The Senate

Standing Committee on Finance and Public Administration

Transparency and accountability of Commonwealth public funding and expenditure

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Senate Finance and Public Administration Committee

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Executive Summary

The Commonwealth's financial transactions and the accounting for those transactions have changed greatly since Federation. In the past twenty years in particular there have been significant changes in the way that the executive government presents its budget to the parliament for approval and in the way in which it accounts for past expenditure.

The Commonwealth Government adopted accrual accounting in 1997 and in 1999-2000 for the first time presented a budget based on accrual accounting principles. In that budget the Government also adopted an outcomes and outputs reporting framework.

The Committee considers that the adoption of accrual accounting and budgeting has the potential for enhancing the management of the Commonwealth's funding and expenditure and has done so to an extent. Nevertheless, accrual budgeting and especially the associated outcomes and outputs framework, while resulting in some improvements in transparency, have posed challenges for Parliament's control of the appropriations processes.

The Senate required the Committee to inquire into a number of specific matters under the general reference on the transparency and accountability to Parliament of Commonwealth funding and expenditure. These specific matters included the impact of outcome budgeting, multiple sources of funding and the use of ordinary annual services to fund activities, including non-annual services, on the Parliament's ability to scrutinise, approve and monitor proposed and actual expenditure. The Committee was also required to recommend options for improving the transparency and specificity of the budget documents, and to propose other measures to improve the Parliament's oversight of proposed and actual Commonwealth funding and expenditure.

The Committee has made several recommendations and a number of suggestions in all these areas which, if adopted, would go some way to restoring the Parliament's constitutional and historical prerogatives with regard to the control of the Executive's funding and expenditure.

With regard to multiple sources of funding, the Committee has made recommendations for the production of a separate document setting out past and expected expenditure from special appropriations; for the tabling of topical information about the transfer of funds from one form of appropriation to another; for the return of net appropriations to appropriation bills; and for limiting the amounts of unspent appropriations. The Committee has also made recommendations in relation to the inclusion of new items of expenditure in the appropriation bills.

With regard to possible improvements to the budget documents the Committee has recommended that transparency and specificity could be improved by changes such as the presentation of financial data at the program level; by better specification of outcomes; by including data for forward years at the outcome and output levels in the Portfolio Budget Statements; and by the adoption of one agreed accounting standard.

The Committee has concluded that Parliament's oversight of proposed and actual public funding and expenditure could be improved by changes within the Senate committee system, such as more specific monitoring of the financial reports of the government by Committee Office staff, and by the Executive ensuring that the Appropriation bills are drafted so that departmental expenditure must be against an outcome or purpose set down in the bills. The Committee has also agreed with a number of suggestions made by the Auditor–General on specific measures the Audit Office could take to assist Senate committees with the consideration of estimates.

Recommendations

Recommendation 1

The Committee recommends that the government produce and table with the annual budget documents a document that sets out the past and expected expenditure from all Special Appropriations. The data in that document should be set out against the programs that are funded from the relevant appropriation.

Recommendation 2

The Committee recommends that the Government implement a system of review for standing appropriations to ensure that access to the CRF is withdrawn when no longer required and to ensure that standing appropriations are subject to periodic government and parliamentary review.

Recommendation 3

The Committee recommends that the government ensure that where transfers of amounts between different forms of appropriation occur, that the transfers be highlighted in the reporting documents. Because the reporting of these events in agencies' financial statements may not occur until well after the event, these transfers should be documented and tabled as they occur.

In making this recommendation the Committee is aware that there might be many such transfers and that there could therefore be practical difficulties in the timely provision of the data. The Committee therefore recommends that Finance consider the practical implications of the above recommendation and report to the Committee on this matter this financial year.

Recommendation 4

The Committee recommends that the central role in the management of net appropriations should be returned to the Appropriation Acts so as to ensure that these significant transfers of funds are fully transparent to the Parliament. In making this recommendation the Committee is aware that the management of net appropriations is complicated and that the Department of Finance and Administration is investigating other options. If a procedure other than returning the central role to the Appropriations Acts is proposed, the Committee would expect that the Parliament and its committees would be consulted. In particular, the Committee would expect Finance to report to it on any proposed alternative approach this calendar year.

Recommendation 5

The Committee recommends that agencies report the amounts of their unspent appropriations and the reasons for the underspend to Finance at the end of each financial year and that the government tables in Parliament a consolidated

report on the amount and reasons for the underspend within six months of the end of the relevant financial year. The Committee further recommends that unspent appropriations be returned to the CRF unless the finance minister determines that there is good cause for the funds to be retained.

Recommendation 6

The Committee recommends that unless the Government can propose another mechanism that would overcome the accountability and transparency issues raised in connection with the carry over of appropriations it should discontinue the appropriation of funds to agencies for the purpose of depreciation.

Recommendation 7

The Committee recommends that the State and Territory jurisdictions provide to the Commonwealth comprehensive annual statements of the purposes and expenditures of GST revenues to enable their incorporation into Budget Paper No. 3.

Recommendation 8

The Committee recommends that the Senate continue to seek clarification from the Government as to which items the Government believes should be included in the different appropriation bills. The Senate should then form a view as to the appropriateness of the split. When any differences are resolved to the satisfaction of the Senate, the Department of Finance and Administration should be required to monitor and enforce the split.

Recommendation 9

The Committee recommends that the Standing Committee on Appropriations and Staffing should report expeditiously on its negotiations with Government in relation to the appropriate split of items of expenditure in the different appropriation bills so that the issue may be considered by the Senate.

Recommendation 10

The Committee recommends that the Clerk advise the President of the Senate with respect to concerns about the matters included in periodic Appropriation bills and that the President table a statement accompanying the bills or return the bills to the House of Representatives or to the minister for clarification, elucidation or adjustment.

Recommendation 11

The Committee recommends that a common approach be taken for the Portfolio Budget Statements and that estimates for three forward years be included for departmental and administered items.

Recommendation 12

The Committee recommends that outcomes be expressed in clear, simple and measurable terms.

Recommendation 13

The Committee recommends that expenditure should be reported at the levels of programs in the budget documents, including in the schedules to the Appropriation Acts.

Recommendation 14

The Committee recommends that the terms 'administered' and 'departmental' be defined in the appropriation bills or other appropriate documents.

Recommendation 15

The Committee recommends that the ongoing process being undertaken to harmonise the accounting standards should continue and should be expedited by the Government setting a deadline for its completion.

Recommendation 16

The Committee recommends that the Government should give consideration to a system for funding depreciation whereby gross capital expenditure would be separately reported and budgeted for as required, with a subdivision of expenditures between asset replacement (i.e. the depreciation component) and asset expansion.

Recommendation 17

The Committee recommends that the Senate Standing Legislative and General Purpose Committees report as necessary in their reports on the estimates on the format and contents of the PBS and PAES that are referred to them.

Recommendation 18

The Committee recommends that the Committee Chairs Group examine proposals made by the Auditor-General for measures to assist the Legislative and General Purpose Standing Committees in their consideration of the estimates.

Recommendation 19

The Committee recommends that the Government ensure that future appropriation bills that the Senate cannot amend under the provisions of the Constitution restore the need for any approved expenditure to be legally linked to and connected with a specific outcome or purpose.

Chapter 1

Background to the inquiry

Establishment of inquiry

1.1 On 20 June 2006, the Senate referred the following matter to the Finance and Public Administration References 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 Minister for Finance, 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

(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.

1.2 The Committee's terms of reference are reproduced in Appendix 1.

Conduct of the inquiry

1.3 The Finance and Public Administration References Committee had been required to report by 19 October 2006, but was unable to report by that date because the committee ceased to exist on 10 September 2006. On 14 August 2006 the Senate had resolved to amend the relevant Orders of the Senate so that, from 11 September 2006, the separate References and Legislation Committees would be replaced by one Legislative and General Purpose Committee.

1.4 The Senate also resolved that the newly-established legislative and general purpose committees should inquire into and report on matters referred to their predecessor committees that had not been disposed of by those committees and, in considering those matters, might consider the evidence and records of those committees relating to those matters. Consequently, from 11 September 2006, the inquiry, with the same terms of reference, was conducted by the Senate Finance and Public Administration Legislative and General Purpose Committee.

1.5 On 19 October 2006 the Senate granted the Committee an extension of time to 7 December 2006 to report on the reference. On 5 December 2006 and 6 February 2007 the Senate granted further extensions of the reporting date, to 8 February 2007 and to 1 March 2007.

1.6 The Committee conducted three public hearings on the reference on 8 September, 12 October and 27 November 2006 in Canberra. Lists of witnesses and of the submissions made to the inquiry may be found in Appendices 2 and 3.

Origin of the reference

1.7 The Commonwealth Budget was presented on the basis of accrual budgeting and in the outcomes/outputs framework for the first time in the 1999-2000 financial year. It is timely therefore for the Committee to consider transparency and accountability issues relating to accruals and to the Budget framework. In addition, in December 2005 the former Finance and Public Administration References Committee reported on an inquiry into government advertising and accountability.

1.8 That inquiry raised issues in relation to government accountability to Parliament for funding and expenditure that were broader in scope than it could consider in detail.[1] These included matters arising from the High Court of Australia's majority ruling against the plaintiffs in *Combet v the Commonwealth of Australia*.[2]

1.9 The committee recommended that the Senate should refer to it the matter of the impact of outcome budgeting for appropriations on Parliament's consideration and approval of government expenditure, and the accountability of government for such expenditure.[3]

1.10 As reported above, the Senate referred the matter to the Committee on 20 June 2006.

Report structure

1.11 Chapter 2 sets out the constitutional provisions for funding and expenditure, historical developments and the current accrual-based outcomes/outputs framework.

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1 Senate Finance and Public Administration References Committee, *Government Advertising and Accountability*, December 2005, p. 51.

2 An interesting exposition of some of the implications of this judgement may be found in Submission 10 (Professor Lindell).

3 Senate Finance and Public Administration References Committee, *Government Advertising and Accountability*, December 2005, p. xxiii.

1.12 Chapters 3 and 4 discuss the proliferation of funding sources. Chapter 3 covers Special Appropriations, Special Accounts, revenue retained under Section 31 of the *Financial Management and Accountability Act 1997* and annual departmental carryovers; Chapter 4 covers tax expenditures, the advance to the Finance Minister, the Goods and Services Tax and ordinary annual services.

1.13 Chapter 5 examines measures for improving transparency and the specificity of budget documents. The key matters addressed are portfolio budget statements, outcome statements and program-level expenditure information, accounting standards and treatment of depreciation.

1.14 In Chapter 6, the Committee turns to measures to improve Parliamentary oversight. These include the role of Senate committees, committee staff and the Auditor-General, as well as legislative changes.

1.15 Chapter 7 presents the Committee's conclusions and recommendations.

Chapter 2

Outcome budgeting and reporting

Constitutional provisions

2.1 The Constitution of the Commonwealth of Australia adopted from Great Britain the notion of the sovereignty of parliament with regard to taxing and spending. The relevant (principal) sections of the Constitution are sections 51, 81 and 83, which read as follows:

> **51.** The Parliament shall, subject to this Constitution, have power to make laws for the peace, order, and good government of the Commonwealth with respect to: -
>
> **(i.)** Trade and commerce with other countries, and among the States:
>
> **(ii.)** Taxation; but so as not to discriminate between States or parts of States:
>
> **(iii.)** Bounties on the production or export of goods, but so that such bounties shall be uniform throughout the Commonwealth:
>
> **(iv.)** Borrowing money on the public credit of the Commonwealth:
>
> **81.** All revenues or moneys raised or received by the Executive Government of the Commonwealth shall form one Consolidated Revenue Fund, to be appropriated for the purposes of the Commonwealth in the manner and subject to the charges and liabilities imposed by this Constitution.
>
> **83.** No money shall be drawn from the Treasury of the Commonwealth except under appropriation made by law.

2.2 Other relevant sections of the Constitution include Sections 53 and 54, which are discussed later in this report.

2.3 Much of the Committee's inquiry revolves around Section 83 and relates to a range of concerns about the manner in which the Commonwealth's finances are appropriated. These concerns are discussed in the Chapters that follow.

2.4 To understand the context in which these concerns have arisen it is necessary to set out the two main elements of the Government's approach to managing Commonwealth finances: accrual accounting and budgeting and the outcomes/outputs framework.

Accrual accounting and budgeting

2.5 Accrual accounting allows for the recognition and recording of economic transactions and events as they occur, regardless of when (or whether) the related cash receipt or payment takes place. For example, in the books of a business that sells goods, a sale would be recorded as 'income', even though payment from the purchaser may not yet have been received; the purchaser would be recorded under the asset heading 'Debtors'. Subsequent payment would be recorded as an increase in the asset 'Cash' and an offsetting reduction in 'Debtors'. Correspondingly, a purchaser's failure to pay would cause an increase in the expense item 'Bad Debts Written Off', with an offsetting reduction in 'Debtors'.

2.6 Cash accounting, on the other hand, would record the transaction under 'Receipts' when payment was received – or nothing at all if the purchaser defaulted. Obviously, internal records would be kept of Debtors and Bad Debt Write-offs, but, under cash accounting, they do not form part of an integrated accounting framework of the kind that would allow comprehensive financial statements to be interpreted to assess the operational performance of the entity.[1]

2.7 Accrual budgeting is budgeting on the basis of accruals.

The case for accrual accounting and budgeting

2.8 Professor Barton, School of Accounting and Business Information Systems, Australian National University, has put the case for the government's adoption of accrual accounting and budgeting as follows:

> The case for the adoption of accrual accounting and budgeting systems [AABS] is an overwhelming one. Without AABS, the government has no systematic records of its vast holdings of non-cash assets and portfolio of liabilities… There can be no effective management of such a vast portfolio of assets and liabilities without appropriate accounting records of them. Furthermore, management attention was [formerly] concentrated on fiscal policy issues, cash budget compliance and cash management, and a refocussing of management attention to encompass all the non-financial assets and liabilities of the Government required "a cultural change" … As well, accrual accounting is needed for cost control of departmental operations and of programs for delivery of services to the public. This information is necessary for determining priorities in expenditure programs, and for facilitating better management of government resources and hence efficiency of operations. In brief, accrual accounting is required for the final resource management role of government. But as well, by facilitating

1 Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-2002, Department of the Parliamentary Library, 28 May 2002, p. 33.

> greater efficiency in use of the government's own vast stock of resources, it helps to promote improved macroeconomic management of the economy.[2]

Historical context

2.9 The nature of the Commonwealth's financial transactions and the methods of accounting for those transactions have changed significantly since Federation, with changes in the size and responsibilities of government and changes in technology and accounting methods. They will no doubt continue to evolve.

2.10 For many years following Federation, the Commonwealth used cash accounting and budgeting systems (CABS). There was good reason for this:

> Historically, governments have operated on an annual cash basis because this is fundamental to the democratic constitutional safeguards which have been evolving since the days of King Charles I of England. The basic safeguard is that no monies shall be collected or spent except in ways and amounts approved by Parliament through budget appropriations.[3]

2.11 Although cash reporting and budgeting continued to be used in the budget until 1999, the presentation of the budget had changed significantly in the 1980s with the introduction of Program Management and Budgeting (PMB) and the Financial Management and Improvement Plan (FMIP).

2.12 The framework for presenting the budget prior to the 1980s and the changes which resulted from PMB and the FMIP have been described as follows:

> Since Federation, appropriations for departmental administrative expenses had been presented in highly dissected form, with separate line-items for each type of expense – salaries; overtime; travel; postage and telephone; office equipment; repairs and maintenance; etc. [The early years of Federation even had the salaries appropriations identifying, separately, staff positions and classifications.] Such line-item appropriations meant that there was no flexibility available to managers to re-arrange their resources to meet changing needs. By aggregating all of the separate departmental administrative expenses into a separate single line-item appropriation titled 'running costs', managers were given greater freedom to make rational operational decisions, such as employing more staff rather than paying overtime, or purchasing computers rather than employing additional people

2 Professor Allan Barton, *Accrual Accounting and Budgeting Systems Issues in Australian Governments*, Paper presented to the Annual Congress of the European Accounting Association, Dublin, March 2005, pp 11-12.

3 Commonwealth Department of Finance, *The New Financial Reports of Agencies*, Commonwealth of Australia, Canberra, July 1994, p. 9, quoted in Professor Allan Barton, *Accrual Accounting and Budgeting Systems Issues in Australian Governments*, Paper presented to the Annual Congress of the European Accounting Association, Dublin, March 2005, p. 7.

– decisions that were formerly made difficult by the existence of line-item appropriation limits.[4]

2.13 Other major changes that were made prior to the adoption of the current system included the enactment of the *Financial Management and Accountability Act 1997*, the *Auditor-General Act 1997* and the *Commonwealth Authorities and Companies Act 1997*.

