Australian Government

Department of Finance and Administration

DEPARTMENT OF FINANCE AND ADMINISTRATION

SUBMISSION TO THE

SENATE FINANCE AND PUBLIC ADMINISTRATION REFERENCES COMMITTEE

Inquiry into the transparency and accountability of Commonwealth public funding and expenditure

4 August 2006

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1. INTRODUCTION

1.1 Purpose of this Submission

This is a submission from the Department of Finance and Administration (Finance) to the inquiry of the Senate Finance and Public Administration References Committee (the Committee) into the transparency and accountability to Parliament of Commonwealth public funding and expenditure.

The purpose of the submission is to provide information to the Committee on relevant policy and administration developments, explanation of current reporting and accountability arrangements and an overview of work in progress on the matters at issue and likely future directions.

1.2 Overview of reporting and accountability arrangements

The Australian Government completed its move to accrual budgeting in 1999-2000 with the tabling of the first accrual-based budget. The move followed recommendations in support of an accrual approach in 1995 and 1996 by the Joint Committee of Public Accounts and Audit (JCPAA) and the National Commission of Audit[1] (NCOA).

In addition to comprehensive application of independent, accounting standards, the changes to budgeting, reporting and accountability in 1999-2000 included some changes to the form and content of annual appropriations, explicit attribution of resources to the outcomes and outputs that they would be used to achieve, and publication of a set of budgeted financial statements for each agency in the general government sector.

Appropriation types did not change significantly in the move to accrual-based budgeting. A summary of current appropriation types is provided in Figure 1. The figure shows that there are two basic appropriation types: special and annual. Within the two basic types, different appropriation classifications are used for different purposes.

1.2.1 Special Appropriations

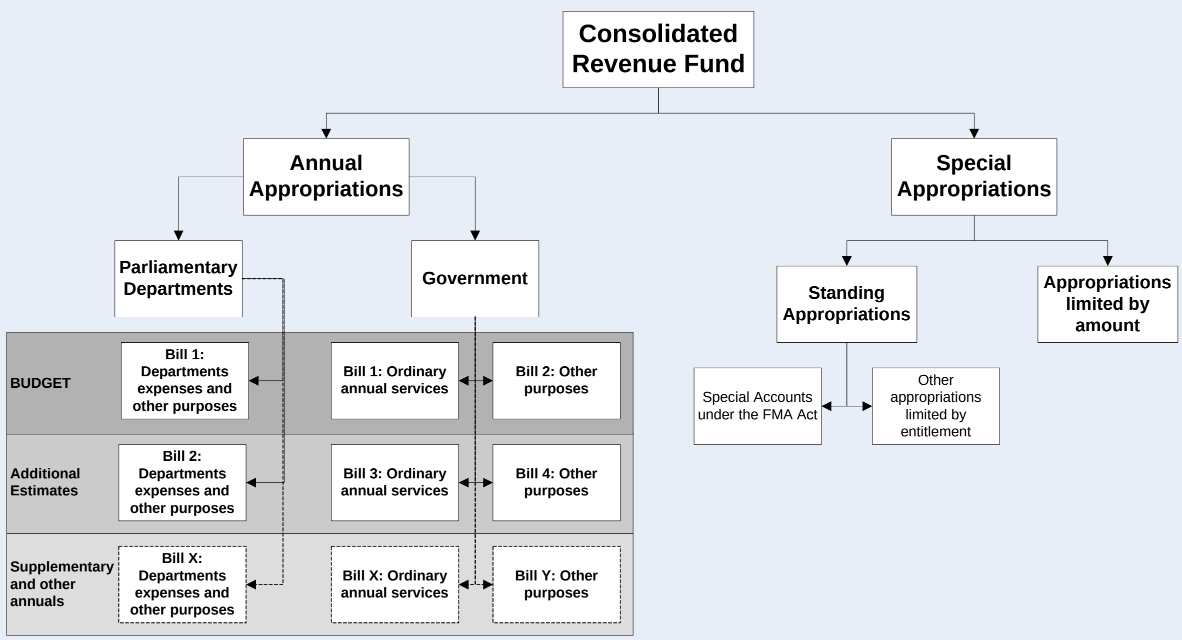
In 2005-06 almost $244 billion was drawn from the Consolidated Revenue Fund (CRF) under special appropriations, including around $55 billion for tax refunds under the *Tax Administration Act 1953*. This represented more than 80% of all appropriation drawings for the year. Special appropriations are used for purposes approved by both Houses of Parliament, which are prescribed within specific legislation (other than annual

[1] Joint Committee of Public Accounts and Audit, Reports no.338 and 341, and National Commission of Audit, *Report to the Commonwealth Government*, June 1996

appropriation Acts). They are subject to full Parliamentary scrutiny procedures before they are enacted giving Senators and Members the opportunity to examine and assess the impact of the relevant provisions.

