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UNAPPROPRIATED EXPENDITURE - AVOIDING UNINTENDED BREACHES

SUMMARY

1. Changes to the Public Finance Act (PFA) relating to the Controller function have reinforced the need for departments to ensure that there is appropriate authority for all departmental and non-departmental expenses and capital expenditure that they administer, and all departmental net assets that they hold. In particular, departments are reminded that:
 - It is unlawful to incur expenses or capital expenditure in excess of, or without, an existing appropriation or other authority from Parliament (e.g. imprest supply);
 - Use of imprest supply must have prior authorisation from Cabinet (or from joint Ministers acting with Cabinet authority) - it cannot be authorised retrospectively;
 - Any expenses or capital expenditure incurred in excess of or without appropriation, and without prior authority for use of imprest supply, can only be made lawful by being subsequently validated by Parliament in an Appropriation Act, or by the limited powers of the Minister of Finance under s.26B of the PFA;
 - If breaches are identified, authority must be obtained immediately through Cabinet (or through Joint Ministers if the criteria are met) to enable any further expenditure to be made. This process cannot validate any initial breach;

- Past practice of seeking retrospective approval for expenditure through changes to appropriations in future baseline updates (e.g. by way of fiscally neutral transfers) are not appropriate. These were never appropriate. However, with Treasury now required to produce monthly reports to the OAG, it is much more likely that instances of expenditure without appropriate authority will be detected; and
 - The Auditor General has powers under the PFA where authority is exceeded or lacking, including reporting breaches to parliament, or, in more serious cases, preventing payments from bank accounts.
2. This circular outlines the statutory background and processes to be followed for the revised controller function. It also provides detailed guidance on technical issues that have been identified as part of the monthly Controller reporting process so far. These issues relate to:
- In-principle transfers;
 - Aligning opening net assets to audited year end results; and
 - Net asset schedules for departments who forecast output deficits.
3. Departments are also requested to carefully monitor compliance with the scope of their appropriations. Changes to appropriation scope can be made during the financial year, and authorised under imprest supply if necessary, if a scope problem is identified before the relevant expenditure is incurred. Further advice on dealing with scope issues will be provided at a future date.

AUTHORITY MUST BE SOUGHT BEFORE EXPENDITURE IS INCURRED

4. Section 4 of the PFA states that “The Crown¹ or an Office of Parliament must not incur expenses or capital expenditure, except as expressly authorised by an appropriation, or other authority, by or under an Act.”
5. Imprest Supply provides the mechanism for Cabinet (and delegated Joint Ministers) to make decisions in advance of an authority granted under the next Appropriation Act.
6. Instances where authority is exceeded by actual expenditure are unlawful and are considered unappropriated expenditure. These can only be validated:
- By the Minister of Finance under section 26(B) of the PFA²; or

¹ Crown as defined in the PFA includes Ministers of the Crown and all departments

² If the breach is in the last three months of the financial year, is less than 2 percent of the appropriation and only if the breach is within the scope of an existing appropriation.

- By Parliament as part of an Appropriation Act that applies to that financial year.
7. These instances must be reported in Departmental Annual Reports in accordance with Section 26D of the PFA.
 8. Departments, in their role of administering appropriations, are responsible for ensuring and monitoring that sufficient authority exists before incurring expenses or capital expenditure.
 9. Where additional authority is likely to be needed during the financial year the Minister responsible for the Appropriation must obtain authority under imprest supply by;
 - Cabinet agreement; or
 - Joint Ministers agreement if Cabinet delegation is granted (through power to act or meeting the criteria set out by the Cabinet Office for guidelines for changes to baselines).
 10. Changes to the scope of an authority during a financial year have complex imprest supply implications and departments should seek advice from Treasury on the financial recommendations required to ensure sufficient authority is obtained.

POWERS OF AUDITOR GENERAL

11. The Public Finance Amendment Act 2004 made significant changes to the Controller function of the Auditor-General.
12. The legislative provisions for the Controller function are set out in sections 65Y to 65ZB of the PFA.
13. The move to fully accrual based appropriations gave Parliament an opportunity to modernise the Controller function to meet the requirements of the accrual accounting environment and to strengthen the function.
14. The key features of the Controller function are:
 - a requirement for the Treasury to supply monthly reports to the Auditor-General, to enable the Auditor-General to examine whether expenses and capital expenditure have been incurred in accordance with an appropriation or other authority (section 65Y);
 - a power for the Auditor-General to direct a Minister to report to the House of Representatives if the Auditor-General has reason to believe that any expenditure has been incurred that is unlawful or not within the scope, amount, or period of any appropriation, or other authority (section 65Z);
 - a power for the Auditor-General to stop payments from the Crown bank account; and

- a power for the Auditor-General to stop payments out of departmental bank accounts (section 65ZA).

CONTROLLER FUNCTION IN OPERATION

15. The requirement for Treasury to produce a monthly report to the Auditor-General is generated using the information provided by Departments to Treasury for the completion of the Crown financial statements through CFISnet.
16. Treasury is also tracking changes to authority made under imprest supply to reflect the current level of parliamentary authority to compare against actual expenditure.
17. In collating this information, Treasury will rely on the following controls and safeguards:
 - The information provided by Departments is subject to Departments' own internal control processes;
 - The information provided by Departments is also used for internal purposes by the Treasury and the departments themselves;
 - Departments are subject to an annual department internal control evaluation;
 - Departments are subject to annual audits, and their financial statements must reconcile to the CFISnet returns; and
 - There is an audit trail from the imprest supply and other authorities to Cabinet minutes.

