

REPORT OF PROCEEDINGS BEFORE

GENERAL PURPOSE STANDING COMMITTEE No. 1

**INQUIRY INTO THE CURRENT PROVISIONS FOR THE
APPROPRIATION OF MONEYS AND AUTHORISATION OF
EXPENDITURES**

At Sydney on 1 May 2000

The Committee met at 2.00 p.m.

PRESENT

Reverend the Hon. F. J. Nile (Chair)

The Hon. A. B. Kelly
The Hon. D. F. Moppett
The Hon. J. F. Ryan
The Hon. H. S. Tsang
The Hon. Dr. P. Wong

ROBERT JOHN SENDT, Auditor-General, New South Wales Audit Office, 234 Sussex Street, Sydney, affirmed,

ERIC LUMLEY, Assistant Auditor-General, New South Wales Audit Office, 234 Sussex Street, Sydney, and

GEOFFREY PAUL WHITE, Senior Audit Manager, New South Wales Audit Office, 234 Sussex Street, Sydney, sworn and examined:

CHAIR: I welcome the media and members of the public to this hearing of General Purpose Standing Committee No. 1 for its inquiry into the current provisions for the appropriation of moneys and authorisation of expenditure. I say to members of the media that, under Standing Order 252 of the Legislative Council, evidence given before the Committee and any documents presented to the Committee that have not yet been tabled in the Parliament "may not, except with the permission of the Committee, be disclosed or published by any Member of such Committee or by any other person". Copies of guidelines governing broadcast of the proceedings are available. Mr Sendt, in what capacity are you appearing before the Committee?

Mr SENDT: I appear as the New South Wales Auditor-General.

CHAIR: Did you receive a summons issued under my hand in accordance with the provisions of the Parliamentary Evidence Act 1901?

Mr SENDT: I did.

CHAIR: Are you conversant with the terms of reference of this inquiry?

Mr SENDT: I am.

CHAIR: Mr Lumley, in what capacity are you appearing before the Committee?

Mr LUMLEY: As Assistant Auditor-General.

CHAIR: Mr Lumley, did you receive a summons issued under my hand in accordance with the provisions of the Parliamentary Evidence Act 1901?

Mr LUMLEY: I did.

CHAIR: Are you conversant with the terms of reference of this inquiry?

Mr LUMLEY: I am.

CHAIR: Mr White, in what capacity are you appearing before the Committee?

Mr WHITE: As Senior Audit Manager with the New South Wales Audit Office.

CHAIR: Did you receive a summons issued under my hand in accordance with the provisions of the Parliamentary Evidence Act 1901?

Mr WHITE: I did.

CHAIR: Are you conversant with the terms of reference of this inquiry?

Mr WHITE: I am.

CHAIR: If you consider at any stage during your evidence that, in the public interest, certain evidence or documents you may wish to present should be heard or seen only by the Committee, the Committee will be willing to accede to your request and resolve into a confidential session. However, I should warn you that the Parliament may override that decision at any time and make your evidence public. Mr Sendt, I understand that you have an opening statement?

Mr SENDT: As I came into the position of Auditor-General since the start of this inquiry I thank you for making this time available to me. As indicated in the July 1999 submission by the Audit Office to this Committee, a critical issue is the extent to which Parliament wishes to have an ex ante role in controlling the use of public resources. This issue is not essentially a legal one. It is well established that Parliament has the right, and indeed the responsibility, to oversee the use of public resources by the executive arm of government. The essential matter to be answered is where Parliament sees the boundary between its oversight role and the role of Executive Government in the delivery of government services.

Whatever the level of involvement that Parliament sees as appropriate, ranging from largely laissez faire to a very hands-on approach, legislation can be drafted, controls determined and systems put in place. Those controls and systems will themselves have costs in their design in ongoing compliance by Treasury and agencies and by Parliament in effectively utilising the data reported back to it. Against those costs Parliament will need to judge the benefits that accrue from the level of involvement that it determines. In addressing this question, Parliament is exercising a role of stewardship over the Consolidated Fund, which largely represents moneys raised under legislative fiat—either directly by the State or indirectly by the Commonwealth—from the taxpayers of New South Wales. To date that role has largely concentrated on the annual appropriation of cash from the Consolidated Fund.

There are a number of serious shortcomings associated with that existing concentration on Consolidated Fund cash. First, the introduction of accrual accounting has amply demonstrated that decisions can be taken by budget-funded government agencies that may have real costs to the taxpayer, but not in the year the subject of the appropriation. Employee benefits such as superannuation have been a classic example of this. This can lead to agency decision-making being distorted by the need to remain within that year's Consolidated Fund cash. For example, an agency might choose a more expensive, in-house option in undertaking or expanding a function because it involves a lower in-year cash cost to the agency than paying an external provider.

Second, it is argued by many agency representatives that a concentration on the Consolidated Fund appropriation limit does not sit comfortably with the move to accrual accounting and the view that good financial management is about monitoring against accrual financial statements. Third, most agencies have access, to some degree, of retained revenues that are not constrained to a particular program. If cash appropriations were to be reinstated at the program level, agencies could freely transfer such retained revenue between programs to partly or wholly overcome what they saw as an inappropriate apportionment of Consolidated Fund cash. Fourth, it is entirely feasible that an agency could comply with all legal requirements in respect of its Consolidated Fund draw down—and indeed with all accounting standards and

other mandatory requirements in reporting its finances—yet still be providing ineffective, inappropriate services at inefficient cost levels.

If Parliament's real concern, as I believe it should be, is with ensuring that taxpayers' funds are used not only legally but also efficiently and effectively, it may be time to consider augmenting existing controls with some more relevant to that broader role. I make two suggestions in this regard. One addresses the specific issue of financial controls and the other the efficiency and effectiveness issue. On the first, Parliament should retain its right to control cash to be drawn down from the Consolidated Fund. However, that is not a sufficient control over agency finances. My suggestion would be that the Public Finance and Audit Act or the annual Appropriation Act should also specify that the net cost of services, as presented in the budget papers, should not be exceeded.

This limit should be specified at the program level for all budget-dependent agencies. This suggestion overcomes some of the difficulties I mentioned earlier. It relates more closely to the totality of expenditures incurred by agencies rather than simply one source of funding those expenditures. It also clearly re-establishes Parliament's role in respect of individual programs and, in doing that, it overcomes the potential for agencies to use the flexibility of their own revenues to replace Parliament's priorities with their own. I would see a control over net cost of services as a more important, relevant and powerful control over resources than the existing appropriation control. If that view is accepted by Parliament, the annual Appropriation Bill should then seek Parliament's approval to incur expenditure up to the proposed net cost of services for each program.

Parliament may be inclined to agree that some flexibility be given to the Treasurer to adjust the net cost of services between programs within the one agency or between agencies within the same portfolio. The extent of the delegated adjustment could itself be subject to limitation, for example, in dollar or percentage terms. The Consolidated Fund cash appropriation, at least for recurrent services, might then become a subsidiary more broadly set and perhaps with more flexible control. The current proposals to rewrite the Public Finance and Audit Act indicate a future move to output budgeting in place of program budgeting. At such a time the focus of any controls at the program level would necessarily change to an output class or output group level.

This leads to the second suggestion which deals with the issue of efficiency and effectiveness. Most jurisdictions in Australia have now adopted some form of output or outcome budgeting. As I said earlier, if Parliament is to hold the Executive responsible for the proper use of public resources, information on outputs and outcomes, planned and realised, is essential. While some information of this nature is currently published in the budget papers and in agency annual reports, serious attention by agencies to these measures of the performance will occur only when they are linked with the allocation and appropriate process.