Some special appropriations are limited by amount while others are limited by entitlement eligibility criteria specified in the legislation. These appropriations are often referred to as standing appropriations because they 'stand' as long as the conditions specified in legislation apply.

Figure 1: Types of appropriation



Special accounts are a type of special appropriation available under the *Financial Management and Accountability Act 1997* (FMA Act). They may be used when the Government wishes to earmark amounts for specific government programmes or to increase the transparency of the amounts. Special accounts are established either by passage of specific legislation by Parliament or by a Finance Minister's Determination under the FMA Act which may be disallowed by Parliament. Most of the current special accounts have been established through a Finance Minister's determination.

Agencies are required to report on estimated expenditure under each special appropriation, and estimated debits and credits to special account balances, in Portfolio Budget Statements (PB Statements) at the time each budget is tabled. The actual special appropriation expenditure and debits and credits to special accounts must be reported in each agency's financial statements.

1.2.2 Annual Appropriations

Annual and special appropriations have been the basis for Parliament to authorise withdrawal of moneys from the CRF since 1901. However the form and content of each type of annual appropriation bill has changed over time. Accrual-based annual appropriations provided, for the first time, a direct relationship between the outcomes to be achieved and the resources applied, consistent with information provided in PB Statements and agency annual reports every year.

Within annual appropriations there is a range of categories applying different controls and accountability obligations for different purposes:

- Advance to the Minister for Finance;
- Receipts retained under section 31 of the FMA Act;
- Appropriations for Goods and Services Tax;
- Separate departmental and administered annual appropriations; and
- Separate annual appropriations for ordinary annual services of government.

These are explained below.

1.2.2.1 Advance to the Finance Minister (AFM)

The AFM is a provision approved by Parliament as part of the annual appropriation Acts. It allows the Minister for Finance and Administration to use the Advance, within limits set in the legislation, for situations where an agency needs additional appropriation urgently which is either unforeseen or arises because of erroneous omission or understatement of estimates when the appropriation bill was finalised.

The Advance has been a feature of the annual appropriation Acts since the first Commonwealth Budget in 1901. The trend since Federation has been for the amount available from the Advance to represent a declining proportion of total annual appropriations. The total amount available for AFM in the 2006-2007 annual appropriation Acts is $390 million, or 0.6% of the total appropriation for Acts 1 and 2 of $62.5 billion. By way of comparison, in 1983-1984 the AFM was $270 million, or 1.6% of total appropriations for Acts 1 and 2 of $16.7 billion.

Determinations created under the AFM provisions are registered as soon as possible on Federal Register of Legislative Instruments and those determinations which remain as a final charge are reported in the document AFM as a final charge and are tabled in Parliament.

1.2.2.2 Receipts retained under section 31 of the FMA Act (net appropriations)

Net appropriation arrangements are a longstanding feature of the Commonwealth's financial framework[2]. They provide a means by which an agency's appropriation can be increased by an amount equivalent to the receipts the agency generates.

Once a net appropriation agreement has been made, Parliament is kept informed of the expected and actual increases to an agency's appropriation. Parliament is informed of estimated receipts in agency PB Statements before it decides on the annual appropriation Acts.

The Australian National Audit Office (ANAO) noted in its recent audit of net appropriation agreements that, "quite specific obligations in relation to keeping proper accounts and records are placed on agency Chief Executives by the FMA Act and the Finance Minister's Orders (FMOs). These include an obligation to keep the records of the agency in a manner that, among other things, ensures that moneys are only expended for the purpose for which they were appropriated, and the limit (if any) on appropriations is not exceeded."[3]

The FMA Act places responsibilities on agency chief executives to report the actual amounts received in the appropriation note to their financial statements, published in annual reports.

1.2.2.3 Appropriations for Goods and Services Tax (GST)

Annual appropriation Acts do not include allowance for GST. This approach is in line with the accepted accounting practice for GST, which specifies that revenues, expenses and assets are to be recognised net of the amount of recoverable GST.