2.14 With the enactment of the *Financial Management and Accountability Act 1997* the Trust Fund that had been established by the Audit Act of 1901 was abolished and was replaced by two funds, the Reserved Money Fund and the Commercial Activities Fund. In his Second Reading Speech, the then Minister for Finance stated:

> Apart from components of the Reserved Money Fund that may be established pursuant to other enactments, the components of these two funds will be established or varied by Finance Minister's determinations. The effect of such determinations will be to specify the kinds of money that may be drawn from the CRF [Consolidated Revenue Fund] or Loan Fund and credited to a particular component and the purposes on which that money may then be spent. Since the spending of money from such a fund is, in all respects, an appropriation, the proposed Act will require that these determinations by the Finance Minister be tabled as disallowable instruments that do not take effect until the period of disallowance has passed. This procedure is more visible and provides a greater measure of Parliamentary control that has traditionally been the case in the establishment of Trust Accounts under the *Audit Act 1901*.[5] [6]

2.15 In the event, the Government abolished the Reserved Money Fund, the Commercial Activities funds and the Loan Fund in 1999. This was done by the enactment of the *Financial Management Legislation Amendment Act 1999* which amended the FMA Act so as to abolish fund accounting.

2.16 The current system of budgeting, which was first implemented in the 1999-2000 Budget, involved major changes, including:

- a move to accrual budgeting;
- a shift in the focus of agency reporting from programs to planned outcomes;

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4 Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-02, Department of the Parliamentary Library, 28 May 2002, p. 30.

5 The Hon John Fahey, *House of Representatives Hansard*, 12 December 1996, pp 8345-8346, quoted in Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-02, Department of the Parliamentary Library, 28 May 2002, p. 31.

6 An element that continues under the new legislative regime is that the determinations made by the Finance Minister under the amended Financial Management and Accountability Act that establish, vary or abolish Special Accounts are disallowable instruments.

- the presentation of general government financial statements in accordance with two accounting standards;
- the presentation of performance information to allow assessment of agency performance; and
- the reporting and other requirements of the *Financial Management and Accountability Act 1997* and the *Charter of Budget Honesty Act 1998* at the whole-of- government level.

The outcomes/outputs framework

2.17 In a 'Guidance Document' issued to other agencies in November 2000, the Department of Finance and Administration (Finance) provided the following description of the framework introduced in the 1999-2000 Budget:

> - government (through its ministers and with the assistance of relevant agencies) specifies the outcomes it is seeking in a given area;
> - these outcomes are specified in terms of the impact government is aiming to have on some aspect of society (e.g. education), the economy (e.g. exports) or the national interest (e.g. defence);
> - Parliament appropriates funds to allow the government to achieve these outcomes through administered items and departmental outputs;
> - items such as grants, transfers and benefit payments are administered on the government's behalf by agencies, with a view to maximising their contribution to the specified outcomes;
> - agencies specify and manage their outputs to maximise their contribution to the achievement of the Government's desired outcomes;
> - performance indicators are developed to allow scrutiny of effectiveness (i.e., the impact of the outputs and administered items on outcomes) and efficiency (especially in terms of the application of administered items and the price, quality and quantity of outputs) and to enable the system to be further developed to improve performance and accountability for results.[7]

2.18 Finance claimed that the outcomes and outputs framework would help answer three fundamental questions:

- What does government want to achieve?

  (outcomes)
- How does it achieve this?

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7 Department of Finance and Administration, *The Outcomes and Outputs Framework Guidance Document*, November 2000, p. 5.

(outputs and administered items)

- How does it know if it is succeeding?
(performance reporting)[8]

2.19 Finance asserted that the framework has two basic objectives: to improve agencies' corporate governance and to enhance public accountability. The department elaborated on these objectives as follows:

> Managing through outcomes and outputs helps improve decision making and performance by focussing attention on the fundamental questions outlined above. It can also improve the understanding and knowledge of those outside the agency who have an interest in its performance, including ministers, parliament and external accountability bodies such as the Auditor General.
>
> Agencies apply inputs (eg finances, human resources, capital equipment) to the activities and processes that generate the products and services that constitute their outputs. These inputs include the funds appropriated to them from the budget or received through purchaser/provider arrangements, as well as revenue raised through other means, such as sales, levies and industry contributions.[9]

2.20 Finance also stated that 'Outcome statements define the purpose of appropriations in the Budget Bills, while administered items and departmental outputs are detailed in the Portfolio Budget Statements, which form part of the Budget Papers'.[10]

2.21 There is no necessary correlation between accrual budgeting and the outcomes/outputs framework.

> The changes involved were massive – not only was the financial reporting basis for the budget to change from cash to accruals, but its structure was changing from inputs to outcomes and outputs. There is no necessary relationship between the two changes: it would have been possible to have accrual budgeting based on inputs, or moved to outcomes/outputs on a cash basis.[11]

2.22 Nevertheless, accrual budgeting and the outcomes/outputs framework are effectively complementary.

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8 Department of Finance and Administration, *The Outcomes and Outputs Framework Guidance Document*, November 2000, pp 3-4.

9 Department of Finance and Administration, *The Outcomes and Outputs Framework Guidance Document*, November 2000, pp 4-5.

10 Department of Finance and Administration, *The Outcomes and Outputs Framework Guidance Document*, November 2000, p. 5.

11 Professor Stephen Bartos, Director, National Institute for Governance, University of Canberra, *Submission 5*, p.15.

Application of the framework

2.23 The application of the outcomes and outputs framework was the subject of a recent performance audit conducted by the Australian National Audit Office (ANAO).[12] The objective of the audit was to assess the application of the framework in Australian Government agencies.

2.24 The report on the audit, which was tabled on 6 February 2007, includes a detailed description of the framework and is recommended to readers who may wish to gain a more complete understanding of the way in which Commonwealth public moneys are appropriated and spent.

2.25 The report's recommendations cover matters such the specification of outputs, the appropriateness of performance indicators and the integration of outcomes and outputs cost and performance information into regular management reports. ANAO also proposed six matters for the consideration of the department of finance. These included better integration of programs into the outcomes and outputs framework and enhanced reporting of expenditure and performance against specified new budget measures.[13]

Some significant changes

Cash accounting and budgeting

2.26 Cash accounting is an essential management tool in the private and in the public sectors. Professor Barton has identified the need for cash information in the public sector as follows:

- Cash is central to all government fiscal policies because it funds the resources required to provide all the goods and services to the community.
- Cash budgets provide Parliament with information on the *new resources* required for allocation to departments and programs to citizens in the form of goods and services and how they are to be funded through taxation and other measures. (Provision of new resources involves government policy decisions and parliamentary approval.)
- Cash is central to macro-economic management of the economy.
- Long term cash budgets extending over the economic cycle are needed to determine whether current policies are compatible with the objective of intergenerational equity. A long term cash deficit indicates that, on current expectations, taxation receipts are inadequate to fund the budgeted provision of services.

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12 Australian National Audit Office (ANAO), *Application of the Outcomes and Outputs Framework*, Audit Report No. 23 2006-2007.

13 Australian National Audit Office (ANAO), *Application of the Outcomes and Outputs Framework*, Audit Report No. 23 2006-2007, pp 31-33.

- CABS is also necessary for efficient cash management by government to ensure adequate liquidity throughout the year and to minimise borrowing costs.[14]

2.27 Professor Barton concluded that 'for fiscal policy purposes, efficient cash management, and budget legal compliance and accountability purposes, CABS is necessary and the information must be available on a timely basis such as daily for cash management'.[15]

2.28 It is important to note, as did a senior Finance officer, Ms Campbell, and Mr McPhee, the Commonwealth Auditor-General, in their evidence, that cash information is still reported in the budget papers and within accruals accounting.[16] Additionally, within the new Central Budget Management System, departments and agencies are responsible for providing monthly forecasts of cash requirements and reporting monthly on financial performance and trends.[17]

Annual appropriations?

2.29 The FMA Act of 1997 classified money that was en route to or from a fund as Received Money or Drawn Money. The Act provided that Drawn Money held by agencies as unused/uncommitted advances that had been drawn against an appropriation which had lapsed at a particular time would lose its status as Drawn Money and be dealt with as Received Money. It would thus be paid promptly into the CRF. This was to prevent the accumulation of 'hollow logs'.[18]

2.30 Changes to the financial framework in the 1999-2000 Budget ensured that the annual Appropriation Acts do not lapse at the end of the year, with the result that funds may be carried over from year to year. The Committee considers the issues that arise from the existence of 'carryovers' in Chapter 3.

Role of the Department of Finance and Administration

2.31 ANAO provided information on the changes that have occurred within the Commonwealth Public Service in the control of government finances.

> 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

14 Professor Barton, *Submission 8*, pp 8-9.

15 Professor Barton, *Submission 8*, p. 9.

16 Ms Campbell, *Committee Hansard*, 8 September 2006, pp 21-22; Mr McPhee, *Committee Hansard*, 27 November 2006, p. 12.

17 Department of Finance and Administration, *Supplementary Submission 6b*, [p. 3.]

18 Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-02, Department of the Parliamentary Library, 28 May 2002, p. 32.

latter role included the centralised reporting of estimated and actual appropriations expenditure.

With the devolution of greater authority to agencies and the repeal of the Audit Act, and the commencement on 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:

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.

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 the agencies during the 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.[19]

2.32 It was suggested during the inquiry that Finance should take a more interventionist role in the budget process especially in relation to the definition of outcomes and in determining the items that should be included in the different annual Appropriation Acts. These matters are discussed later, in Chapter 3.

Conclusions

2.33 The Committee agrees with Professor Barton that the case for the adoption of accrual accounting and budgeting is overwhelming. In the Committee's opinion, their adoption has significantly enhanced the management of the Commonwealth's finances and has led to improvements in certain aspects of transparency and accountability. However, the accounting and budgeting processes, and particularly the adoption of the outputs/outcomes framework, have also resulted in new challenges in accountability and transparency for the Parliament, for the public and even for ministers of the executive government. The most significant of these challenges are discussed in the following chapters of this report.

19 ANAO, *Submission 4*, pp 5-6.

Chapter 3

Proliferation of Funding Sources

Introduction

3.1 There is a question as to the degree to which Parliament controls the purposes for which monies are appropriated. Professor Lindell, Professorial Fellow in Law, the University of Melbourne and Adjunct Professor in Law, the University of Adelaide and the Australian National University, for example, stated that:

> Unfortunately the modern reality is that Parliament is gradually losing control over the expenditure of public funds. Appropriations are increasingly permanent rather than annual and they are also framed in exceedingly broad terms …[1]

3.2 The proliferation of sources from which government can obtain funds raises questions as to the extent to which the Parliament controls even the amount of money made available to government.

3.3 The various sources of funding other than the annual Appropriations Acts that are specifically identified in the Committee's terms of reference are: Special Appropriations; the Advance 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. Tax expenditures should be added to the list.

3.4 In this chapter the Committee considers four of these sources of funding – Special Appropriations, Special Accounts, revenue retained under Section 31 of the FMA Act and annual departmental carryovers. The remaining sources of funding are considered in Chapter 4.

Special (or Standing) Appropriations

3.5 Special (or Standing) Appropriations are monies that are appropriated by Acts of Parliament other than the annual Appropriations Acts and which generally continue for longer than a financial year (hence 'Standing Appropriations').

3.6 The great majority of the government's finances are appropriated by means of Special Appropriations. In 2002-2003, more than $223 billion was spent from the Consolidated Revenue Fund under the authority of Special Appropriations. This represented more than 80 percent of all appropriations drawings for the year.[2]

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1 Professor Lindell, *Submission 10*, p. 4.

2 Australian National Audit Office (ANAO), *Financial Management of Special Appropriations*, Audit Report No. 15 of 2004-2005, p. 11.

3.7 Some Special Appropriations are finite, but many are open-ended in the sense that payments authorised under most of the Acts that make provision for Special Appropriations are limited only by the eligibility criteria of the organisations or persons affected by them. These criteria are typically specified in the relevant Act or in subordinate legislation.

3.8 Although the initial (usually open-ended) appropriation is approved by the Parliament when the relevant bill is enacted, the Parliament effectively exercises little on-going control over expenditure from Special Appropriations.[3] (It should be noted, however, that agencies are required to identify expected expenditure from Special Appropriations in their PBS, and actual expenditure should be shown in their annual financial statements.)

3.9 Some of the possible consequences of a lack of Parliamentary control may be seen in the findings of an ANAO audit of Special Appropriations, *Financial Management of Special Appropriations*, in which ANAO found a range of technical breaches. The audit highlighted that departments and agencies need to be mindful of the legislative requirements and appropriation management practices relating to Special Appropriations.[4]

3.10 ANAO found *inter alia* that it is 'important that there is defined responsibility and accountability for [special] … appropriations and that access to the CRF is withdrawn when it is no longer needed'.[5]

3.11 The Committee also has concerns about the open-endedness of many standing appropriations. It considers that if Finance were regularly and routinely to review standing appropriations and report publicly on those reviews, this would ensure not only that access to the CRF is withdrawn when no longer needed but also would ensure that standing appropriations do not entirely escape government and parliamentary scrutiny.

3.12 Alternatively, the Parliament could ensure that enabling legislation includes sunset clauses, even if the period of operation of the appropriation is lengthy. In some cases, these clauses might provide for periods of a decade or more. In this way, however, no appropriation would be open-ended and forever escape parliamentary scrutiny.

3.13 In this context, the Committee has also considered whether ANAO might be asked to consider and advise the Government whether a periodic review of standing

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3 The Parliamentary Library in response to client requests has adopted in its regular *Bills Digests* the practice of identifying provisions in bills that would impose or change a Special Appropriation.

4 Australian National Audit Office (ANAO), *Financial Management of Special Appropriations*, Audit Report No. 15 of 2004-2005, p. 14.

5 ANAO, *Submission 4*, p. 35.

appropriations should take place and on what basis, and whether as a matter of principle any appropriation should be open-ended, but should be finite, even if the expiry date is decades hence.

3.14 Professor Bartos commented on Special Appropriations as follows:

> One of the notable features of budgeting in Australia is our increasing reliance on special appropriations. They have grown to almost 80% of budget spending; which means that Parliamentary scrutiny of Appropriations Bills has become a relatively minor aspect of overall budgetary transparency and accountability…
>
> The implications of this are that there should be correspondingly greater attention paid to the performance of government programs funded via special appropriations: in particular in the areas of social security and health spending.
>
> One option for this would be a separate reporting vehicle on those areas of spending; the obvious possibility is a budget-related paper that provides the Parliament with information on spending through special appropriations.[6]

3.15 In response to that suggestion, Finance pointed out that information on special appropriations may be found in the PBSs, for both the past year and the year to which the estimates apply.[7] ANAO submitted that agencies are already required separately to disclose in their PBS their expected use of special appropriations.[8] However, Professor Bartos made it clear that he was advocating a consolidation of the data in one document:

> It is currently possible to find all the detail of special appropriations by going through each individual portfolio budget statement and adding them up. But you have also got to ask who has got the time to do that. It is a fairly difficult task. It also leads to the problem … that the issues are dealt with piecemeal in different committees at different times so it is hard to form an overview.[9]

3.16 In a further response to a question from the Committee about the considerations that might be involved in producing a separate document, Finance stated that:

> … it would need to be considered in terms of the additional value offset of bringing that information together and whether that information in a single place, outside the context of the agency that is delivering against the special

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6 Professor Bartos, *Submission 5*, p. 9.

7 Ms Kathryn Campbell, General Manager, Financial Management Group, Department of Finance and Administration, *Committee Hansard*, 8 September 2006, p. 22.

8 ANAO, *Submission 4b*, [p. 15.]

9 Professor Bartos, *Committee Hansard*, 12 October 2006, p. 4.

> appropriation, would be of added value. That would need to be given to the government for consideration.[10]

Committee's conclusions

3.17 While it acknowledges that the proposal to produce a separate, consolidated budget paper on Special Appropriations would necessarily involve additional resources, the Committee considers the value of such a document for transparency in general and for the estimates committee processes in particular would warrant the application of those resources. In reaching this conclusion, the Committee is mindful of comments made by its predecessor committee in its report on the 2006-2007 Budget estimates, that:

> The concern with cross portfolio programs, like those in the Indigenous affairs realm, is that it makes it very difficult to identify who is responsible and answerable for expenditure and performance. This is also of concern to the Committee in relation to the Department of Human Services and related agencies, as previous Committee reports have shown.[11]

3.18 Government's increased reliance on Special Appropriations as a main source of funding, together with the growth in cross portfolio programs with the attendant obstacles these pose for Parliamentary scrutiny, makes it important that the Parliament and its committees have readily available to them a consolidated document of Special Appropriations.

Recommendation 1

3.19 The Committee recommends that the government produce and table with the annual budget documents a document that sets out the past and expected expenditure from all Special Appropriations. The data in that document should be set out against the programs that are funded from the relevant appropriation.

3.20 Many standing appropriations may escape government and parliamentary scrutiny because they are open-ended. The Committee has considered whether this apparent deficit in accountability might be overcome by the government implementing routine reviews of standing appropriations and reporting the results of those reviews. ANAO could be asked to advise government on those matters. Alternatively, Parliament might ensure that all acts providing for standing appropriations include sunset provisions, even if the expiry dates are decades hence.

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10 Mr Mike Louden, Acting General Manager, financial Management Group, Department of Finance and Administration, *Committee Hansard*, 27 November 2006, p. 4.

