of stock items. These stock items are commonly referred to as Nato Item Identification Numbers (NIINs). Each NIIN is a discrete item within the sample.

The stocktakes are based on a sample of NIINs that are selected from the respective information system, and then verified to what is physically on stock at the Defence establishments. The sampling methodology used for the stocktake was a statistical sampling technique commonly used by major accounting firms world wide, including those contracted by Defence.

A summary of the average error rates, based on the sample of NATO Item Identification Numbers (NIINs) selected for verification, is below. They represent the percentage of NIINs from the sample selected that contained an error. These results have been reported to Defence during the 2003-04 audit. The findings, and the associated inventory and asset management issues were summarised in separate site visit management letters that were issued to Defence between 7 June and 28 July 2004. Defence management responses to each of these management letters were received on 10 February 2005.

Defence Establishment	Percentage of NIINs in the sample that contained a quantity error (note 1)	
	General Stores Inventory	Repairable Items
DNSDC Moorebank	37%	29%
RAAF Amberley	25%	49%
RAAF Townsville	16%	9%

Note 1 – a representation of the number of NIINs that contained a quantity error from the sample selected. The extent of the discrepancy for each NIIN is not included in the above table as these varied for each NIIN. A quantity error occurs where there is a discrepancy between the 'total stock recorded on the information system (ie SDSS)' and the 'total physical stock on hand'. The extent of errors were, in financial and operational terms, materially significant, which culminated in the audit scope limitations on the Department's financial statements.

In addition to the ANAO stocktakes, Defence, through its internal audit program and separate quality assurance reviews, also completed a series of stocktakes in 2003-04. Defence management also reported high error rates for the General Stores Inventory and Repairable Item components and consequently, were unable to certify the

completeness and accuracy of the General Stores Inventory and Repairable Item balance.

The quantities recorded for the Explosive Ordnance Inventory component were assessed as materially correct for financial reporting purposes. Notwithstanding this, data anomalies were also identified throughout the stocktake process, but these were not material from a financial statement perspective.

PM 17 **Senator Sherry requested a copy of the legal advice associated with Audit Report No. 15, 2004-05, *Financial Management of Special Appropriations*.**

Answer:

The original legal advice referred to in the report was requested by the Department of Finance and Administration, and the Department would need to be asked to supply it. We have however, attached Finance Circular 2004/06 of 10 June 2004, which reflects the self-executing nature of the CRF in advice to agencies. It is a faithful reflection of the substance of the legal advice.

PM 18 and 19 **Senator Sherry asked for the Surplus Revenue results for the financial years 1999-2000 to 2002-03 inclusive and their calculations, provided to the ANAO by Finance on 26 October 2004 (paragraphs 2.28 and 2.31 of the Audit Report)**

Answer:

The attached Department of Finance and Administration documents show the surplus revenue result (PM 18) and lay out the method of calculation (PM 19).

Attachment for PM 17

Finance Circular 2004/06 – Appropriations and the
Consolidated Revenue Fund



Finance Circular

No. 2004/06

To all *Financial Management and Accountability Act 1997* Agencies

Appropriations and the Consolidated Revenue Fund

Purpose

The purpose of this Finance Circular is to advise agencies about appropriations and the Consolidated Revenue Fund, following recent legal advice. Fundamentally, that advice is that an appropriation is required to support the expenditure of any money held by the Commonwealth, including special public money. Special public money includes, for example, money held by the Commonwealth on trust.

The Constitutional requirement for an appropriation

1. The Consolidated Revenue Fund (CRF) is established by section 81 of the Constitution, which provides that “all revenues or moneys raised or received by the Executive Government of the Commonwealth shall form one Consolidated Revenue Fund ...”.
2. The Commonwealth views the CRF as being self-executing in nature, meaning that all revenues or moneys (including taxes, charges, loans and trust moneys) form part of the CRF automatically upon receipt. There is no constitutional requirement for a fund called the Consolidated Revenue Fund to also be established in statute (as had previously occurred under the *Audit Act 1901*), or for amounts to be actively credited to such a fund. Rather, this money automatically forms part of the CRF directly through the operation of the Constitution.
3. Section 83 of the Constitution provides that no money may be drawn from the Treasury of the Commonwealth without a legal appropriation authority. Spending money without an appropriation is a breach of section 83 of the Constitution.
4. The purpose of sections 81 and 83 of the Constitution is to ensure that no revenues or moneys raised or received by the Commonwealth is expended otherwise than in accordance with an appropriation made by law. Money, to be drawn from the CRF for spending, must first be appropriated in a law, and that law must specify the purpose for which the money is to be spent. In this way, the constitutional concept of the CRF safeguards the Parliament’s ultimate control over public expenditure.

