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**ANAO Submission to the Senate Finance and Public
Administration References Committee –**

**Inquiry into the Transparency and Accountability of
Commonwealth Public Funding and Expenditure**

1. Introduction

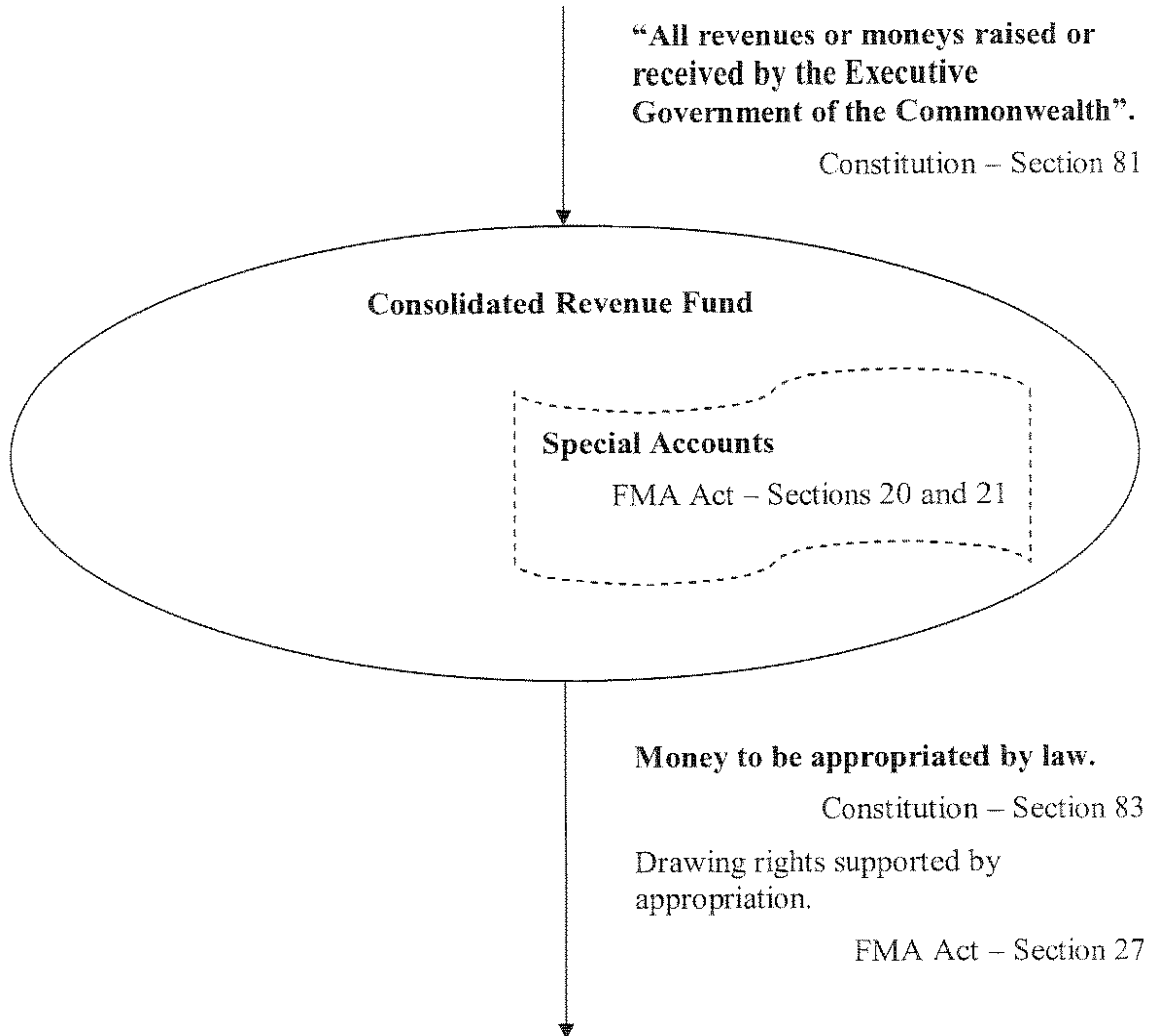
Background

1.1 The Australian Constitution creates a framework within which the Executive Government receives and may spend money. Taken together, the requirements of Section 81, Section 83 and Section 97 (governing accounting and audit) create a regime for Parliament to exercise control over and require accountability for Executive Government spending.

The Consolidated Revenue Fund

1.2 The Constitutional concepts of the Consolidated Revenue Fund (CRF) and appropriations safeguard the Parliament's ultimate control over public expenditure. Accordingly, from a financial framework perspective, it is important for the composition and operation of the CRF be well understood by agencies that draw on appropriations. The CRF from 1 July 1999 is reflected in Diagram 1 on the following page, which was prepared by the Department of Finance and Administration (Finance).

Diagram 1: The Consolidated Revenue Fund from 1 July 1999



The Consolidated Revenue Fund under the *Financial Management and Accountability Act 1997* (FMA Act) as amended by the *Financial Management Legislation Amendment Act 1999*.

Source: Department of Finance and Administration, 2003.

1.3 In recent years, Finance has undertaken significant work to develop a sound basis for understanding the composition of the CRF. In this context, Finance has reached a number of conclusions about the nature and composition of the CRF. These include the following.¹

- The CRF is 'self-executing'. That is, all revenues or moneys received by the Commonwealth automatically form part of the CRF, whether or not the Commonwealth has credited those moneys to a fund or account which is designated as part of the CRF.
- The CRF includes money borrowed by the Commonwealth and 'trust money', as well as money in the nature of revenue. As a result, an appropriation is required to spend all such money, including that held on trust.
- The wide range of circumstances in which Commonwealth money is raised or received makes it impracticable to identify the precise balance of the CRF at any particular time.

1.4 In terms of this last characteristic, in 2002-03, Finance introduced reporting in the Consolidated Financial Statements (CFS) of the end of financial year balance of the CRF. The 2004-05 CFS included a 30 June 2005 derived balance of the CRF of \$825 million. This figure represented total general government sector cash, less cash controlled and administered by Commonwealth authorities and companies, plus special public monies.²

1.5 Monitoring cash available to be spent is an important part of appropriation management. However, the CRF is a legal and Constitutional construct and it is not an account for the purposes of the Commonwealth's financial reporting. Accordingly, available cash is a separate issue to the amount of funds that have been appropriated, but not yet drawn. In this context, as of 30 June 2005, there was more than \$14 billion in undrawn appropriation balances comprising:³

- \$7.71 billion in Annual Appropriations;

¹ Audit Report No.15 2004-05, *Financial Management of Special Appropriations*, pages 32-33.

² Special public money is defined as public money that is not held on account of the Commonwealth or for the use or benefit of the Commonwealth. Trust money is an example of special public money.

³ The figures for Annual Appropriations and Special Appropriations taken from entity financial statements. The figure for Special Accounts is taken from Note 44 in the Consolidated Financial Statements.

- \$5.35 billion in Special Accounts; and
- \$974 million in limited Special Appropriations.⁴

Agency responsibilities

1.6 The Constitutional underpinnings for control over Executive Government spending have not changed since Federation. However, there have been significant changes made to the Commonwealth's financial framework, including appropriation management.

1.7 Under the *Audit Act 1901* (Audit Act), Finance had a central role in maintaining a reasonably detailed and prescriptive financial framework, including the provision of central accounting and payment systems. This latter role included the centralised reporting of estimated and actual appropriations expenditure.

1.8 With the devolution of greater authority to agencies and the repeal of the Audit Act, and the commencement on 1 January 1998 of the *Financial Management and Accountability Act 1997* (FMA Act) and related Acts, there were important changes in appropriation management roles and responsibilities. In particular, agencies have the following responsibilities:⁵

- maintaining records of all appropriations, including any adjustments that occur over the course of the financial year;
- maintaining records that link, or are able to link, transactions to appropriations;
- recording amounts debited from appropriations prior to or as payments are made;
- ensuring that appropriations are not exceeded and are expended for the purpose appropriated; and
- implementing adequate controls over appropriations.

1.9 For its part, Finance remains responsible for developing and maintaining the financial framework, and the provision of guidance on the operation of that framework. Finance also prepares the Annual Appropriation Acts and analyses the estimates that are prepared by agencies during the

⁴ Balances do not exist for unlimited Special Appropriations.

⁵ Finance Circular 2004/16, *Appropriation Management: Responsibilities of Agencies*, 28 October 2004, para 6.

