hl.let.15095

27 June 2006

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

Dear Mr Sands

TRANSPARENCY AND ACCOUNTABILITY OF COMMONWEALTH PUBLIC FUNDING AND EXPENDITURE

Thank you for your letter of 26 June 2006, in which the committee invites me to comment on the matters referred to the committee on 21 June 2006 relating to the transparency and accountability of Commonwealth public funding and expenditure.

At this stage I would like to put before the committee two papers which were prepared for senators on matters within the committee's terms of reference. The first, entitled *Parliamentary Control of Finance, Government Funding and the Financial System*, is largely a consolidation of points which were made to the committee in the context of its inquiry into government advertising. It may be useful to the committee, in that it summarises issues in relation to parliamentary accountability arising from the current financial system. The second, entitled *Ordinary Annual Services of the Government*, is a more detailed treatment of the problem of interpretation of section 54 of the Constitution which has recently arisen in the context of the outcomes system of appropriations.

At a later stage, I may wish to provide further information to the committee and to comment on other submissions which the committee may receive. I would also be pleased to elaborate on the points made here should the committee so wish.

Yours sincerely

(Harry Evans)

hl.misc.15093
27 June 2006

PARLIAMENTARY CONTROL OF FINANCE, GOVERNMENT FUNDING AND THE FINANCIAL SYSTEM

A development of major parliamentary significance in 2005 was that attention was drawn to the effect of the financial system put in place since 1997, which makes it extremely easy for government to find large amounts of money for virtually any purpose, and without specific and advance parliamentary approval. The system was largely established by the *Financial Management and Accountability Act 1997* (the FMA Act), which was presented as a streamlining and modernisation of public finances. The potential of the system did not become clear until 2005, when the government spent $55 million on an advertising campaign for its industrial relations policies, which had not yet been enacted, and for which no parliamentary appropriation had been made. This was done simply by spending departmental appropriations that had been appropriated for vaguely-stated "outcomes", which are a feature of the new system.

Such is the "new" financial system that the Parliament does not effectively control either the amount of money available to government or the purposes on which it may be expended. This is due to:

- the variety of sources of money available for expenditure apart from appropriations, and the undermining of sections 81 and 83 of the Constitution

- the form of the annual appropriations

- the undermining of section 54 of the Constitution in relation to the ordinary annual services of the government.

Appropriations and sources of money

The annual appropriations made by Parliament for departmental expenditure now amount to something less than 20 percent of all government expenditure. Special appropriations, more accurately called standing appropriations, most of which are of indefinite duration and indefinite amount, now account for most government expenditure. In addition, departments have available to them other sources of expenditure:

- advances to the Minister for Finance and Administration, which are limited to urgent and unforeseen or overlooked expenditure, and which potentially amount to $390 million in the appropriation acts for the financial year 2006-07

- departments are able to carry over surpluses from their annual appropriations, providing them with cash to add to their appropriations in the future

- revenue which may be retained by agreement of the Minister for Finance and Administration under section 31 of the FMA Act (departments are able to raise revenue from each other, as well as other persons and bodies)

- special accounts created by the Minister for Finance and Administration under sections 20 and 21 of the FMA Act, in 2002-03 amounting to $3.4 billion, into which some revenues are directly paid

- GST appropriations under section 30A of the FMA Act, to allow payment of the GST tax.

The Minister for Finance and Administration may also increase the annual appropriations of departments within specified ceilings, totalling $40 million in the appropriation acts for 2006-07.

Section 81 of the Constitution provides that all money raised or received by the government shall form one Consolidated Revenue Fund, to be appropriated by the Parliament for the purposes of the Commonwealth.

This provision is now interpreted by government to mean nothing more than that money raised by the Commonwealth belongs to the Commonwealth, and does not require that revenue be actually credited to an identifiable fund. Thus the money flowing to departments does not actually appear in any consolidated account.

Section 83 of the Constitution provides that no money shall be drawn from the Treasury of the Commonwealth except under appropriation made by law.

Government is able to say, with technical accuracy, that all of the money expended by government is authorised by something in some act of Parliament which is interpreted as an appropriation. These appropriations, however, are so scattered through the statute book and in such a variety of forms that it is very difficult to attain a comprehensive view of

them. In 2005 a senator's estimates question on notice asked for figures for all of the sources of appropriations since 1998, but complete figures were not provided.