CHAIR: Do any of the other witnesses wish to add anything?

Mr LUMLEY: Not at this stage.

The Hon. J. F. RYAN: Mr Sendt, you would be familiar with the working paper entitled "Fundamental Review of New South Wales Annual Reporting Legislation", which has been circulated by Treasury?

Mr SENDT: I am.

The Hon. J. F. RYAN: Are you familiar with various modifications that have been made to that document?

Mr SENDT: I think that I, in Treasury, drafted the first chapter about six years ago. So I am familiar with numerous modifications which have been made over time. I am not necessarily sure that I am familiar with every modification.

The Hon. J. F. RYAN: In a recent briefing session to this Committee, members of the Treasury indicated that they have significantly modified some of the proposals, particularly in relation to the Audit Office, that were originally outlined in this document, which resulted in some concern to the Audit Office. Are you familiar with any changes that might have been made?

Mr SENDT: I am familiar with our responses to the original paper. I am not familiar with subsequent changes. Mr Lumley or Mr White may be.

The Hon. J. F. RYAN: For example, there was heated discussion about the use of the term "true and fair test" or the test of a true and fair view of an accounting standard. As I recall it, the Audit Office had some concern with that as a sole test. As we have been informed, that will not necessarily be the benchmark which Treasury proposes for its proposed revised Public Finance and Audit Act, or whatever Treasury proposes to call it. Are you familiar with that process and with the fact that some action has been taken in relation to some of the recommendations that have been made?

Mr LUMLEY: No, we have not been aware of any action. We responded to an early draft, and our response to the paper was back in February 1998, which is over two years ago. We have not been made aware of any changes or proposals since that time.

CHAIR: There is no ongoing working consultation between the Audit Office and the Treasury?

Mr LUMLEY: No.

Mr WHITE: Not recently. There was in the early days, but certainly not in the last 12 months.

Mr SENDT: The Audit Office participated as an observer on the working party chaired by the Treasurer that originally came up with the proposal.

The Hon. J. F. RYAN: I will read you something that was said to the Committee at a recent hearing:

The working party proposed a continuance of the Treasurer's power to direct agencies to depart from accounting standards. That power was to be tied to a true and fair test, that is, if its compliance with accounting standards did not present a true and fair test of an agency's operations, the Treasurer would have the power to require departure from the standard. The former Auditor-General noted that a true and fair test is subjective. It is possible that an agency, the Treasurer, or the Auditor-General could have a different view of true and fair. This would lead to qualification of financial statements, even though the agencies comply with accounting standards. Instead, the Auditor-General recommended

that the Treasurer's power to require departure from accounting standards be retained; that this power will not be tied to a true and fair view test.

Is that an adequate response to the concern you raised about the use of the true and fair test for accounting standards?

Mr SENDT: That seems to substantially get back to the existing position where the Treasurer can make the direction, but we would then qualify on the basis that the statement does not meet accounting standards. The concern of the previous Auditor-General, the concern of the Audit Office and the concern of the current Auditor-General are as you stated: "true and fair" are subjective terms that could have different interpretations by the Treasurer, by the agency concerned and by audit.

CHAIR: What terminology would you prefer?

Mr SENDT: We would prefer to remain with accounting standards.

CHAIR: Normal accounting standards?

Mr SENDT: Normal accounting standards.

The Hon. J. F. RYAN: That appears to be what Treasury intends to do, from what we have been told.

Mr SENDT: From what you read, it certainly sounds that way.

The Hon. J. F. RYAN: I understand that one other area of difference related to the funding arrangements for the Audit Office. I think there was some discussion about the financial audits, where the working paper suggested that the Audit Office financial audits be funded by the Consolidated Fund appropriation rather than by invoicing agencies, which is your current practice as I understand it. There was strong support, Treasury reported to us, including from the Audit Office, for retaining current arrangements. It was concluded that current funding arrangements for the Audit Office would be retained in the new legislation. I take it you are happy with that outcome?

Mr SENDT: Certainly to the extent that the current arrangements are based on charging agencies for the cost of audits. We would be happy with that. There may be other aspects in relation to our finances at present that we might have views on, for example the funding of performance audits.

CHAIR: Normally we have copies of opening statements tabled, even though they are in *Hansard*, so that members of the Committee can have copies of them. There are a couple of quotes in the opening statement that we might refer to and we would like to be accurate in doing so.

The Hon. A. B. KELLY: How are they funded?

Mr SENDT: For performance audits, or special audits as they are referred to in the Act, we receive an amount of approximately \$1.2 million a year from the Budget. We also contribute part of the margin we made on our financial audits—an amount approximately the same—so that we have a budget of about \$2.3 million per year for performance audits. I make the point

that in Victoria, for example, the Auditor-General receives approximately \$6 million a year from the Budget to carry out performance audits. At present we undertake around 12 performance audits at year.

If you are familiar with any of our reports you would know that they are fairly detailed, they drill down substantially into individual activities or groups of activities of agencies. They are quite expensive to undertake. We have around 400 audit clients on whom we conduct financial audits. As I said, we do about 12 performance audits a year, and generally they are not on whole departments. We can only touch the surface of auditing performance within the State. If I can use this forum to plead: A greater quantum of funds there would be put to very good use in extending the range of performance audits that we could do.

The Hon. A. B. KELLY: Why would it not be charged back to the client and reflect the cost of where it should be attributed?

Mr SENDT: It is generally the practice, not only in New South Wales but elsewhere throughout Australia and in audit offices overseas, that those types of audits are to be funded directly from the public purse, as it were, rather than by charging individual clients. The reason for that partly is that we see the clients of those reports being very much Parliament. I am not saying that financial audits do not have Parliament as the client, but they are very much geared towards helping Parliament appreciate the performance of particular agencies. Because they are not universally carried out each year it may be inappropriate or unfair to charge a particular agency one year for a substantial performance audit—I was going to say "random", but obviously that is not the right term—on something other than an ongoing basis.

The Hon. A. B. KELLY: So that would actually give the Audit Office more flexibility in picking and choosing who it wanted to audit in a particular year, rather than waiting until it is incorporated in the Budget?

Mr SENDT: The Audit Office still determines which performance audits it undertakes. The funding from Treasury or the Crown is not conditional on our doing particular audits.

The Hon. A. B. KELLY: I am suggesting that if, for example, the budget was in the Department of Land and Water Conservation, it would have to be put in the year before you could do the audit. You can make up your mind next week that you are going to audit a particular department or agency.

Mr SENDT: Yes. If, as you mentioned, the Department of Land and Water Conservation were to get a budget supplementation to pay us that would be a time-consuming and cumbersome process.

The Hon. A. B. KELLY: Some of the agencies might not be very keen to push the Crown.

Mr LUMLEY: Not at all.

CHAIR: How do you select the agency you wish to audit? Does that come about through some concern that you have from controversy, or is it indicated to you that there are some problems in that agency?

Mr SENDT: Each year, around August, we right to all members of Parliament. We right to the central agencies and ask for suggestions as to any areas we might look at. Normally, at that time, we send out a very draft program of areas that we might have in mind and ask for comments on those or other suggestions. We are also cognisant of issues that arise through media or other sources, where there appear to be problems in particular agencies. We get suggestions from members of the public as to areas that should be looked at. We select the program based on the input we get from outside sources. Obviously, suggestions that come from members of Parliament or parliamentary committees get a fairly high weighting. We also try to look at issues that have significance for a number of areas.