Budget and Additional Estimates processes. In addition, following the introduction of agency transactional banking on 1 July 1999, Finance provides the mechanism for agencies to draw down appropriated funds into agency bank accounts.

Committee Terms of Reference

1.10 In December 2005, the Senate Finance and Public Administration References Committee (the Committee) tabled a report titled *Government advertising and accountability*. In Chapter 4 of this report, the Committee examined what the High Court judgement in *Combet v Commonwealth of Australia*⁶ had revealed about the legislature's control of government expenditure. As this issue raised questions and matters that were considered broader in scope than could be considered in detail by the government advertising and accountability inquiry, the Committee included the following recommendation in its report:⁷

The Committee recommends that the Senate refer to the Finance and Public Administration References Committee for inquiry and report the matter of the impact of outcome budgeting for appropriations on Parliamentary consideration and approval of government expenditure, and the accountability of government for such expenditure.

1.11 On 21 June 2006, the Senate referred the following matter to the Committee, for inquiry and report by 19 October 2006:

The transparency and accountability to Parliament of Commonwealth public funding and expenditure including:

- a. the impact on the Parliament's ability to scrutinise, approve and monitor proposed and actual expenditure of:
 - i. outcome budget appropriations and reporting;
 - ii. multiple sources of funding including special appropriations, advances to the Finance Minister, annual departmental carry-over surpluses, revenue retained under Section 31 of the *Financial Management and Accountability Act 1997*, special accounts and goods and services tax appropriations; and

⁶ *Combet v Commonwealth of Australia* [2005] HCA 61.

⁷ Senate Finance and Public Administration References Committee, *Government advertising and accountability*, December 2005, Recommendation 1, para 4.76.

- iii. the use of ordinary annual services to fund activities including non-annual services;
- b. options for improving the transparency and specificity of budget papers and related documents; and
- c. other measures to improve the Parliament's oversight of proposed and actual Commonwealth funding and expenditure.

1.12 This submission responds to the Committee's invitation of 26 June 2006 to the ANAO to make a written submission to the Committee's inquiry.

Submission structure

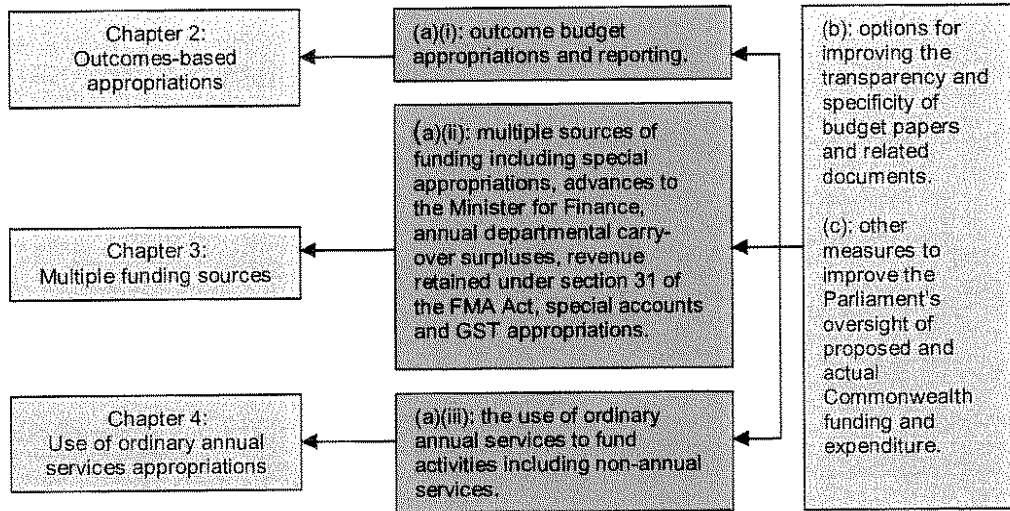
1.13 This submission has been prepared drawing upon the knowledge gained by ANAO through its broad range of audit activities. The ANAO submission also draws upon analysis of the 2006-07 Appropriation Acts passed during the most recent Budget Sittings.

1.14 The following figure outlines the structure of ANAO's submission. The Committee's first term of reference is addressed by Chapters 2, 3 and 4. The Committee's second and third terms of reference relate to options and measures that could assist to improve transparency and accountability to the Parliament. Ultimately, it is for the Parliament to decide the approach it wishes to take in appropriating funds from the CRF. However, in recognition of the special relationship the Auditor-General⁸ has with the Parliament,⁹ and consistent with the Committee's terms of reference, ANAO has identified in Chapters 2, 3 and 4 a number of issues that the Committee may wish to consider in addressing its Terms of Reference.

⁸ Among other things, this is reflected in the Auditor-General being an independent officer of the Parliament (see section 8(1) of the *Auditor-General Act 1997*).

⁹ Joint Committee of Public Accounts and Audit, Report 331, *An Advisory Report on the Financial Management and Accountability Bill 1994, the Commonwealth Authorities and Companies Bill 1994 and the Auditor-General Bill 1994, and on a Proposal to Establish an Audit Committee of Parliament*, September 1994, page 94.

Committee's Terms of Reference



2. Outcomes-based appropriations

Introduction

2.1 Managing programme performance in the public sector has always been a challenge, because results are not measured in dollars alone, and it is difficult to secure agreement on how best to measure the effectiveness of government programmes.

2.2 In this context, it is a common approach worldwide for governments to express the range of programmes delivered in the context of a generic framework. For the Australian Government, this has evolved from the programme budgeting and management approach of the start of the reform era in the early 1980s to the current framework focused on outcomes and outputs.

2.3 In April 1997, the Government decided to implement an accrual-based outcomes and outputs framework for managing resources in the public sector. The new framework was viewed as a key component in creating a more competitive, efficient and effective public sector, and to provide a more complete picture of performance, including financial performance, for decision-making and accountability. Under the framework, agency managers were to have better and more complete information on which they could manage their operations and be accountable to Government and the Parliament on their performance.¹⁰

2.4 The first Budget prepared under the new accrual framework was in 1999-2000. In the 1999-2000 Budget Papers, it was announced that, with the introduction of accrual budgeting, there had been some revisions to the structure of the Appropriation Bills. In particular:

- a change to the 1965 Compact between the Senate and the Government on the content of Appropriation Bills No.1 and No.2 had been agreed;
- in recognition of the funding for long-term commitments, the Appropriation Bills, while related to activity in a specific year, would not lapse at 30 June each year; and
- Appropriation Bills would be focused on agency outcomes.

¹⁰ *Specifying Outcomes and Outputs*, Department of Finance and Administration, 1998.

2.5 The outcomes and outputs framework was intended to shift the focus from inputs to an orientation on results.¹¹ Previously, annual appropriations were made in two parts. Running costs for each entity were appropriated as a single amount. Appropriations for other services, in many cases individual programmes, were appropriated as individual line items. Appropriating to outcomes was expected to allow for better information for decision-making by Government and assist Parliament in its scrutiny of Government programmes and performance.¹²

Development and adoption of outcomes-based annual appropriations

2.6 The early stages of implementation for the framework in the Australian Government differed from the approach taken in other countries and in some Australian States. Some jurisdictions placed more emphasis on outputs and efficiency in the early stages of development. More recently, those jurisdictions have begun to place greater emphasis on outcomes and the relationship between outputs and outcomes.

2.7 There is no evidence that we are aware of to suggest that either approach is more effective in terms of embedding a performance culture. What is clear is that the initiative is unlikely to be effective if it does not include both outputs and outcomes as part of an integrated performance information and evaluation framework.

Structure of the Annual Appropriation Acts

2.8 In most years, three annual appropriation Bills are prepared at the time of each Federal Budget and three are prepared, as necessary, at Additional Estimates. For the 2006-07 Budget, \$62.7 billion was appropriated through the following three Acts:

- *Appropriation (Parliamentary Departments) Act (No. 1) 2006-2007* which appropriated \$171,607,000 for all the departmental outputs, administered expenses and non-operating costs of the three Parliamentary departments;

¹¹ *Outcomes and Outputs: Are We Managing Better as a Result?*, Ian McPhee, Auditor-General for Australia, CPA National Public Sector Convention, Friday 20 May 2005.