The Australian National Audit Office, in three reports, pointed out illegalities and serious problems in the management of special appropriations, special accounts and the system of retaining revenues.[1] These problems were not the product of poor management alone, but of a financial system which by its nature leads to loose dealings with money. The Department of Finance and Administration promised better management, but the Parliament is still not in the position properly belonging to a legislature, of actually approving the expenditure.

Form of annual appropriations

The annual appropriations are now in such a form that there is very little limitation on the purposes for which the money may be spent. Money is appropriated within departments for outcomes, and the outcomes are so nebulous and vaguely expressed that the purposes of expenditure are unknown until the expenditure occurs. For example, the Department of Employment and Workplace Relations has only three outcomes:

1 Efficient and effective labor market assistance
2 Higher productivity, higher pay workplaces
3 Increased workforce participation.

These are vague aspirations vaguely expressed, not purposes for which money is appropriated.

The appropriation acts provide that the Portfolio Budget Statements (PBS) may be consulted for determining the purposes on which appropriations may be expended, but the PBS are similarly vaguely expressed. For example, in the PBS of the Department of Employment and Workplace Relations, the information about the outcomes of the department consists of a series of further aspirations which the department is to support.

The result of this is that many questions at Senate estimates hearings are directed towards locating particular projects and subjects of expenditure in the outcomes of departments. It is almost never obvious to which outcome a particular project or subject of expenditure belongs.

This situation virtually allows government to expend money on any project which comes to mind at any time.

Ordinary annual services

Under section 54 of the Constitution, the bill which appropriates money for the ordinary annual services of the government must deal only with such appropriations and all other appropriations must be in the second appropriation bill. The definition of ordinary annual services of the government, and the delineation of those items which are ordinary annual services items and those items which are non-ordinary annual services items, is the subject of an agreement between the Senate and the government, known as the Compact of 1965. The content of the Compact has been modified from time to time by agreement between the Senate, represented by its Appropriations and Staffing Committee, and the Minister for Finance and Administration.

The purpose of the distinction in section 54 is to identify the bills which the Senate may amend directly under section 53 and those to which it must request amendments, but the distinction is also a useful tool for parliamentary scrutiny and control of expenditure, in that it separates normal ongoing expenditure from other projects.

Thus, under the Compact, new policies are regarded as not part of the ordinary annual services of the government. This distinction, however, has been violated in recent times. Taking advantage of the nebulous nature of departmental outcomes, departments have been able to start up new policies by using ordinary annual services money.

A glaring example of this came to notice with the appropriation bills for assistance to the victims of the Asian tsunami. The form of the bills disclosed that ordinary annual services money appropriated to departments had been expended on tsunami relief, which cannot possibly be an ordinary annual service of the government. In its passage through the Senate, the bill to replenish the ordinary annual services money already expended was treated as a non-ordinary annual services bill, but as the bills were passed without amendment this had no practical consequence.

In 1999 the Senate Appropriations and Staffing Committee agreed that appropriations for "continuing activities for which appropriations have been made in the past" could be classified as ordinary annual services appropriations. This seems to have been taken to mean that anything falling within the statements of outcomes is an ordinary annual service, an assumption quite contrary to section 54 of the Constitution and the Compact of 1965.

Illustration: the WR advertising campaign

These problems, which vitally affect parliamentary control of government expenditure, were well illustrated by the advertising campaign in relation to the government's proposed workplace relations legislation.

This expenditure was charged to Outcome 2 of the Department of Employment and Workplace Relations. Clearly, it was felt that that outcome is so all-embracing that it authorised expenditure on a completely new advertising campaign for legislation which had not been disclosed. If that were so, then Parliament, in making appropriations, would be giving government a blank cheque to spend money for any purpose.

Outcome 2 also occurred in the appropriation act for the ordinary annual services of the government. So a new advertising campaign for legislation not yet disclosed was also regarded as an ordinary annual service of the government. This was clearly in violation of section 54 of the Constitution and the Compact of 1965.

Judgment of the High Court

The validity of the advertising campaign was challenged in the High Court, on the basis that the expenditure was not properly authorised by an appropriation by Parliament.

By a majority of 5 to 2 the court found that the advertising campaign was an authorised purpose of expenditure under the appropriations made by the Parliament for the Department of Employment and Workplace Relations.[2]

The judgment reinforced the point that annual appropriations are now in such a form that there is very little limitation on the purposes for which the money may be spent. The effect of the judgment is that the court will not correct this situation. It is Parliament's responsibility to ensure that expenditure is appropriate.