The FMA Act was amended by Parliament to incorporate section 30A which provides for an increase to the relevant appropriation by the amount recoverable for GST. Section 30A only applies where the agency can recover the amount of the payment as an input tax credit under the GST law. This means that the net impact on the CRF of the GST supplement under section 30A is zero, once the recoverable GST paid by agencies has been refunded by the Australian Taxation Office.

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[2] Section 35 of the Audit Act 1901 was the equivalent of section 31 of the FMA Act

[3] Australian National Audit Office, *Management of Net Appropriation Agreements*, No.28, Canberra 2005

The *Financial Management and Accountability Orders* require agencies to disclose the amount each appropriation was increased by section 30A during the reporting period in the notes to their financial statements.

1.2.2.4 Separate departmental and administered annual appropriations

The accrual-based outcomes budgeting framework specifically identifies resources that agency chief executives administer on behalf of government and cannot change. These items are referred to as administered items, consistent with government accounting rules. Annual appropriations for administered items are limited by outcome. Outcomes identify the results or consequences that the government is seeking to achieve with each appropriation. Changes to the appropriation for administered items in each outcome are made only through the appropriation Acts.

Resources that are not classified as administered are called departmental items. This classification includes resources associated with agency operating costs amongst other activities that are determined under accounting standards to be controlled by agencies.

The concept of departmental items has some similarity, but is not identical to, the classification of running costs under cash budgeting arrangements. Annual appropriation bills provide a notional attribution of departmental items against each outcome but do not limit movement of those resources between outcomes during the year. Details of departmental assets, liabilities, equity, revenue, expenses, capital and cash are presented in agency financial statements. PB Statements include forecast financial statements for the budget year and agency annual reports include audited final statements.

PB Statements also include information on non-financial indicators used by government to monitor agency performance in contributing to outcomes. Results in terms of those indicators, as well as the financial results, are presented in agency annual reports.

1.2.2.5 Separate annual appropriations for ordinary annual services of government

In 1965 the Senate and the Executive Government established a formal understanding about the content of annual appropriations for the ordinary annual services of government (Bill 1) and other annual appropriations (Bill 2). That understanding, referred to as the Compact, has been refined periodically since 1965. The change to accrual and outcome concepts in 1999 required a modest refinement to accommodate changes in accounting treatment for revenue and expenditure.

The refinements to the Compact specified in correspondence between the Minister for Finance and Administration and the President of the Senate in 1999 reflected the introduction of concepts such as departmental and administered resources, outcomes and new arrangements for treating capital expenditure and equity movements.

Under the Compact, Bill 1 contains appropriations for departmental items and outcomes that have previously been the subject of appropriations approved by Parliament, excluding payments to other Australian governments and non-operating ‘capital’ costs. Bill 2 incorporates items not classified to Bill 1, including payments to other Australian governments, administered appropriations for capital within new outcomes (including construction or acquisition of land, public works and buildings and major plant and equipment).

Annual appropriations for ordinary annual services and for other purposes cannot be increased without Parliamentary consent (except as outlined above). The intended use of annual appropriation expenditure is explained in PB Statements from four dimensions: total agency resourcing, by source and outcome, is summarised in a single table; the estimated financial impact of each new measure for each agency is identified; appropriations applied to specific outcomes are reported along with non-financial performance information on effectiveness, efficiency, quality and quantity of outputs. Forecast financial statements prepared in accordance with accounting standards, incorporating all revenue, expenses, assets and liabilities of each agency are also provided.

Agency annual reports provide information on results in relation to sources and uses of revenue, performance against outcomes and other indicators identified in the relevant PB Statements, and audited financial statements for the agency.

2 THE IMPACT OF OUTCOME APPROPRIATIONS AND REPORTING ON TRANSPARENCY AND ACCOUNTABILITY

Accrual-based, outcome budgeting and appropriations introduced some major improvements in the scope and substance of information provided to Parliament.

Accrual budgeting, accounting and reporting has provided new information on assets and liabilities that was not comprehensive or reported in a coherent and consistent framework under previous accounting arrangements. It has also provided information in a way that allows much greater comparability from year to year and greater precision in the revenues and expenses attributable to each accounting period.

Cash budgeting and reporting made it difficult to interpret financial performance and trends over time because it included receipts and payments that did not coincide with the amounts earned or expenses incurred during the accounting period. Payments for major capital and receipts from major asset sales were particularly prone to distort cash results.

Changes in the net financial position of agencies were not able to be reported under cash budgeting in Australia. Indeed, without information on the true value of assets and the extent of liabilities, the full financial situation of agencies was not clear. This risk was largely unknown to Parliament until the introduction of accrual budgeting and reporting at the agency level.