¹² *ibid.*

- *Appropriation Act (No. 1) 2006-2007* which appropriated \$53,334,597,000 for the ordinary annual services of the Government, and hence could not be amended by the Senate (in accordance with Section 53 of the Constitution); and
- *Appropriation Act (No. 2) 2006-2007* which appropriated \$9,214,607,000 for matters that were not proposed for the ordinary annual services of Government. It covers both administered expenses (grants to the States, payments to the Territories and local government and new administered expenses) as well as non-operating costs.

2.9 Table 1 on the following page provides an overview of the amounts appropriated in the 2006-07 Budget Appropriation Acts. This table outlines that a relatively small percentage (36 per cent) of the amount appropriated in the 2006-07 Budget Appropriation Acts was actually tied to particular outcomes. This is because:

- non-operating amounts are not appropriated by reference to outcomes; and
- departmental outputs are appropriated as a single amount for each entity, the allocation to outcomes being notional rather than restrictive.¹³

2.10 The Portfolio Budget Statements identify the total resources for entity outcomes, including the amount expected to be funded from Annual Appropriations and the amount expected to be funded from Special Appropriations. In the case of Special Appropriations, the funds may only be expended for the purposes for which the legislation provides. At the time of ANAO's recent audit titled *Financial Management of Special Appropriations*, Special Appropriation drawings represented more than 80 per cent of all appropriation drawings.

¹³ The predecessor running costs arrangements also enabled agencies to make flexible use of the resources available for the delivery of their assigned programs. Resource agreements between departments/agencies and the Department of Finance provided further flexibility as they could include: receipts retention and sharing of receipts; multi-year carryovers of funds that would otherwise have lapsed at year end; multi-year borrowings against the forward estimates of running costs; workload adjustment formulae for agencies whose resource needs were affected by unpredictable changes in demand for their services; and property resource agreements and workplace bargaining agreements. Source: Chapter 9 of the Final Report of the National Commission of Audit, June 1996.

Table 1

Appropriation Act	Outcomes-based (\$ '000)							Non-Operating (\$ '000)					Total (\$ '000)
	Departmental Outputs	Administered Expenses	Payments to States, ACT, NT and local government	New Administered Expenses	Equity Injections	Loans	Previous Years' Outputs	Administered Assets and Liabilities					
Appropriation Act No. 1	37,180,745	16,153,852	N/A	N/A	N/A	N/A	N/A	N/A			53,334,597		
Appropriation Act No. 2	N/A	N/A	6,131,725	-	2,864,156	17,709	-	201,017			9,214,607		
Parliamentary Departments	157,037	685	N/A	N/A	-	-	-	13,885			171,607		
TOTALS	37,337,782 (59%)	16,154,537	6,131,725 (36%)	-	2,864,156	17,709	-	214,902	3,096,767 (5%)	62,720,811 (100%)			

Source: ANAO analysis of 2006-07 Budget Appropriation Acts.

Defining 'departmental' and 'administered'

2.11 Of the \$53.3 billion appropriated by Act No. 1, \$37.2 billion (or 70 per cent) was for departmental outputs. The equivalent figure for the Parliamentary Departments Appropriation Act was \$157 million (92 per cent of the total).

2.12 The majority decision in *Combet v Commonwealth of Australia* included the following discussion on departmental and administered items:

Section 7 [of Appropriation Act (No.1) 2005-2006] makes radically different provision for the way in which amounts issued out of the Consolidated Revenue Fund for a departmental item may be applied, from the provision made by s 8 for the way in which amounts issued out of the Consolidated Revenue Fund for an administered item may be applied. ...Departmental items are not tied to outcomes; administered items are.

2.13 Compared to departmental items, under the Appropriation Acts, appropriations for administered expenses (including payments to the States, Territories and local government) are tied to a particular outcome of the relevant entity. Where an entity has only one outcome, its administered expenses appropriation is, in effect, able to be spent on any aspect of the entity's administered activities. In the 2006-07 Budget, a total of \$1.6 billion was appropriated for administered expenses to entities with a single outcome.

2.14 Finance has explained the differences between departmental and administered appropriations as follows:¹⁴

The implementation of accrual budgeting has provided for the new concepts of departmental and administered expense appropriations and non-operating appropriations. Departmental expense appropriations provide funding for all the expected expenses required to carry out activities in the current year. Those expenses include employee entitlements and depreciation. Because the cash to meet such expenses can be required at times other than when the expenses are incurred, the departmental expense appropriations do not lapse. Thus, in law, departmental expense appropriations can be drawn down and spent at any time. Amounts from departmental expense appropriations which are unspent at the end of a financial year remain available to be spent in later years.

Because administered expenses are incurred on behalf of the Government, they are treated differently. Each annual appropriation act provides a process

¹⁴ Estimates Memorandum 2003/27, *Refresher on Appropriation Framework – Rules*, p. 4.

whereby the Finance Minister may limit the amount which may be issued from an administered expense appropriation item by making a determination. This process gives effect to clauses in the appropriation acts (eg. section 8 of Appropriation Act No. 1). Called the 'Section 8' process, it aims to ensure that amounts not required in a financial year are not available to be spent in a later year. In making the determination, the Minister takes into account the amount of expenses incurred during the year against each outcome for each type of administered expense appropriation. The effect of the determination is that administered expense appropriations which have not been expensed in a year cannot be spent in later years.

2.15 The Appropriation Acts define the terms 'departmental item' and 'administered item'. Departmental item is defined as being the total amount set out in the Schedule to the Act in relation to an entity. Administered item is defined as being an amount set out in the Schedule opposite the outcome of an entity. However, the terms 'departmental' and 'administered' are not themselves defined.

2.16 Budget Paper No.4 for 2006-07 stated¹⁵ that departmental outputs involve expenses over which an entity has control. This definition is in accordance with the Finance Minister's Orders (Financial Statements) and Australian Accounting Standard 29 (AAS29).

2.17 The definitions of the terms 'departmental' and 'administered' in the Finance Minister's Orders have been refined over recent years, with greater explanatory material being included. The relevant extract of the current version has been included as Attachment A. The Australian Accounting Standards Board is also undertaking work that relates to the distinction between 'administered' and 'controlled' items, and how they should be accounted for.¹⁶ Nevertheless, the terms 'departmental' and 'administered' are not actually defined in the Acts themselves.

2.18 Difficulties in interpretation of the term 'departmental item' were commented on by the majority decision in *Combet v Commonwealth of Australia* as follows:

what does emerge from consideration of the Compact of 1965 and subsequent events is the difficulty of marking any clear boundary around the types of

¹⁵ Page 4.

¹⁶ ANAO, *Opinions*, June 2006, p. 14.

expenditure that after 1987-1988 were included within the "running costs" appropriation for a department, or, since the adoption of accrual accounting and budgeting, fall within a "departmental item". Rather, as counsel for the defendants submitted, neither the Compact of 1965 in its original form, nor in the form it now takes, sheds any useful light on that question.

2.19 However, as has been noted by the Office of the Australian Government Solicitor, these terms were not defined by the High Court:¹⁷

Four members of the High Court (Gummow, Hayne, Callina and Heydon JJ) in a joint judgement, concluded that for departmental items (as opposed to administered items) it was not necessary to demonstrate that the expenditure fell within the terms of a particular outcome (such as outcome 2). Rather, it was sufficient to demonstrate that the amount to be spent was applied for 'departmental expenditure'.

...The joint judgement did not give detailed consideration to what might be encompassed by 'departmental expenditure'.

2.20 As indicated above, the definition of departmental and administered expenditure has been reviewed in recent years but may benefit from a further review in light of the High Court decision. There is a separate issue of whether there would be benefit in the Appropriation Acts themselves explicitly addressing the difference between expenditure that is 'departmental' in nature, as compared to expenditure that is 'administered' in nature.

¹⁷ Office of the Australian Government Solicitor, *Litigation Notes 29 November 2005*, p. 5.

Specifying outcomes

2.21 At the time of introducing outcomes based appropriations, outcomes were defined as:¹⁸

Results, impacts or consequences of actions by the Commonwealth on the Australian community. Planned outcomes are the results or impacts that the Government wishes to achieve. Actual outcomes are the results or impacts actually achieved.

2.22 As discussed, amounts appropriated for departmental activities are notionally allocated to outcomes in the annual Appropriation Acts, while administered expenses are appropriated to a particular outcome. The Budget Papers state that allocating administered expenses across outcomes will provide a precise specification of how much can be spent on each outcome.¹⁹

Number of outcomes

2.23 The fundamental elements of the outcomes and outputs framework have not significantly changed since its introduction. However, there is considerable variation between agencies in terms of outcome and output structures and the way outcomes and outputs are expressed.