A joint judgment by four of the majority justices was accurately characterised by one of the dissenters, Justice McHugh, as authorising an agency "to spend money on whatever outputs it pleases".[3] In so holding, the joint judgment, as indicated by dissenting Justices McHugh and Kirby, effectively repudiated the principles on which earlier relevant judgments of the court were based.[4]

The separate judgment of Chief Justice Gleeson explicitly put the responsibility for control of expenditure back on to the Parliament:

> If Parliament formulates the purposes of appropriation in broad, general terms, then those terms must be applied with the breadth and generality they bear.[5]

The problem is Parliament's problem, not the court's. It is now clear that control of expenditure must be undertaken by Parliament or it will not be undertaken at all.

Parliament could undertake that control by winding back outcomes budgeting and returning to greater specification of the purposes of appropriations in appropriation acts. That would be difficult to achieve and is not likely to occur. The alternative is for Parliament to insist on greater explanation and scrutiny of government expenditure. Chief Justice Gleeson helpfully indicated what must be done:

> The higher the level of abstraction, or the greater the scope for political interpretation, involved in a proposed outcome appropriation, the greater may be the detail required by Parliament before appropriating a sum to such a purpose; and the greater may be the scrutiny involved in a review of such expenditure after it has occurred.[6]

The Parliament, which effectively means the Senate, must diligently pursue and enhance its scrutiny of expenditure, both pre-expenditure scrutiny, principally through the estimates process, and post-expenditure scrutiny, to which the estimates process is also adapted.

Effective scrutiny, however, depends on transparency of government activities and the provision of adequate information. The Senate must insist that transparency is applied and that adequate information is provided.

The judgment also made it clear that the question of what are the ordinary annual services of the government is a non-justiciable question for the Senate alone to determine. The point that the expenditure on the advertising campaign could not be expenditure for the ordinary annual services of the government was referred to before the court and appeared in the judgments. This appearance did not indicate that the court has decided that the question is justiciable. The argument advanced to the court was that the Parliament could not have intended that the appropriations which have been used for the advertising campaign should be so used because, if the Parliament had so intended, it would not have included the money in the ordinary annual services bill. It was a question of interpreting the Parliament's intention in making the appropriation, not of judicially determining what

are the ordinary annual services. The responsibility for making that determination still clearly rests with the Senate.

A further example

A report by the Auditor-General on the Roads to Recovery program was presented in March 2006.[7] Apart from identifying some of the troubles with that program which had been the subject of political controversy, the report demonstrated that the outcomes system of appropriations has effectively removed parliamentary control of the purposes of expenditure. The Department of Transport and Regional Services has two outcomes: "a better transport system for Australia", and "greater recognition and development opportunities for local, regional and territory communities". Having previously charged expenditure on the Roads to Recovery program to the first outcome, the department decided that the program could just as well be charged to the second outcome, and in this it had the support of a legal opinion. This confirmed that, apart from having indefinite amounts of money not appropriated by the Parliament at their disposal, departments and agencies are able to spend that money on whatever they choose.

Subsequent action

The Scrutiny of Bills Committee presented a report in November 2005 on the problems posed for parliamentary control of expenditure by standing appropriations.[8] The committee expressed an intention to scrutinise under its scrutiny criteria provisions for such appropriations in bills in the future.

In late 2005 the matter of appropriations for the ordinary annual services was taken up by the Senate's Appropriations and Staffing Committee following references to the matter by the Australian National Audit Office.

The Senate made a reference to the Finance and Public Administration References Committee on the financial system in June 2006.

hl.misc.15094
27 June 2006

ORDINARY ANNUAL SERVICES OF THE GOVERNMENT

In 2005 the Australian National Audit Office (ANAO) took up the question of items of expenditure which may have been wrongly classified as ordinary annual services of the government. ANAO considered that there was a misunderstanding about what the Senate and the government had agreed to in relation to this issue.

The question of interpretation arose from the appropriation bills presented early in 2005 to authorise expenditure on relief for the victims of the Asian tsunami. Part of that expenditure was contained in a bill devoted to ordinary annual services of the government. As expenditure on tsunami relief could not possibly be expenditure for the ordinary annual services of the government, the bill was treated in the Senate as a non-ordinary annual services bill, and, on the question being raised by ANAO, this was communicated to ANAO.