For example, we might look at the management of stress leave in the public sector. It cuts across all agencies. Obviously, we also look at areas where we think there is a problem, where we have some concern. We look at areas where we think there are savings to be made or sensible recommendations to be made by us. We try, as much as possible and commensurate with doing only a dozen audits a year, to capture each area of government over a period of years. For example, we have not done any performance audits in the environmental area for some time, so we are now looking at doing one in relation to the Environment Protection Authority. Those are the sorts of criteria we use to come up with the program.

CHAIR: Who makes the final decision? You might end up with 35 or 40 areas that are all very important. Do you make a personal decision? I know you are new. Do you have a new policy? What is your policy?

Mr SENDT: We have the criteria I mentioned, and individual proposals are assessed as to whether they are high on each criterion. But at the end of the day a fair degree of subjectivity is involved and I make the final decision.

The Hon. J. F. RYAN: Is the current legislative base under which performance audits are conducted included within the Public Finance and Audit Act?

Mr SENDT: Yes, section 38B of the Act.

The Hon. J. F. RYAN: Your capacity to make these choices is firmly entrenched in existing legislation?

Mr SENDT: Yes.

The Hon. J. F. RYAN: It is interesting that Treasury said to us, and maybe it is something I have not quite worked out yet, that the Auditor-General is to be given a clear mandate to conduct financial statement audits of agencies and their controlled entities, and on the whole Government and, secondly, performance audits on the operations of individual agencies as well as public sector-wide issues.

The Hon. A. B. KELLY: Was that in relation to some particular areas that you cannot do audits on the now?

Mr LUMLEY: That was to do with the audit performance indicators [API], not performance audits.

The Hon. J. F. RYAN: So the APIs are new but basically the legislation confirms your existing practice with regard to performance audits?

Mr LUMLEY: We already have a mandate to do performance audits.

The Hon. J. F. RYAN: As I understand it, when you do a performance audit you are entitled to report to the Parliament without any discussion with the Government or the agency prior to that, although naturally good management would suggest that you do it?

Mr SENDT: No, that is not correct. Under the legislation I am required to submit a copy of the report to the Minister and to the CEO of the organisation concerned. I cannot table the report until 28 days after doing so. Within that period the CEO has the opportunity of responding to my report, and that response must also be included in the tabled version.

The Hon. A. B. KELLY: That is a normal management practice in any audit in case—everybody is human—there are some fundamental errors in it, to protect you as much as anything.

The Hon. J. F. RYAN: I think that Treasury was actually suggesting to us that it wanted to take that procedure a little further. It suggested that draft performance audits on sector-wide issues be given to the Premier and the Treasurer and other interested Ministers for review and the comments to the Auditor-General being provided through the Premier and or the Treasurer. Its further recommendation was that those comments would be published at the same time or together with, even bound in the same copy as, your report.

Mr SENDT: Where we are doing a report that is dealing specifically with one agency it is fairly clear to whom we send the report. For example, our recent report on emergency departments in hospitals goes to the Minister for Health and the director-general of the Department of Health. If we are doing a report on the management of stress leave within the public sector, that might entail sampling five, 10 or 15 agencies to see what they do. It is impractical to send five, 10 or 15 drafts out and get that many responses back and try to co-ordinate them. I think the suggestion being made is that for those types of reports it be made clear in the legislation that the Premier and Treasurer have the responsibility of responding on behalf of the Government.

CHAIR: So if it dealt with a general policy area, where you were concerned with the overall functioning of the Government in the financial area, that is the type of thing that would certainly go to the Premier and the Treasurer?

Mr LUMLEY: The sort of across-the-board reviews rather than specific to agencies. For example, stress leave would be across the public sector.

CHAIR: The previous Auditor-General was critical of what he regarded as unauthorised expenditure of money. That dealt with government policy almost. Is that the sort of thing that would go to the Premier and the Treasurer?

Mr SENDT: The issue that Mr Ryan has raised is specifically in relation to performance audits. The issue in relation to unauthorised expenditure comes up in relation to financial audits. One difficulty there is that it is generally the individual agencies' financial statements that we have to qualify even though it may have been an issue of government management or Treasury management that led to the unauthorised expenditure of appropriations.

CHAIR: Where would the report go then?

Mr SENDT: At present—and I do not believe any changes are proposed—the reports would go to Parliament, but they would be reports on the individual agencies concerned.

The Hon. J. F. RYAN: From you?

Mr SENDT: From me.

The Hon. J. F. RYAN: And there would not be appended to it responses by Ministers at the same time?

Mr SENDT: No.

The Hon. J. F. RYAN: Would you be concerned if that were to be required?

CHAIR: That is part of the reason we are following this line of questioning, whether in some way this may hinder your freedom.

Mr SENDT: If you look at the totality of our financial reports for the year and the material that is presented to Parliament I think it would probably quickly appreciate the difficulties if every report had to be formally responded to by a CEO or a Minister. All our reports—whether it is a report to Parliament or the independent audit report, which is the report which we give as auditors as to auditors in the private sector, the report that appears in the annual report—are always discussed with agency management in advance to make sure, as Mr Kelly referred to, that we are not making some error of fact or interpretation. To have a formal response on every issue or every report would be, I think, impractical.

The Hon. J. F. RYAN: Let us take the most recent example of where there has been some difference between you and Treasurer. It relates to volume 1 of your report in which you reported on the compliance with the General Government Debt Elimination Act of 1995. It would be fair to say that the Treasurer has not been exactly complimentary of your report in that regard. I think that essentially Treasury was saying, "You get the first bite of the media cherry. Your report becomes public and then sometime later when no-one is interested we get to make some sort of response." Treasury believed fairness required it to have an opportunity to respond on the same day, at the same time, to your report, having seen at first. Would that in some way compromise your independence?

Mr SENDT: No, the draft report was given to Treasury in advance—both of the text specifically dealing with the consolidated financial statements and the general government sector. It was given to Treasury well in advance of publication. The introduction to the report, which dealt largely with compliance with the General Government Debt Elimination Act was also given to Treasury well in advance of publication. It came back with some suggestions, some of which were incorporated; others were not. The time and date of publication were known to the Government in advance. It had the opportunity, if it wished, to put out a rebuttal at the same time my report was tabled. Some Ministers have done this on performance audit reports, for example.

The Hon. J. F. RYAN: Do you think that that regime adequately covers the opportunity for Treasury or anybody to make a response to your report? Is there a need to require responses from various departments to be tabled at the same time as your report, or bound in the same volume?

The Hon. A. B. KELLY: Or is it more to do with the political nature of it? The report will end up in a library somewhere. The newspaper clippings will not. There will not be 400 reports that will all be responded to. Obviously, on 99 per cent of them there will be agreement on the content. But if the Treasurer had a certain period in which to respond and did not respond to it then that would be it; it would be printed anyway. It would then be very difficult for the department later to make public comment because it had the opportunity to give a response and have it incorporated in the document. Parliamentary committees incorporate dissenting reports in the final committee report. If it is in the report it is in the library and there would probably be a lot less need for the political media banter that might follow.

Mr SENDT: It is certainly one solution. I think Parliament are would have to think through the issues that that might raise in terms of timeliness of reporting, taking your point that not all 400 agencies would want to respond to reports. I have statutory deadlines by which I must report. Often for agencies whose financial years end on 30 June, which is the bulk of agencies, my reports come out in November and December. The Audit Office is often criticised for the reports coming out to close to Christmas. I can understand that: many people are not around to respond or to analyse the reports. I would be reluctant to have anything happen that would delay the reports.