INSTANCES WHERE REPORTED ACTUALS ARE OUTSIDE THE SCOPE OF AN EXISTING AUTHORITY

18. The CFISnet reporting enables the authority in terms of amount to be monitored. If Departments become aware of expenditure which exceeds the scope of an appropriation they should inform the Treasury Vote Analyst immediately.

INSTANCES WHERE REPORTED ACTUALS EXCEED THE AMOUNT OF THE AUTHORITY

19. Where the amount of an authority has been exceeded Departments will be contacted by Treasury to provide an explanation for inclusion in the report to the Auditor-General.
20. At a minimum, the Department is expected to inform the Minister responsible for the appropriation that the existing authority has been exceeded and that the

Minister will have to seek additional authority under imprest supply for subsequent expenditure expected to be incurred in this appropriation.

21. In consultation with the Treasury, the Auditor-General may recommend possible further actions including the Auditor-General writing firstly to the Chief Executive of the Department and, once acknowledged, to the Minister holding the appropriation. The letter to the Chief Executive will indicate that:
 - once an appropriation or other statutory authority has been breached, no further expenditure may be incurred until an appropriate authority has been provided; and
 - until that occurs, there should be no funding of any further disbursements from the Crown or departmental bank account in respect of that appropriation or other statutory authority.
22. If authority is not obtained at this stage, the Auditor-General may then invoke the power to direct the Minister, Treasury or Department to stop payments from the relevant bank account, and/or (where a breach of appropriation or other authority has already occurred) to direct the relevant Minister to report to the House. Reporting to the House is a disclosure action, not a validating one, and therefore breach of appropriation will still need to be validated as outlined in paragraph 6 above.
23. The procedure outlined above will not prevent the Auditor-General from exercising the power to direct the appropriation Minister to report to the House, where appropriate. That power may also be exercised, for example, where expenditure is detected that is outside of the scope of an appropriation.

ISSUES IDENTIFIED TO DATE

24. The monthly reporting of appropriations has been operational since September 2005. There are some areas where authority was exceeded which will cause issues going forward unless processes are put in place.
25. Instances identified to date relate to:
 - In-principle transfers;
 - Aligning opening net assets to audited year end results; and
 - Net asset schedules for departments who forecast output deficits.

In-Principle Transfers

26. There will be some occasions where the final amount of an expense or capital transfer is not known before the end of the financial year. In these cases, Vote Ministers may seek approval in principle for an expense or capital transfer before the end of the year (i.e. during the MBU or FTC process). The Vote Minister should include the best estimate of the maximum amount to be transferred.

27. Where approval in principle is given for expense or capital transfers, the Vote Minister is to confirm the amount, in consultation with the Minister of Finance, as soon as the final amount is known. Without this approval, there is no authority to incur expenses.
28. Departments that have in-principle transfers agreed in the March baseline update need to ensure that there is sufficient authority in the next financial year to operate until the first technical changes round at the October baseline update.
29. This is of particular importance where authority for expenses or capital expenditure is limited to one financial year (i.e. no appropriation or other authority exists for the next financial year).
30. We recommend that departments seek Joint Ministers approval in late June to transfer authority to the next financial year subject to the enactment of the imprest supply act if there is not sufficient authority already in place, to avoid exceeding parliament's authority and breaching Section 4 of the PFA.

Aligning Opening Net Assets to Audited year end results

31. Net asset schedules included in the appropriation act are based on estimated actual opening positions which may differ from actual year end results due to:
 - The level of capital injections drawn down differing from the estimated actual forecast;
 - The level of capital withdrawals made differing from the estimated actual forecast;
 - Actual output deficits differing from the estimated actual forecasts;
 - Retention of surplus issues; and
 - Revaluations of property, plant and equipment.
32. Retention of surplus is allowed by section 22(1) of the PFA when the conditions are met.
33. Any revaluations that meet the definition of remeasurements in Section 2(1) of the PFA are covered under Section 22(2) and require no further authority than that section.
34. In order to align the opening net assets for the remaining factors not covered by section 22 of the Act, departments are required to seek joint ministers approval as part of the October baseline update to the new opening balance of net assets using the following formula:

Capital injections per audited 30 June result (schedule 1:0:4 Line 705);

less capital injections per estimated actual;

plus capital withdrawals per estimated actual (schedule 1:0:4 Line 710);

less capital withdrawal per audited 30 June result; and

equals Net increase/(decrease) in opening net assets requiring approval.

35. These changes to net assets are required for both increases and decreases of net assets due to the factors outlined in paragraph 36. A mechanism for obtaining approval for these changes will be included in the October baseline update circular.

Net Asset Schedules for Departments who forecast output deficits

36. Net asset schedules are included in appropriation acts providing the authority for departments to hold net assets to the specified limit. (Section 22(3) of the PFA).
37. For departments that forecast output deficits, which in effect reduce forecast net assets, the monthly monitoring of net assets creates an issue when the actual deficit is lower than the forecast deficit in the appropriation act.
38. Within the Net Asset schedule included in the actual Appropriation Act there is scope for other adjustments to be made with sufficient explanation provided to minimise this problem going forward.
39. Treasury will be contacting departments who have this specific issue with instructions to remedy this issue.

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for Secretary to the Treasury