



Auditor-General for Australia



18 March 2014

Dr Andrew Southcott MP
Chair
Joint Committee of Public Accounts and Audit
Parliament House
CANBERRA ACT 2600

Dear Dr Southcott

Thank you for the opportunity to make a submission to the Committee's inquiry into the rules relating to the *Public Governance, Performance and Accountability Act 2013* (PGPA Act).

The attached submission from the Australian National Audit Office canvasses a number of issues relevant to the progressive implementation of the revised financial management framework and provides comments on a number of the draft rules referred to the committee by the Department of Finance, or have been released for public consultation.

We would be pleased to discuss our submission with the committee at the public hearing scheduled for 7 April 2014.

Yours sincerely

Ian McPhee

ANAO Submission

**JCPAA Inquiry into the rules relating to the
*Public Governance, Performance and Accountability
Act 2013 (PGPA Act)***

ANAO Submission to the JCPAA Inquiry into the rules relating to the *Public Governance, Performance and Accountability Act 2013 (PGPA Act)*

Reform of the Commonwealth's financial management framework

1. As noted in the Committee's Report No 438, 'the significance of the financial framework should not be underestimated. The current financial framework, with the Financial Management and Accountability and Commonwealth Authorities and Companies Acts (FMA and CAC Acts) at its heart, was world leading when introduced and has served Australia well over the last 15 years. Almost 200 organisations are operating under this framework and the associated rules, which largely set the controls for spending of around \$400 billion per year'.

2. While the current framework remains fundamentally sound, there is no doubt it will benefit from reform to reflect contemporary developments in public sector management and to streamline some of the more detailed requirements. On the basis of our work, key priority areas include:

- an enhanced performance measurement and reporting regime;
- arrangements that better facilitate joined-up government and accommodate the concepts of collective responsibility and multiple accountabilities; and
- a differential financial reporting regime to streamline the financial reporting requirements for Commonwealth entities, which is compliant with the Australian Accounting Standards while still meeting the needs of the government and parliament.

3. These matters are not being addressed in the first tranche of Rules developed by the Department of Finance (Finance) but are scheduled for consideration in the development of the suite of Rules required after 1 July 2014.

Objectives and key elements of the reform agenda

4. The stated objectives of the reform of the financial framework are extensive and include:

- improved quality of information to Parliament to support its constitutional role in relation to Commonwealth expenditure;
- a more mature approach to risk across the Commonwealth;
- improved productivity and performance of the Commonwealth public sector with concomitant benefits for a broad range of stakeholders; and
- reduced red tape within the Commonwealth and for partners who contribute to the delivery of Australian Government programs and services, including grant recipients.

5. Finance has articulated the following guiding principles for the resource management framework¹ as follows:

- Government should operate as a coherent whole;
- Public resources are public resources, and a common set of duties should apply to all resources handled by Commonwealth entities;
- Performance of the public sector is more than financial; and
- Engaging with risk is a necessary step in improving performance.

6. Going forward, the ANAO would suggest the following additional guiding principle be applied in developing the remaining elements of the framework:

- The financial framework, including the rules and supporting policy and guidance, should support the legitimate requirements of the government and the parliament in discharging their respective responsibilities.

7. Our purpose in suggesting this additional guiding principle is to recognise that the executive government is accountable to the parliament for the use of public resources in a manner consistent with legislative requirements and conventions, and the resource management framework has traditionally played a significant part in assisting government to manage its responsibilities in relation to public resources efficiently and effectively, and to respond to the legitimate information needs of the parliament.

Staged implementation of the reforms

8. The staged implementation of the reforms, which will take several years on current expectations, is consistent with the implementation strategy proposed when the PGPA Act was passed. Meeting the stated objectives of the reforms will require a considered approach to implementation and effective leadership by all agencies.

9. There are a range of consequences from adopting the staged approach to implementation which will need to be managed by both Finance and other public sector entities, including:

- various elements of the reforms are being considered without the benefits of a full understanding of the composition of the revised financial framework;
- priority areas for attention, particularly performance measurement and reporting, are not being considered in Stage 1;
- there is uncertainty whether subsequent amendments will be required to current proposals in framing future elements of the framework; and

¹ Department of Finance submission dated 5 March 2014, para 2

- a long term investment in project and change management in progressively implementing the reforms, and undertaking training of staff by all public sector entities, is required if the stated benefits are to be realised.