Subsequently, ANAO questioned other expenditure made from appropriations for the ordinary annual services, and raised the question again. Following further correspondence, which is referred to in Audit Report No. 25 of 2005, it appears that the Department of Finance and Administration (DoFA) has adopted a particular interpretation of the Thirtieth Report of the Appropriations and Staffing Committee, and is adhering to a view that any expenditure on existing outcomes of departments is expenditure for the ordinary annual services of the government. This is contrary to the agreement between the Senate and the Government known as the Compact of 1965 and with subsequent determinations by the Senate, including the determination made on the Thirtieth Report of the committee.

It is necessary to set out briefly the history of this matter.

Classification of the ordinary annual services

Section 53 of the Constitution provides that the Senate may not amend a bill appropriating money for the ordinary annual services of the government, but may request amendments of such a bill. An appropriation bill not for the ordinary annual services of the government may be directly amended by the Senate. Section 54 of the Constitution provides that an appropriation bill for the ordinary annual services of the government must contain only those appropriations.

The classification of appropriation bills on the basis of whether they are for the ordinary annual services of the government determines how the Senate deals with a bill procedurally. This classification of appropriation bills, however, is also a useful adjunct to parliamentary accountability for expenditure, because it enables the Parliament to see at once which

expenditure is for normal ongoing activities of the government and which expenditure is for other purposes.

The classification of appropriations was the subject of an agreement between the Senate and the Government in 1965, known as the Compact of 1965. It was then agreed that appropriations for the following matters would be regarded as not part of the ordinary annual services of the government:

(a) the construction of public works and buildings;
(b) the acquisition of sites and buildings;
(c) items of plant and equipment which are clearly definable as capital expenditure;
(d) grants to the States under section 96 of the Constitution; and
(e) new policies not authorised by special legislation, subsequent appropriations for such items to be included in the appropriation bill not subject to amendment by the Senate.

The agreement was subsequently confirmed by the Senate, including by a resolution of 1977, which provides that appropriations for expenditure on:

(a) the construction of public works and buildings;
(b) the acquisition of sites and buildings;
(c) items of plant and equipment which are clearly definable as capital expenditure;
(d) grants to the States under section 96 of the Constitution; and
(e) new policies not previously authorised by special legislation,

are not appropriations for the ordinary annual services of the government, and that proposed laws for the appropriation of revenue or moneys for expenditure on the said matters shall be presented to the Senate in a separate Appropriation Bill subject to amendment by the Senate.

The application of the Compact of 1965 was the subject of correspondence between the Appropriations and Staffing Committee and the government, tabled in the Senate on 3 November 1988 and 4 April 1989. It was agreed that expenditure on computers, which, due to changes in technology, are no longer major items of capital equipment, and expenditure on the fitting out of buildings, should be regarded as part of the ordinary annual services subject to certain limits.

Under the terms of these determinations by the Senate, clearly expenditure for new policies could not be part of the ordinary annual services of the government.

The current question relates to correspondence between the Appropriations and Staffing Committee and the Minister for Finance and Administration and the Thirtieth Report of that committee in 1999.

The modifications of 1999

In February 1999 the then Minister for Finance and Administration wrote to the President of the Senate suggesting that there should be some "modest changes", consequent upon the impending introduction of accrual budgeting, to the Compact of 1965 between the Senate and the government on what constitutes the ordinary annual services of the government under section 53 of the Constitution.

The proposal submitted by the minister was:

(i) all equity injections and loans, including for defence purposes, in Bill 2;
(ii) new administered expenses that fall within an existing outcome included in Bill 1;
(iii) asset replacement will be typically funded from depreciation provisions appropriated in Bill 1 as part of the price of outputs. [Bill 1 is the ordinary annual services bill and Bill 2 the other bill.]

It should be noted that only *administered expenses* (as distinct from departmental expenses) falling within "existing outcomes" would be ordinary annual services. What was meant by "existing outcomes" in any event? The minister's proposal also stated that appropriations for new capital acquisitions would be contained in the appropriation bill not for the ordinary annual services "so that Parliament can clearly distinguish between Government resourcing for *ongoing activities* and its investment in agencies" (emphasis added). So "ongoing activities" were ordinary annual services.

The minister's proposal was referred to the Appropriations and Staffing Committee by the President.

That committee, and the Senate by subsequently endorsing the committee's report, agreed that:

> the classification of appropriation items according to whether they fall within the category of ordinary annual services of the government … remain unchanged except that:
>
> (i) items regarded as equity injections and loans be regarded as not part of ordinary annual services
>
> (ii) all appropriation items for continuing activities for which appropriations have been made in the past be regarded as part of ordinary annual services

(iii) all appropriations for existing asset replacement be regarded as provision for depreciation and part of ordinary annual services. (Thirtieth Report of the committee, adopted by the Senate on 22 April 1999.)