The Hon. A. B. KELLY: Surely it could be done within the same timeframe. As you said, you give them a draft; you give them the opportunity now.

Mr SENDT: Performance audit reports are generally not so time critical. They typically take six months or longer to draft. There is frequent discussion with the agencies. In fact, frequent drafts are exposed to the agencies so that the final report that goes to them is no surprise. With reports such as the one referred to at present we basically get them to the printer as quickly as we can in order that it gets to Parliament as quickly as we can get it there. For example, a report is coming out—I think, two weeks tomorrow—to Parliament dealing with most of the agencies that have a December year end, for example, universities. I am still seeing drafts of those coming across my desk. It will be going to the printer next Tuesday. There is still quite a lot of work to be done between now and then. If that report had to be exposed in a formal sense to each university, with the opportunity for their comments to come back and to be included, that would delay the process by some weeks I would imagine.

The Hon. J. F. RYAN: I imagine the question that the Parliament will want to address itself to is whether in any way it would compromise the independence of the office of auditor. To some extent, the whole reason for having an auditor is to have someone who is able to make an impact. If a series of reports about the same issue to the some extent question each other, the capacity of the Auditor-General to have an impact is minimised. That appears to be the political intention of the government in doing that. I do not mean just the current Government; I suspect any government of any political persuasion would want the same opportunity. My concern is whether, if that had to be the case, it would compromise the function of the Auditor-General as an independent officer of the Parliament.

Mr SENDT: I think there could be the opportunity for that compromise. Governments and Ministers can respond in a style that perhaps even Auditors-General do not use initially. If you then had a report with what I would consider to be a fairly well thought out and well structured report by my office and then with a, shall I say, more passionate attack upon the findings of that report it may be that it would compromise the impact of the report. I am not

meaning that simply in the sense that it would take away media attention, but the language of the response might be such that the report itself was diminished.

The Hon. J. F. RYAN: I suppose to some extent you are constrained by certain accounting standards as to what you can say. A Minister making a response on behalf of a department is not necessarily so constrained. He needs to make a response, does he not?

Mr SENDT: That is correct.

The Hon. J. F. RYAN: It would be fair to say that by manipulating language it is possible to diminish what the Auditor-General might have said. It was that kind of thing that was of concern to me. I have no objection to agencies being able to respond at the same time. My personal concern was that there is no other statutory agent of the Parliament—neither the Ombudsman nor the commissioner of ICAC—who is required to have his reports vetted and commented upon before they are presented to Parliament. Acceptance of the proposal would make you unique, would it not?

Mr SENDT: It certainly would. It would be unique in any audit office around the world to my knowledge.

CHAIR: It would be more damaging if, by law, you had to include the response from the Treasury and the response did not come or was late in coming. As you said, you are working to a very close timetable. If that became a legal requirement you could not publish your report.

The Hon. A. B. KELLY: But surely you could embed that in the legislation. The department could have, say, five days to respond. Obviously, it would know the content to start with. It would be just a matter of drafting of things; not spending weeks doing your job again. If the response does not arrive then that is it: the report is printed.

CHAIR: Yes, if it did happen the Auditor-General would need all that protection.

The Hon. H. S. TSANG: The impression I have now is that the Auditor-General is being persuaded that if the Minister or the Government has the opportunity to respond at the same time it would compromise his position. The opposite might be true. If the Minister or the Government had the time to respond it could assist the Auditor-General in preparing a report that is less political. It would avoid having a fight with the Auditor-General releasing a report one week, with all the press publicity, and the next week the Government waging a press war against the Auditor-General. If the Government had the opportunity to respond beforehand the situation might be less political. That would be a good thing for the Parliament. Would it not also be of some advantage to the Government to have the opportunity to report at the same time?

Mr SENDT: As I said, Mr Tsang, the government, the relevant Minister and the chief executive officer are almost invariably aware of what is going into my report because we expose the drafts, on an informal basis, to agency management prior to completion of the report. So they are well aware of what is going into the report. As I said in respect of my volume 1 report earlier this year, Treasury had received perhaps not a final draft but fairly close to a final draft at least a week before it went to the printer, so Treasury had knowledge of it some two weeks before it was tabled.

The Hon. A. B. KELLY: Do you have a system similar to that existing in private enterprise, that is, what is generally termed a management report, which although different to your audit report might be more detailed on some items and obviously would cover some of the same things, but which goes to the management of the agency rather than as a report to Parliament?

Mr SENDT: We certainly do.

The Hon. A. B. KELLY: My experience is that that generally comes out earlier than the audit report, certainly in private enterprise and in local government.

Mr SENDT: Perhaps Mr Lumley could answer that.

Mr LUMLEY: It could. You are referring to what we call our management letter.

The Hon. A. B. KELLY: Exactly. It is a long letter!

Mr LUMLEY: We can have one before the report, and we might have a final one; we could have an interim one and then a final one. So, depending on the timing of it, it might or it might not.

CHAIR: So there is dialogue going on?

Mr SENDT: Yes.

CHAIR: It is not just a sudden appearance of the report?

Mr LUMLEY: No.

CHAIR: If I could clarify something. Mr Kelly referred a moment ago to a five-day turnaround provided by legislation. You may not be in agreement in principle with that at the moment, but would that be sufficient compromise?

Mr SENDT: All it may simply do is result in the report being available five days later. But administratively, or mechanically, it is certainly possible.

CHAIR: In principle, would you be in favour of this exposure process? It seems that Treasury is leaning in that direction, and legislation is being drafted, although we have not got a copy of it at this stage. We may be able to influence the outcome of that legislation.

Mr SENDT: I certainly would not be in favour of that, Mr Chair. I think it would compromise the independence of the Audit Office. Our client is very much seen to be Parliament, and our reports are directed to Parliament and not to government. As I said, the government is always aware of what is coming because we do not come up with these issues out of the air; we come up with these issues as a result of being out there working in agencies and finding out what is going on. So agencies certainly are aware of the issues.

Mr WHITE: The Premier's Department even telephones agencies and asks them to make sure that they are aware of what is going to go into a report, so that Ministers can be advised.

Mr SENDT: As I said before, I think it would diminish the standing of the reports if there were capacity for response by Ministers on any issues that they wanted to raise. And they have that capacity now.

CHAIR: We understand the role of Executor Government, but you are upholding the principle, which obviously members of Parliament would support, that you report to the Parliament; that you are not a servant of the Executive Government but a servant of the Parliament.

Mr LUMLEY: Exactly right.

The Hon. A. B. KELLY: How do we, as members of Parliament, find out about comments on the audit report?

The Hon. J. F. RYAN: The government, if it feels passionately enough, circulates something—which it usually does.

The Hon. A. B. KELLY: Perhaps through the media, but not in an official document.

The Hon. J. F. RYAN: The Treasurer has all of the capacity —

The Hon. A. B. KELLY: But it is in the media, and it becomes hype.

Mr LUMLEY: That is after tabling, I might add. But, on the responses, our experience is that responses to our reports contain very little anyway; there is no meat at all in them. So they are different from the performance audits and our audit opinions. All of those reports are exposed in one way or another. The performance audits are normally more controversial, so we give them 28 days to provide a response. But, for our across-the-board reviews, which you would see in the normal reports at the agency level, there is very little in the responses when we receive them.