5. The Treasury of the Commonwealth, noted in section 83, and the CRF, referred to in section 81, apply to the same range of moneys. Essentially, the CRF is now regarded as comprising all moneys raised or received by the Commonwealth, irrespective of the capacity in which those moneys are raised or received. This means that all expenditure by the Commonwealth, including the expenditure of special public money such as money held on trust by the Commonwealth, must be supported by a valid appropriation.

6. Accordingly, it is not possible to expend money, nor to make payments from an official account, without a valid appropriation.

The Nature of Appropriations and the Role of the FMA Act

7. A valid appropriation provides the parliamentary authority to withdraw amounts from the Consolidated Revenue Fund. An appropriation must specify the purpose for which it is made and it must nominate an amount to be appropriated, or specify a formula or criteria by which the amount appropriated can be determined.

8. An appropriation has the twofold purpose. It authorises the withdrawal of particular amounts from the CRF and it also restricts the expenditure of those amounts to a particular purpose.¹

9. Section 5 of the *Financial Management and Accountability Act 1997* (FMA Act) describes an appropriation as a statutory authority to draw money from the CRF, noting that it does not matter whether a provision uses a particular term like 'appropriation' or 'appropriated'. This is consistent with the High Court's view that there is no legislative formula which must be followed to make a valid appropriation.² That is, the form of an appropriation provision is not as important as its substance.

10. Overall, therefore, the financial management framework established by the FMA Act reflects the constitutional requirement that money cannot leave the CRF without an appropriation made by law for the purposes of the Commonwealth.

11. Amounts in the CRF will equate to public money, as defined in section 5 of the FMA Act, unless a statutory exception amends the application of the definition of 'public money', such as occurs in the *Commonwealth Places (Mirror Taxes) Act 1998*. The FMA Act requires that public money must be paid into an official account. Amounts in all official accounts are part of the CRF.

12. The FMA Act also reflects constitutional requirements for withdrawing money from the CRF by stating that public money (including special public money) cannot be withdrawn from an official account without a drawing right that, in turn, requires the support of an appropriation.

Forms of Appropriations

13. Commonwealth laws authorising money to be drawn from the CRF are either annual or special appropriations. An appropriation of either kind must specify the purpose for which it is made.

¹ *Victoria v The Commonwealth and Hayden (the Australian Assistance Plan Case)* (1975) 134 CLR 338 at 392

² *Northern Suburbs General Cemetery Reserve Trust v The Commonwealth* (1992-93) 176 CLR 555 at 582.

14. Annual Appropriation Acts are the source for around 25 per cent of all Government expenditure, with 3 Acts generally prepared at the time of each Budget and a further 3 prepared as necessary at Additional Estimates.

15. Special appropriations exist in Acts that deal with particular purposes of spending, covering the remaining 75 per cent, or so, of Government spending. They can provide funding for both departmental and administered expenses. An important sub-category of special appropriations are standing appropriations, which authorise the payment of money where an entitlement exists, with the amount to be appropriated and paid having to be calculated in accordance with a law, rather than being specified as an amount in the appropriation itself.

16. Some examples of standing appropriations exist in the FMA Act, such as:

- Special Accounts: Sections 20 and 21 of the FMA Act provide the appropriation authority for expenditure up to the balance of a Special Account, whether for the purposes of making payments out of the CRF or for making notional payments within the CRF, such as between two FMA Act agencies;
- Section 28 of the FMA Act appropriates the CRF for repayments, where the repayment is required or permitted by an Act or other law, and where there is no other appropriation for the repayment; and
- Section 39 of the FMA Act provides the authority for the appropriation of the CRF for investment of public money.

Contacts

16. If you have any questions about this Finance Circular, please contact the Legislative Review Branch by email LegislativeReview@finance.gov.au. Related information can also be obtained through Finance's website: www.finance.gov.au/finframework.