2.24 Act No.1 for 2006-07 included 115 entities with a total of 177 outcomes. However, the majority of Budget-funded entities have only one outcome (as can be seen from the following table).

¹⁸ Treasury Portfolio Budget Statement 1999-2000, Glossary, page 204.

¹⁹ Budget Paper No.4 2006-07, p.4.

Number of Outcomes	Number of Entities	Total Appropriation for Departmental Outputs in 2006-07 (\$ '000)	Total Appropriation for Administered Expenses in 2006-07 (\$ '000)
1	88	9,562,304	1,264,667
2	14	3,884,313	4,163,717
3	6	3,158,121	5,205,152
4	4	2,689,694	1,583,500
5	1	311,009	86,437
6	-	-	-
7	1	17,063,404	-
8	-	-	-
9	-	-	-
10	-	-	-
11	-	-	-
12	-	-	-
13	-	-	-
14	-	-	-
15	1	511,900	3,850,379
TOTAL	115	37,180,745	16,153,852

2.25 Although most entities have a single outcome, the majority of entities have a number of outputs supporting those outcomes. There were over 500 outputs identified in the Portfolio Budget Statements (PBSs) of the 115 entities funded under Act No.1 in 2006-07. However, Parliament does not approve expenditure at output level.²⁰

2.26 In this context, there are some entities with substantial departmental appropriations that have nominated a single outcome, and few supporting outputs. For example, the Australian Taxation Office (ATO) is the largest entity in the Treasury Portfolio in terms of departmental appropriations. Act No.1 appropriated \$2.5 billion in departmental funding, and no administered funding, to the ATO's single outcome, *'Effectively managed and shaped systems that support and fund services for Australians and give effect to social and economic policy through tax, superannuation, excise and other related systems'*. The ATO's PBS shows that there are five outputs that contribute to the achievement of its outcome. Almost half of the ATO's appropriation is attributed in the PBS to one output, *'Compliance assurance and support - revenue collection'*.

²⁰ There are some entities that have just one Output to support the achievement of their outcome. For instance, the Federal Court of Australia has a single outcome, *'Through its jurisdiction, the Court will apply and uphold the rule of law to deliver remedies and enforce rights and in so doing, contribute to the social and economic well-being of all Australians'*, supported by a single Output, *'Federal Court Business'*.

2.27 Another entity in the Treasury portfolio with a single outcome is the Australian Securities and Investments Commission (ASIC). Its outcome is 'a fair and efficient market characterised by integrity and transparency and supporting confident and informed participation of investors and consumers'.²¹ ASIC also has four supporting outputs.

2.28 In scrutinising ASIC's performance in assessing and investigating possible breaches of the corporations legislation, the Parliamentary Joint Committee on Corporations and Financial Services (JCCFS) raised concerns that there may be a lack of resources available for sufficient priority to be given to the assessment and investigation of possible breaches of the corporations legislation by ASIC.²² Specifically, the Committee stated that:

It is not clear to the Committee whether the regulator [ASIC] has the resources to perform its functions in relation to corporate insolvencies or that the importance of ASIC's insolvency functions are adequately recognised in the law.²³

... inadequate funding of the designated regulatory authority in relation to corporate insolvency laws can represent a serious misallocation of a country's resources given that the impact of corporate insolvencies can be widespread and devastating for so many people.

2.29 This is indicative of some of the difficulties Parliament has had in scrutinising, approving and monitoring proposed and actual expenditure where there is one high level outcome, and few supporting outputs.

2.30 In comparison, there are entities in other portfolios whose departmental appropriations are relatively small, but who have multiple outcomes and/or several detailed outputs. For example, the Office of National Assessments (ONA) has a total appropriation in Act No.1 2006-07 of

²¹ The 2006-07 Portfolio Budget Statements show that ASIC will receive an appropriation of \$275.7 million for 2006-07. This represents an increase of almost 24 percent in funding on ASIC's 2005-06 appropriation of \$222.7 million. ASIC's appropriation to its single outcome has more than doubled in the past seven years.

²² Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: a Stocktake*, June 2004.

²³ The Committee noted in this regard that there was no specific mention of ASIC's insolvency role provided in the statement of its corporate aims in s1(2) of the ASIC Act.

\$28 million, all of which was for departmental outputs. ONA has two outcomes²⁴:

- Enhanced government awareness of international political and leadership developments, international strategic developments, including military capabilities and international economic developments; and
- Enhanced intelligence support for Defence planning and deployments, in peacetime and conflict, to maximise prospects for military success and to minimise loss of Australian lives.

2.31 There are also entities that have substantial annual appropriations with a relatively large number of outcomes. For example:

- the Department of Defence (Defence) has seven outcomes²⁵, with a total appropriated amount for Act No.1 of \$17.1 billion. Until 2003-04, Defence had only one outcome '*The defence of Australia and its national interests*'. Whilst the number of nominated outcomes has increased, more than 90 per cent of funds appropriated in Act No.1 were for three of these outcomes (those for Navy, Army and Air Force capability). In any event, as all Defence's Annual Appropriations are departmental, the allocation across outcomes is notional; and
- the Department of Health and Ageing (Health) has 15 outcomes covering both departmental outputs and administered expenses totalling \$4.4 billion. The appropriated funds were more evenly divided across Health's nominated outcomes with no single outcome representing more than 21 per cent of the total appropriated funds.

Approaches to specifying outcomes

2.32 The Solicitor-General has advised that the Constitution requires appropriations to be expressed with sufficient specificity for a court to be able to determine whether any particular expenditure is authorised by the appropriation in question.²⁶ The Office of the Australian Government Solicitor has advised Finance that an appropriation in an Act does not need to take a

²⁴ The ONA's PBS shows three groups of Outputs - 'Product', 'Briefing', and 'Coordination' – which were applied across both outcomes.

²⁵ Defence's outcome seven is funded through a special appropriation and not Appropriation Act No.1.

²⁶ See Audit Report No.15 2004-05, *Financial Management of Special Appropriations*, page 46.

particular form.²⁷ There simply needs to be a sufficiently clear indication from the Parliament that it is authorising expenditure from the CRF for a particular purpose.

2.33 In a submission to the High Court in *Combet v Commonwealth of Australia*, counsel for the Commonwealth stated as follows in respect of the interpretation of outcome based appropriations:²⁸

The current form of Appropriation Acts means that outcomes are necessarily expressed in general terms. Given that they are required to encapsulate in a few words or sentences the diverse activities and responsibilities of a Commonwealth agency, it is inappropriate to adopt a narrow and pedantic approach to their interpretation.

An Appropriation Act is also fundamentally an instrument facilitating the workings of government. Accordingly, outcomes need to be interpreted in a practical sense with due deference being given to the views of the relevant agency as to what expenditure can reasonably be viewed as conducive to achieving the particular outcomes.

Accordingly, where an appropriation designates as its purpose an outcome, then expenditure on anything which a person could reasonably conclude is capable of contributing to the achievement of that outcome is expenditure which is supported by the appropriation.

2.34 Ultimately, it is for the Parliament to identify the degree of specificity with which the purpose of an appropriation is identified.²⁹ In this respect, Chief Justice Gleeson of the High Court has commented as follows:³⁰

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

2.35 The level of detail and specificity concerning outcomes and outputs does vary between entities as indicated above. On this issue, we are aware of

²⁷ *ibid.*

²⁸ *Combet v Commonwealth of Australia*, First, Second and Third Defendant's Submissions, 28 July 2005, p. 3.

²⁹ *Surplus Revenue Case* (1908) 7 CLR 179 at 200 per Isaacs J; *Attorney-General (Vict) v The Commonwealth* (1945) 71 CLR 237 at 253, 256 per Latham CJ; *Victoria v The Commonwealth and Hayden* (1975) 134 CLR 338 at 404 per Jacobs J; cf *Cincinnati Soap Co v United States* 301 US 308 (1937) at 321-322.

³⁰ *Combet v Commonwealth of Australia* [2005] HCA 61, Gleeson CJ at 27.

several reports over recent years that have identified some areas needing improvement in current practice, particularly in the specification and measurement of outcomes. For example, the ANAO concluded in its audit of Annual Performance Reporting³¹ that:

in order to provide accountability and transparency to parliamentarians and other stakeholders, agencies' annual reporting frameworks need to be improved, particularly in relation to:

- the specification of agencies influence on, and contribution to, shared outcomes;
- performance measures relating to quality and effectiveness/impact;
- the efficiency of agency operations and the cost effectiveness of outputs delivered; and
- targets or other basis for comparison.