CHAIR: If I could clarify something. Mr Kelly asked a question and Mr Ryan seemed to respond to it. Perhaps the witnesses should respond to Mr Kelly's question.

Mr SENDT: What was the question?

The Hon. A. B. KELLY: You produce your report to Parliament. How do we get the government's response if it does not form part of the report? We all get copies of these on our desks as soon as they are produced, but must be get the *Daily Telegraph* to find out what is the view of the government on it? It might be that the media picks up on some emotive issue, and the response to the media report might be equally emotive. Therefore we would not get the calm response that we would expect to get from the document itself.

The Hon. H. S. TSANG: Mr Chair, I think Mr Kelly's question should be addressed to government, not to the Auditor-General.

CHAIR: The Auditor-General may not answer the question, but I think he should be given the opportunity to answer it. He might say, for instance, "The government must answer that."

Mr SENDT: I was going to say that I am not sure how Parliament can ensure that whatever Executive Government puts out is provided to it. I might mention, though, that part of your question touched on the issue of responding to the media. The Treasurer's response in relation to my report did not arise so much from when my report was published; it arose from a newspaper article on my report written some three weeks later. So there was no response to my report at the time of its release. The response that came from the Treasurer came when a newspaper article was written some three weeks later.

CHAIR: Would you normally decide whether you are going to have a press conference when you release a report?

Mr SENDT: I do not have press conferences.

CHAIR: Is a media statement issued summarising the contents of the report?

Mr SENDT: No. The closest we would come to a press conference is when we release our performance audit reports. Because of their nature, because they are fairly detailed reports, once they are formally tabled, or given to the Clerk if the lower House is not sitting, copies are given to the media in Parliament House, and some of my staff will stand by in case there are any questions to be asked. Occasionally, one of the media representatives will ask for an on-air comment by way of interview on radio or television. But we do not have a practice of holding media conferences or issuing press statements.

CHAIR: Would you do the on-air interview yourself?

Mr SENDT: Not necessarily, no.

CHAIR: Do you have a public relations officer or media officer give the on-air interview?

Mr SENDT: No. It is generally the author of the report. As I said, these reports can be very detailed, for example, the one on emergency departments in hospitals. It was known that that report was coming out. Some of the media were here, some from regional areas—I do not know whether they came specifically because of that report—and they had some in-depth questions that really only the author of the report could answer.

The Hon. A. B. KELLY: Why only if the lower House is not sitting? You did not mean "if Parliament is not sitting"?

Mr SENDT: No. I only table my reports in the lower House. That is in accordance with the legislation.

The Hon. Dr P. WONG: Mr Tony Harris, the former Auditor-General, has highlighted on a number of occasions a very important issue that seems to be at the base of the difficulty with appropriations and expenditures in New South Wales, and that is that Parliament has ceded powers over appropriations to governments. Parliament has virtually no capacity to suggest amendments to appropriations for the ordinary services of government, including appropriations for the use of the Parliament. Bearing in mind the impediments of drastic changes in the powers of the Parliament, which are regulated by the New South Wales Constitution, what legislative mechanism, if any, would you suggest to redress this situation? I will quote what Tony Harris has said:

This House has no capacity to suggest amendments to appropriations for the ordinary services of government. The definition of "ordinary services of government" is so widely expressed in New South Wales as to encompass most expenditures. Appropriations for Parliament are included in the ordinary services of government. So Parliament has no say on its own Appropriation Bill. There are several examples of Parliament appearing to have constrained its powers in dealing with the government and allowing the government very broad powers in its dealing with Parliament. That seems to be the kind of ethos that underpins the pragmatic view of the bureaucracy when it deals with appropriations.

Mr SENDT: Perhaps I could make a couple of points. If those do not fully answer your question, perhaps you could come back to me on any points that I have not covered. You made the point that Mr Harris said that Parliament had ceded power to the Executive Government. I am not sure whether that remark was specifically in relation to the Legislative Council or to Parliament more generally.

It is obviously a feature of the Westminster system of government that the lower House, or whatever it may be called in the particular jurisdiction, is that which controls the budget process, and failure to have control over that virtually guarantees the loss of that party's capacity to form government. Of course, in New South Wales there are the particular constitutional issues in regard to the power of the Legislative Council to reject or amend money bills. Mr Harris may have been referring to two things. One is that the change in the appropriation process, from one that was linked to programs to one that effectively is only at the agency level, has resulted in a diminishing of Parliament's interaction with the Executive Government or responsibility for determining expenditures. That is why I suggested that a control over net cost of services, if Parliament saw that as being appropriate, should happen at the program level.

One of the difficulties with the program level appropriations on a cash Consolidated Fund basis is, as I mentioned, the fact that agencies have their own source of cash that they can move around between programs to alter the priorities that Treasury or Parliament may have seen as appropriate. A control over net cost of services at the program level would reinstate that power of Parliament, or that influence of Parliament, over the Executive Government as to how money should be spent.

"Ordinary annual services" is a term that has not been defined. I think the advice that the Audit Office received many years ago was that it could largely encompass every existing activity of government. I think the former Auditor-General took the view that he could not see any example—maybe he saw some after he made that statement—that could not be forced to fit within that definition. The provision of capital works is part of the ordinary function of government, and therefore it could be argued that even appropriations for capital works and services are for the ordinary annual services of government, particularly if they are of a function such as education or health, where capital works are being undertaken every year. One might argue that something like the Olympics is not part of the ordinary annual services of government, but it would have to be that type of clearly one-off activity that would escape the net. I am not sure to what extent I have answered your question.

CHAIR: To clarify that: Do you think this ordinary function of government issue should be clarified in the legislation, if there is a new Act coming up to say that something like the Olympic Games, a tunnel or some one-off matter should perhaps have more scrutiny by the Parliament?

Mr SENDT: I think if the term "ordinary annual services" is going to continue to exist, it probably helps to have some definition of it. One that arises is that over recent times Consolidated Fund cash appropriations have been more closely allied to the accounting treatment. If something is seen by accounting standards as expense as opposed to an investment or a balance sheet item, the appropriations follow that distinction. Previously, what went into Consolidated Fund recurrent appropriations and Consolidated Fund capital appropriations had no real basis of distinction. Some things were clearly one type and some things were clearly another type, and there was a lot of grey area in between.

I can speak from some experience gained in more recent years in Treasury prior to taking up this position and say that Treasury attempted to tie up the appropriations more closely with the accounting treatment so that recurrent expenditure could generally be seen as something that would be treated as an expense rather than as a balance sheet item. If that sort of treatment clashes with a definition of ordinary annual services, if Parliament appropriates money for ordinary annual services and if that does not align with accounting standards in some way, there is still the problem of the potential for difficulties.

CHAIR: You have made a good point. You said that we should have a link for net costs not to be exceeded by having the net cost related back to the program. I think all members of this committee would like that, too. In accrual accounting, how do we get back to the link?

Mr SENDT: The program statements in the budget papers show the net cost of services by program. They do not show Consolidated Fund appropriations by program and, as I said, one reason for that is that Treasury saw those appropriations or the division of those appropriations between programs as becoming increasingly irrelevant because of other sources of cash that agencies were able to apply to programs or by which agencies could vary the apportionment between programs. The amount of Consolidated Fund cash appropriations shown against each program became less and less meaningful. However, the net cost of services is shown.

CHAIR: You said "net". That would help to get over the business of shifting money.

Mr SENDT: The net cost of services largely looks at the outlays of the organisation and not what its sources of funds are. It basically controls what the agency is doing, what it is spending its money on or what it is spending the taxpayers money on, and it also looks at whether it will be cash in this year or cash out the door next year or the year after.