In considering the general effect of accrual budgeting, the committee observed:

> Given that all expenditure on achieving an existing outcome, including maintaining and replacing existing assets involved in achieving that outcome, is to be regarded as part of expenditure on that outcome, it is logical that such expenditure should be classified as part of ordinary annual services.

The seeming equation of “continuing activities” with “existing outcomes” clearly arose from the language in the minister's proposal. At that time the meaning and content of the expression “outcomes” was not clear.

In effect, the committee took up the minister’s expression “ongoing activities” (slightly altering it to “continuing activities” and adding the definitional phrase “for which appropriations have been made in the past”), and this was what was adopted by the committee and the Senate. This expression was adopted because it avoided the lack of clarity about what would be involved in “outcomes”.

In that context, there was still an expectation that new policy proposals, which cannot by definition be “continuing activities”, would not be included in the ordinary annual services bill. The adoption of the alternative formulation was an attempt at an explanation or an interpretation of the concept of “new policy” which, it was presumed, would be of assistance in classifying appropriations in the context of accrual budgeting.

The classification criteria adopted in the Appropriations and Staffing Committee’s Thirtieth Report were not intended to replace the classification criteria previously established under the Compact of 1965. The report clearly stated that the original criteria “remain unchanged” except as modified by the new criteria. All of the criteria must be read together. When that is done, it clearly emerges that paragraph (ii) of the new criteria, referring to “continuing activities” of government as part of the ordinary annual services, is a clarification of the concept of “new policies” in the accrual setting.

On this basis, proposed expenditure, both departmental and administered, for new policies should continue to be in appropriation bills not for the ordinary annual services.

The concept of “new policy”, and indeed the concept of “continuing activities” of government, involve problems of interpretation. Those problems, however, have always been present. They are to be solved by consideration of particular cases.

Another case

The question was again raised by ANAO following its examination of the operations of the Australian Securities and Investment Commission (ASIC).

In examining the operations of ASIC the attention of ANAO was drawn to the fact that $90.7 million for ASIC to implement new policies announced by the government had been included in the appropriation bill for the ordinary annual services.

Initially, ANAO suggested that an apparent difference in interpretation between the Senate and DoFA should be the subject of further discussion. DoFA, however, rejected this approach and asserted that its interpretation of the 1999 modification of the Compact of 1965 should stand. The ANAO then recommended, in its report No. 25 of 2005-06, "that the Department of the Senate and Finance should take steps to develop a shared understanding of the appropriate location between the Annual Appropriation Acts of departmental amounts for new policy" (paragraph 2.14).

The assertion by DoFA that money for new policies may be included in the ordinary annual services bill is based on a claim that, in the 1999 modification of the Compact, the Senate agreed that any expenditure falling within existing outcomes could be included in the ordinary annual services bill. This is clearly a misreading of the 1999 modification. DoFA appears to be construing part, and only part, of the language put by the minister to the committee, rather than the terms adopted by the committee and the Senate.

Given that outcomes are now so nebulous (and the vagueness of their content was not known in 1999), under the interpretation adopted by DoFA virtually any expenditure could be included in ordinary annual services. If that interpretation is allowed to stand, the distinction between ordinary annual services and other expenditure could virtually disappear.

It would also be much more difficult for the Parliament generally, and Senate estimates hearings in particular, to distinguish between expenditure for normal ongoing government activities and other expenditure. Anomalies such as "ordinary annual tsunamis" would multiply. The way in which the Senate deals with appropriations would be unnecessarily complicated.

Consideration by the Appropriations and Staffing Committee

The interpretation of the effect of the 1999 agreement expounded here has been endorsed by the Appropriations and Staffing Committee, which is examining the disagreement that has now arisen.

[1] Reports Nos 24 of 2003-04, 15 of 2004-05, 28 of 2005-06.
[2] *Combet v Commonwealth* [2005] HCA 61, reasons for judgment 21 October 2005.
[3] at 89.
[4] *Attorney-General (Victoria) v Commonwealth*, (1945) 71 CLR 237; *Brown v West* (1990) 169 CLR 195. Referred to at 89, 233, 234.
[5] at 27.
[6] at 7.
[7] Report No. 31 of 2005-06.
[8] Fourteenth Report of 2005.