2.36 Currently, the ANAO is undertaking a cross-portfolio performance audit of the reporting of outputs and outcomes. It is reviewing the policies and practices in place within selected entities for estimating, recording and reporting the cost of outcomes and outputs. The main focus is on whether policies and practices are in place in selected agencies for estimating, recording and reporting the cost and price of outcomes and outputs, whether these entities have established reliable cost attribution systems and robust performance measures relating to their outcomes and outputs, and the extent outcomes and outputs information is used in agency decision-making. This report is expected to be tabled by the end of this calendar year.

2.37 Earlier audit work has shown that the influence of outcomes and outputs information on decision-making and resource allocation appears mixed. Agencies with specific performance measures have been able to provide useful information for budget planning and annual reports. In this respect, examples of good practice were illustrated in the Finance and ANAO Better Practice Guide on Performance Reporting in Annual Reports, published in 2004³².

³¹ Australian National Audit Office, *Annual Performance Reporting*, Audit Report No.11, 2003-04, 4 November 2003.

³² Australian National Audit Office and Department of Finance and Administration, *Better Practice in Annual Performance Reporting*, 8 April 2004, prepared in response to a recommendation of the Joint Committee of Public Accounts and Audit in Report No 388, June 2002.

2.38 Well specified outcomes and outputs combined with good performance information can be valuable for a variety of purposes, both internal and external to the agency. At the same time, it is also clear that poor performance information is counterproductive. Not only is it unhelpful, but it can be misleading, costly, and create perverse incentives.

2.39 Similarly, inadequately specified outcomes can provide quite limited information for decision making. This can be the case where outcomes lack specificity, are aspirational in nature and/or are expressed in terms of an overall objective rather than a specific impact. Among other things, broad outcome statements allow Budget-funded entities to attribute particular activities or programmes to more than one outcome, which reduces the information value of nominated outcomes to the Parliament.

2.40 This was highlighted in ANAO's recent audit of the Roads to Recovery (R2R) Programme administered by the Department of Transport and Regional Services (DOTARS).³³ The R2R Programme was funded through a special appropriation. Payments under that appropriation were consistently recorded by DOTARS in its Annual Reports against the first of its two outcomes, which was then '*A better transport system for Australia*'.³⁴ The audit report identified that DOTARS had made a series of payments under the Programme that were outside the purposes of the special appropriation. However, DOTARS obtained legal advice to the effect that payments for the purposes of the R2R Programme, purportedly made under the special appropriation, could fall within the terms of what was then DOTARS' Outcome 2: '*Greater recognition and development opportunities for local, regional and territory communities*'.³⁵ The advice meant that 99.8 percent of all payments under the R2R Programme were recorded against Outcome 1, with 0.2 percent recorded against Outcome 2.

2.41 In May of this year, the Clerk of the Senate commented as follows to the Joint Committee of Public Accounts and Audit in relation to the R2R Audit Report:

³³ Audit Report No. 31 of 2005-2006, *Roads to Recovery*, Australian National Audit Office, 1 March 2006.

³⁴ DOTARS' outcome 1 now states '*Fostering an efficient, sustainable, competitive, safe and secure transport system*'.

³⁵ DOTARS' outcome 2 now states '*Assisting regions to manage their own futures*'.

Apart from identifying some problems with this program, this report demonstrates that the outcomes system of appropriations has effectively removed parliamentary control of the purposes of expenditure... As long as the outcomes remain as vague and nebulous as they are currently, and the information provided to Parliament is of such paucity, loose shuffling of money such as revealed by this report and previous reports will continue.

2.42 There have been recent moves to increase the use within government of programme-level information and controls. For example, additional internal reporting requirements, particularly in relation to programme information, have been established to provide better information for decision-making. Similarly, programme level controls also exist for funding of long-term commitments by some Departments (in accordance with Regulation 10 of the Financial Management and Accountability Regulations 1997).³⁶

2.43 The experience to date suggests that there would be merit in further reviewing the breadth and presentation of outcome descriptions; and examining whether the greater use of programme-level information would assist Parliament in its work, and improve the transparency and accountability of Commonwealth public funding and expenditure.

Reporting

2.44 The Australian Government publishes two main ex-post annual financial reports, the Final Budget Outcome (FBO) Report and the CFS.³⁷ While the two reports are sourced from the same financial data in respect of the general government sector, the CFS are subject to an audit report while the FBO Report is not. The ANAO has previously acknowledged that the matter of whether the FBO report should be subject to audit was a policy matter for the Government and the Parliament.

2.45 The Australian Accounting Standards Board is progressing the development of an accounting standard for government that harmonises the reporting requirements under accounting standards and Government Finance

³⁶ Regulation 10 provides as follows: If any of the expenditure under a spending proposal is expenditure for which an appropriation of money is not authorised by the provisions of an existing law or a proposed law that is before the Parliament, an approver must not approve the proposal unless the Finance Minister has given written authorisation for the approval.

³⁷ The FBO Report must, by law, be publicly released and tabled by the Treasurer by 30 September each year. The CFS is, by law, to be given to the Auditor-General for audit as soon as practicable after preparation but no later than 30 November each year. The FBO Report for 2004-05 was released on 23 September 2005 and the audited CFS for 2004-05 on 21 December 2005.

Statistics (GFS) for the General Government Sector. The ANAO continues to support the strategic objective to achieve harmonisation because of the importance of reducing the complexity and potential confusion that arises from the preparation of financial reports on different accounting bases and of improving comparability of budget statements with audited reports on the budget outcome. Under this approach, the Government would continue to prepare the CFS in addition to the harmonised financial report for the General Government Sector.

Role of the PBS

2.46 Presenting annual appropriations in terms of the nominated outcomes for each agency can allow Parliament to identify the results that the Government is working towards and how it proposes to allocate funds to contributing to those results. The information in appropriations is supported by a large amount of supporting detail in the relevant entities' PBS containing financial statement projections, performance measures and allocation of resources within agencies.

2.47 The purpose of the PBS and Portfolio Additional Estimates Statement (PAES) (as set out in Part A of agency PBSs, 'User Guide') is to inform Senators and Members of Parliament of the proposed allocation of resources to outcomes by agencies within the portfolio. The PBS and PAES facilitate understanding of the proposed appropriations in the annual Appropriation Bills. They set out the amounts being requested in the annual Appropriation Bills alongside the estimated amounts available from all other appropriation sources. In this sense, the PBS and PAES are declared to be 'relevant documents' to the interpretation of the Bills according to Section 15AB of the *Acts Interpretation Act 1901*.

2.48 The stated aim of the move to outcomes appropriations was to allow a clear linkage through PBS and PAES to agency annual reports and financial statements.³⁸ However:

- whilst the PBS provides considerable additional detail in respect of departmental outputs, the amounts are not required to be spent in the

³⁸ Budget Paper No. 4, *Agency Resourcing 1999-2000*, circulated by the Honourable John Fahey, M.O., Minister for Finance and Administration of the Commonwealth of Australia for the information of Honourable Members on the Occasion of the Budget 1999-2000, p. iv.

manner identified in the PBS (as outlined in *Combet v Commonwealth of Australia*);

- for administered expenses, generally less detail is provided in the PBS than for departmental items. Further, whilst an administered appropriation may be used for any or all of the activities mentioned for that item in the PBS, its use is not restricted to those activities mentioned in the PBS; and
- notwithstanding the additional detail provided, the final appropriation sources may not be certain, especially where outcomes are specified so as to overlap with the purposes of other funding sources, such as special appropriations.

2.49 Sound performance information helps agencies be accountable. In this respect, PBSs set out performance measures and statements of expected performance by each agency and its programmes, with the results of actual performance reported later in annual reports. However, through its audit activities, ANAO has identified some variability in the reliability of the appropriation funding data provided to the Parliament in the PBS and PAES. In particular, in certain circumstances, the PBS has not provided a good indication of how some appropriated funds will actually be used by entities. For example:

- in the recent audit of Management of Net Appropriation Agreements,³⁹ ANAO identified that the accuracy and consistency of the Section 31 receipt estimates that are disclosed in agency PBSs should be improved;
- in Audit Report No. 15 2004-05 *Financial Management of Special Appropriations*, ANAO found several instances in which annual appropriations were requested for activities for which Parliament had already provided a special appropriation; and
- in Audit Report No. 4 2005-2006 *Post Sale Management of Privatised Rail Business Contractual Rights and Obligations*, ANAO found that the PBS reporting of FACS had consistently over-estimated the amount of funding it required to pay the purchaser of the passenger rail business for concessional rail travel.