The move to accrual budgeting and reporting in agencies also facilitated the preparation of whole-of-government financial statements. Consolidated Financial Statements are now constructed using agency financial information that is also used by agencies to prepare their own accrual financial statements and reports.

Many of the flexibilities and conventions established under cash budgeting have continued on similar lines under accrual budgeting. For example, running costs were appropriated as a block for each agency under cash budgeting, in a similar, but not identical way to, departmental expenses. The main difference between treatment of running cost and departmental appropriations is that running cost appropriations could only be used in the year that they were appropriated. Departmental appropriations are available for use in any period once appropriated.

Another significant difference between departmental items and running costs is the transparency and independence of the definition of departmental items. Departmental items are explicitly defined in Finance Ministers Orders and can be traced to Australian Accounting Standards established by the Australian Accounting Standards Board. In contrast, the concept of running costs was described in Department of Finance guidance but was not explicitly based on accounting standards or law.

The introduction of outcomes and outputs to identify the results that governments and agencies are seeking to achieve provided a significant improvement in expressions of government intentions and desired results. While there remains room for improvement in the explanation of outcomes, the explicit identification of performance indicators was a major step forward. Previous performance reporting was limited to identification of cash funding of broad activities which were not easily reconciled with programs and often accompanied by little explanation of performance expectations or results in PB Statements and annual reports respectively.

In addition to improvements in budget and annual reporting achieved through accrual-based outcome budgeting, the Government has strengthened transparency and accountability arrangements in other ways, including through the *Charter of Budget Honesty Act 1998* (CBH Act), presentation of cash and accrual financial information using two important methods: Government Finance Statistics (GFS) and Australian Accounting Standards (AAS).

The CBH Act mandates timely reporting of the overall fiscal strategy and position of governments. It requires the Australian Government of the day to comply with explicit principles of sound fiscal management, to publish its fiscal strategy with each budget and regular fiscal reports within each year. It imposes specific requirements for a mid-year fiscal update and end year budget outcome, an intergenerational report every five years and a pre-election report when a general election is called. The CBH Act requires reports to be prepared on the basis of external reporting standards. These requirements provide new and considerable extension of transparency and accountability for fiscal policy and government financial management over arrangements before 1998.

The Government has implemented a substantial number of ANAO audit recommendations for increasing transparency and accountability above and beyond the improvements achieved through the establishment of accrual-based outcome budgeting arrangements.

The ANAO has produced some valuable reports on aspects of appropriations and reporting in the last few years, mainly in relation to reporting by agencies[4]. Finance has worked closely with agencies to rectify problems and identify areas for improvement in future. Finance has issued guidance jointly with the ANAO and independently to

[4] ANAO report no.s 18 of 2001-02 (Performance information in PB Statements), 11 of 2003-04 (Performance Reporting), 24 of 2003-04 (Special Accounts), 15 of 2004-05 (Special Appropriations), 28 of 2005-06 (Net Appropriations), May 2002 Better Practice Guide to Performance Information in PB Statements, April 2004 Better Practice Guide on Annual Performance Reporting.

improve the quality and extent of reporting, for example on special appropriations, special accounts, net appropriations and performance information in PB Statements and agency annual reports.

The consequences of changes made as part of the accrual-based outcomes arrangements and related initiatives has been to improve the scope, quality and reliability of financial information by agencies and the Australian Government more generally. Budget information in particular is more comprehensive, based on external reporting standards, and provides better alignment between appropriation Acts, PB Statements and agency annual reports. Parliament is provided with estimates of expenditure from all appropriations before they are required to vote on the annual appropriation bills. Details on estimates have increased in the years since the first accrual budget in 1999, particularly in relation to special appropriations, special accounts and net appropriations.

3 STRATEGY FOR IMPROVING BUDGET INFORMATION

Finance maintains an on-going focus to ensure that the financial reporting and accountability arrangements best meet the Government's needs. This involves continuous review and analysis, response to external reviews and other feedback as opportunities arise. Finance has focused primarily on three key strategies for achieving on-going improvements to budget reporting and accountability arrangements:

(i) Simplification and refinement of practices and procedures
(ii) Legislative amendment
(iii) Additional training, information and guidance

3.1 Simplification and refinement of practices and procedures

Finance monitors the impact of policy, procedures and practices as part of its normal administration and advice function. There have been many reviews of the accrual-based outcome arrangements since they were introduced: some undertaken by Finance and others initiated externally, including by the Joint Committee of Public Accounts and Audit, the ANAO and university academics.