11 Senate Finance and Public Administration Legislation Committee, *Budget estimates 2006-07*, June 2006, p. 8.

Recommendation 2

3.21 **The Committee recommends that the Government implement a system of review for standing appropriations to ensure that access to the CRF is withdrawn when no longer required and to ensure that standing appropriations are subject to periodic government and parliamentary review.**

Special Accounts

3.22 Finance defines Special Accounts as follows:

> A Special Account is a mechanism used to record amounts in the [Consolidated Revenue Fund] that are set aside for special purposes. The *Financial Management and Accountability Act 1997* (FMA Act) provides an appropriation for the purposes of each Special Account, up to the balance of the Special Account.[12] [13]

3.23 Section 20 of the FMA Act enables the Minister for Finance to establish Special Accounts into which amounts may be credited and enables the minister to specify the purposes for which amounts may be debited from the accounts. Subsection 20(4) of the FMA Act authorises the appropriation of funds from the CRF to these Accounts. Subsection 20(4) reads as follows:

> 20(4) The CRF is hereby appropriated for expenditure for the purposes of a Special Account established under subsection (1) up to the balance for the time being of the Special Account.
>
> Note: An Appropriation Act provides for amounts to be credited to a Special Account if any of the purposes of the Account is a purpose that is covered by an item in the Appropriation Act.

3.24 Most Special Accounts are established by determinations made under the FMA Act, but Special Accounts may also be established under other Acts of Parliament and abolished by their repeal, in whole or in part.[14]

3.25 Presumably appropriations authorised by the annual Appropriations Acts for Special Accounts established under the FMA Act are made on the basis of the outcomes that are specified in the Appropriations Acts. That is how they are reported in the PBS. For example, Finance reports the Comcover Special Account against Outcome 2, Output Group 2.1 – Government businesses.

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12 Australian National Audit Office (ANAO), *Agency Management of Special Accounts*, Report No. 24, 2003-2004, p. 11.

13 An example of a Special Account is the Comsuper Special Account which had an opening balance of $4.7 million at the beginning of 2006-2007. It is estimated that the Account's receipts for the 2006-2007 financial year will amount to $60.5 million and payments will be $60.4 million.

14 An interesting example of a Special Account established by an Act other than under the FMA Act is the FFMA Account which was established by the *Future Fund Act 2006*.

3.26 The Finance Minister's determinations establishing Special Accounts or that revoke or vary those determinations, are disallowable instruments under the provisions of section 22 of the FMA Act.[15]

3.27 A comprehensive list of Special Accounts is published as a note to the Consolidated Financial Statements. The title and purpose of each account, the receipts and payments and the opening and closing balances for the relevant financial year are shown.[16]

3.28 The amount of funds in Special Accounts may be assessed from the ANAO's finding that as of November 2003 there were 241 accounts which had held $3.40 billion at 30 June 2003. During 2002-2003, $10.33 billion was credited to Special Accounts and $10.06 billion was debited.[17]

Administration of Special Accounts

3.29 ANAO found that, in 2001-2002, 41 percent of Special accounts were not reported in agency financial statements. In 2002-2003, 17 percent were not reported, which suggests that the ANAO's recommendations were heeded by most agencies and that reporting has improved to some extent. The listing of Special Accounts in the Consolidated Financial Statements (CFS) also indicates that agencies' reporting of Special Accounts has improved.

3.30 ANAO raised concerns about the ability of agencies to transfer funds from administered Special Accounts to Annual Appropriations for departmental outputs. This may be done by means of notional intra-agency transactions in which an agency charges a 'fee' for services provided to a Special Account or is reimbursed for amounts initially paid out of its departmental appropriation for activities relating to the purposes of the Account. ANAO pointed out that 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.[18]

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15 The Regulations and Ordinances Committee has given only one notice for a disallowance motion under section 22. That was given in the previous Parliament and concerned a matter which was resolved when DoFA provided amended supporting documentation.

16 See, for example, *Consolidated Financial Statements for the Year ended 30 June 2005*, circulated by Senator the Honourable Nick Minchin, Minister for Finance and Administration, December 2005, Note 44 to the financial statements, pp 184-222.

17 Australian National Audit Office (ANAO), *Agency Management of Special Accounts*, Report No. 24, 2003-2004, p. 11.

18 ANAO, *Submission 4*, p. 37.

3.31 In a supplementary submission ANAO again raised this issue, in the following terms:

> ANAO considers that the important issue is the current uncertainty as to the transfer of amounts within and across the various forms of appropriations, together with the extent of transparency over such transactions.[19]

3.32 In its initial submission to the inquiry ANAO had identified transparency as an issue of concern in relation to the management of Special Accounts:

> 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.[20]

3.33 The nature of the executive's capacity to transfer funds between Special Accounts and annual appropriations was illustrated by the Auditor-General:

> I will give you a practical example. When you have a special account, you often have a whole branch involved in managing whatever the special account is about. Some departments therefore say that when they provide computers to the individuals in that branch—as they do the rest of the department—it is quite legitimate to charge the special account for the computers going to the staff members in the branch because they are related to their responsibility for managing the special account. It is not universally applied, but doing that, based on legal advice, is consistent with the terms of the special account's purposes. We are not suggesting there is any issue there. Therefore, provided that the departments have a legitimate revenue retention arrangement—the point that Mr Boyd was making—they can expend the money from the special account and credit the department's vote for computer services provided. It is then accredited to the departmental appropriation, which can be utilised on administration of a range of outcomes which may or may not bear a relationship to the original purpose of the special account. So, legally, it is valid; we are just highlighting that we are not sure whether parliament knows the extent of this activity.[21]

Committee's conclusions

3.34 Special accounts grant a right to departments to draw from the CRF. While there are guidelines on the management of such accounts and they are reported in agency PBS there is no consolidated list of such accounts and their balances.

3.35 The Committee considers that there would be merit in requiring the minister for finance no later than 31 August each year to table a consolidated register of special accounts. This would detail the relevant statutory provisions, date of

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19 ANAO, *Supplementary Submission 4b*, [p. 17.]

20 ANAO, *Submission 4*, p. 36.

21 Mr Ian McPhee, Auditor-General, Australian National Audit Office, *Committee Hansard*, 27 November 2006, p. 13.

establishment/duration, purpose, and the amount expended at the close of the financial year. The Committee notes that this suggestion is consistent with amendments proposed to the Financial Framework Legislation Amendment Bill (No. 2) 2005 and rejected by the Government.

3.36 Potentially, the executive government's ability and especially the ability of departmental secretaries and other chief executive officers to transfer funds from one form of appropriation to another could significantly compromise the Parliament's ability to control and scrutinise government expenditure. As suggested by the Auditor-General, few Parliamentarians (or indeed Ministers) would be aware of the extent of these transfers or indeed of the executive's capacity to effect such transfers. It is essential therefore that these transfers are reported transparently to the Parliament.

Recommendation 3

3.37 The Committee recommends that the government ensure that where transfers of amounts between different forms of appropriation occur, that the transfers be highlighted in the reporting documents. Because the reporting of these events in agencies' financial statements may not occur until well after the event, these transfers should be documented and tabled as they occur.

3.38 In making this recommendation the Committee is aware that there might be many such transfers and that there could therefore be practical difficulties in the timely provision of the data. The Committee therefore recommends that Finance consider the practical implications of the above recommendation and report to the Committee on this matter this financial year.

Net Appropriations (Section 31 Agreements)

3.39 The mechanism to credit amounts to annual appropriations that have been debited from Special Accounts is an effective Section 31 Agreement.

3.40 Net Appropriations (or Section 31 Agreements) cover funds that agencies receive from non-appropriation sources and are made under the authority of Section 31 of the FMA Act. Under Section 31 the Finance Minister may enter into agreements with other ministers (or with the chief executive officer of an agency with an appropriation item for which the Finance Minister is responsible) for the purposes of items in Appropriation Acts that are marked 'net appropriation'. Section 10 of *Appropriation Act (No. 1) 2006-2007* provides that each departmental item and several administered items are so marked.

3.41 Section 31 agreements are legislative instruments, but are not disallowable.

3.42 Appropriations Act (No. 1) also deals with Section 31 agreements in that it provides that for departmental items and for those administered items that are marked 'net appropriation', 'the amount specified in the item is taken to be increased in accordance with the agreement, and on the conditions set out in the agreement. The increase cannot be more than the relevant receipts covered by the agreement'.

Administration of Section 31 Agreements

3.43 ANAO recently conducted an audit of net appropriation agreements. In its report, *Management of Net Appropriation Agreements*, which was tabled in January 2006, ANAO reported that in 2004-2005, 67 agencies reported Section 31 receipts totalling $1.46 billion. Those figures contrasted with those for 1996-97, the last full financial year before the commencement of the FMA Act, when net appropriation receipts amounted to $831 million.[22]

3.44 ANAO observed that:

> Significant Constitutional consequences result from the operation of Section 31 agreements. Specifically, an effectively executed agreement provides an agency with an appropriation authority to spend the receipts to which it applies.[23]

3.45 ANAO was interested therefore in determining whether the agreements that had been entered into between 1/1/98 and 30/6/05 were effective, that is, that they had been properly executed under the terms of the FMA Act. ANAO found that 68 percent of agreements had been effectively executed, but assessed 18 percent as 'ineffective'. ANAO reported that a number of agencies were unable to provide evidence to demonstrate the effectiveness of the remaining 14 percent.[24]

3.46 The Auditor also found that 16 agencies 'had increased the reported available balance of their annual appropriations by amounts that were at no time captured by a Section 31 agreement, or [had] spent receipts prior to having an agreement in place'. The ANAO data indicate that $5.8 billion was spent by agencies from 1997 to 2005 without having a demonstrably effective Section 31 agreement in place. For instance, in some cases agreements were entered into by officers who lacked the requisite delegated authority.[25]

3.47 ANAO devoted a chapter of its report to accountability issues. It reported that there were three mechanisms through which agencies reported their Section 31 agreements to government and Parliament.

3.48 First, since 1 January 2005, Section 31 agreements have been registered on the Federal Register of Legislative Instruments. ANAO found, however, that there had often been delays of some months between the signing of an agreement and its

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22 Australian National Audit Office (ANAO), *Management of Net Appropriation Agreements*, Audit Report No. 28, 2005-2006, p. 14.

23 Australian National Audit Office (ANAO), *Management of Net Appropriation Agreements*, Audit Report No. 28, 2005-2006, p. 17.

24 Australian National Audit Office (ANAO), *Management of Net Appropriation Agreements*, Audit Report No. 28, 2005-2006, p. 19.

25 Australian National Audit Office (ANAO), *Management of Net Appropriation Agreements*, Audit Report No. 28, 2005-2006, p. 19.

appearing on the register. There was also apparently some uncertainty about whether the Legislative Instruments Act was intended to apply to Section 31 agreements. Finance responded to the ANAO report, stating that Section 31 agreements would in future be provided to Parliament within six days of the instrument commencing and, in order to remove doubt, that agreements would be registered so that they would be deemed to be legislative instruments under the Act. Finance also informed ANAO that it would continue to work with the Attorney-General's Department to remove any remaining uncertainties.[26]

3.49 Second, estimated receipts are disclosed in the PBSs and PAES. ANAO reported, however, that the current presentation of those estimates may not assist users of the documents to understand the extent to which the agency expects to increase its annual appropriations for amounts collected under their Section 31 agreements. ANAO found that the consistency and accuracy of the estimates could be improved. ANAO suggested that improved guidance could assist agencies to improve the transparency of the PBSs and PAES data.[27]

3.50 Third, the increase in agencies' annual appropriations resulting from Section 31 receipts is disclosed in annual financial statements. ANAO reported, however, that a number of agencies had overstated or misstated their receipts. It concluded that improvements were required in agencies' reporting and disclosure of appropriations, including in their PBS and PAES.

3.51 ANAO reported that a number of agencies had addressed these issues in their 2004-2005 financial statements.[28]

3.52 In its submission to the inquiry, ANAO also dealt with notional transactions and retrospectivity in Section 31 Agreements as follows:

> … 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.[29]
>
> … greater specificity in the FMA Act as to the conditions under which an agreement [a Section 31 Agreement] can be applied retrospectively to

26 Australian National Audit Office (ANAO), *Management of Net Appropriation Agreements*, Audit Report No. 28, 2005-2006, pp. 26, 118, 121.

27 Australian National Audit Office (ANAO), *Management of Net Appropriation Agreements*, Audit Report No. 28, 2005-2006, p. 27.

28 Australian National Audit Office (ANAO), *Management of Net Appropriation Agreements*, Audit Report No. 28, 2005-2006, p. 26, 28.

29 ANAO, *Submission 4*, p. 38.

amounts previously received would assist in enhancing the rigour of the financial framework and promoting orderly governance of appropriations.[30]

Outcome of the audit

3.53 ANOA informed the Committee that Finance had agreed to the following audit recommendations:

> 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 Appropriations Acts, rather than through delegated legislation Section 31 Agreements'.[31]
>
> 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 received by an agency.[32]

3.54 ANAO also reported that there would be an increased focus on legislative compliance as part of its future financial statement audit coverage and that:

> This will involve confirming the presence of key documents or authorities, and sample testing of relevant transactions directed at obtaining assurance about compliance with key aspects of legislative compliance in relation to *annual appropriations, special appropriations, annotated appropriations (through section 31 arrangements) and special accounts*.[33] (Committee's italics)

3.55 Given the results of the audits conducted to date, the Committee fully supports that initiative.

Suggestions for reform

3.56 ANAO drew the Committee's attention to the audit's conclusion that there may be merit in examining the on-going role of individual agency agreements in the management of net appropriations. Two matters were identified in ANAO's submission, namely:

- The instrument establishing the agreement could be changed to reduce the potential for officials to act without Ministerial authorisation; and

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30 ANAO, *Submission 4*, p. 32.

31 ANAO, *Submission 4*, p. 34.

32 ANAO, *Submission 4*, p. 32-33.

33 Australian National Audit Office (ANAO), *Management of Net Appropriation Agreements*, Audit Report No. 28, 2005-2006, p. 28.

35 ANAO, *Submission 4*, p. 33.

- 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.[35]

3.57 It should be remembered with regard to ANAO's second suggestion above that, prior to the commencement of the FMA Act, the annual Appropriation Acts identified the sources from which net appropriations could be received.[36] ANAO submitted that:

> 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.[37]

Committee's conclusions

3.58 The Committee accepts that the government attempts to achieve a measure of transparency before the event by mandating the disclosure of estimated receipts in the PBSs and PAES, but notes that ANAO reported that the presentation of those estimates may not assist users of the documents to understand the extent to which an agency expects to increase its annual appropriations through the mechanism of Section 31 Agreements. The Committee notes that agencies are required to disclose in their annual financial statements the increase in annual appropriations resulting from Section 31 receipts but also notes that ANAO found that a number of agencies had overstated or misstated their receipts.

3.59 Given the significant role played by Section 31 Agreements in the transfer of funds between different categories of appropriations, the administrative shortcomings discovered by ANAO and the apparent confusion among the government's advisors about the uses to which the funds in Special Accounts may be applied, the Committee is concerned about Section 31 Agreements. The evidence leads it to question whether Section 31 Agreements are the most appropriate vehicles for authorising increases in agencies' annual appropriations by the amounts they receive from non-appropriations sources.

3.60 In that context, Finance, in answer to a question from the Committee, stated that since the publication of the audit report it had been considering whether the central role in net appropriations should be returned from agency agreements to the Appropriation Acts. It identified the issues involved as follows:

> … there are a variety of agencies and therefore a variety of receipts under the individual agreements. By implication, the impact of taking it back into

36 ANAO, *Submission 4*, p. 33.

37 ANAO, *Submission 4*, p. 33.

> the appropriation acts would mean that a generic set of issues or types of receipts would need to be agreed on. So we would be looking at the variety of the different types of receipts and the effect that would create upon agencies. We would look at whether it is viable to do it that way or whether there are alternative mechanisms to doing it as part of the annual acts.[38]

3.61 The Committee appreciates the complexity of the issues involved in any change to the system for managing net appropriations. However, the Committee emphasises the point that the concerns it has outlined above in relation to Section 31 Agreements make it crucial that Finance, in consultation with ANAO and other relevant bodies, address this matter with a view to removing the ambiguity and looseness of the current system and improving the transparency and compliance of net appropriation transfers.

Recommendation 4

3.62 The Committee recommends that the central role in the management of net appropriations should be returned to the Appropriation Acts so as to ensure that these significant transfers of funds are fully transparent to the Parliament. In making this recommendation the Committee is aware that the management of net appropriations is complicated and that the Department of Finance and Administration is investigating other options. If a procedure other than returning the central role to the Appropriations Acts is proposed, the Committee would expect that the Parliament and its committees would be consulted. In particular, the Committee would expect Finance to report on any proposed alternative approach this calendar year.

Annual departmental carryover surpluses

3.63 As reported in Chapter 2, unspent funds appropriated for the use of agencies in the various Appropriation Acts may be carried over from year to year. The quantum of the carryover[39] has been assessed by ANAO which drew on the CFS for 2004-2005 and entities' financial statements to determine that there was more than $14 billion in undrawn appropriation balances as of 30 June 2005, comprising:

- $7.71 billion in Annual Appropriations;
- $5.35 billion in Special Accounts; and
- $974 million in limited Special Appropriations.[40]

(The amounts above compare with the amounts appropriated in the *Appropriation Act (No.1) 2006-2007*, namely, $37 billion for departmental outputs and $16 billion for

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38 Mr Louden, *Committee Hansard*, 27 November 2006, p. 4.

39 'Carryovers' in this report is used in a general sense to describe unspent funds from the annual appropriations. The Auditor-General explained that what is involved is really the authority to spend funds that have been carried over from many years.