³⁹ Audit Report No. 28 2005-06.

Financial statement audits

2.50 The financial reporting requirements for Commonwealth agencies and authorities are contained in Finance Minister's Orders made under Section 63 of the FMA Act and Section 48 of the *Commonwealth Authorities and Companies Act 1997* (CAC Act). The Finance Minister's Orders provide minimum mandatory disclosure and reporting requirements for each Commonwealth agency and authority. The mandatory requirements of the Finance Minister are combined with guidance (formally identified as Explanatory Notes) prepared by Finance. They are published in a single document.

2.51 Agencies are required to disclose in the notes to their financial statements:

- acquittals of the authority to draw cash from the CRF through appropriations for each appropriation; and
- reporting of outcomes and outputs.

2.52 Having regard to the findings of recent performance audits of the financial framework and the views expressed by the Joint Committee of Public Accounts and Audit (JCPAA) on the importance of agencies' adherence to the framework, ANAO has increased the focus on legislative compliance as part of our financial statement audit coverage. In particular, work programmes focussing on key aspects of legislative compliance in relation to annual appropriations, special appropriations, annotated appropriations, special accounts and the investment of public funds are being applied in the 2005–06 financial statement audits to obtain reasonable assurance about an agency's compliance with targeted legislative aspects of the financial management framework. This work does not reduce the need for each entity to conduct its own quality assurance process over legislative compliance.

3. Multiple funding sources

Introduction

3.1 Growth in the number and scope of appropriations, combined with more than one appropriation existing for the same purpose, affects the control over drawings from the CRF. In this context, management of appropriated funds is an issue that is regularly examined in ANAO performance audits of programmes and activities. In addition, the ANAO has undertaken a series of audits examining the Commonwealth's financial framework. Key audits in this series have been:

- Audit Report No.24 2003-04, *Agency Management of Special Accounts*;
- Audit Report No.15 2004-05, *Financial Management of Special Appropriations*;
- Audit Report No.22 2004-05, *Investment of Public Funds*; and
- Audit Report No.28 2005-06, *Management of Net Appropriation Agreements*.

3.2 Each of the financial framework audits revealed quite widespread shortcomings, particularly in relation to appropriations and compliance with the requirements of the financial framework. The table on the following page outlines the audit conclusions from each report. Through its inquiries into each of the framework audits, the JCPAA has emphasised the importance the Parliament places on compliance with the legislation that establishes the financial framework.

Audit Report	Agency Management	Overall Conclusions	Finance's Role
		Accountability to the Parliament	
No. 24 2003-04: Agency Management of Special Accounts	Non-compliance with a number of legislative requirements and inadequate understanding of, and non-compliance with, aspects of the legislation that has established particular Accounts. Appropriation management procedures were found to be inadequate in a number of agencies.	Widespread non-reporting of Special Accounts (41 percent not reported in 2001-02), and significant inaccuracies in the financial disclosures on some of those Accounts that have been reported.	<p><u>Finance Circulars:</u></p> <p>2003/04: Guidelines for the Implementation of Administrative Arrangements Orders and other Machinery of Government changes;</p> <p>2003/09: Guidelines for the Management of Special Accounts;</p> <p>2004/06: Appropriations and the Consolidated Revenue Fund;</p> <p>2004/07: Drawing Rights – Payments and Debiting Appropriations;</p> <p>2004/08: Appropriation for Repayments under Section 28 of the FMA Act;</p> <p>2004/09: Net Appropriation Agreements (Section 31 Agreements) [replaced by 2005/07];</p> <p>2004/10: Using the FMA Regulation 10 Delegation;</p> <p>2004/16: Appropriation Management – Responsibilities of agencies;</p> <p>2004/17: Appropriation for Payment to CAC Act Bodies;</p> <p>2005/03: Estimation by agencies of their next-day drawdown cash requirements;</p> <p>2005/05: Investment of Surplus Money</p> <p>2005/06: The financial framework – accountability for compliance and dealing with breaches;</p> <p>2005/07: Net appropriation agreements (Section 31 Agreements)</p> <p>2005/08: Section 30 of the FMA Act – Reinstatement of appropriations for amounts repaid;</p> <p>2005/11: Investment of public money – section 39 of the FMA Act;</p> <p>2005/13: Allocation of responsibilities for special appropriations.</p> <p><u>Financial Management Guidance:</u></p> <p>No. 5: Implementation of AAOs and other Machinery of Government changes, September 2003;</p> <p>No. 7: Management of Special Accounts, October 2003.</p>
No. 15 2004-05: Financial Management of Special Appropriations	Inadequate attention by a number of entities to their responsibility to ensure that a correct, valid appropriation to support a particular payment has been identified before spending funds, and to accurately disclose their use of Special Appropriations.	More than half of all existing Special Appropriations were not appropriately disclosed by the responsible entities in their annual financial statements. In the five-year period covered by the audit, 21 entities made, but did not disclose as Special Appropriation drawings from the CRF, payments totalling at least \$13.1 billion from 11 Special Appropriations. Errors identified in the reporting and disclosure of Special Appropriation spending.	
No. 22 2004-05: Investment of Public Funds	Shortcomings in the management of the investment of public funds. Entities require strategies and procedures that both comply with the investment parameters provided by the Parliament and optimise risk-adjusted returns.	Between 11 and 13 entities purchased and reported holding investments not authorised by the relevant legislation. In total more than \$566 million in unauthorised investments were identified.	
No. 28 2005-06: Management of Net Appropriation Agreements	Inadequate attention by a number of agencies to their responsibility to have in place demonstrably effective Section 31 arrangements that support additions made to annual appropriations and the subsequent expenditure of those amounts.	The current presentation of budget estimates does not assist in providing users of the PBSs with a clear understanding of the extent to which the relevant agency expects to increase its annual appropriation for amounts collected under its Section 31 agreement. Further, agency financial statements have not accurately reflected the use of Section 31 arrangements.	

3.3 As a positive response to the comments of the JCPAA and the matters raised by the audit reports, Finance has issued further guidance to agencies on these matters. In addition, Finance is introducing requirements for agency Chief Executives to provide an annual statement of compliance with the legislative and policy elements of the financial management framework. Further, in respect of future audit reports that consider financial framework issues, Finance has indicated that it will write to relevant Chief Executives regarding their responsibilities under the financial framework to investigate compliance failings and suggesting that consideration be given to informing the responsible minister and/or Parliament of the results of that investigation.

3.4 This chapter of the submission outlines some of the issues raised in ANAO's reports regarding net appropriation agreements made under Section 31 of the FMA Act, Special Appropriations and Special Accounts.

FMA Act provisions relating to appropriations

3.5 The FMA Act provides various mechanisms by which a lawful appropriation may be provided to support the retention and expenditure by an agency of amounts received from non-appropriation sources.

3.6 Section 31 of the FMA Act provides a means by which agencies can increase their annual departmental and, in some cases, administered appropriations by the amount of relevant receipts covered by their Section 31 agreement. An alternative mechanism for the retention and spending of receipts is a Special Account. Sections 20 and 21 of the FMA Act provide a standing appropriation for expenditure for the purposes of a Special Account, up to the balance for the time being of the Account.

3.7 Appropriations and other receipts are to be credited to a Special Account in accordance with the provisions of the establishing Determination or legislation. The balance of a Special Account represents amounts within the CRF that are hypothecated, or set aside, for the specific purposes of that Account.

3.8 Other provisions of the FMA Act that are relevant to appropriations management by agencies are more in the nature of 'recycling' provisions. That is, they do not provide an effective net increase in the appropriation otherwise available for expenditure on approved outcomes. Relevant provisions are:

- Section 28, which applies if an Act or other law requires or permits the repayment of an amount received by the Commonwealth and, apart from that section, there is no appropriation for the repayment;
- Section 30, which provides for amounts previously paid out of an appropriation and then repaid to the Commonwealth to be re-credited to the appropriation from which the original payment was made, such that the appropriation is available to be paid out again;
- Section 30A, which operates to automatically increase appropriations for the recoverable GST component of payments made; and
- Section 32, which provides the Finance Minister with the authority to issue directions transferring appropriations between agencies upon a change of agency functions.