Marc Mowbray-d'Arbela
Branch Manager
Legislative Review Branch
Financial Management Group

10 June 2004



Michael Culhane
Branch Manager
Finance and Banking Branch
Financial Management Group

10 June 2004

Lay out and Method of Calculation



Australian Government
Department of Finance and Administration

Reference: 04/03396
Contact: Sue Baker
Telephone: 6215 3740
e-mail: sue.baker@finance.gov.au

Mr Brian Boyd
Executive Director
Performance Audit Services Group
GPO Box 707
CANBERRA ACT 2601

Dear Mr Boyd

Performance Audit of Financial Management of Special Appropriations

You will recall that, on 10 June 2004, representatives from the Cash Management and Financial Reporting Division of the Department of Finance and Administration (Finance) met with you, in the context of the performance audit mentioned above, to discuss the existing methodology for calculation of surplus revenue under section 94 of the Constitution.

At the meeting, it was agreed that Finance would provide you with calculations, applying the methodology, for the financial years 1999-00 to 2002-03. Calculations for these financial years are now attached. We had also intended providing you with a calculation for the 2003-04 financial year but unfortunately we are unable to do so until all agencies' financial statements have been finalised and signed off. This is expected within the next two weeks, when we will provide you with a copy of this calculation.

receipt of calculation notes and incorporated in the body of the report in Division of Surplus Revenue.

Should you wish to discuss the calculations, please do not hesitate to contact Sue Baker, Acting Branch Manager, Cash Management Branch, on 6215 3740.

Yours sincerely

Anne Hazell
Division Manager
Financial Reporting and Cash Management

26 October 2004

Calculation of Surplus Revenue under Section 94 of the Constitution

As at 30 June 2000

	Amount	Amount
Material FMA Agency Cash Balances		\$3,171,442,000
Plus		
small FMA Agency cash balances		\$79,593,000
Plus		
Special Public Monies		
Equals: Audited Consolidated Revenue Fund balance		<u>\$3,251,035,000</u>
Plus		
Reserve Bank of Australia investment by AOFM out of the OPA		\$9,200,000,000
Equals: Total Revenue caught by Section 94 of the Constitution		<u>\$12,451,035,000</u>
Less		
Undrawn Appropriations – Annual Appropriations and Special Appropriations (for specified amounts)		
Previous years' annual departmental	\$161,851,788	
Previous years' administered retention	\$586,212,984	
Special appropriations	No data	<u>\$748,064,772</u>
Annual Appropriation Budget Bills		
Act 1 00-01	\$38,530,846,000	
Act 2 00-01	\$5,128,526,000	
PD Act 1 00-01	<u>\$154,492,000</u>	<u>\$43,813,864,000</u>
Standing Appropriations for Debt Repayment that are quantifiable and certain with respect to due date for payment		
• Securities issued to non-Commonwealth entities (bills, notes, bonds)	\$76,448,292,000	
• Loans	\$6,183,171,000	
• Other debt - assuming it fits the above requirements	<u>\$3,854,472,000</u>	<u>\$86,485,935,000</u>
Equals: Total Offsets		<u>\$131,047,863,772</u>
Equals: Surplus/(deficit) Revenue		<u><u>(\$118,596,828,772)</u></u>

Balance amounts confirmed as correct and balances confirmed by legal advice as being appropriate:

..... *[Signature]* Branch Manager, Cash Management

Dated ... 21/10/04

Acknowledged

..... *[Signature]* Division Manager, Financial Reporting and Cash Management

Dated 26/10/04

Calculation of Surplus Revenue under Section 94 of the Constitution

As at 30 June 2001

	Amount	Amount
Material FMA Agency Cash Balances		\$623,016,000
Plus		
small FMA Agency cash balances		\$101,030,000
Plus		
Special Public Monies		
Equals: Audited Consolidated Revenue Fund balance		<u>\$724,046,000</u>
Plus		
Reserve Bank of Australia investment by AOFM out of the OPA		\$13,400,000,000
Equals: Total Revenue caught by Section 94 of the Constitution		<u>\$14,124,046,000</u>
Less		
Undrawn Appropriations – Annual Appropriations and Special Appropriations (for specified amounts)		
Previous years' annual departmental	\$459,961,504	
Previous years' administered retention	\$1,153,746,438	
Special appropriations	No data	<u>\$1,613,707,941</u>
Annual Appropriation Budget Bills		
Act 1 01-02	\$41,425,224,000	
Act 2 01-02	\$4,524,716,000	
PD Act 1 01-02	\$164,761,000	<u>\$46,114,701,000</u>
Standing Appropriations for Debt Repayment that are quantifiable and certain with respect to due date for payment		
• Securities issued to non-Commonwealth entities (bills, notes, bonds)	\$67,338,340,000	
• Loans	\$6,379,762,000	
• Other debt - assuming it fits the above requirements	\$5,669,641,000	<u>\$79,387,743,000</u>
Equals: Total Offsets		<u>\$127,116,151,941</u>
Equals: Surplus/(deficit) Revenue		<u><u>(\$112,992,105,941)</u></u>