40 ANAO, *Submission 4*, pp 4-5.

administered expenses; a total of $53 billion. It should be noted that, in addition to the above, there are also large sums of money that have been appropriated by way of Special Appropriations that are 'carried over' because the appropriation is open ended.)

3.64 In this context it is significant that the long title of Appropriation Act (No. 1) is now:

> An Act to appropriate money out of the Consolidated Revenue Fund for the ordinary annual services of the Government, and for related purposes;

rather than:

> An Act to appropriate money out of the Consolidate Revenue Fund for the service of the year ending on 30 June …, and for related purposes;

which was the long title of the Acts prior to 1999-2000 when the accrual-based outcomes/outputs system was adopted.

3.65 Concerns have been expressed in the literature and by witnesses at the inquiry about the ability of agencies to carry over unspent funds, for example:

> The most dramatic weakening of Parliament's role, however, comes not from the *structure* of the Acts but from what they actually do – or, rather, do not do.
>
> The annual Appropriation Acts do not lapse on 30 June.
>
> Ostensibly, this is to permit the Executive to finance its accrued expenses (such as provisions for employee leave entitlements and depreciation of assets etc.) included in the amounts for a current year's appropriation, but for which no actual payment is required until some event in a future year …[41]

3.66 The author of the Research Paper from which the above is quoted canvases what he calls a worst case in which the Executive might make use of carryovers to thwart the will of the Parliament. He postulates that a combination of accrued expense provisions and Special Accounts could allow the Executive to establish:

> … what are, in effect, 'hollow logs' of 'appropriations made by law' (section 83 of the Constitution); and Parliament has unwittingly surrendered its most sacred power – the power to prevent the Executive from continuing to function when denied supply for the ordinary annual services of the Government.[42]

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41 Maurice Kennedy, *Cheques and Balances*, Department of the Parliamentary Library, Research Paper N0. 16, 2001-2002, pp 41-43.

42 Maurice Kennedy, *Cheques and Balances*, Department of the Parliamentary Library, Research Paper N0. 16, 2001-2002, pp 41-43.

3.67 That proposition was put by the Committee to the Auditor-General, who responded as follows:

> I think at a conceptual or theoretical level there is something in that. But it is not forever; it is, I imagine, for a relatively constrained period of time because the government needs authority across a very broad range of programs. Whether this level of authority, despite the size of it, provides the breadth and the coverage to allow a government to continue for too long would need deeper analysis. But I think it certainly—put it this way—gives greater authority than there used to exist under a cash system, where the authority lapsed at 30 June.[43]

3.68 Mr Tony Harris, a former senior Commonwealth Government official and New South Wales Auditor General, who gave evidence in a private capacity, submitted that:

> By allowing accrual appropriations, the Parliament has allowed the government to establish hollow logs and to forfeit control over the use of those accumulated monies for which the government has no present need. (One instance seen by the writer concerned an additional appropriation of over a billion dollars successfully sought to meet additional salaries in the defence department. Ultimately that appropriation was not used for salaries but to compensate the department for a write-down in asset values for the amount appropriated.)[44]

3.69 Mr Harris also submitted that:

> A corollary to re-establishing adequate Parliamentary control over public monies is that annual appropriations revert to annual lives so that at the end of the financial year appropriations lapse and that there would be a severe reduction in the ability of the minister for finance to siphon off appropriations or monies to special accounts.[45]

Committee's conclusions

3.70 It is of course the case that any funds carried over at the end of a financial year have at one time or another been legally appropriated, ostensibly for particular purposes, and it might be argued that the ability of agencies to retain funds for future liabilities is conducive to better asset management and greater transparency. However, any perceived increases in managerial efficiency must be considered in the context of loss of Parliamentary control of the appropriations.

3.71 The Committee has concluded that to address some of the transparency issues surrounding carried over appropriations, agencies should report to Finance soon after the end of each financial year the amount of their unexpended funds on each of their

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43 Mr Ian McPhee, Auditor General, *Committee Hansard*, 27 November 2006, p. 7.

44 Mr Harris, *Submission 7*, p. 1.

45 Mr Harris, *Submission 7*, p. 2.

outcomes (or programs) and the reasons for the underspend. The government would then arrange for a consolidated report to be tabled in Parliament within six months. Parliamentarians and the public would thus be informed of any significant underspending on the specific purposes for which funds had been appropriated. The underspent appropriations should be returned to the CRF unless the finance minister determines that there is good cause why they should be retained by the agency.

Recommendation 5

3.72 **The Committee recommends that agencies report the amounts of their unspent appropriations and the reasons for the underspend to Finance at the end of each financial year and that the government tables in Parliament a consolidated report on the amount and reasons for the underspend within six months of the end of the relevant financial year. The Committee further recommends that unspent appropriations be returned to the CRF unless the finance minister determines that there is good cause for the funds to be retained.**

3.73 Much of the departmental underspend is in relation to funds appropriated for depreciation. Many of the issues highlighted in relation to appropriations not lapsing could be addressed by government ceasing to appropriate funds for depreciation.

Recommendation 6

3.74 **The Committee recommends that unless the Government can propose another mechanism that would overcome the accountability and transparency issues raised in connection with the carry over of appropriations it should discontinue the appropriation of funds to agencies for the purpose of depreciation.**

Chapter 4

Tax expenditures, AFM, GST

and ordinary annual services

4.1 In this chapter the Committee considers sources of funding not dealt with in Chapter 3 – tax expenditures, the Advance to the Finance Minister and the Goods and Services Tax. It also examines the question of funds appropriated for ordinary annual services.

Tax Expenditures

4.2 The Australian Treasury (Treasury) defines a tax expenditure as 'a tax concession that provides a benefit to a specified activity or class of taxpayer … A tax expenditure can be provided in many forms, including a tax exemption, tax deduction, tax offset, concessional tax rate or deferral of a tax liability'.[1]

4.3 Treasury produces an annual Tax Expenditures Statement (TES) in December. The TES is tabled in the Senate, usually on the first sitting day of the following calendar year and, under a Procedural Order of the Senate, is referred to the legislative and general purpose committees for consideration by the committees during their examination of the additional estimates.

4.4 Treasury has stated in the TES that:

> Concessional arrangements that give rise to tax expenditures often only receive consideration from Parliament at the time they are introduced. Furthermore, the cost of tax expenditures is generally not directly observable as it does not arise from a direct transaction with government. The publication of information on tax expenditures contributes to the review and assessment of tax expenditures, especially whether their objectives are being met at a reasonable cost and in the interest of the community in general.[2]

4.5 In the 2006 TES Treasury estimated that tax expenditures in 2006-2007 would amount to approximately $41 billion.[3]

4.6 Treasury considers that the publication of the TES is an integral component of the government's budget reporting and that publication serves three key functions:

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1 Australian Department of the Treasury, *2006 Tax Expenditures Statement*, Dec 2006, p. 1.

2 Australian Department of the Treasury, *2005 Tax Expenditures Statement*, Dec 2005, p. 2.

3 Additional quantitative information on tax expenditures may be found in the annual publication of the Productivity Commission, *Trade and Assistance Review*, which assesses assistance provided to industry by tax concessions.

- to allow tax expenditures to receive a similar degree of scrutiny to direct expenditures;
- to allow for a more comprehensive assessment of government activity; and
- to contribute to the design of the tax system, by promoting and informing public debate on all elements of the tax system.[4]

4.7 Dr Mark Burton, Law School, University of Canberra, submitted that while the TES may meet the OECD rules for reporting tax expenditures it does not contain any critical commentary regarding the operation of the identified tax expenditures.[5] Dr Burton made a number of suggestions for greater transparency for reporting tax expenditures. In brief, they are:

- A clear statement of the benchmark taxation principles against which 'tax expenditures' might be ascertained and quantified.
- Identification of all tax expenditures, including reporting on goods and services tax expenditures and matters such as tax evasion, and Commissioner of Taxation lenience for classes of taxpayers.
- Gathering sufficient 'raw' data as to enable informed critical assessment of the operation of tax expenditure, such as the number and characteristics of taxpayers who benefit; the deadweight tax compliance associated with a particular measure; and the use to which the benefit of the tax expenditure is put.
- Publication of a critical appraisal of the merits of each case which explains why the particular tax expenditure has been adopted and also why the tax expenditure has assumed the legislated form.
- The preparation of the tax expenditures report be undertaken by an independent agency.[6]

4.8 Professor Bartos submitted that:

> Inclusion of detailed tax expenditure in the budget papers, preferably broken down by function in the same way as other expenditure, would be a highly desirable step forward in transparency.[7]

4.9 Treasury responded to the suggestion that detailed tax expenditures should be included in the budget papers as follows:

> … publication of the TES shortly after the publication of the MYEFO [Mid Year Economic and Fiscal Outlook] means that it provides the Government with more timely input regarding tax expenditures for use in formulating the Budget. If the TES were to be published with the Budget papers it

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4 Australian Department of the Treasury, *2006 Tax Expenditures Statement*, Dec 2006, p. 2.

5 Dr Mark Burton, *Submission 3*, p.4.

6 Dr Burton, *Submission 3*, pp 6-7.

7 Professor Bartos, *Submission 5*, p. 12.

> would not be available in time to provide an input into the Budget planning, which commences some months before the Budget is presented, and this would detract from its use in policy formulation.[8]

4.10 Treasury also noted that the publication of a detailed TES is required by the *Charter of Honesty Act 1998* with the MYEFO and that any change would require an amendment to the Act. The suggested change, if implemented, would also have significant resource implications for Treasury.[9]

4.11 ANAO informed the Committee that its Planned Audit Work Plan 2006-2007 includes a potential performance audit examining the preparation of the TES.[10]

Committee's conclusions

4.12 Tax expenditures provide what is in effect a subsidy through income foregone for certain activities or categories of persons. Subsidies generally are provided by means of special appropriations and the Committee considers that the reporting of tax expenditures should be no less transparent than the reporting of special appropriations. The Committee supports the publication of the TES; it is an essential accountability mechanism.

4.13 In view of the arguments put by Treasury the Committee does not consider that there is any compelling need for a change to the timing of the publication of the TES. The Committee suggests that ANAO and Treasury examine Dr Burton's submission (see paragraph 4.7 above) to ascertain in what respects the TES could be further improved.

4.14 The Committee considers that Dr Burton's suggestions require further consideration with greater attention to be given to what is expected to be achieved from tax expenditures, processes for periodic review and exploration of notional allocation of such expenditures to other budget expenditures that fall within economic functions and sub functions.

Advance to the Finance Minister

4.15 The Advance to the Finance Minister (AFM) is an appropriation authorised by the annual Appropriation Acts which is made available to the Minister for Finance and Administration as a central contingency fund to provide urgent funding to agencies, through the year, where the appropriated funds prove to be insufficient or a new appropriation is required.

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8 Mr Paul McCulloch, Acting Executive Director, Revenue Group, The Treasury, *Correspondence*, 9 January 2007.

9 Mr Paul McCulloch, Acting Executive Director, Revenue Group, The Treasury, *Correspondence*, 9 January 2007.

10 ANAO *Supplementary Submission 4b*, [p. 14.]

4.16 AFM funding should only be made available if agencies are able to meet two essential tests:

- The need for funding must be urgent; and
- The need for funding was unforseen, or has arisen because of erroneous omission or understatement.

4.17 All applications must satisfy both legislative criteria. An advance from the AFM is only issued if it is the last available legal source of funding.

4.18 Provisions relating to the AFM are set out in Section 12 of Appropriation Acts Nos. 1 and 3 and Section 13 of appropriation Acts 2 and 4. Under Appropriation Acts Nos. 1 and 3, AFM has remained at $175 million for a number of years and under Appropriation Acts Nos. 2 and 4, has remained at $215 million.

4.19 Since 1 January 2005, determinations made under these provisions are registered on the Federal Register of Legislative Instruments and are tabled monthly in Parliament together with explanatory statements relating to the determinations. The determinations set down the purpose of the Advance, the agency receiving the funds, and the amount and the outcome against which the funding is appropriated. Additional information may be found in the explanatory statement, including how the determination meets the tests outlined in the legislation.

4.20 Funds from the AFM may be advanced pending the passage of the Additional Estimates or may remain as a Final Charge for the financial year. Funds provided pending the Additional Estimates may be recovered from agencies when the additional Appropriation Bills are passed. Determinations that are made as a Final Charge are not recovered from agencies during the year. Those Issues are documented in an annual report to Parliament, *Advance to the Finance Minister as a Final Charge*.

4.21 That report discloses amounts issued from the AFM that remained as a final charge to the AFM as at 30 June, including details of expenditure against each item. The reports can be found on Finance's website.

4.22 The *Advance to the Finance Minister as a Final Charge* is referred each year with the particulars of proposed expenditure to the relevant Senate (estimates) Committee for inquiry and report. After the Senate votes on the third reading of the additional appropriations bills, the Issues document is considered in the Committee of the Whole. According to *Australian Senate Practice*:

> The Senate considers [statements of expenditure from advances] in committee of the whole on a motion that the statements be approved. This does not have the effect of authorising the expenditure, which is authorised

> in the original appropriation. Rejection of such a motion would signify dissatisfaction with a statement as an accountability document.[11]

4.23 Appropriations for the AMF have not increased for several years and are now much less significant as a source of funds than in the past. This may be because the additional financial flexibility provided to government agencies by the outcomes/output framework and especially the ability of agencies to carry over surpluses has alleviated their need to access the AFM.

Committee's conclusions

4.24 The Committee considers that the AFM provides a necessary level of flexibility to enable a government to meet contingencies. It considers that the means of accounting to Parliament for the use of the AFM are sufficient to enable the Parliament to scrutinise expenditure from the Advance.

Goods and Services Tax

4.25 The Government does not classify the GST as a Commonwealth Government tax, and receipts and expenditure from the GST therefore are not reported in the Commonwealth's accounts. For the same reason, as discussed earlier, tax expenditures relating to the GST are not reported in the Tax Expenditure Statement.

4.26 The Government's policy regarding the treatment of the GST in its accounts may be found in the Finance Minister's *Statement of Compliance* to the CFS.

> … Australian Accounting Standard AAS31 and other relevant accounting standards would suggest the gross amount of GST and associated payments to the States and Territories be included in the Australian Government's consolidated financial statements. However, the clear policy intent of the *Intergovernmental Agreement on the Reform of Commonwealth-State financial Relations* is that the GST is a State tax collected by the Australian Government in an agency capacity. Therefore, accrued GST revenues and associated payments to the States and Territories have not been brought to account in these statements. Full disclosure of the GST collected for the States and Territories is provided in Note 46 of these statements … [12]

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11 Harry Evans, ed., *Odgers' Australian Senate Practice*, 11th edition, Department of the Senate, 2004, p. 273.

12 *Consolidated Financial Statements for the year ended 30 June 2005*, Circulated by Senator Nick Minchin, Minister for Finance and Administration, December 2005, Commonwealth of Australia, 2005, p. 33.

4.27 ANAO does not agree with the Government's treatment of the GST and has qualified its audit of the CFS on a number of occasions. [13] ALP and Australian Democrats members of the Committee agree with the ANAO that the GST is a Commonwealth tax and should be counted as such.

Committee's conclusions

4.28 The Government publishes the gross amounts of revenue and expenses, assets and liabilities relating to the GST in a note to the CFS. Additionally, the Government, in view of the fact that all GST revenue goes to the States and is the subject of an intergovernmental agreement, provides details of the GST in Budget Paper No. 3 (Federal Financial Relations). In view of the Government's rationale for its accounting of the GST the Committee agrees that Budget Paper No.3 is the appropriate reporting vehicle for additional detail in relation to the GST.

4.29 The Committee does not consider that there is adequate detail in the data published in Budget Paper No. 3 in relation to the expenditures and purposes to which the States and Territories put the GST. The Committee considers that the level of reporting would be greatly enhanced if the States and Territories were to provide to the Commonwealth comprehensive statements of the purposes and expenditure of GST revenue that could be included in the budget documents.

Recommendation 7

4.30 The Committee recommends that the State and Territory jurisdictions provide to the Commonwealth comprehensive annual statements of the purposes and expenditures of GST revenues to enable their incorporation into Budget Paper No. 3.

Recoverable GST

4.31 Section 30A of the FMA Act provides that agencies' appropriations are increased to the extent of the recoverable GST they pay on acquisitions and importations. Finance informed the Committee that:

> 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.[14]

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13 In his Independent Audit Report on the *Consolidated Financial Statements for the year ended 30 June 2005* the Auditor-General stated that the non recognition of GST revenue and expenses 'does not accord with Australian Accounting Standard AAS 31 *Financial Reporting by Governments* which requires that all of the Government's assets, liabilities revenues and expenses be recognised in its financial statements'.

14 Department of Finance and Administration, *Submission 6*, p. 16.

4.32 Finance also submitted that because agencies can only recover the amount of the payment as an input credit under the GST law, the net impact on the CRF of the GST supplement is zero, once the recoverable GST paid by agencies has been refunded by the Australian Taxation Office.[15]

4.33 Agencies are required to disclose in the notes to their financial statements the amount each appropriation was increased by Section 30A during the relevant reporting period.[16]

4.34 ANAO submitted that Section 30A of the FMA Act is a 'recycling' provision, that is, it does not provide an effective net increase in the appropriation otherwise available for expenditure on approved outcomes.[17] However, ANAO emphasised that agencies should report clearly and accurately on the exercise of this and other authorities under the FMA Act, because:

> 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.[18]

4.35 The Committee considers that the treatment of recoverable GST is reasonable and that disclosure in an agency's financial statements probably provides sufficient transparency and accountability.