The PGPA Act and the proposed Consequential and Transitional Provisions Bill

10. The PGPA Act was passed in June 2013 and it is intended that the substantive provisions of the Act will come into effect on 1 July 2014. Finance has indicated that a small number of amendments to the PGPA Act are proposed.² The ANAO has no issues with these amendments from its perspective.

11. There is however, one further proposal for amendment of the Act relating to section 38 of the Act *Measuring and assessing performance*³ that the ANAO considers would be prudent. This issue was raised earlier in our submission to the Committee dated 22 May 2013. The phrase ‘measure and assess the performance of the entity in achieving its purposes’ can be interpreted narrowly. This is why Australian Accounting Standards⁴ separately require government agencies to account for income, expenses, assets and liabilities that they control, as well as separately account for administered income, expenses, assets and liabilities. Examples of administered transactions include taxes, fines and fees, and transfer payments which give rise to income, expenses, assets and liabilities that are not attributable to the government agency and therefore not accounted for by entities as transactions that they control, but rather as separately identified administered transactions. It is obviously critically important that the performance of an agency not only encompass information on the delivery of programs but also information on the effectiveness of programs, even though policy responsibility rests with government. Clarification of this issue could be pursued in conjunction with the development of the revised performance framework to give greater confidence that assessment of performance relates to the impact or effectiveness of government programs or activities for which an entity carries administrative responsibility, including those that involve multiple entities and other jurisdictions.

12. The enactment of the PGPA Act has necessitated consequential amendments to other legislation. Finance has advised that the preparation of a Consequential and Transitional Provisions Bill is well advanced involving proposals to amend more than 250 pieces of legislation. These are mainly consequential or transitional amendments but also involve the amendment of section 50 of the *Auditor-General Act 1997* (Auditor-General Act) to provide protection of the ANAO’s annual appropriation and to protect the confidentiality of interim reports, or parts thereof, that have been agreed to by the Prime Minister; the ANAO has separately advised the JCPAA of these proposals. Ongoing discussions are being held with Finance on the necessary amendments to the Auditor-General Act to give effect to these matters.

13. The Committee may be aware that, in response to the High Court’s judgement of 20 June 2012 in *Williams v Commonwealth* (2012) 288 ALR 410 (*Williams*), section 32B was included in the FMA Act. This section was included to ‘establish a supplementary power for the Commonwealth to make commitments to spend public money where there is not currently

² See Attachment H of the Finance submission of 5 March 2014.

³ Subsection 38(1) states that ‘The accountable authority of a Commonwealth entity must measure and assess the performance of the entity in achieving its purposes’.

⁴ See Australian Accounting Standard AASB 1050 *Administered Items*.

legislative authority'.⁵ The FMA regulations⁶ list arrangements, grants and programs to which section 32B applies. To continue providing this legislative authority for the arrangements, grants and programs listed in the regulations, the ANAO understands it is proposed to retain section 32B of the FMA Act and the related regulations after 1 July 2014. However, it is unclear from the information provided to date, why appropriate provisions have not been included in the PGPA Act to provide this support.

The PGPA Act Rules

14. We note that the primary focus of the Committee's inquiry is the Rules developed to date to support selected provisions of the PGPA Act.

15. The ANAO understands it is intended that a total of 20 rules will be tabled in the Parliament prior to 1 July 2014. Of these, 14 have been released for public consultation and were provided to the Committee as part of Finance's first submission to the Committee dated 5 March 2014. Six rules, including two rules that address the important aspects of public administration of grants and procurement, were not released for public consultation and have been provided to the Committee in Finance's second submission dated 18 March 2014.

16. The rules have been developed in the context of the guiding Principles referred to earlier, a number of design principles as well as a set of principles that apply to the Public Sector Reform Agenda. Taken together, the approach adopted has placed a strong emphasis on reducing the level of prescription by applying the legislative regime that currently applies to entities subject to the CAC Act. Notwithstanding this position, the ANAO notes that the majority of the rules developed to date are technical in nature and a number, in large part, reflect existing requirements that apply to Commonwealth agencies that are subject to the *Financial Management and Accountability Act 1997* (FMA Act).