Balance amounts confirmed as correct and balances confirmed by legal advice as being appropriate:

..... *[Signature]* Branch Manager, Cash Management

Dated 21/10/04

Acknowledged

..... *[Signature]*
Division Manager, Financial Reporting and Cash Management

Dated 26/10/04

Calculation of Surplus Revenue under Section 94 of the Constitution

As at 30 June 2002

	Amount	Amount
Material FMA Agency Cash Balances		\$1,360,619,000
Plus		
small FMA Agency cash balances		\$112,572,000
Plus		
Special Public Monies		
Equals: Audited Consolidated Revenue Fund balance		\$1,473,191,000
Plus		
Reserve Bank of Australia investment by AOFM out of the OPA		\$10,400,000,000
Equals: Total Revenue caught by Section 94 of the Constitution		\$11,873,191,000
Less		
Undrawn Appropriations – Annual Appropriations and Special Appropriations (for specified amounts)		
Previous years' annual departmental	\$518,353,055	
Previous years' administered retention	\$1,244,541,255	
Special appropriations	No data	\$1,762,894,310
Annual Appropriation Budget Bills		
Act 1 02-03	\$43,445,965,000	
Act 2 02-03	\$6,120,821,000	
PD Act 1 02-03	\$166,102,000	\$49,732,888,000
Standing Appropriations for Debt Repayment that are quantifiable and certain with respect to due date for payment		
• Securities issued to non-Commonwealth entities (bills, notes, bonds)	\$63,821,067,000	
• Loans	\$5,752,582,000	
• Other debt - assuming it fits the above requirements	\$3,562,513,000	\$73,136,162,000
Equals: Total Offsets		\$124,631,944,310
Equals: Surplus/(deficit) Revenue		(\$112,758,753,310)

Balance amounts confirmed as correct and balances confirmed by legal advice as being appropriate:

..... *[Signature]* Branch Manager, Cash Management

Dated *21/10/04*

Acknowledged

..... *[Signature]*
 Division Manager, Financial Reporting and Cash Management

Dated *26/10/04*

Calculation of Surplus Revenue under Section 94 of the Constitution

As at 30 June 2003

	Amount	Amount
Material FMA Agency Cash Balances		\$1,278,818,000
Plus		
small FMA Agency cash balances		\$105,103,000
Plus		
Special Public Monies		\$77,136,000
Equals: Audited Consolidated Revenue Fund balance		\$1,461,057,000
Plus		
Reserve Bank of Australia investment by AOFM out of the OPA		\$12,200,000,000
Equals: Total Revenue caught by Section 94 of the Constitution		\$13,661,057,000
Less		
Undrawn Appropriations – Annual Appropriations and Special Appropriations (for specified amounts)		
Previous years' annual departmental	\$1,597,846,995	
Previous years' administered retention	\$1,745,234,798	
Special appropriations	No data	\$3,343,081,793
Annual Appropriation Budget Bills		
Act 1 03-04	\$40,503,801,000	
Act 2 03-04	\$5,528,876,000	
PD Act 1 03-04	\$167,279,000	\$46,199,956,000
Standing Appropriations for Debt Repayment that are quantifiable and certain with respect to due date for payment		
• Securities issued to non-Commonwealth entities (bills, notes, bonds)	\$57,953,011,000	
• Loans	\$4,710,731,000	
• Other debt - assuming it fits the above requirements	\$2,096,178,000	\$64,759,920,000
Equals: Total Offsets		\$114,302,957,793
Equals: Surplus/(deficit) Revenue		<u>(\$100,641,900,793)</u>

Balance amounts confirmed as correct and balances confirmed by legal advice as being appropriate:

..... *P. B. Cole* *AG* Branch Manager, Cash Management

Dated *21/10/04*

Acknowledged

..... *[Signature]*
 Division Manager, Financial Reporting and Cash Management

Dated *26/10/04*