Funds appropriated for ordinary annual services

4.36 Any consideration of how funds intended for the ordinary annual services of the government are appropriated must begin with the relevant Constitutional provisions – Sections 53 and 54.

Constitutional provisions

4.37 Sections 53 and 54 of the Constitution read as follows:

> **53.** Proposed laws appropriating revenue or moneys, or imposing taxation, shall not originate in the Senate. But a proposed law shall not be taken to appropriate revenue or moneys, or to impose taxation, by reason only of its containing provisions for the imposition or appropriation of fines or other pecuniary penalties, or for the demand or payment or appropriation of fees for licences, or fees for services under the proposed law.
>
> The Senate may not amend proposed laws imposing taxation, or proposed laws appropriating revenue or moneys for the ordinary annual services of the Government.

15 Department of Finance and Administration, *Submission 6*, p. 16.

16 Department of Finance and Administration, *Submission 6*, p. 17.

17 ANAO, *Submission 4*, p. 29.

18 ANAO, *Submission 4*, p. 30.

> The Senate may not amend any proposed law so as to increase any proposed charge or burden on the people.
>
> The Senate may at any stage return to the House of Representatives any proposed law which the Senate may not amend, requesting, by message, the omission or amendment of any items or provisions therein. And the House of Representatives may, if it thinks fit, make any of such omissions or amendments, with or without modifications.
>
> Except as provided in this section, the Senate shall have equal power with the House of Representatives in respect of all proposed laws.
>
> **54.** The proposed law which appropriates revenue or moneys for the ordinary annual services of the Government shall deal only with such appropriation.

4.38 The Clerk submitted that, while the purpose of the distinction in section 54 is to identify bills that the Senate may amend directly under section 53 of the Constitution and those to which it must request amendments, the distinction is a useful tool for parliamentary scrutiny and control of expenditure in that it separates normal ongoing expenditure from other projects.[19]

Ordinary annual services

4.39 Professor Bartos described ordinary annual services in his publication, *Public Sector Governance Australia*, as follows:

> But just what are ordinary annual services? What sorts of proposed spending can the Senate amend and what does it have to leave alone? This was the subject of much debate and disagreement for the first half of the twentieth century. The matter was finally resolved in what is known as the "Compact of 1965", an agreement between the Senate and the Executive that saw some items such as new buildings, grants to the States and new policies put into their own appropriation bill (Bill 2) that the Senate had power to amend. An amendment to the Compact was agreed with the introduction of accrual budgeting in 1999, whereby appropriations for depreciation (to allow replacement of capital equipment) were classed as "ordinary annual services".[20]

New policies

4.40 The Clerk informed the Committee that new policies are regarded as not part of the ordinary annual services under the Compact and submitted that this part of the Compact has been violated in recent times. He submitted that:

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19 Clerk of the Senate, *Submission 1*, p. 4.

20 Professor Bartos, *Submission 5*, p. 10.

> Taking advantage of the nebulous nature of departmental outcomes, departments have been able to start up new policies by using ordinary annual services money.[21]

4.41 As an example, the Clerk reported that funds provided by the Government for the relief of victims of the 2004 Asian Tsunami had come from agencies' appropriations for ordinary annual services. Providing relief for this natural disaster, in the Clerk's words, could 'not possibly be an ordinary annual service of the government'.[22]

Continuing activities

4.42 The Clerk's submission is based on the premise that the Senate and the executive have different views regarding whether 'continuing activities for which appropriations have been made in the past' should be classified as ordinary annual services. The Clerk submitted that the Senate's agreement with the executive on this matter:

> … seems to have been taken to mean that anything falling within the statements of outcomes is an ordinary annual service, an assumption quite contrary to section 54 of the Constitution and the Compact of 1965.[23]

4.43 Finance submitted that:

> Under the Compact, Bill 1 contains appropriations for departmental *items and outcomes* that have previously been the subject of appropriations approved by the Parliament, excluding payments to other Australian governments and major replacement and new capital items. Bill 2 incorporates items not classified to Bill 1, including payments to other Australian governments, *administered appropriations for new outcomes* and replacement and new capital, including construction or acquisition of land, public works and buildings and major plant and equipment.[24] (Committee's italics)

4.44 The Clerk informed the Committee, however, that:

> What the Appropriations and Staffing Committee agreed to, and what the Senate agreed to, was 'continuing activities'. The department of finance, as I understand it, is saying that what was really agreed to was 'existing outcomes', which is something quite different. 'Continuing activities' is considerably more objective and more in keeping with the original Compact of 1965 than 'existing outcomes'.[25]

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21 Clerk of the Senate, *Submission 1,* p. 4.

22 Clerk of the Senate, *Submission 1*, p. 4.

23 Clerk of the Senate, *Submission 1,* p. 4.

24 Department of Finance and Administration, *Submission 6*, p. 8.

25 Clerk of the Senate, *Committee Hansard*, 8 September 2006, p. 14.

4.45 With regard to Finance's interpretation that the Compact applies only to administered items the Clerk stated that:

> … regardless of whether things are administered expenses or departmental expenses, the principle which the senate and its committees set down in earlier decisions was that all appropriations for new policies would be in bill No. 2.[26]

Suggested remedy

4.46 Professor Bartos submitted that a diminution in the number of appropriation items for non-annual services has been underway for many years. He submitted that:

> One of the problems for the scrutiny of the budget by the Senate is that adherence by the executive to the 1965 Compact is difficult to monitor. It depends on a number of factors including:
>
> > Knowledge by departments/agencies of the significance of the distinction between ordinary annual services and non-annual services
> >
> > Willingness of the executive to ensure that they comply (including through promulgation of regulations or Finance department orders)
> >
> > Senate committees themselves being aware of the significance of the issue and raising it in their estimates hearings at budget time.[27]

4.47 Professor Bartos elaborated on these factors as follows:

> The high rate of staff turnover, especially in budgeting/finance areas of government agencies, gives rise to the possibility that awareness is low…The second question, Department of Finance and Administration monitoring and enforcement of the split, is an area the committee should probably explore with that department in due course.

4.48 He suggested that:

> Audit coverage of the budget documents would be one way of strengthening monitoring of not only this but many other aspects of the accuracy and reliability of budget reporting, but it would have huge resource implications for the ANAO and in any case is unlikely to be adopted by the executive government.[28]

4.49 ANAO referred to the differing views in relation to the Compact and quoted from a submission made to the High Court in *Combet v Commonwealth of Australia* which was to the effect that the Compact is a political agreement and that it is non-justiciable. ANAO concluded that:

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26 Clerk of the Senate, *Committee Hansard*, 8 September 2006, p. 7.

27 Professor Bartos, *Submission 5*, p. 10.

28 Professor Bartos, *Submission 5*, pp. 10-11.

> In this light, and consistent with long-standing practice, the Compact, and its interpretation, are properly matters for the Parliament to resolve.[29]

4.50 The Senate Standing Committee on Appropriations and Staffing has been considering this matter for some time, since late 2005,[30] but apparently agreement has not been reached with the Government because a report has not been presented to the Senate.

4.51 A member of the Committee queried whether, in view of the tension between the Senate and Finance, the Senate and the government and the Senate and the House of Representatives with respect to money bills, a statement by the President should not accompany appropriation bills which would declare how the Senate views the bills:

> I am very sympathetic to the idea that ordinary annual services bills should be swept through … But the real issue is new programs and changes to programs and it tends to be very grey in [those] areas. That is another one [recommendation] we could suggest which would sharpen the focus for the consideration of appropriation bills.[31]

4.52 Professor Lindell suggested that the Senate might wish to consider whether the wording of the Compact of 1965 should be altered to strengthen the restriction which seeks to ensure that capital expenditure and expenditure for new services are not dealt with in the Appropriation Acts No. 1.[32]

Committee's conclusions

4.53 The suggestions that have been discussed above are worthy of consideration. However, given the potential for disagreement (or misunderstanding) that exists in relation to this issue, the Committee suggests that the Senate continue to work to clarify those matters that should be included in the annual appropriation bills.

Recommendation 8

4.54 The Committee recommends that the Senate continue to seek clarification from the Government as to which items the Government believes should be included in the different appropriation bills. The Senate should then form a view as to the appropriateness of the split. When any differences are resolved to the satisfaction of the Senate, the Department of Finance and Administration should be required to monitor and enforce the split.

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29 ANAO, *Submission 4*, p. 40.

30 Clerk of the Senate, *Submission 1*, p. 8.

31 Senator Murray, *Committee Hansard*, 12 October 2006, p. 14.

32 Professor Lindell, *Submission No. 10*, p. 10.

Recommendation 9

4.55 The Committee recommends that the Standing Committee on Appropriations and Staffing should report expeditiously on its negotiations with Government in relation to the appropriate split of items of expenditure in the different appropriation bills so that the issue may be considered by the Senate.

Recommendation 10

4.56 The Committee recommends that the Clerk advise the President of the Senate with respect to concerns about the matters included in periodic Appropriation bills and that the President table a statement accompanying the bills or return the bills to the House of Representatives or to the minister for clarification, elucidation or adjustment.

Chapter 5

Improving transparency and specificity of budget documents

5.1 In this chapter the Committee discusses how the nature of the system of Commonwealth funding and expenditure is revealed in the presentation of the Budget and the Budget documents.

Previous parliamentary reports

5.2 Parliamentary committees in the past have reported on the adequacy of the explanatory material provided with the Budget.

Reports on the Portfolio Budget Statements

5.3 One of the Committee's predecessor committees, the Finance and Public Administration Legislation Committee, published three reports on *The Format of the Portfolio Budget Statements* in 1997, 1999 and 2000. In its third report, tabled in November 2000, that committee concluded, *inter alia*, that:

> … the PBS are … well-crafted documents which contain a wealth of useful information, once the reader has grasped the underlying concepts of accrual budgeting, budgeting processes, the reporting framework and reporting requirements. The PBS are not for the uninitiated.
>
> They are evolving, however, and may eventually reach a point where they can more closely merge the government's aspirations for them as budgeting statements and senators' hopes for a simple, straightforward, user-friendly, yet detailed guide to the estimates.[1]

5.4 The question regarding the adequacy of budget reporting was raised with the Auditor-General in this inquiry. He responded as follows:

> I think the short answer is that this whole area is a journey rather than a destination. The system continues to evolve. We need to learn from the experience as we go. I think there are some areas that are worthy of attention. Our submission points out some of those areas, including, for instance, the description of the outcomes and the consistency of the use of outcomes across agencies and whether greater use of program information would assist senators in their work. There is the perennial issue of performance information. There is also the issue of the understanding of the financial management framework itself. I came into the room as Ms Campbell was speaking about Finance's plans, where appropriate, to try to

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1 Senate Finance and Public Administration Legislation Committee, *The Format of the Portfolio Budget Statements: Third Report*, November 2000, p. 39.

> simplify the financial framework, because in some areas it is complex and does require a level of detailed knowledge.[2]

Report on the accrual budget documents

5.5 In June 2002 the Joint Committee of Public Accounts and Audit (JCPAA) reported on a review of the accrual budget documents. Among its several other recommendations the JCPAA recommended that:

> Agency outcome statements should:
>
> > Completely and clearly define their key objectives to reflect the impacts Government expects from their work;
> >
> > Completely and clearly define the impacts Government expects from agency administered items; and
> >
> > Accurately articulate the purpose of the relevant appropriations under the Appropriation Acts of the Commonwealth Budget.[3]

5.6 The Government agreed in principle with these recommendations and in its response to the committee's report on 13 May 2003 stated that Finance was developing Outcomes Principles that would require the development of more specific, less aspirational outcomes statements where appropriate.[4]

Reporting on forward estimates in the PBS

5.7 In the second report on the format of the PBS, the Senate Finance and Public Administration Legislation Committee recommended that forward estimates for outcomes and outputs should be included in the PBS.[5] In its third report the committee again recommended that forward estimates be provided in the PBS, but only for administered items.[6]

5.8 The Government did not accept those recommendations because:

> … there is already extensive reporting of forward estimates provided in the budget documentation. Forward estimates information is provided at an aggregate level (cash and actual) as well as for agency expenses, measures and on a functional basis. This information is published at both Budget and Mid Year Economic and Fiscal Outlook update.

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2 Mr Ian McPhee, *Committee Hansard*, 8 September 2006, p. 36.

3 Joint Committee of Public Accounts and Audit, *Report 388 Review of the Accrual Budget Documentation*, June 2002, p. *xxi*.

4 JCPAA Report 388: Review of the Accrual Budget Documentation – Government response to recommendations of a policy nature, *Senate Hansard*, 13 May 2003, p. 10580.

5 Senate Finance and Public Administration Legislation Committee, *The Format of the Portfolio Budget Statements: Second Report*, October 1999, p. 28.

6 Senate Finance and Public Administration Legislation Committee, *The Format of the Portfolio Budget Statements: Third Report*, November 2000, p. 40.

> The purpose of the Portfolio Budget Statements (PBS) is to explain the annual Appropriation Bills before the Parliament. As such, forward estimates information by output and for each administered item (or by program prior to the introduction of outcome-output budgeting) have never previously been included in the PBS, nor in the Explanatory Notes.[7]

5.9 The Committee agrees that one important purpose of the PBS is to explain the annual appropriations. This is manifested by the inclusion of specific reference to the documents in the Appropriation Acts, and particularly to the provision that declares that the PBS are relevant documents for the purposes of section 15AB of the *Acts Interpretation Act 1901*.[8] However, the PBS also have other purposes, which should include informing the Parliament of the expected future levels of expenditure on particular budget measures. The Committee's predecessor committee stated:

> Mr Murphy [a Finance official] responded that the focus of the PBS was the budget year. From a strictly budgeting viewpoint, this is correct. But as the committee has repeatedly pointed out, in approving the Appropriation Bills, senators have to satisfy themselves that previous expenditure has been wise. Were detailed forward estimates available in the PBS, they might disclose that, in two years' time, a given output required a huge injection of money, one explanation for which might be wastage or inefficiency in the past. At the very least, the proposed changing expenditure pattern would be worthy of examination.[9]

Committee's conclusions

5.10 The Committee is aware that much detailed information is provided in connection with the Budget, including some financial information for forward years, and it appreciates that much effort and many resources are needed to produce that information. The Committee also accepts that government provides that information in good faith in part to assist the Senate to perform its role in scrutinising government funding and expenditure. Nevertheless, this Committee, like the Senate Finance and Public Administration Legislation Committee, also considers that the provision of program level forward estimates for outcomes, outputs and administered items in the PBS would enhance the transparency and accountability of government for its funding

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7 Senator the Hon. Christopher Ellison, Minister for Justice and Customs, *Senate Hansard*, 8 February 2001, p. 21745.

8 *Appropriation Act (No. 1)2006*, ss. 4(1).

9 Senate Finance and Public Administration Legislation Committee, *The Format of the Portfolio Budget Statements: Third Report*, November 2000, pp 16-17.

and expenditure,[10] especially in view of the carry over of funds and programs to future years. (See Chapter 3, paragraphs 3.63 to 3.74.)

5.11 The Committee also notes that there is insufficient mapping of spending by agencies on particular programs between the Budget Papers and the PBS. Expenses are classified on two different bases. The PBS classify expenses by outcome. Budget Paper No. 1 classifies by function or purpose. The two are not reconciled. Transparency is further reduced where responsibilities sit across portfolios. For example, spending on the Housing and Community Amenities function and the three sub-functions[11] traverses programs in the portfolios of Defence, Transport and Regional Services and Family and Community Services. There are no program descriptions. Instead, users have to try their luck hunting programs through at least three different sets of PBS.

Recommendation 11

5.12 **The Committee recommends that a common approach be taken for the Portfolio Budget Statements and that estimates for three forward years be included for departmental and administered items at the program level. This should be able to be referenced back to functional and sub-functional splits in the other Budget papers.**

Formulation of statement of outcomes

5.13 It seems to have been widely accepted by most observers, including by Parliamentarians, ever since the Government decided to adopt the accrual-based outcomes/outputs framework from the 1999-2000 Budget that appropriating moneys according to outcomes, with departmental outputs and administered items contributing to the achievement of those outcomes, would emphasise *performance* rather than *process* in the public sector and would increase accountability.[12]

5.14 Professor Bartos submitted that:

> The transition to outcomes/outputs accrual budgeting in 1999-2000 was accompanied by further significant changes in budget reporting. Some of these added to transparency and accountability: in particular, information is now available on assets and liabilities, changes in the net worth of government can be monitored, and there is now consistency between the

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10 In its recent report on the application of the outcomes and outputs framework ANAO also has suggested that the provision of forward estimates on the basis on which Parliament appropriates funds should be further considered in any future review of the framework. Australian National Audit Office (ANAO), *Application of the Outcomes and Outputs Framework*, Audit Report No. 23 2006-2007 p. 93.