17. While a rigorous review of the existing financial framework is necessary to eliminate constraints on the efficiency and effectiveness of public sector entities, it is also important as part of this process that appropriate recognition is given to the responsibilities of the executive government, including in discharging its responsibilities to the parliament. Consistent with the approach taken in the development of the Financial Management and Accountability and Commonwealth Authorities and Companies Acts, this requires an assessment of the minimum requirements to be embedded in the financial framework to serve the interests of both government and the parliament; and as previously indicated, the ANAO considers the guiding principles should also reflect the interests of these key stakeholders. This is particularly the case in relation to central elements of public administration in the Commonwealth including the commitment of relevant money, and corporate planning and the performance framework.

18. The PGPA Act Compendium, Attachment C of the Finance submission of 5 March 2014, provides a useful outline of the key elements of the proposed new financial framework. These elements include the rules together with supporting policy and guidance material, where considered appropriate. The ANAO suggests that the need to develop policy and/or guidance should be determined by a considered assessment of the status that should be

⁵ See the Explanatory Memorandum to the *Financial Framework Legislation Amendment Bill (No.3) 2012*, paragraph 12.

⁶ See FMA regulation 16.

accorded to particular requirements and issues, based on the need for entities to comply with, or have regard to, particular requirements and the benefits of consistency in approach across Commonwealth entities. This will avoid uncertainty about the status of material issued, which has been an issue on occasions in the past.

19. The presentation of policy and guidance material needs to ensure the status of the material is clear and unambiguous. The presentation of the accounting and auditing standards issued by the Australian Accounting Standards Board and the Australian Auditing Standards Board respectively are useful examples of where there is clear distinction between mandatory requirements and guidance material.

20. The transition of the existing Fraud Control Guidelines⁷ to the new framework is a good example of where a case exists for the proposed rule, *Preventing, detecting and dealing with fraud*, to be supported by policies issued by the responsible Minister to address issues such as the definition of fraud and mandatory reporting requirements, together with guidance material.

21. The ANAO considers that, except for the rule on the *Commitment of relevant money*, which is discussed below, the rules provided to the Committee will provide a reasonable basis for the substantive commencement of the Act on 1 July 2014, noting that rules on a number of key matters are still under development.⁸

22. It is also encouraging that Finance has now prepared draft guidance for each of the rules to be in place on 1 July 2014 and has also developed draft model Resource Management Instructions; this allows for a more informed assessment to be made about the totality of the financial framework in relation to those matters on which rules have been prepared. In view of the timeframes involved, the ANAO was still reviewing this material at the time of preparing this submission.

Commitment of relevant money

23. The rule on the commitment of relevant money is intended to replace a number of existing regulations that govern the approval and commitment of public moneys by FMA Act agencies. These regulations are quite prescriptive and there are benefits in streamlining existing requirements. The ANAO also acknowledges that the proposed rule will result in requirements applying to all Commonwealth entities for the first time.

24. The proposed rule requires an official, who approves the commitment of relevant money, to record the approval in writing as soon as practicable after giving it. An approval must be consistent with any written requirements, including instructions given by the accountable authority.

25. The proposed rule has no requirement for officials who approve the expenditure of relevant money to: make reasonable enquiries or to record the terms of the approval⁹.

⁷ These are issued by the responsible Minister in accordance with Regulation 19 of the *Financial Management and Accountability Regulations 1997*.

⁸ These include rules on corporate plans, performance statements and annual reports.

⁹ The existing FMA Regulation 9 requires, in effect, the approver to be satisfied, when making reasonable enquiries, that the spending proposal would be a proper use of Commonwealth resources. The existing FMA

Recognising the benefit of streamlining existing requirements, the ANAO agrees that these existing requirements are best addressed in supporting guidance material.

26. Nevertheless, the proposed rule is a substantive departure from existing obligations that explicitly require an approver to be satisfied, after making reasonable inquiries, that giving effect to the spending proposal would be a proper use of Commonwealth resources.¹⁰ The proposed rule imposes no direct obligation on an official to be satisfied that the proposed commitment of relevant money represents the 'proper use' of the money and relies instead on: the general duty of the accountable authority to promote the proper use of relevant money (the duty is included in section 15 of the PGPA Act); and on the accountable authority issuing instructions, delegations or directions to officials that must be complied with in approving the commitment. While it may be expected that an accountable authority would take the necessary steps to require an official to be satisfied that the proposed commitment of relevant money would represent the 'proper use' of such money, there is no obligation on the accountable authority to do so.