The Hon. J. F. RYAN: That is probably a tighter definition than the Treasury is going to be happy with, I suspect. Is there not evidence of an intended provision in the budget because the Appropriation Bill lists each of the Ministers with a figure next to the portfolio.

Mr LUMLEY: That is the appropriation.

The Hon. J. F. RYAN: There is supposed to be an opportunity for Ministers to move money around their portfolios specifically to allow them to vary the allocation.

Mr SENDT: Parliamentary control over net cost of services could still be held in conjunction with some degree of flexibility. As I said, Parliament may define the degree of flexibility in dollar or percentage terms. It may define whether the Treasurer of the day has the power to move limits or move net cost of services limits between programs within the one agency only, or between programs within a portfolio, or even more widely. Parliament may also restrict the amount that can be moved, whether in dollar terms or percentage terms.

The Hon. J. F. RYAN: Certainly that is a lot more constraining than are the current arrangements.

Mr SENDT: It certainly is, yes.

The Hon. J. F. RYAN: Related to that is the issue of the Treasurer's Advance. The discussion paper and our recent briefing from Treasury dealt with this matter. You will be aware that Mr Harris discussed the Treasurer's Advance in his submission and said that it was not being used for emergency purposes but appeared to be used to fund ordinary Government services that did not appear to be associated with an emergency. Treasury had put to the committee that there is a need for some level of flexibility on the part of the Treasurer.

The regime that Treasury suggested is that there should be some tightening of what we now know is section 22 of the Public Finance and Audit Act which essentially means that an emergency would be what we understand to be a natural disaster or something of that nature, and there would be two other funds. One per cent of the budget appropriation would be available for capital expenditure and another maximum of one per cent would be available for recurrent expenditure. Apparently the current arrangements do not allow for capital expenditure. Essentially, within those two constraints, the Treasurer would have two per cent of the budget which he or she would be able to move around as he or she saw fit. Do you see that as a reasonable regime? Would you see budgeting to the maximum net costs of services as an important addition to that, or do you think that, under the current arrangements whereby each Minister gets an appropriation, it would be reasonable to allow the Treasurer that level of flexibility?

Mr SENDT: I think the issue of the Treasurer's Advance and section 22 can be overlaid on either a cash-based appropriation system or a net cost of service type of authorisation system. You have raised the issue of the view that the Treasurer's Advance should only be used for emergencies. To my mind, that seems to confuse—I am sorry, I do not mean your question—the issue of section 22 powers and the Treasurer's Advance.

The Hon. J. F. RYAN: I think I might have. I think it was not only emergency, but also unforeseen expenditure. I think that was the terminology.

Mr SENDT: Yes. Views have been expressed not only by the previous Auditor General but also by others that the Treasurer's Advance should be tightened up. At the moment, the Treasurer's Advance is available for any recurrent services and I think I would have some sympathy with the view that some minimal amount be available for the Government of the day to meet issues that may not fall into the category of natural disaster and which give it some flexibility. Once again, whether one per cent on both recurrent and capital is an appropriate amount is the issue. That would probably be a significantly larger amount than currently exists for the Treasurer's Advance.

The Hon. J. F. RYAN: Do you think there should be any constraints on what the Treasurer's Advance should be? I think that Treasury was considering that it should be an open discretion on the part of the Treasurer to use the advance in whatever way Treasury saw fit.

Mr SENDT: Are you talking about the quantum or the way in which it can be used?

The Hon. J. F. RYAN: The way that it can be used.

The Hon. A. B. KELLY: Because one has a limit now and the other one does not at all. It can be unlimited in quantum and there has been discussion of a maximum. It not just one per cent, but up to a maximum.

Mr SENDT: The two issues are related. The larger the quantum that might be allowed, perhaps the greater is the degree of constraint on how it can be used. The smaller the quantum that is allowed, the more of the Parliament may be more relaxed.

The Hon. J. F. RYAN: Would you consider one per cent for capital and one per cent for recurrent to be in a range where total flexibility would apply?

Mr SENDT: I think the one per cent for the recurrent side applied to recurrent receipts.

Mr LUMLEY: One per cent of recurrent receipts was going to be the limit of the Treasurer's Advance, yes.

Mr SENDT: That would probably be in the order of—

Mr WHITE: It is about \$160 million.

Mr LUMLEY: That would be less than it is now, I might add.

The Hon. A. B. KELLY: Yes, it is less.

Mr LUMLEY: But there is also a proposal, as you said, for a Treasurer's Advance for capital expenditure as well, so we would have not just recurrent which would be met under the Treasurer's Advance but capital as well. That seems reasonable to me.

Mr SENDT: If section 22 were tightened up substantially and the Government found itself in the position where issues that it may formerly have funded from section 22 could no longer be funded through that mechanism because of the tightening up, the Government would then have to make a decision on whether those items could be funded from a fairly limited Treasurer's Advance or whether the Government of the day should come back to Parliament to request further appropriations.

The Hon. J. F. RYAN: I think the only argument, particularly in the capital area, against complete flexibility is to what extent, in the final year of a government's operation and the first year of its operation, the Treasurer's Advance could become an election war chest which a Government may use as a means of funding particular projects of apparent specific electoral appeal in specific electorates. Do you see any way of constraining that type of behaviour, or do you see it as desirable to constrain that type of behaviour?

Mr SENDT: If you are still only talking in the order of one per cent of capital outlays and if you are talking about the budget sector, you are probably looking at approximately \$3.5 billion in capital outlays. I am not sure if that is the right figure, but it is something of that order. One per cent of that is only \$35 million which, in the scheme of things, is not substantial.

The Hon. J. F. RYAN: I am not sure that Treasury had that in mind. Treasury actually defined what the one per cent would be one per cent of.

The Hon. A. B. KELLY: Yes. It was net cash receipts.

The Hon. J. F. RYAN: It is something we can pursue later.

Mr LUMLEY: We are talking about capital now, are we?

The Hon. A. B. KELLY: Yes.

The Hon. J. F. RYAN: That is capital. Capital did not have the definition that you have placed on it. You have placed a definition on capital expenditure so it could in fact be \$160 million. The wording indicates that it could actually be both—one per cent of next year's estimated recurrent receipts.

Mr SENDT: In that case, I think I would have a problem if the Treasurer's Advance were as significant as that.

CHAIR: Are you making submissions on the matter to the Treasurer?

Mr SENDT: As Mr Lumley said, the last submission we made was two years ago and we have not seen a revised document since then.

The Hon. A. B. KELLY: I gather from the evidence that Treasury gave that they are still working on it and have not finalised a position.

The Hon. J. F. RYAN: I got the impression that a bill has been drafted but has not been approved by Cabinet and that Treasury is awaiting some response from this committee.

Mr LUMLEY: It had not be drafted when I attended the hearing when the committee last met in February.

The Hon. J. F. RYAN: In any event, that is the proposal that has been put to this committee. We will have to make some comment. We have commented that on the capital side, it appeared to be large.

Mr LUMLEY: Perhaps the Mr White knows whether or not that has happened?

Mr WHITE: No.

Mr LUMLEY: It is my understanding that it has not been drafted.

The Hon. J. F. RYAN: Would appropriation based on the net cost of services have any impact on the end-of-year spending? That appeared to be another concern of Treasury. There is a need to allow Ministers some flexibility because that provided some incentive to ensure that departments do not deliberately waste money that had been allocated to them for a 12-month period.