3.9 These provisions serve discrete purposes in agencies' appropriation management processes. In that context, it is important that agencies provide a clear and accurate account of the extent to which they have exercised the authority provided by Section 31 and other provisions of the FMA Act to increase their available appropriations. Inaccuracies in reporting can provide the Government and the Parliament with a misleading impression of the extent to which an agency has actually generated additional appropriation authority through its transactions with other entities.

3.10 The operation of Section 28 of the FMA Act was examined in the course of ANAO's recent performance audit of Financial Management of Special Appropriations.⁴⁰ Finance Circular No. 2004/08, *Appropriation for Repayments under Section 28 of the FMA Act*, was issued by Finance in August 2004.

3.11 Issues concerning the operation of Sections 30 and 32 arose during the course of ANAO's audit of net appropriation agreements.⁴¹ In particular, Chapter 2 of that report identified deficiencies in the manner in which appropriations were transferred to the Bureau of Meteorology upon its establishment, including the absence of Section 32 directions to support the transfer of cash. This contributed to the Bureau breaching Section 83 of the Constitution.

⁴⁰ ANAO Audit Report No. 15 2004-05, *Financial Management of Special Appropriations*, Canberra, 23 November 2004, pp. 41-43.

⁴¹ ANAO Audit Report No. 28 2005-06, *Management of Net Appropriation Agreements*.

Increasing Annual Appropriations through net appropriation arrangements

3.12 Net appropriation arrangements are a longstanding feature of the Commonwealth's financial framework. They provide a means by which an agency's appropriation item in the annual Appropriation Acts can be increased by amounts received from non-appropriation sources. This provides the agency with the appropriation authority to retain and spend those amounts.

3.13 During the course of the 1990s, the use of net appropriation arrangements became more widespread amongst agencies, in part reflecting public sector management reforms introduced at the time. This particularly related to an increasing focus on user charging and cost-recovery by agencies for some services, as a means of improving resource allocation and reducing the call on Budget funding for agency running costs. In 2004-05, 67 agencies reported Section 31 receipts totalling \$1.46 billion.

3.14 Under the Commonwealth's current financial framework, Section 31 of the FMA Act allows the Finance Minister to enter into net appropriation agreements (known as Section 31 agreements) for the purposes of appropriation items in Appropriation Acts that are marked "net appropriation". The FMA Act requires that an agreement be made with the Minister responsible for the appropriation item or, in the case of items for which the Finance Minister is responsible, with the Chief Executive of the agency for which the appropriation is made.

3.15 A Section 31 agreement specifies the types of departmental and/or administered receipts that will be eligible to be retained by the relevant agency, and the terms on which the relevant appropriation item will be increased for those receipts by operation of the agreement. For example, the agreement may require certain receipts to be shared with the Budget in nominated proportions. The annual Appropriation Acts provide that, if a Section 31 agreement applies to an appropriation item, the amount specified in the item is taken to be increased in accordance with the agreement, on the conditions set out in the agreement. The increase cannot be more than the relevant receipts covered by the agreement.

3.16 In this respect, the relevant provisions of the annual Appropriation Acts and FMA Act provide the Executive Government with the authority to increase the appropriations set out in the Schedules to the Appropriation Acts, providing certain specified steps are undertaken. The terms of Section 31 of the

FMA Act must be complied with in order for an agency to obtain the authority to retain and spend amounts received from non-appropriation sources.

3.17 Audit Report No.28 2005-06 *Management of Net Appropriation Agreements* assessed agencies' financial management of, and accountability for, the use of net appropriation agreements to increase available appropriations. Many of the findings of this performance audit related to agencies' understanding of, and compliance with, the current financial framework. The audit also identified scope for enhancing certain aspects of the financial framework as it operates in respect to net appropriations.

Retrospective application of Section 31 agreements

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

3.19 The basis on which legal advice provided to agencies has concluded that agreements made under Section 31 of the FMA Act can be expressed so as to apply to amounts previously received has been the broad nature of the language of that Section, and the absence of any provision requiring that such agreements may only operate prospectively. In this context, greater specificity in the FMA Act as to the conditions under which an agreement can be applied retrospectively to amounts previously received would assist in enhancing the rigour of the financial framework and promoting orderly governance of appropriations.

3.20 Irrespective of any legislative changes, retaining cash receipts for significant periods in anticipation of subsequently obtaining the necessary appropriation authority to spend those amounts, or operating for a period of time as if that authority existed when it did not, can put an agency at risk of spending in excess of its legally available appropriation. This risk would be reduced by changes to administrative practices that meant that, wherever possible, Section 31 agreements are in place prior to agencies receiving eligible amounts.

3.21 In this respect, Finance agreed to an audit recommendation that it consider the merits of including greater specificity in the relevant legislative

provisions regarding the conditions under which net appropriation agreements may be applied retrospectively to amounts previously received by an agency.

Role of Section 31 agreements

3.22 One of the more significant changes under the FMA Act from the net appropriation arrangements that previously existed was the change in the role played by the agreement itself.

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

3.24 The audit found that difficulties have been encountered by a number of agencies in terms of ensuring an agreement that is relied upon has been effectively executed and/or is capable of operating in the manner intended. In this context, the audit concluded that there may be merit in examining the ongoing role of individual agency agreements in the management of net appropriations. Areas that could be examined include:

- The nature of the instrument that is used to provide an agency with access to net appropriations. Changes to the instrument could provide greater certainty over the effectiveness of net appropriation arrangements by reducing the potential for officials to act without Ministerial authorisation. One option may be to revise the relevant legislative provisions so that the Finance Minister (or his or her delegate) may, following consultation with the relevant Minister, issue a direction regarding the conditions under which specified receipts may be retained by an agency; and
- Whether instruments relating to individual agencies should be retained as the means of specifying eligible receipts. Specifically, returning the central role in net appropriations from individual agency agreements to the annual Appropriation Acts so as to provide certainty and transparency in relation to the majority of net appropriations that will

be available to agencies, without the need for separate agency agreements in all cases.

3.25 Finance agreed to an audit recommendation that it examine options to improve the framework for net appropriation arrangements, including the merits of specifying the relevant terms and conditions (including common eligible receipts) in the annual Appropriation Acts, rather than through delegated legislation (Section 31 agreements).

Special Appropriations

3.26 Audit Report No.15 2004-05 *Financial Management of Special Appropriations* found that during 2002-03, there were 414 Special Appropriations in existence. Finance has advised agencies that Special Appropriations, rather than Annual Appropriations, would generally be appropriate where there is a need or desire (on the part of the Government) to:

- fund a legal entitlement to a benefit which is to be provided to those who satisfy criteria set out in law (for instance, age pensions);
- give effect to inter-governmental funding agreements or arrangements;
- demonstrate the independence of an office from the Parliament and the Executive by providing for the automatic payment of remuneration of holders of statutory offices (such as judges);
- demonstrate Australia's ability to meet its financial obligations independently of parliamentary approval of funds (as, for instance, in the repayment of loans);
- provide urgent payment where alternative arrangements are unsuitable or inappropriate (for instance, for relief from natural disasters); or
- provide funding for unique circumstances which would be difficult to accommodate in Annual Appropriation bills.⁴²

3.27 Special Appropriations are not subject to the Parliament's annual budgetary control in the manner that Annual Appropriations are. They are, however, subject to the Parliament's examination (through Estimates Committees, for example).

⁴² Estimates Memorandum 2003/27, *Refresher on Appropriation Framework – Rules*, Department of Finance and Administration, 28 August 2003.

3.28 Each Special Appropriation provides a right to spend money from the CRF subject to meeting legislative criteria. In some cases the appropriation is not limited in amount. It is therefore important that there is defined responsibility and accountability for such appropriations and that access to the CRF is withdrawn when it is no longer needed. ANAO concluded that this had not been the case, as follows:

- a large number of Special Appropriations that entities no longer required remained in existence. In the main, entities did not seek to have unnecessary Special Appropriation clauses repealed.
- in some instances, entities had obtained more than one appropriation for the same purposes; and
- no entity had accepted responsibility for some Special Appropriations. Conversely, there were also instances where more than one entity claimed to be administering the same payments from the same Special Appropriation. Other situations involved shared responsibility, but in circumstances where accountability arrangements often lacked clarity.