27. The ANAO also notes that:

- the proposed rule is inconsistent with the obligation, specified in section 71 of the PGPA Act, that Ministers must not approve a proposed expenditure of relevant money unless the Minister is satisfied, after making reasonable inquiries, that the expenditure would be a proper use of relevant money; and
- the proposed rule is a significant departure from the draft rule that was issued by Finance for public consultation in late January 2014 and there has been very limited consultation on the rule now proposed.

28. In view of this situation, the ANAO does not consider that the proposed rule will provide the government and parliament with sufficient confidence that officials, in approving the commitment of relevant money, will be required in all cases to form a judgment that it represents the proper use of such money. Because the need to explicitly consider 'proper use' has historically been a fundamental principle of public administration when committing public funds, and has served a beneficial purpose without being a compliance burden, we do not see a valid basis to vary this in the context of the implementation of the PGPA Act.

29. There is a related issue that we would also flag for the Committee's consideration – whether, as a matter of principle, the basis for decisions (that is the substantive reasons) to enter into commitments that may result in the expenditure of public moneys above a certain threshold (as determined by entities) should be recorded. This is currently a requirement in relation to the proposed expenditure of grants¹¹ and is generally accepted practice, at least for higher value expenditure. Given the special responsibilities that attach to the use of relevant moneys (essentially public moneys), it would not be unreasonable to require approvers to

Regulation 12 requires, in circumstances where a spending proposal has never been given in writing, for the approval to record the 'terms of the approval' in writing.

¹⁰ Proper use is defined by subsection 44(3) of the FMA Act as being efficient, effective, economical and ethical use that is not inconsistent with the policies of the Commonwealth. This is commonly accepted to involve an assessment of 'value for money'.

¹¹ FMA Regulation 12 requires an approver to record the basis of the approval where the spending proposal relates to a grant.

record the basis of their decisions for expenditure above an agreed threshold which may be determined by entities.

30. On a separate but related matter, the proposed rule does not incorporate any specific requirements in relation to the commitment of expenditure beyond available appropriations, currently governed by FMA Regulation 10. The ANAO acknowledges that PGPA Act and particular government policies include requirements designed to control these commitments and notes the commitment made in Attachment I of Finance's submission of 5 March 2014 that the Budget process would include a new requirement allowing the Finance Minister to review the impact of significant proposed spending commitments before commitments are made, where they go beyond available appropriations.

31. The proposed requirements go some way towards a system that provides some control over commitments that rely on future appropriations but nevertheless are less than the requirements traditionally relied on by Finance Ministers in this area. Any control would be most effective as part of the resource management framework, rather than as a budgetary control because it is transactions entered into by entities that commit expenditure over the forward estimates that are the focus of current arrangements. Ultimately it is a matter for those in government responsible for Budget preparation to determine the extent to which explicit requirements need to be in place to control the commitment of expenditure by government and officials that goes beyond available appropriations, as this issue goes to the extent of lock-in of future budgets – an issue that has been subject to explicit controls by governments over many years.

32. We also note that the proposed rule allows for the approval of the commitment of expenditure in aggregate. (The existing regulations use the singular expression 'an expenditure proposal'). The ANAO recognises the benefits of allowing the approval of aggregate expenditure in some circumstances, and considers that the supporting guidance should discuss the reasonable use of, and the risks involved in, officials approving aggregate expenditure proposals.

Comments on other rules

33. We also provide the following comments on the state of play in relation to corporate planning and performance statements and the proposed rule on Audit Committees.

Corporate Planning and the performance framework

34. Draft rules on corporate plans and performance statements have been released for public consultation. Finance's submission of 18 March 2014 includes a brief on the proposed approach to the development of a new performance framework. The ANAO will continue to consult with Finance on its development, noting that the timeframes proposed are relatively tight.

35. The ANAO, in particular, supports the commitment to addressing cross-jurisdictional performance measurement as an integral element of the new framework and notes Finance's commitment to work with agencies on the existing framework.