Mr SENDT: I think that there would be the same choice that exists now in terms of cash appropriations. Towards the end of a year, if an agency has not reached its limit—either a cash appropriation limit or a net cost of services expenditure limit—there will always be a tendency to spend up or lose the allocation. The system that was introduced to address that issue that is in place in New South Wales and even in a number of other jurisdictions is one of

allowing agencies some carry over of underspent appropriations. I am not justifying that when it leads to problems of legal authority to subsequently spend the money, but that was the basis of the change that was introduced back in 1988-89 to overcome that particular problem.

The Hon. A. B. KELLY: What year was that?

The Hon. J. F. RYAN: It was the Greiner Government?

The Hon. A. B. KELLY: That was the answer I was after.

The Hon. J. F. RYAN: I am not denying that. In fact, the change was intended to have that impact. What I am saying is that if the committee were to recommend that in future the Parliament should appropriate on a net cost of services basis, one of the arguments that might be put against that is that it would simply result in various departments having an end-of-the-year spend up. Is there any way of having both the obviation of the end-of-year spend up and a net cost of services appropriation?

Mr SENDT: Can I clarify that I am not necessarily suggesting that the appropriations should be on a net cost of services basis. What I am suggesting is really a two-part process. One is that, as part of the appropriation process, Parliament authorise Ministers and departments to incur expenditure to a certain level of each program. There would still be a cash appropriation which may be more broadly set than at the programs. It may even be more broadly set than at agencies. But I am not suggesting that agencies would necessarily be cashed up for the full cost of their net cost of services. Most jurisdictions that have introduced an accrual appropriation—and they use that term—still hold back or claw back some parts of those appropriations dealing with, for example, depreciation. I am suggesting that it be a two-part system: retain the cash appropriations but have some authorisation limit on the net cost of services.

Turning to the substantive part of your question—could there be a system that has net cost of services and some feature that discourages end-of-year spend-ups—the answer is yes. There could be provision that, if the net cost of services is not reached on a program or an agency level, that amount is carried forward to the following year. In addition, we would have to address the issue of the cash appropriation. Those two things will not necessarily move in alignment: the cash appropriation may be used fully and the net cost of services may not be. For example, a department may use its cash to pay invoices that it had to hand on 1 July: it has not incurred its full expenditure in the current year, but it has used all of its cash paying its bills. Those two issues will have to be addressed separately. However, as I said in my opening remarks, systems can be designed and controls can be introduced. It is not essentially a legal question but a question of what role Parliament sees itself as having.

CHAIR: On a point of clarification, we discussed a moment ago the Treasurer's advance of 1 per cent on a proposal of current receipts for capital expenditure as well as 1 per cent for recurrent expenditure. What amount do you believe should be given to the Treasurer for capital expenditure and recurrent expenditure? Will you clarify what you would recommend as a fair percentage?

Mr SENDT: If the percentage is of total estimated receipts, 1 per cent for recurrent Treasurer's advance would not seem inappropriate to me. However, if it has the same base in respect of capital, I think that figure would be too high and I would suggest a much lower figure that equated perhaps to 1 per cent of estimated current outlays.

CHAIR: In other words, a similar amount of money.

Mr SENDT: No. If current outlays are in the order of \$3.5 billion—I think they are around that level—1 per cent of that would be about \$35 million. The government of the day would still have the opportunity to come back to Parliament with further appropriation bills. There are some practical difficulties: for example, if Parliament was not sitting at the time and the Government needed to introduce legislation. However, the Government has at least two major windows of opportunity to introduce further appropriation bills towards the end of the calendar year, some five or six months after the Budget has been introduced, and in the early part of the following calendar year before the year has ended.

CHAIR: It is 1 per cent of what? How would you describe that 1 per cent?

Mr SENDT: Of capital outlays.

CHAIR: Thank you. Do you ever audit how the Treasurer uses that advance? Has an Auditor-General ever looked at that issue?

Mr LUMLEY: Yes, we look at it throughout our audits at the agency level when additional funds are requested and the source of funds is the Treasurer's advance. It is spread over all the audits we do. We would touch on that issue at the individual audit level.

The Hon. D. F. MOPPETT: It comes back to whether remaining within the appropriations is an object in itself.

Mr LUMLEY: Yes.

The Hon. D. F. MOPPETT: Is that the object of government and of Parliament?

Mr SENDT: I think one of the fundamental objects of government in the broad sense— executive and parliamentary—is to provide public goods where the market mechanism does not operate satisfactorily, and to do that by raising taxes. The budgetary process is a fundamental feature of government.

The Hon. D. F. MOPPETT: To put it simply, if we say that there is an ultimate penalty if one exceeds appropriation—if we accept that that is absolutely terrible; it is a cause of resignation in the Japanese economy—it would be easy for agencies to say, "We accurately estimate that we need X dollars, so we will put in the budget X plus Y dollars." What is the object: to remain within X or to do something else?

Mr SENDT: I do not think we can distinguish between those two objectives. The government of the day must determine the needs that it will address within the constraints of available finances. It may have some particular policy about the level of debt, as the current Government does through the legislation that it introduced. Other governments may have other macroeconomic policies or targets. However, when the budget is introduced, Parliament stamps its authority on those appropriations and other controls, and I believe Ministers, CEOs or agencies do not have the right to take it upon themselves to exceed those amounts without proper advance authority.

CHAIR: Because accountants have a certain attitude, I imagine that you would definitely be in favour of debt reduction.

Mr SENDT: I am not an accountant.

CHAIR: But you have an accounting background.

The Hon. A. B. KELLY: Are you an economist?

Mr SENDT: That is correct.

CHAIR: There is pressure on the Government to go in the other direction and to spend money and increase the debt. It has been criticised in some sectors for its strong policy of debt reduction.

Mr SENDT: Determining an appropriate level of debt for a government has occupied both accountants and economists for many years. There was no clear answer. In the private sector, companies that operate in particular industries tend to have a debt-to-equity ratio that can be measured and which tends to mirror that of their competitors. It reflects the risk of that industry.

The current Government, through legislation, has an objective of zero debt. My mandate does not allow me to question the merits of government objectives—perhaps even before parliamentary committees—so I shall not comment specifically about that point. I do not have any views that a particular level of debt is the right level. For example, borrowing is useful for spreading the cost of infrastructure across the generations that use that infrastructure.

The Hon. Dr P. WONG: Mr Sendt, in 1998 there was a change in the way in which the Consolidated Fund was used; there was a shift from appropriation for specific purposes to appropriation per agency. Is it desirable to provide for the appropriation of money from the Consolidated Fund for specific purposes? How can appropriation for specific purposes be made while ensuring government accountability?

Mr SENDT: If we were to return to Consolidated Fund cash appropriations by specific programs, that would be a somewhat illusory power on the part of Parliament because most agencies have some cash resources of their own that they can use to augment particular programs. If Parliament decides to alter the appropriations of particular agencies between programs because it believes there is some merit in that course, there is no mechanism at present to stop an agency redistributing its cash to overcome that change. That is why I suggest that, if Parliament wants to have control at program level—a control of net cost of services that is on the other side of the ledger; it is not about controlling one input but, in effect, the totality of the agency's expenditure, ignoring capital investments—that is a much more powerful, useful and robust control.

The Hon. Dr P. WONG: Once there is appropriation per agency, we can no longer see any programs—I think John Ryan raised this issues. We do not know where the money has been spent unless we know that a certain agency has received a lump sum for which it must be accountable to Parliament.