11 See *Budget Paper No. 1 2005-2006*, pp 6-13.

12 See, for example, Australian National Audit Office, *Submission 4*, p. 9.

> reporting structure in the budget papers and departments'/agencies' Annual Reports.[13]

5.15 But as pointed out in a Research Paper published by the Commonwealth Parliamentary Library in 2002:

> … there is an apparent paradox. The adoption of an accruals-based system of accounting makes the Executive's financial activities more transparent to the Parliament in its role of holding the Executive more accountable for those activities *after the event*. Yet the supposedly necessary complementary changes to the appropriation structures, wherein the Parliament's authority is given *before the event* for the Executive's financial activities, may actually have diminished Parliament's capacity to control the Executive in the way the Constitution envisaged.[14]

5.16 The current situation contrasts with that in earlier times:

> Although Parliament was presented with a detailed list of intended budgetary spending, in practice there was little or no management information on what or how resources were expended. The system was strong on *ex ante* controls but weak on expenditure management...[15]

5.17 To the extent that Parliament's capacity to control the spending of the executive has been diminished, this appears to have resulted from the current structure of the annual Appropriation Acts and in particular the outcomes/outputs presentation of proposed expenditure.

5.18 The JCPAA has registered concern about the broad formulation of outcomes. In its 2002 report the committee stated that:

> The Committee highlighted several examples of poor output and outcome definitions during the public hearing. There was concern that the outcome statements were too broad and far reaching, whilst some output statements were difficult to comprehend.[16]

5.19 Professor Geoff Lindell submitted that '… the statement of outcomes can frequently be so open ended as to cease to be a meaningful description of the purpose of any expenditure'.[17]

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13 Professor Stephen Bartos, *Submission 5*, p.2.

14 Maurice Kennedy, *Cheques and Balances: Research Paper No. 16 2001-2002*, Department of the Parliamentary Library, p. 34.

15 John Wanna, Joanne Kelly & John Forster, *Managing Public expenditure in Australia*, Allen & Unwin, St Leonards, NSW, p. 301.

16 Joint Parliamentary Committee of Public Accounts and Audit, *Report 388 Review of the Accrual Budget Documentation*, June 2002, p. 11.

17 Professor Lindell, *Submission 10*, p. 9.

5.20 Professor Lindell observed that a need for greater specificity of purposes is not inconsistent with the need for flexibility. He suggested that a category of departmental expenditure could be drafted that would describe running and regular expenditure for items of expenditure that are not thought to require detailed itemization. These items could include the acquisition of office furniture and stationery and the payment of salaries. Professor Lindell submitted that this category of expenditure should not include departmental expenditure which is capable of being identified by reference to the nature of the policies promoted and implemented by an agency.[18]

5.21 ANAO pointed out that broad statements of outcomes allow budget-funded agencies to attribute particular activities or programs to more than one outcome and that this reduces the information value of nominated outcomes to Parliament. This was highlighted in ANAO's recent audit of the Roads to Recovery Programme administered by the Department of Transport and Regional Services.[19] In that case, payments that related to the transport outcome were subsequently reported against the regional services outcome so as to prevent the department being reported for breaching Section 83 of the Constitution.

5.22 In its supplementary submission, ANAO suggested that if there were greater specification of the purposes of appropriations in Appropriation Acts (for example through greater specification and/or the number of outcomes) the potential for this type of cross-outcome program attribution might be reduced.[20]

5.23 Broad formulation of outcomes may lead to further obfuscation of the government's accountability to the Parliament even with regard to administered expenses. In this context, Maurice Kennedy wrote:

> Under the terms of an annual appropriation, an entity is allowed to switch its operating capacity resources (Departmental Outputs) between Outcomes, but not its 'deliveries' (Administered Expenses): those appropriated amounts can only go to the recipients covered by that particular Outcome. However … the Outcomes for Administered Expenses are often expressed so broadly that they do not impose particularly strict legal limits on the purposes for which the appropriated amounts may be applied.[21]

5.24 ANAO submitted that:

> The experience to date suggests that there would be merit in further reviewing the breadth and presentation of outcome descriptions; and

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18 Professor Lindell, *Submission 10, p. 9.*

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

20 ANAO, *Supplementary Submission 4b*, [p. 12.]

21 Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-02, Department of the Parliamentary Library, 28 May 2002, p. 40.

> examining whether the greater use of programme-level information would assist Parliament in its work, and improve the transparency and accountability or Commonwealth public funding and expenditure'.[22]

5.25 In its recent report on the application of the outcomes and outputs framework ANAO recommended that agencies incorporate periodic reviews of outcomes into their business or budget planning processes with the aim of ensuring that outcome statements are sufficiently specific and enable the identification and measurement of an agency's contribution to the achievement of outcomes.[23]

5.26 Professor Bartos submitted that the Committee should:

> Recommend to the executive that the Minister for Finance and Administration be delegated a power to require outcomes descriptions to be expressed in clear, simple and measurable terms. In practice, this power would be exercised by his department in negotiations with other departments, and could be expected to result in considerable improvement in budget transparency… [24]

5.27 With regard to the specificity of outcomes Finance informed the Committee that it was:

> In a process of continuing improvement in assessing outcomes to determine whether or not they provide the parliament and the people with an appropriate level of detail and [was] working with agencies to refine their outcome descriptions as well as performance indicators that go with those outcomes.[25]

Committee's conclusions

5.28 The Committee has concluded that the broad formulation of outcomes has accompanied a loss of program detail and specificity in the appropriations processes of the Parliament. This poses challenges for parliamentary scrutiny. Outcomes must be more precisely and meaningfully specified in the appropriations bills and in all other budget documentation. There is also a need for cross-agency consistency of performance with measures of cost, quality and timeliness. Systematic evaluation of results against targets also needs to be built into budgeting processes, including through active involvement of Finance.

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22 Australian National Audit Office, *Submission 4*, p. 23.

23 Australian National Audit Office (ANAO), *Application of the Outcomes and Outputs Framework*, Audit Report No. 23 2006-2007, p. 31.

24 Professor Stephen Bartos, *Submission 5*, p. 11.

25 Ms K Campbell, *Committee Hansard*, 8 September 2006, p. 21.

Recommendation 12

5.29 **The Committee recommends that outcomes be expressed in clear, simple and measurable terms and that the Department of Finance and Administration play an active role in improving and evaluating the quality of outcomes.**

Program-level expenditure information

5.30 Witnesses suggested that one way of ensuring that the Parliament is presented with a greater level of detail in the Appropriation bills and the supporting documentation is by the use of program-level information.

5.31 ANAO, for example, suggested that the greater use of program-level expenditure information might assist parliament in its work. Reference has also been made earlier in this report to suggestions that financial reporting in the budget documents should be according to programs, and that the current outcomes/outputs reporting should be at a level that the public and ministers commonly understand as programs.[26]

5.32 The Committee was informed that the government already collects expenditure information at this level for its own internal purposes. ANAO informed the Committee that:

> 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).[27]

5.33 Also in relation to programs, Finance informed the Committee that:

> The need for a greater range of information below outcome level was recognised in the Budget Estimates and Framework Review (BEFR) in 2002, with the decision being made by Government at that time that agencies would be required to develop and submit programme information.
>
> The introduction of the Central Budget Management System (CBMS) has assisted agencies to submit this information in a more comprehensive form, and Finance is still evaluating the quality of the data. The decision to publish programme information is one for the Government to make. However, once quality issues are addressed Finance will be in a position to advise the Government on options for greater use, including publication, of programme information.[28]

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26 See Professor Bartos, *Submission 5*, p. 11.

27 Australian National Audit Office, *Submission 4*, p. 23.

28 Department of Finance and Administration, *Submission 4b*, [p. 5.]

5.34 Professor Bartos made the following suggestions for change:

> Either a) seek reporting on the program information currently used for budget decision making or b) a preferable option, break the current outcomes/ outputs structure down to a level that corresponds to what the public and ministers commonly understand as programs.[29]

5.35 As the Committee has reported earlier, in Chapter 2, ANAO recommended in its recent report on the application of the outcomes and outputs framework that Finance consider opportunities for improvement that relate to better integration of programs into the outcomes and outputs framework, including developing criteria to guide agencies' decision-making on the inclusion of program information.[30]

5.36 Bearing in mind that program level information is capable of being reported from the CBMS[31] the Committee suggests that the budget documents might be presented as shown in Appendix 3 at outcomes, outputs and program levels. Presentation of the government's finances in this or a similar form would assist senators and others in their scrutiny of the annual budget and would thus enchance transparency.

5.37 ANAO submitted that a key issue in any move to greater use of program-level information and controls would be a sound approach to identifying individual programs:

> A reasonable principle to adopt would be to identify distinguishable components (an approach that is advocated by the accounting standard on segment reporting) so as to focus on major and significant programmes. Another useful guide … would be the breakdown that the agency uses for its own executive decision-making.[32]

5.38 The Auditor-General suggested that care should be taken not to require universal presentation of program information:

> It needs to be appropriately targeted so that it assists the parliament. You will remember that in the old program budgeting days we used to have programs for corporate services.[33]

5.39 Although it might be asserted that program budgeting had been tried and had failed, Wanna et al were of the view that:

> During the 1980s the quest to adopt program budgeting took on something of a 'holy grail' with officials treating the term as an incantation – a

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29 Professor Bartos, *Submission 5,* p. 11.

30 Australian National Audit Office (ANAO), *Application of the Outcomes and Outputs Framework*, Audit Report No. 23 2006-2007, p. 31.

31 See Ms Campbell, *Committee Hansard*, 8 September 2006, p. 20.

32 ANAO, *Supplementary Submission 4b*, [p. 12.]

33 Mr McPhee, *Committee Hansard*, 27 November 2006, p. 9.

> miraculous salvation for the ills of public finance. The 'implementation' of program budgeting remains one of the great myths of the recent era of Australian public sector management. It cannot be said that it was ever discontinued, because despite the rhetoric it was never implemented in the first place.[34]

Committee's conclusions

5.40 The Committee has concluded that the presentation of program-level information in the Appropriation Acts and in the other budget documentation should lead to greater specification of the objectives of proposed expenditure and hence greater transparency and should be implemented. The evidence and in particular redevelopment of Finance's budgeting systems indicate that presentation of expected and actual expenditure as well as forward estimates on this basis is feasible, and a system of program reporting could be implemented relatively quickly and easily. The Committee considers that presentation of information on this basis should also improve accountability because it should be more focussed and therefore more comprehensible.

Recommendation 13

5.41 **The Committee recommends that expenditure should be reported at the levels of programs in the budget documents, including in the schedules to the Appropriation Acts.**

Departmental outputs and administered expenses

5.42 The terms 'departmental' and 'administered' are not defined in the Appropriation Acts.[35]

5.43 The Committee was informed that 'departmental' and 'administered' are defined in Finance Minister's Orders and those definitions have been refined over time, but ANAO indicated that it might be beneficial if the expenditure that is 'departmental' and expenditure that is 'administered' were explicitly addressed in the Appropriation Acts.[36] ANAO also informed the Committee that the Australian Accounting Standards Board (AASB) is undertaking work that relates to the distinction between 'administered' and 'controlled' items and how they should be accounted for.[37]

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34 John Wanna, Joanne Kelly & John Forster, *Managing Public Expenditure in Australia*, Allen & Unwin, St Leonards, NSW, p. 304.

35 'Administered item' and 'departmental item' are defined respectively in the Acts by reference to an amount set out in the Schedule under 'Administered Expenses' and as the total amount set out under 'Departmental Outputs'.

36 ANAO, *Submission 4*, pp 14-15.

37 ANAO, *Supplementary Submission 4b*, [p. 9.]

5.44 ANAO submitted examples of difficulties that agencies have encountered as a result of the apparent confusion surrounding the interpretation of these items. One department in 2002-2003 had reclassified expenditure appropriated as a departmental output as an administered expense; others had drawn (erroneously) on administered items to meet the departmental costs of administering those same items; and appropriations for similar activities undertaken by different agencies have been allocated differently, either as departmental outputs or administered expenses.[38]

Committee's conclusions

5.45 Obviously there is an element of confusion surrounding the allocation of expenses as departmental or administered, and that confusion must necessarily be reflected in the documentation provided to the Parliament. This in turn will adversely affect the transparency of government funding and expenditure. The Committee considers therefore that this issue should be resolved swiftly and trusts that the work of the AASB will assist in this regard. However, given the progress made by that body on the harmonisation of accounting standards, the Committee questions whether the government should necessarily await the AASB findings before moving to alleviate the confusion that apparently exists.

5.46 The Committee considers that when a reasonable consensus is reached on the definitions of 'administered' and 'departmental' that those definitions should be explicitly addressed in the Appropriation Acts.

Recommendation 14

5.47 **The Committee recommends that the terms 'administered' and 'departmental' be defined in the appropriation bills or other appropriate documents.**

Accounting standards

5.48 The Committee was informed that the use of two different accounting standards and inadequate cash reporting lead to confusion and a waste of resources.

5.49 Professor Bartos submitted that the adoption of accruals led to the unnecessary duplication of reporting in the budget papers against two accounting standards: Government Financial Statistics (GFS) and Australian Accounting Standards (AAS). In his submission Professor Bartos touched on the strengths and weaknesses of both standards but concluded that:

> There can be unproductive debates over the details contained within reporting standards that make not the slightest differences to decision making, accountability or transparency.[39]

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38 ANAO, *Supplementary Submission 4b*, [pp 9-10.]

39 Professor Bartos, *Submission 5*, pp. 7-8.

5.50 Professor Bartos concluded that the standard itself is not important; what is important is that one standard be adopted and applied consistently so that reliable estimates of trends can be reported. He submitted that there is currently an attempt being made to harmonise the AAS and GFS standards and that harmonisation would be a highly desirable outcome. In the meantime in his view the best approach would be to adopt just one of the two.[40]

5.51 Mr Harris submitted that having two accounting standards leads to confusion. He asserted that the Parliament is entitled to impose its own choice on what standard the executive should use to report to Parliament:

> If Parliament insisted, as it can, that GFS be used by Commonwealth departments and other government reporting entities, the cost of duplicated reporting would be eliminated and the clarity of government reporting would be enhanced.[41]

5.52 Professor Barton has written that:

> The present system of accounting in the Australian Government is untenable with the presentation of two sets of accrual budget statements and outcome financial statements which show very different results for all components; and secondly, the absence of CABS [Cash Accounting and Budgeting System] which is needed for fiscal policy purposes, appropriation bills and good cash management. In principle, the solutions are obvious ones, i.e. –
>
> a) the reintroduction of CABS as a subset of AABS [Accrual Accounting and Budgeting Systems] for the direct recording and timely reporting of cash transactions as occurred prior to 1999; and
>
> b) harmonisation of the sound features of AAS [Australian Accounting Standards System] and GFS [Government Finance Statistics System] into one combined, robust accrual accounting FMIRS [Financial Measurement Information and Reporting System] system which is based on the GFS model and is relevant for the public sector.[42]

5.53 Professor Barton submitted that if agreement is not reached shortly by the AASB the GFS system, as modified according to the recommendations of the HoTARAC [Heads of Treasury Accounting and Reporting Advisory Committee] Committee, be adopted. He noted that the implementation of that system would require an amendment to the Charter of Budget Honesty Act 1998.[43]

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40 Professor Bartos, *Submission* 5, p. 8.

41 Mr Harris, *Submission 7*, p. 4.

42 Professor Barton, *Accrual Accounting and Budgeting Systems Issues in Australian Government*, *Submission 8a*, p. 22.

43 Professor Barton, *Submission 8*, p. 1,

5.54 Professor Barton also submitted that budgeting and financial reporting of administered items would be simplified if they were reported on a cash basis, and commented that, 'They are normally cash transfers and they would be more easily understood as such'.[44]

5.55 Professor Barton informed the Committee that it 'would be easy for Parliament to follow each set of budget statements if the full cash budget statements are presented, and are then adjusted for below-the-line non-cash accrual items'.[45]

Committee's conclusions

5.56 Witnesses acknowledged that the current use of two different accounting standards for the budget documents is at least potentially confusing and supported the harmonisation exercise that is underway. They also acknowledged that the harmonisation exercise has taken some time. The Committee considers that the sooner this matter is finalised the better because any confusion must inevitably lead to less transparency than would otherwise be the case. There were suggestions that if a standard were not agreed upon within twelve months, that the Parliament should unilaterally declare that the budget documents brought before must conform to one standard, and that this standard should be based on the GFS system.

5.57 The Committee shares the frustration of those who have advocated this course and will revisit the issue if significant progress towards a single agreed standard has not been reported within twelve months from the time of the tabling of this report.

Recommendation 15

5.58 **The Committee recommends that the ongoing process being undertaken to harmonise the accounting standards should continue and should be expedited by the Government setting a deadline for its completion.**

Other suggestions for improved transparency

5.59 Professor Bartos made a number of other suggestions for changes to the Budget documentation that he considered would result in greater transparency. These included the provision of better functional information in Budget Paper No. 1; the provision of more functional information in the estimates reconciliation table in Budget Paper No. 1; and publication of time series and graphs on trends in net worth, together with an explanation for those trends.[46]

5.60 ANAO commented on the above suggestions as follows:

> Some of the other additional information being advocated … may provide additional information for some users but may not be of information value

44 Professor Barton, *Submission 8*, p. 3.

45 Professor Barton, *Correspondence*, 28 August 2006.

46 Professor Bartos, *Submission 5*, pp 11-12.

> to many Parliamentarians. The Budget Papers are already voluminous, and ANAO is unaware of the extent to which Parliamentarians require the additional information suggested.[47]

Committee's conclusions

5.61 The Committee considers that these matters of detail are probably best left for the consideration of the different Legislative and General Purpose Committees when they are examining the estimates. The committees may wish to note the suggestions and determine in the light of their experience whether their adoption would assist them in their work.