Special Accounts

3.29 A Special Account is a mechanism used to record amounts in the CRF that are appropriated for specified purposes. Special Accounts can be created through a determination by the Finance Minister (which is a disallowable instrument), or through an Act of the Parliament. Special Accounts enable money to be earmarked within the CRF for the purposes for which the account has been established.

3.30 The Determination or legislation establishing a Special Account usually provides the legal authority for amounts to be credited to the Account. In some instances, legislation requires (as opposed to permits) amounts to be credited to a Special Account. In these circumstances, the crediting occurs by operation of law without any administrative action needing to be taken. The relevant entity is then responsible for ensuring that its accounts and records properly reflect that crediting.

3.31 In addition, provisions in the Annual Appropriation Acts permit the debiting of an amount from an annual appropriation item, and the crediting of that amount to a Special Account, where any of the purposes of the Special

Account is a purpose that is covered by the item.⁴³ However, where an amount is debited from an Annual Appropriation or Special Appropriation and credited to a Special Account, the conditions applying to the expenditure of that amount may change. That is, when the amount is appropriated to an entity through the Annual Appropriation Acts, it is usually appropriated either for departmental expenses, or for the achievement of an administered outcome. If the amount is subsequently credited to a Special Account, the funds may only be spent on the purposes of the Special Account.

3.32 Special Accounts represent a type of special appropriation, as there is a standing appropriation for the purposes of each Account, up to the balance of the Account. In this context, amounts may be debited against a Special Account in the following circumstances:

- in accordance with the specified purposes of each Account, up to the balance of the Account;
- correcting clerical errors;
- when the crediting of an Account occurred through the exercise of a discretion by an official, and the exercise of that discretion was actuated by a fundamental mistake of fact or law, the credit may be reversed; and
- some recently established Special Accounts include a provision that the Special Account may be debited for the purpose of reducing the balance of the Account 'without making a real or notional payment'.⁴⁴ The transparency of reductions to Special Account balances where there has been no payment, real or notional, is an issue that would benefit from further disclosure by agencies where such transactions occur.

⁴³ See, for example, section 14 of *Appropriation Act (No.1) 2006-07*.

⁴⁴ A note to the Determinations establishing the relevant Accounts states that this purpose has been included 'solely for extinguishing all or part of the appropriation under Section 20 of the FMA Act' for the purposes of those Special Accounts. Such a provision relates to concerns raised in the Special Accounts audit where ANAO identified that some entities had returned cash to the Official Public Account from their agency bank accounts and reported a consequential reduction in the balance standing to the credit of the Special Account. Legal advice at the time was that such actions did not legally reduce the balance hypothecated by the Special Account, with the result that the balances were reinstated.

3.33 Guidelines issued by Finance state that a purpose of a Special Account is generally expressed in specific terms that distinguish the Special Account from other purposes for which money may be appropriated by the Parliament.

Transfers to and from Appropriations

3.34 An issue that has arisen in a number of the financial framework series of audits has been the transfer of amounts within and across appropriations. Notional intra-agency transactions have usually related to the agency charging a 'fee' for services provided to a Special Account, or being reimbursed for amounts initially paid out of its departmental appropriation for activities relating to the purposes of the Account.

3.35 The movement of appropriation authority from Special Accounts to Annual Appropriations is possible through effective net appropriation arrangements. Such movements change the purposes to which funds may ultimately be applied. In this respect, ANAO has examined a number of instances where amounts debited from administered Special Accounts have been credited to an entity's Annual Appropriation for departmental outputs. In such circumstances, it is not simply the purpose to which amounts may ultimately be put that can change, but the nature of the relevant entity's control over those funds.

3.36 The movement of appropriation authority from Special Accounts to Annual Appropriations was first raised in ANAO's January 2004 report titled *Agency Management of Special Accounts*. This report noted that:⁴⁵

According to legal advice obtained by Finance on the Special Accounts framework, it is ordinarily not possible to debit a Special Account and credit an annual appropriation. This is because the purposes of the Special Account are normally different from, and narrower than, the purposes of an annual appropriation item. The uncontrolled crediting of amounts to Departmental appropriations therefore would be inconsistent with those statutory provisions that confine expenditure from Special Accounts to the specified purposes of the Account.

3.37 The necessary mechanism to credit amounts to Annual Appropriations that have been debited from Special Accounts is an effective Section 31 Agreement. Accordingly, the management of such transactions was examined

⁴⁵ Audit Report No.24 2003-2004, *Agency Management of Special Accounts*, page 74.

further in ANAO's January 2006 report titled *Management of Net Appropriation Agreements*. This report noted that:⁴⁶

In order for an agency's annual appropriation to be increased for such amounts, the notional 'payment' received from the Special Account must be able to be treated as both:

- an 'eligible receipt' for the purposes of its Section 31 agreement; and
- a 'relevant receipt' for purposes of the net appropriation provisions of the annual Appropriation Acts.

A number of agencies have had a practice of including amounts debited from internally managed Special Accounts in the Section 31 receipts added to their annual appropriations. Despite this, there is ongoing uncertainty as to whether both of those conditions have been satisfied.

3.38 In that report, ANAO recommended that Finance take the necessary steps to align the provisions relating to notional transactions in the annual Appropriation Acts with those set out in Section 6 of the FMA Act. This would then provide certainty as to the capacity of amounts debited from internally managed Special Accounts to be captured by agencies' Section 31 agreements. Finance agreed with qualification to the recommendation, advising that it will give policy consideration to this recommendation and to whether such transactions should be included in Section 31 agreements.

⁴⁶ Audit Report No.28 2005-2006, *Management of Net Appropriation Agreements*, page 67.

4. Use of ordinary annual services appropriations

The Compact of 1965

4.1 Section 53 of the Constitution provides that the Senate may not amend proposed laws appropriating revenue or moneys for the ordinary annual services of the Government. In order to settle the question of which matters fit into the term 'ordinary annual services of the Government', the Senate and the then Government made an agreement, known as the *Compact of 1965* (the Compact). The Compact, which was altered in 1999 for the introduction of accrual budgeting, requires that:

- Annual Appropriation Acts No.2, No.4 and No.6 include, among other things, activities for which appropriations have not been made in the past, all non-operating appropriations, and grants to the States authorised by Section 96 of the Constitution; and
- Annual Appropriation Acts No.1, No.3 and No.5 include the costs and expenses of maintaining the Government's ordinary annual services.

4.2 In this context, recent ANAO audit activities have identified issues with adherence to the terms of the Compact. For example, Audit Report No.15 2004-05 *Financial Management of Special Appropriations* examined instances where, irrespective of the existence of a Special Appropriation to meet certain expenditure, entities obtained additional appropriation authority for this expenditure through Annual Appropriations.

4.3 As a result of that audit, the Senate Appropriations and Staffing Committee considered the specific instance of multilateral aid payments raised by ANAO. This Committee concluded in its 41st report that an initial payment to an international organisation in effect represents a new policy decision and therefore should be in Appropriation Act No. 2, whereas subsequent payments represent a continuing government activity of supporting the international organisation and therefore represents an ordinary annual service and should be in Appropriation Act No. 1. At the time of ANAO's audit, initial payments were being included in Act No. 1.

4.4 ANAO has also identified differing views on the requirements of the Compact.⁴⁷ For example, the *Appropriation (Tsunami Financial Assistance) Act 2004-2005* appropriated a total of \$131.375 million to 10 agencies in six portfolios to replace funding diverted from current programmes to meet the needs of the initial Asian Tsunami crisis. The Bill for the Act was presented to the Parliament as being for the ordinary annual services of the Government, but the Senate passed it 'without amendment', indicating, we understand, that it was passed as a Bill not for the ordinary annual services of the Government.

4.5 In addition, in *Combet v Commonwealth of Australia*, it was submitted to the High Court by the defendants that:

The [*Compact of 1965*] Agreement is a political agreement the terms of which are vague and indeterminate. It is non-justiciable.

4.6 In this light, and consistent with long-standing practice, the Compact, and its interpretation, are properly matters for the Parliament to resolve.

⁴⁷ Specifically, Audit Report No. 25 2005-06, *ASIC's Implementation of Financial Services Licenses* outlined that there is not a shared understanding between the Department of the Senate and the Department of Finance and Administration of the appropriate allocation between the Annual Appropriation Acts of departmental amounts for new policy.