36. In light of the timeframe currently proposed for the introduction of corporate plans (to commence from 2015-16) and performance statements (to be required after 1 July 2016), it

will most likely be a number of years before there is a demonstrable improvement in the Commonwealth's performance framework as a result of the introduction of the PGPA Act. As indicated in ANAO Report No 21 2013-14 *Pilot Project to Audit Key Performance Indicators*, while much has been written on the importance of KPIs to inform the assessment of program performance, making a difference requires leadership, effective governance, and a desire to understand the impact of government programs and how even better outcomes may be achieved. Both government and government agencies have important roles in improving current practices.

37. In this context, the ANAO considers that, to assist in improving the standard of performance measurement and reporting in the short term, there is considerable scope for Finance to enhance the level of communication with entities on performance measurement as part of its strategy to implement a revised performance regime, noting that agencies will continue to be required to report on performance on an annual basis under the current framework, and sections 37 and 38 of the PGPA Act will require entities to maintain proper records in relation to performance and to measure and assess performance.

38. While no structural changes to the existing performance regime can be anticipated given the timeframes involved in developing and implementing a revised framework, we consider it is important that Finance and agencies are responsive to improving the measurement and reporting on program performance, including addressing relevant recommendations made by the JCPAA and the ANAO. This could include, for example, emphasising the factors that are important to enhanced measurement and reporting including: leadership by senior management; the use of proxy measures to assess the impact of progress where direct measures are not readily available; the importance of reliable data capture methods and systems; and giving higher priority to improving performance indicators, particularly indicators that are designed to measure the impact or effectiveness of programs.

Audit committee for Commonwealth entities

39. The proposed rule includes a requirement that: the majority of members of the audit committee of non-corporate entities to be persons who are not officials of the entity; and for the majority of members of the audit committee of corporate entities to be persons who are not employees of the entity. This requirement will commence on or after 1 July 2015.

40. The ANAO supports proposals to increase the number of independent members on audit committees in non-corporate entities (most audit committees of corporate entities are independent from entity management as they are a sub-committee of the entity's governing board).

41. It can be expected that there will be a substantial increase in independent members to meet the requirement for a majority of members of non-corporate entities to be persons who are not officials of the entity. It is therefore suggested that entities take the opportunity to consider a broad range of options, including appointing members with strong commercial and business experience and senior officials from other entities who are able to bring their broad public sector experience to the work of committees.

The development of the rules

42. On the process for the development of the rules that are included in the Committee's terms of reference, the ANAO notes that quite extensive governance arrangements have been established to assist in the development of the rules and guidance material. These arrangements include a project board and a number of steering committees on which a large number of entities were represented. These arrangements have been supported by a project office staffed by Finance officials. In practice, these arrangements have their teething problems, and the ANAO suggests that lessons learned from the experience to date be used to review future governance arrangements.

Concluding comments

43. The Commonwealth's financial framework is central to an efficient, effective and accountable public sector and the ANAO supports efforts to streamline key elements of the framework. In this context, the ANAO considers it is important that a balance is struck between reducing the level of prescription and ensuring that key requirements are retained in the revised framework to protect the interests of the government and the parliament.

44. The timeframe for finalising the full package of material and associated deliverables required to be in place prior to 1 July 2014 (this includes finalising supporting guidance material, the provision of appropriate training to entities and the updating of entity level systems, policies and procedures), will be very compressed, and is at a time when many entities are expected to deliver on other government priorities in a tightening resource environment. The training of officials is particularly important in view of the changes in both the content and structure of the legislation, including the inclusion of additional duties on accountable authorities and officials.

45. While recognising that the broad ranging reform agenda will take some years to implement fully, the ANAO notes that by focussing on a limited number of rules that will take effect from 1 July 2014, a number of key issues have been deferred until after 1 July 2014. This will necessarily mean that a number of the stated benefits of the reforms will not be realised for some time, assuming the effectiveness of the rules and any associated policy and guidance in achieving those benefits.

46. The ANAO recognises that it is relatively early days in terms of the development and implementation of the new framework and major components are still to be developed. We have highlighted a number of issues that might beneficially be addressed in the rules developed to date to meet the needs of the parliament and the government, and which we consider are in the interests of the long term efficiency and effectiveness of public sector entities.