Reporting on budget, financial and public sector reform

5.62 Professor Bartos submitted that there is virtually no information in the public domain on what (if any) financial management improvement projects are underway within government.[48]

5.63 ANAO agreed that there is value in the early signalling of proposed changes to the financial framework but suggested that the amount and rate of change has reduced in recent years as the framework has stabilised and that there is no need for such disclosure.[49]

Committee's conclusions

5.64 The Committee accepts that it is possible that as the accruals based outcomes/outputs framework has matured that there has been a perception within government that there is little need for review and reform. If senators were concerned that insufficient work has been undertaken (or published) they could raise the issue in the context of the estimates processes.

5.65 There is an ongoing need to ensure that accountability deficits do not arise from the implementation of the current framework.

Treatment of depreciation

5.66 Professors Barton and Bartos and Mr Harris commented adversely on the current treatment of depreciation expenses in the Commonwealth Budget.

5.67 Mr Harris submitted that the Parliament's loss of control over the appropriations can be seen in many areas, including in the provision of appropriations for depreciation. He noted that the appropriations made for depreciation seem to have neglected that at the outset of the new financial arrangements, the Parliament had

47 ANAO, *Supplementary Submission 4b*, [p. 13.]

48 Professor Bartos, *Submission 5*, p. 13.

49 ANAO, *Supplementary Submission 4b*, [p. 16.]

already provided the funds to acquire the assets being depreciated. Appropriating for depreciation reimburses the government for appropriations it has already received.[50]

5.68 Professor Bartos suggested that there has been double dipping – agencies may be being funded for depreciation while still receiving additional funds for new assets. He submitted that it now appears that many agencies are not making provision for replacement of assets, and are still seeking supplementation when they need to replace assets or make system replacements or upgrades. He cited the Customs replacement IT system as an example.[51]

5.69 Professor Bartos concluded as follows:

> It would be desirable for the Auditor-General to be asked to report on whether agencies have misused depreciation funding, and if there is supporting evidence that they have, for this component of departmental funding to be withdrawn.[52]

5.70 Professor Barton submitted that depreciation charges should not be directly funded in the budget because:

> While they are necessary accounting charges for the use of physical assets in the outcome statements, funding them directly creates confusion and complications with respect to the accountability for the expenditure of budget appropriations. Rather, gross capital expenditure should be separately reported and budgeted for as required, with a subdivision of expenditures between asset replacement (i.e., the depreciation component), and asset expansion. This methodology has the effect of funding depreciation charges each year only as required for replacement purposes in that year. This is useful information for Parliament and management. *As well, it would avoid the questionable practice of departments building up internal cash balances for future asset replacement or whatever other purpose they may use to spend the funds on*. Also in practice, the lifespans over which costs are allocated for long life assets may bear little relationship to reality, and the annual depreciation charges can be, 'soft' figures. Lifespans are greatly affected by obsolescence, repair and maintenance, and general management of the asset. These matters are not given much consideration in determining asset lifespans for depreciation purposes.[53] (Committee's emphasis)

5.71 Professor Barton informed the Committee that:

> I make a point in my paper with respect to some of the allocations to departments for depreciation purposes. I can give you probably two very good examples. The National Museum of Australia depreciates some of its

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50 Mr Harris, *Submission 7*, pp. 1-2.

51 Professor Bartos, *Submission 5*, p.13.

52 Professor Bartos, *Submission 5*, p.13.

53 Professor Barton, *Submission 8*, p. 3.

> collection items over 5,000 years. They happen to be rocks. I assume Geoscience Australia does the same—Geoscience has a very large collection of rocks. Is it appropriate to fund those depreciation charges? I would say not.[54]

5.72 ANAO commented on the evidence given by other witnesses as follows:

> Budget Paper 4 2006-2007 states (page 4) that expenses typically included in Departmental Outputs appropriations include operational expenses including depreciation. Accordingly, as depreciation funding is not separately identified, or funded, the use of such amounts is not restricted to asset replacement. Because depreciation funding for asset depreciation can be significant and asset replacement expenditure often occurs in large amounts at irregular intervals, it would be open to Finance and the Government to consider approaches such as that outlined by Professor Barton.[55]

5.73 Finance submitted that it continues to review the framework and its different aspects and will examine the issues raised by Professor Barton.[56]

5.74 ANAO has also noted that the funding of depreciation is an issue in any consideration of the Compact of 1965, especially in relation to the matters that should be included in appropriations bill No. 2.[57] The Compact of 1965 has been discussed elsewhere in this report.

Committee's conclusions

5.75 The evidence suggests that there are problems with funding for depreciation in the current framework. Funding for depreciation, particularly for replacement purposes, is opaque. The Committee has recommended earlier in this report that the Government should consider whether funds should continue to be appropriated for depreciation. In that context, the Government should also consider new approaches that would result in greater transparency and, in particular, should consider the approach suggested by Professor Barton.

Recommendation 16

5.76 **The Committee recommends that the Government should give consideration to a system for funding depreciation whereby gross capital expenditure would be separately reported and budgeted for as required, with a subdivision of expenditures between asset replacement (i.e. the depreciation component) and asset expansion.**

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54 Professor Barton, *Committee Hansard*, 12 October 2006, p. 23.

55 ANAO, *Supplementary Submission 4b*, [p. 20.]

56 Department of Finance and Administration, *Supplementary Submission 4b*, [p. 7.]

57 ANAO, *Supplementary Submission 4b*, [p. 20.]

Portfolio Budget Statements

5.77 The extensive and detailed explanatory documents that are tabled with the Budget documents and are now known as Portfolio Budget Statements (PBS) have evolved from the explanatory material first provided by some ministers to the early estimates committees. The PBS in their various guises, eg Explanatory Notes, Program Performance Statements or Portfolio Budget Measures Statements, have often been commented upon not only by committees considering the estimates but also by other committees, including one of this Committee's predecessor committees.

5.78 Those committees generally have been interested in the format of the PBS or in their adequacy as explanatory documents.

5.79 The legal status of the documents is significant. In 2002, when he was considering the legal implications of the sections in the Appropriation Acts that declare that the PBS are relevant documents for the purposes of section 15AB of the *Acts Interpretation Act 1901*, Maurice Kennedy made the following observations:

> The important point is that the PBSs, when read with the relevant provisions of the Appropriation Act, do not impose any additional legal restriction on the purposes to which an entity may apply amounts appropriated to it under an annual Appropriation Act so long as such a purpose is not inconsistent with the terms that describe the entity's outcome(s). Consequently, there seems to be no legal impediment to the Executive's undertaking, during the course of a financial year, *totally new or expanded activities* which had not been foreshadowed to Parliament in the PBSs. Provided that the new or expanded activities were, in some way, related to the achievement of a described outcome, and their costs could be accommodated within the total appropriation provision for that outcome, Parliament may not be formally aware of the matter until details were later revealed in the entity's annual report and financial statements.[58]

5.80 The PBS provide a wealth of information but their value as documents for informing the Parliament as to how funds will be spent is problematic. ANAO informed the Committee that:

- Whilst the PBS provide considerable additional material in respect of departmental outputs, the amounts are not required to be spent in the 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

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58 Maurice Kennedy, *Cheques and Balances*, Research Paper No. 17 2001-02, Department of the Parliamentary Library, 28 May 2002, pp 40-41.

- 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.[59]

5.81 ANAO accepts that the PBS have value as accountability documents, in that they set out performance measures and statements of expected performance, with the results of that performance being reported later in annual reports. However, ANAO has found through its audit activities that in certain cases the PBS have not provided a good indication of how some appropriated funds will actually be used by entities. ANAO referred in particular to its audits of the Management of Net Appropriation Agreements and the Financial Management of Special Appropriations, which have been discussed earlier in this report.[60] ANAO also referred to a finding in its report on the Post Sale Management of Privatised Rail Business Contractual Rights and Obligations that:

> … the PBS reporting of FACS [Department of Family and Community Services] had consistently over-estimated the amount of funding required to pay the purchaser of the passenger rail business for concessional rail travel.[61]

Committee's conclusions

5.82 As mentioned earlier, one of the Committee's predecessor committees considered in depth the content and format of the PBS. Apart from making the above observations the Committee does not propose to comment further in this inquiry, but suggests that the Senate Legislative and General Purpose Committees in their consideration of the estimates should report on the format and content of the PBS of the portfolios that are referred to them. The committees might, for example, comment of the specificity of the definition of outcomes. They might also attempt to determine expenditure on outcomes (or programs) and compare that expenditure with the estimates set out in the PBSs. While this would be accounting for expenditure after the event, such an exercise would enable committees to gauge the accuracy of previous PBS estimates and provide a measure by which new PBS estimates could be tested and assessed.

Contingency reserve

The contingency reserve is a global reserve which is supposed to allow for: amounts not yet allocated to individual programs; the tendency to underestimate costs of

59 ANAO, *Submission 4*, pp 24-25.

60 ANAO made recommendations with regard to PBS performance indicators in its report on the outcomes/outputs framework which has also been discussed earlier in this report. (See Australian National Audit Office (ANAO), *Application of the Outcomes and Outputs Framework*, Audit Report No. 23 2006-2007, p. 31.

61 ANAO, *Submission 4*, p. 25

existing programs in future years; and the tendency to overestimate administered item expenses in the early years as the programs get up to speed. The Committee considers that the transparency of the contingency fund could be improved by production of a reconciliation table by sub-function for changes across the forward estimates. This would be produced in the Budget and in the Mid Year Economic and Fiscal Outlook.

Chapter 6

Improving Parliamentary oversight

6.1 If the budget documents were made more transparent and specific that alone would be a significant step towards improving the Parliament's oversight of Commonwealth funding and expenditure. Additionally, the Department of the Senate could adopt procedures to assist committees and senators in their consideration of these matters.

Senate committees

Consideration of Estimates

6.2 As discussed in Chapter 5, the Senate Finance and Public Administration Committee tabled three reports on the PBS in 1997, 1999 and 2000. In its third report the Committee repeated a recommendation it had made in the previous reports, namely, that:

> Senate legislation committees report in each budget estimates report on the adequacy of the PBS provided for their use and in each additional estimates report on the performance information examined.[1]

6.3 In Chapter 4 the Committee considered matters relating to the treatment of funds for the ordinary annual services of government and, in particular, different interpretations of the Compact of 1965. Professor Bartos was quoted in that Chapter as suggesting that Senate committees should themselves be aware of the significance of the Compact and raise it in their estimates at budget time.[2]

6.4 The Committee considers that it would assist the Senate's scrutiny of Commonwealth funding and expenditure if committees reported regularly on the above matters.

Recommendation 17

6.5 The Committee recommends that the Senate Standing Legislative and General Purpose Committees report as necessary in their reports on the estimates on the format and contents of the PBS and PAES that are referred to them.

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1 Senate Finance and Public Administration Legislation Committee, *The Format of the Portfolio Budget Statements: Third Report*, November 2000, p. 42.

2 Professor Bartos, *Submission 5*, p. 10.

Reports on Annual Reports

6.6 ANAO pointed out that there is a strong emphasis in the current budgetary framework on the compatibility of the reporting documents, particularly the PBS, PAES and agencies' annual reports. ANAO submitted that compatibility between these documents is essential for the comparison of budgeted targets and those actually achieved.[3]

6.7 It would be useful therefore if Legislative and General Purpose Committees in their reports on annual reports checked that the reports accurately reflect the performance indicators in the PBSs and PAES. It would also be useful if they reported on comparisons of the final expenditure on outputs (or programs) with the estimates.

Role of the Auditor-General

6.8 In response to an invitation by the Committee to nominate how ANAO might specifically assist Senate committees in the examination of estimates, ANAO suggested the following:

- The Auditor-General and senior staff could provide a briefing for the Committee on contemporary issues influencing public administration. There may also be advantages in the Department of Finance and Administration also participating in any such briefing, but that would be a matter for that Department and its Minister.
- We [ANAO] could produce a synopsis of recent audit activity for each portfolio including a summary of recent performance reports tables in the Parliament and major issues that arose in the audit of the most recent financial statements. This would ensure the Committee was aware of ANAO's audit activities on a portfolio basis. We could supplement this approach with additional briefing for the Committee or for individual members.
- ANAO currently produces a newsletter for agencies titled "Auditfocus". This newsletter seeks to capture some of the lessons from our audit work that are likely to be of general interest and application, and in this way make a positive contribution to better public administration. A similar document could be produced for Estimates Committees.[4]

6.9 The Committee considers that these suggestions, if implemented, should be of considerable assistance to the Senate committees.

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3 ANAO, *Supplementary Submission 4b*, [p. 15.]

4 ANAO, *Supplementary Submission 4b*, [p. 2.]

Recommendation 18

6.10 The Committee recommends that the Committee Chairs Group examine proposals made by the Auditor-General for measures to assist the Legislative and General Purpose Standing Committees in their consideration of the estimates.

Committee staff

6.11 In response to a request from the Committee[5] that he consider how Senate staff might provide additional assistance to senators and committees in their scrutiny of expenditure, the Clerk stated that a number of procedures would be implemented, namely, that Senate committee staff would monitor the financial reports of government agencies to draw committees' attention to:

- new or amended special appropriations;
- the establishment of or changes to special accounts;
- statements of expenditure from the AMF;
- significant changes of programs and projects to outcomes, unusual or unexplained allocation of items to outcomes and other unexplained expenditure; and
- expenditures from Appropriation Bill (No. 1) which do not meet the test of ordinary annual services.[6]

6.12 The Clerk noted that committees could decide to pursue these matters or individual senators could decide whether to pursue them in the course of estimates hearings.

Legislative changes

6.13 Measures to support scrutiny should be considered together with legislative changes which could be made to reassert the parliamentary process of approval of appropriations and their purposes.[7]

6.14 A number of witnesses suggested that there could be value in amending the Appropriation Acts.

6.15 The Committee discussed and supported in Chapter 4 an ANAO suggestion that there could be benefit in addressing in the Acts explicitly the difference between 'departmental' and 'administered' expenditure.[8]

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5 Senator Murray, *Committee Hansard*, 8 September 2006, p. F&PA pp 9-10.

6 Clerk of the Senate, *Supplementary Submission 1a*, pp 1-2.

7 Clerk of the Senate, *Submission 1a*, p. 3.

8 ANAO, *Submission 4*, p. 15.

6.16 Legislative changes could include the presentation of data under better defined outcomes (and/or under programs) in the Schedules to the Acts. As discussed in Chapter 3, the specification of the relevant terms and conditions (including common eligible receipts) for net appropriations could again be included in the Appropriation Acts, and the terms 'departmental' and 'administered' could be defined in the Acts.

6.17 The Acts could also be amended to ensure that amounts identified as departmental items must be expended against one or other of the specified outcomes (or programs).

6.18 Professor Lindell suggested that the Senate should insist:

> … on the alteration in the words of s 7(2) in future *Appropriation Bills No. 1* so as to restore the need for any approved expenditure to be legally linked to, and connected with, a specific purpose or, to use the current language employed to reflect accrual budgeting, a specific 'outcome'. It hardly needs to be emphasised that the need to link expenditure with a defined purpose forms an essential part of the accountability for expenditure of public funds.[9]

6.19 It might be argued that a requirement that expenditure on departmental items must be against one or other of the nominated outcomes could adversely affect agencies' efficiency. It could be alleged, for example, that agencies would have less flexibility in the use of their appropriated resources than under the present arrangements, or, indeed, had under the running costs system. Against that, agencies should be able to retain a great deal of autonomy with regard to the application of their resources, but would not be able to allocate appropriated funds for purposes not specifically approved by the Parliament.

6.20 Professor Lindell submitted a pertinent quote from Alfred Deakin who stated in 1902 that:

> An Appropriation is a definite parliamentary authority to spend money for a specified purpose. Annual Appropriation Acts usually enact that certain sums 'are hereby appropriated, and shall be issued and applied' for the purpose specified.[10]

6.21 It would of course be open to the government, as it is now, to bring additional appropriation bills before the Parliament if the need arose for additional appropriations beyond the scope of the AFM.

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9 Professor Lindell, *Submission 10*, p. 9.

10 P Brazil and B Mitchell (eds), *Opinions of the Attorneys-General of the Commonwealth of Australia* vol 1: 1901-1914, Opinion No. 48, 59 dated 25 February 1902, quoted in Professor Lindell, *Submission 10*, p. 5.

Committee's conclusions

6.22 The Committee expects that the measures discussed above would enhance and reinforce parliamentary control over Commonwealth public funding and expenditure.

Recommendation 19

6.23 The Committee recommends that the Government ensure that future appropriation bills that the Senate cannot amend under the provisions of the Constitution restore the need for any approved expenditure to be legally linked to and connected with a specific outcome or purpose.

Chapter 7

Conclusions and recommendations

7.1 The Commonwealth's financial transactions and the accounting for those transactions have changed greatly since Federation. In the past twenty years in particular there have been significant changes in the way that the executive government presents its budget to the parliament for approval and in the way in which it accounts for past expenditure.