Recommendations from reviews and on-going process and procedure refinements have resulted in significant changes to budget reporting and accountability, including shorter timeframes for financial reporting where feasible, increases in coverage and detail in reporting of special accounts, special appropriations and net appropriations, improved cash and appropriations management arrangements and initiatives to improve the quality of agency outcome performance information.

Initiatives to improve transparency and accountability, along with other key aspects of financial management, will continue to be undertaken in the future. It is widely recognised within developed and developing countries alike that there is always room for improvement and refinement of financial management arrangements. Even where a high standard is achieved in any jurisdiction, it is unlikely that it will remain the most appropriate in perpetuity for a multitude of internal and external reasons. For that reason, Finance works in close contact with other countries to identify lessons learned and relevant opportunities for further improvement.

Finance also works closely with the independent Australian Accounting Standards Board (AASB), which sets accounting and financial reporting standards for commercial and non-commercial entities in Australia. This relationship has been vital to ensure that appropriate external standards are applied to government financial reporting, including establishment of accounting standards for government, adoption of international financial reporting standards and many matters associated with the accounting treatment of certain transactions and events.

There are several important matters with implications for government accounting and reporting that are currently under consideration by the AASB including harmonisation of government accounting standards, the usefulness of the departmental and administered distinction, valuation and treatment of heritage and cultural assets, and the future of accounting standards AAS27, 29 and 31 which relate specifically to government financial reporting. Finance is working closely with the AASB to ensure that the practicalities of government accounting and the interests of government report users are adequately explained and understood.

3.2 Legislative amendment

Refinements to the legislation relating to financial management, accountability and reporting have been made since the introduction of accrual-based outcome budgeting[5]. These include arrangements for GST, special accounts and act of grace payments. Further legislative amendments will be considered where legislation offers the most effective solution to address areas needing refinement.

3.3 Training, information and guidance

Finance has taken the initiative to provide a large amount of public information, guidance and training to agencies and other stakeholders on all aspects of the accrual-based outcome budgeting and reporting arrangements. The Department's internet site includes Finance Circulars, Finance Ministers' Orders, specialist guidance documents and general information on the framework and Finance's role. In addition, Finance manages the delivery of introductory financial management training through the University of Canberra to Australian public officials and other interested parties. More than 2,000 participants have received training under this programme during the last 18 months.

The Department is finalising the implementation of a new central budget management system (CBMS) that will provide an increase in the efficiency and quality of information provided to Government and the Parliament. The CBMS will facilitate the capture, classification, analysis and reporting of financial information more quickly and efficiently than the current system.

Finance works with other agencies and groups, including the ANAO, Australian Public Service Commission (APSC), and the Management Advisory Committee (MAC) to provide published guidance and advice on aspects of financial accountability and reporting. For example, Finance has produced joint publications with the ANAO and has

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[5] *Financial Framework Legislation Amendment (No.1) Act 2006, Financial Framework Legislation Amendment Act 2005, Financial Management and Accountability Amendment Act 2000.*

taken on full responsibility for development of A-MODEL financial statements guidance, formerly provided through the ANAO. It has contributed to publications by the MAC, for example on Connecting Government, and is working with the APSC to provide joint training programmes and internet information resources on public sector management and governance.

The published guidance and advice that Finance produces or contributes to is additional to the day-to-day advice provided to individual agencies and other stakeholders on the application of financial policies to their activities, or the interpretation of information available on financial management and performance.

Finance strives to improve the operations of the financial framework and ensure that accountability and transparency is a high priority. However, it recognises that there are practical and value for money limits on the frequency and volume of information that can be provided. The substantial investment made by the Government in the CBMS highlights that better information comes at a cost. It is also time-consuming and expensive for agencies to collect the information used in reporting. It is therefore important that cost-effectiveness is a key consideration. The frequency of reporting also needs to be a balance between the cost and benefit of more frequent information.

Provision of more detailed information, and information relating to a longer period into the future, comes with its own risks and challenges. It is often difficult to develop reliable estimates of detailed activities for long periods into the future. The bias inherent in simplifying assumptions and the potential for other influences to change the outcome mean that there are practical limits to the timeframe and level of detail achievable for financial estimates. While the precise trade-off between reliability and scope is a matter of judgement, it is an issue receiving regular attention in Finance reviews of reporting arrangements.