7.2 The changes have been influenced by the magnitude of the Commonwealth's funding and expenditure and by the executive's approach to managing its affairs. In some respects the changes appear to have had positive effects, providing the opportunity for public sector managers to manage better and providing, through the medium of accrual accounting, information about the state of the Commonwealth's finances.

7.3 However, it has become apparent that these positive changes have been accompanied by a loss of program detail and specificity of the appropriations processes of the Parliament.

7.4 The Committee has reached conclusions and made recommendations that should, if implemented, go some way to restoring the Parliament's historical and constitutional prerogatives with regard to public funding and expenditure. These conclusions and recommendations, which may be found in the body of the report, are summarised below under the relevant heading.

Proliferation of funding sources

Special Appropriations

7.5 Government's increased reliance on Special Appropriations as the main source of funding, together with the growth in cross portfolio programs and the attendant challenges these pose for parliamentary scrutiny, make it important that the Parliament and its committees have readily available to them a separate budget paper that covers all Special Appropriations.

7.6 While the Committee is aware that the proposal to produce a separate, consolidated budget paper on Special Appropriations would necessarily involve additional resources, the value of such a document for transparency in general and for the estimates committee processes in particular would warrant the application of those resources.

Recommendation 1

7.7 The Committee recommends that the government produce and table with the annual budget documents a document that sets out the past and expected expenditure from all Special Appropriations. The data in that document should be set out against the programs that are funded from the relevant appropriation.

7.8 Many standing appropriations may escape government and parliamentary scrutiny because they are open-ended. The Committee has considered whether this apparent deficit in accountability might be overcome by the government implementing routine reviews of standing appropriations and reporting the results of those reviews. ANAO could be asked to advise government on those matters. Alternatively, Parliament might ensure that all acts providing for standing appropriations include sunset provisions, even if the expiry dates were to be decades hence.

Recommendation 2

7.9 The Committee recommends that the Government implement a system of review for standing appropriations to ensure that access to the CRF is withdrawn when no longer required and to ensure that standing appropriations are subject to periodic government and parliamentary review.

Special Accounts

7.10 The Committee has concluded that the executive government's ability to transfer funds from one form of appropriation to another could significantly compromise the Parliament's ability to scrutinise and thus control public funding and expenditure. Few Parliamentarians would be aware of the extent of these transfers or indeed of the executive's capacity to effect such transfers. It is essential therefore that these transfers are reported transparently to the Parliament.

Recommendation 3

7.11 The Committee recommends that the government ensure that where transfers of amounts between different forms of appropriation occur, that the transfers be highlighted in the reporting documents. Because the reporting of these events in agencies' financial statements may not occur until well after the event, these transfers should be documented and tabled as they occur.

7.12 In making this recommendation the Committee is aware that there might be many such transfers and that there could therefore be practical difficulties in the timely provision of the data. The Committee therefore recommends that Finance consider the practical implications of the above recommendation and report to the Committee on this matter this financial year.

Net Appropriations (Section 31 Agreements)

7.13 Given the significant role of Section 31 Agreements in transferring funds between different categories of appropriations, the administrative shortcomings discovered by ANAO and the apparent confusion among the government's advisers about the uses to which the funds in Special Accounts may be applied, the Committee is concerned about Section 31 Agreements. The evidence leads it to question whether Section 31 Agreements are the most appropriate vehicles for authorising increases in agencies' annual appropriations by the amounts they receive from non-appropriations sources.

7.14 The Committee notes the suggestion made by ANAO that the central role in net appropriations might be returned from agency agreements to the Appropriation Acts and also notes that Finance has been considering that recommendation and possible alternatives to Section 31 Agreements.

7.15 The Committee appreciates the complexity of the issues involved in any change to the system for managing net appropriations. However, the Committee emphasises the point that the concerns it has outlined above in relation to Section 31 Agreements make it crucial that Finance, in consultation with ANAO and other relevant bodies, address this matter with a view to removing the ambiguity and looseness of the current system and improving transparency and compliance of net appropriation transfers.

Recommendation 4

7.16 The Committee recommends that the central role in the management of net appropriations should be returned to the Appropriation Acts so as to ensure that these significant transfers of funds are fully transparent to the Parliament. In making this recommendation the Committee is aware that the management of net appropriations is complicated and that the Department of Finance and Administration is investigating other options. If a procedure other than returning the central role to the Appropriations Acts is proposed, the Committee would expect that the Parliament and its committees would be consulted. In particular, the Committee would expect Finance to report to it on any proposed alternative approach this calendar year.

Annual departmental carryover surpluses

7.17 The significant amounts of undrawn annual appropriations that remain at the end of a financial year (amounting to $7.71 billion as of 30 June 2005) may be used by agencies for their departmental outputs in following years. Only funds for departmental items may be carried over. Funds appropriated for administered items lapse.

7.18 The 'carried over' funds have at one time or another been legally appropriated, ostensibly for particular purposes. However, there are significant actual and potential problems that arise from agencies' ability to carry over funds from previous years. The funds, which may have been appropriated for one purpose, may be used for another. As far as the Committee is aware, there is nothing to prevent an agency that has had funds appropriated to meet future liabilities from using those funds for current expenses.

7.19 Much of the departmental underspend is in relation to funds appropriated for depreciation. Many of the issues highlighted in relation to appropriations not lapsing could be addressed by government ceasing to appropriate funds for depreciation.

7.20 The Committee has concluded that to address some of the transparency issues surrounding carried over appropriations agencies should report to Finance soon after the end of each financial year the amount of their unexpended funds on each of their outcomes (or programs) and the reasons for the underspend. The government would then arrange for a consolidated report to be tabled in Parliament within six months. Parliamentarians and the public would thus be informed of any significant underspending on the specific purposes for which funds had been appropriated. The underspent appropriations should be returned to the CRF unless the finance minister determines that there is good cause why they should be retained by the agency.

Recommendation 5

7.21 The Committee recommends that agencies report the amounts of their unspent appropriations and the reasons for the underspend to Finance at the end of each financial year and that the government tables in Parliament a consolidated report on the amount and reasons for the underspend within six months of the end of the relevant financial year. The Committee further recommends that unspent appropriations be returned to the CRF unless the finance minister determines that there is good cause for the funds to be retained.

Recommendation 6

7.22 The Committee recommends that unless the Government can propose another mechanism that would overcome the accountability and transparency issues raised in connection with the carry over of appropriations it should discontinue the appropriation of funds to agencies for the purpose of depreciation.

Tax expenditures

7.23 Tax expenditures provide what are in effect subsidies through income foregone. Subsidies are provided directly from the public purse by means of special appropriations. The Committee considers that the reporting of tax expenditures should be no less transparent than that of special appropriations.

Advance to the Finance Minister

7.24 The Committee considers that the AFM provides a necessary level of flexibility to enable a government to meet contingencies. It considers that the means of accounting to Parliament for the use of the AFM are sufficient to enable the Parliament to scrutinise expenditure from the Advance.

Goods and Services Tax

7.25 The Committee considers that the treatment of recoverable GST is reasonable and that disclosure in an agency's financial statements probably provides sufficient transparency and accountability.

7.26 The Committee does not consider that there is adequate detail in the data published in Budget Paper No. 3 in relation to the expenditures and purposes to which the States and Territories put the GST. The Committee considers that the level of reporting would be greatly enhanced if the States and Territories were to provide to the Commonwealth comprehensive statements of the purposes and expenditure of GST revenue that could be included in the budget documents.

Recommendation 7

7.27 The Committee recommends that the State and Territory jurisdictions provide to the Commonwealth comprehensive annual statements of the purposes and expenditures of GST revenues to enable their incorporation into Budget Paper No. 3.

Funds appropriated for ordinary annual services

7.28 The Committee has concluded that the Government and the Senate should work to clarify the matters that should be included in the different appropriation bills.

Recommendation 8

7.29 The Committee recommends that the Senate continue to seek clarification from the Government as to which items the Government believes should be included in the different appropriation bills. The Senate should then form a view as to the appropriateness of the split. When any differences are resolved to the satisfaction of the Senate, the Department of Finance and Administration should be required to monitor and enforce the split.

Recommendation 9

7.30 The Committee recommends that the Standing Committee on Appropriations and Staffing should report expeditiously on its negotiations with Government in relation to the appropriate split of items of expenditure in the different appropriation bills so that the issue may be considered by the Senate.

Recommendation 10

7.31 The Committee recommends that the Clerk advise the President of the Senate with respect to concerns about the matters included in periodic Appropriation bills and that the President table a statement accompanying the bills or return the bills to the House of Representatives or to the minister for clarification, elucidation or adjustment.

Improving the transparency and specificity of the budget documents

Portfolio Budget Statements

7.32 The Committee has concluded that the PBS contain a wealth of information that in general assists parliamentarians who are experienced in their use to understand the intentions of the government in relation to funding and expenditure. The Committee considers that the documents would be of greater use if they were more consistent among portfolios and if they included forward estimates for outcomes, outputs and administered items.

Recommendation 11

7.33 The Committee recommends that a common approach be taken for the Portfolio Budget Statements and that estimates for three forward years be included for departmental and administered items.

Formulation of outcomes

7.34 The Committee has concluded that the broad formulation of outcomes has accompanied a loss of program detail and specificity in the appropriation process of the Parliament. This poses challenges for parliamentary scrutiny. Outcomes must be more precisely and meaningfully specified in the appropriations bills and in all other budget documentation.

Recommendation 12

7.35 The Committee recommends that outcomes be expressed in clear, simple and measurable terms.

Program-level reporting

7.36 The Committee has concluded that the presentation of program-level information in the Appropriation Acts and in the other budget documentation should lead to greater specification of the objectives of proposed expenditure and hence greater transparency and should be implemented. Information on expected and actual expenditure is already collected on this basis within government so that reporting according to programs should be able to be implemented relatively quickly and easily.

Recommendation 13

7.37 The Committee recommends that expenditure should be reported at the levels of programs in the budget documents, including in the schedules to the Appropriation Acts.

Departmental outputs and administered expenses

7.38 The Committee considers that when a reasonable consensus is reached on the definitions of 'administered' and 'departmental' that those definitions should be explicitly addressed in the Appropriation Acts.

Recommendation 14

7.39 The Committee recommends that the terms 'administered' and 'departmental' be defined in the appropriation bills or other appropriate documents.

Accounting standards

7.40 The use of two different accounting standards for the budget documents leads to confusion and inevitably leads to less transparency than would the use of a single uniform standard. A lengthy process to harmonise the different systems has so far not resulted in an agreed outcome. The Committee supports the aim of the harmonisation project, but considers that the project must soon be brought to a conclusion. There were suggestions made during the inquiry that if a standard were not agreed upon within twelve months, that the Parliament should unilaterally declare that the budget documents brought before it must conform to one standard, and that that standard should be based on the GFS system.

7.41 The Committee shares the frustration of those who have advocated this course and will revisit the issue if significant progress towards a single agreed standard has not been reported within twelve months from the time of the tabling of this report.

Recommendation 15

7.42 The Committee recommends that the ongoing process being undertaken to harmonise the accounting standards should continue and should be expedited by the Government setting a deadline for its completion.

Treatment of depreciation

7.43 The Committee has concluded that there are problems with funding for depreciation in the current framework. Funding for depreciation, particularly for replacement purposes, is opaque. The Committee has recommended earlier in this report that the Government should consider whether funds should continue to be appropriated for depreciation. In that context, the Government should also consider new approaches that would result in greater transparency. In particular, it should consider reporting separately on and budgeting for gross capital expenditure, with a subdivision of expenditures between asset replacement and asset expansion.

Recommendation 16

7.44 The Committee recommends that the Government should give consideration to a system for funding depreciation whereby gross capital expenditure would be separately reported and budgeted for as required, with a subdivision of expenditures between asset replacement (i.e. the depreciation component) and asset expansion.

Senate Committees' Consideration of Portfolio Budget Statements

7.45 The Committee has concluded that the PBS (and PAES) provide a great deal of information about the proposed expenditure for the coming year and useful information about expenditure the past year. However, the information is not easily comprehended in the present format, and ANAO has found that in certain cases the PBS have not given a good indication of how appropriated funds will actually be used. The PBS would be much more revealing and useful to parliamentarians if information were presented at the program level, as recommended in this report. Their usefulness would be enhanced further if forward estimates for programs were provided. (See Recommendation 11.)

7.46 The Committee considers that the Senate Legislative and General Purpose Committees in their reports on the estimates should report on the format and content of the PBSs of the portfolios that are referred to them. The committees might, for example, comment on the specificity of the definition of outcomes. They might also compare expenditure on outcomes (or programs) with the estimates of expenditure set out in the PBSs. In this context it should be noted that the Committee has recommended (Recommendation 13) that expenditure should be reported at the program level in the budget documents.

Recommendation 17

7.47 The Committee recommends that the Senate Standing Legislative and General Purpose Committees report as necessary in their reports on the estimates on the format and contents of the PBS and PAES that are referred to them.

Improving parliamentary oversight

Role of the Auditor-General

7.48 The Auditor-General made a number of suggestions for specific measures the Audit Office could take to assist committees with the consideration of the estimates. The Committee has concluded that one or more of the suggestions could be of assistance and considers that they should be further considered by the Committee's

Chairs Group with a view to the implementation of one or more of the proposals for the 2007-2008 Budget estimates.

Recommendation 18

7.49 The Committee recommends that the Committee Chairs Group examine proposals made by the Auditor-General for measures to assist the Legislative and General Purpose Standing Committees in their consideration of the estimates.

Legislative changes

7.50 The Committee has concluded that the Appropriation Bills should be amended as necessary to ensure that appropriated funds whether for departmental or administrative items may only be expended against one or other of the outcomes or purposes specified in the bills.

Recommendation 19

7.51 The Committee recommends that the Government ensure that future appropriation bills that the Senate cannot amend under the provisions of the Constitution restore the need for any approved expenditure to be legally linked to and connected with a specific outcome or purpose.

Committee staff

7.52 The Clerk of the Senate has informed the Committee that a number of procedures will be implemented within the committee secretariats to provide additional assistance to the committees in their scrutiny of the Commonwealth's funding and expenditure. The committee welcomes these procedures.

Senator Brett Mason
Chair

Appendix 1
Submissions Received

Submission Number	Submitter
1	Clerk of the Senate
1a	Clerk of the Senate
2	Clerk of the House of Representatives
3	Dr Mark Burton
4	Australian National Audit Office
4	Australian National Audit Office (*attachment*)
5	Professor Stephen Bartos
6	Department of Finance and Administration
6a	Department of Finance and Administration
7	Mr Tony Harris
8	Professor Allan Barton
9	Mr Bryan Pape
10	Professor Geoffrey Lindell

Appendix 2

Public Hearings and Witnesses

Friday, 8 September 2006 - Canberra

BOYD, Mr Brian Thomas, Executive Director
Performance Audit
Australian National Audit Office

CAMPBELL, Ms Kathryn, General Manager
Financial Management Group
Department of Finance and Administration

COLEMAN, Mr Russell Charles, Executive Director
Performance Audit
Australian National Audit Office

EVANS, Mr Harry, Clerk of the Senate
Department of the Senate

LOUDON, Mr Mike, Division Manager
Financial and Budget Framework Division
Department of Finance and Administration

McPHEE, Mr Ian, Auditor-General
Australian National Audit Office

Thursday, 12 October 2006 - Canberra

BARTON, Emeritus Professor Allan
School of Accounting and Business Information Systems
College of Business and Economics
Australian National University

BARTOS, Professor Stephen, Director
National Institute for Governance
University of Canberra

Monday 27, November 2007- Canberra

BOYD, Mr Brian Thomas, Executive Director
Performance Audit
Australian National Audit Office

COLEMAN, Mr Russell Charles, Executive Director
Performance Audit
Australian National Audit Office

HAWKE, Mr Lewis, Assistant Secretary
Budget Framework and Training Branch
Department of Finance and Administration

KAUFMANN, Mr Brett, Assistant Secretary, Financial Reporting Branch
Department of Finance and Administration

LOUDON, Mr Mike, Acting General Manager
Financial Management Group
Department of Finance and Administration

MCPHEE, Mr Ian, Auditor-General
Australian National Audit Office

Appendix 3

Suggested presentation of budget information

In chapter 5, the Committee discussed ways to improve the specificity of budget documents presented to the Parliament. The table below is a suggested model for reporting appropriations at outcomes, outputs and program levels. (For the Committee's discussion of program-level reporting, see paras. 5.30-5.41.)

Reconciliation of outcome appropriations to outcomes and programs

	($m) 2007-08	($m) 2008-09	($m) 2009-10	($m) 2010-11
Outcome appropriation c made up of:	10	10	10	10
Output c (i) consists of the following administered and departmental items:	6	6	6	6
Administered items for Output c(i) consist of:	2	2	2	2
Program a	1	1	1	1
Program b	1	1	1	1
Output c (ii) consists of the following administered and departmental items:	4	4	4	4
Administered items for Output c (ii) consist of:	3	3	3	3
Program a	2	2	2	2
Program b	1	1	1	1
Departmental items for Output c (ii) consist of:	1	1	1	1
Program a (#)	0.5	0.5	0.5	0.5
Program b	0.5	0.5	0.5	0.5

Note # additional funding for this program resides in the … portfolio which can be found at page … of Budget Paper…