Mr LUMLEY: You can still monitor the situation because expenditure is listed on a program basis in the Budget estimate papers and reporting back is done on a program basis. The only difference is that the appropriation is on not a program basis but an agency basis. We can still monitor the situation. That is why the Auditor-General has said that we can get back to the

net cost of services for programs and the Parliament can monitor that. It is a pretty good control.

CHAIR: We do not have that now.

Mr LUMLEY: Yes, you do.

The Hon. J. F. RYAN: We do not exercise that power.

Mr LUMLEY: No, Parliament has not been doing that.

Mr SENDT: I can suggest another advantage of having net cost of services as a control. If you are looking at the performance indicators, such as outputs and outcomes of an agency, it is much more relevant to look at the outflow side of its finances. You can then start examining outputs per dollars spent rather than outputs per dollar of Consolidated Fund input, which is meaningless if the agency has other sources of revenue. Tying the parliamentary approval mechanism more closely to outputs and outcomes is a potential benefit of moving to a net cost of services control.

The Hon. J. F. RYAN: I think I understand the difference, but, because we are lay people, we might require an explanation of the difference between program budgeting and net cost of services based on programs. Does the word "program" have the same meaning in both expressions?

Mr SENDT: Yes. The program budgets that are currently published in the Budget papers for budget-dependent agencies are at the program level and they show net cost of services by program. There may be a difference between program budgeting and output or outcome budgeting, although I suspect that difference may not be as significant as is often thought. Program budgeting had its genesis in the idea that governments would become more accountable for the services that they provided and the results that they achieved. I do not think that is at all consistent with the use of the term "output" in output budgeting. I do not think any great change is needed to introduce a control over the net cost of services—but that may be a legislative issue. In terms of the Budget papers, the information about net cost of services is already available by program.

The Hon. Dr P. WONG: I am sorry, but I still do not understand. For example, what would you mean by "net cost of services" in the context of a hospital?

Mr SENDT: The net cost of services is effectively the bottom line financial result for an agency or a program. It is the equivalent of a profit or loss in a private sector company. In the case of governments, it is total expenses minus total revenues earned. By "expenses", I mean not simply the cash that goes out the door but all expenses that are incurred, even if the cash may not be a direct cash cost to the agency or the cash cost may occur years down the line, such as in the case of superannuation. It is effectively the total resources consumed by the agency at a whole-of-agency level or on a program level less the revenue that it earns.

Accountants feel comfortable with that concept because it compares directly with the accounting framework used in the private sector. Rather than calling it "profit" or "loss", it is called "net cost of services". The reason is that expenses will always exceed revenues in government departments. The alternative would be to always call it a "loss". So "net cost of

services" is simply the total amount that agencies incur on particular programs less the revenues that they earn that are applicable to those programs.

The Hon. Dr P. WONG: So it is a loss.

Mr SENDT: Yes, if you like, before the government contribution.

The Hon. A. B. KELLY: You might remember that I gave an example once before about some rural industries that try to grow a bit of wheat. Their departments or the soil conservation service might grow some wheat but they lose the incentive to do that and get any income because all of that income went to consolidated revenue and they got nothing out of it. So they had the expenses of putting in the crop and then lost the income. If they got to keep the income they would be keener to do that and reduce the net cost of services.

Mr SENDT: In the case of health—you mentioned hospitals—it would be the total expenses they incur, including superannuation entitlements for employees, less the revenue they earn from providing those services. The biggest revenue earner in government departments is the Department of Health, looking at it on a consolidated basis, including all the area health services, through the private patient fee income. I think the Department of Health, the consolidated entity, has earned revenue of some \$800 million a year and the net cost of services would be its total expenses of some \$5.7 billion or \$5.8 billion less around \$800 million of earned revenue, so the total cost to the taxpayer is around \$5 billion a year. At some stage that cash has to be contributed, and not necessarily this year's Consolidated Fund cash. But it is a better measure of the total cost to the taxpayer.

CHAIR: This is probably a general question but are you happy with this development where departments are encouraged to have this sort of user-pays approach? It seems to be an increasing amount of effort. You mentioned growing the wheat, but there are a lot of other things they are doing in charging the clients money so they do have this cash inflow so the departments are becoming like a business.

The Hon. A. B. KELLY: I was not suggesting that I am in favour of user pays.

CHAIR: I am not suggesting you are. That is what I was trying to say. I am putting a negative question as to whether it is a healthy development that departments seem to keep building up their own income by putting pressure on the consumer.

Mr SENDT: I am not sure whether I should answer that question about whether user charges are a good thing. Perhaps I could say, though, that the retention of those moneys by agencies, rather than them coming back to the Consolidated Fund and either being absorbed into the Consolidated Fund or having to be reappropriated back to the agencies, is a good thing. Once the government of the day has made a decision that a certain regime of user charges is appropriate, however big or small that may be, I think it is sensible to make the agency bear the risk and benefits of collecting that amount of revenue. If the revenue has to be paid into the Consolidated Fund agencies will have no incentive on chasing up the revenue; if it is something they retain themselves they will have that incentive.

The Hon. D. F. MOPPETT: But a long time ago you could talk about departments having no direct benefit in general from revenues earned by them. It is one thing to talk about soil conservation but you would have to go back I do not know how long—it may be

centuries—to find that the urban transport authority did not equate its fares to its net cost of services.

Mr SENDT: Certainly in the case of businesses, trading enterprises, they would retain their revenues, but most departments, other than those that had a special deposits account established to retain those revenues, have to return revenue to the Consolidated Fund. I know from my time in Treasury—so it is certainly within the past 20 years—frequently agencies wrote in with some proposal that if they could have \$200,000 they could generate \$250,000, and that would have to go through the whole Treasury review process, which took time and the opportunity might disappear. However, if the agencies knew they had the capacity to retain that revenue they would go ahead and fund that internally and use the margin for their own purposes or to augment existing appropriations.

The Hon. D. F. MOPPETT: I think one of the problems that Dr Wong was referring to was something that I initiated. One of our great worries as members of Parliament is that in a way the whole process seems to be aimed at achieving a symmetry between the accounting process, the forecasting process and the budgeting process. Somewhere along the line someone historically has decided on costing heads. In the Health Department we will say that we will bring together all the costs of dealing with people in the emergency departments, then those who will stay overnight in hospital and then we will report on the people who stay three days in hospital so that is beautifully reported back to their departments. Everyone collates their figures and it comes back down. Then the budgetary process starts and they say, "It was \$10 million last year. We think that there is an inflationary rate and we have some idea of wages so it will be \$10.2 million next year." And it is all added up again, along these sort of pre-prescribed cost heads, the way the whole expenditure is analysed.

However, to someone living at Coonamble hospital it is just meaningless. There is an accountant doing all this that makes it all fit to the symmetry, but the person who is directing the hospital, saying that "there has been an accident down on the road" or "we have had an outbreak of influenza", will probably see it as a nuisance, that all this is constrained by historical experience, together with factors that give an appropriation that then has to be accounted for and it then comes back to the Auditor-General who says, "You are outside your budget in this particular program". That is where we are struggling as members of Parliament to give some reality to it all.

Mr SENDT: I am not sure if I know what the alternative is.

The Hon. D. F. MOPPETT: I think we are struggling, too.

The Hon. J. F. RYAN: I shall ask a couple of questions with regard to your submission. With regard to authorising expenditure on a net cost of services, you have said that Parliament might be inclined to agree that some flexibility be given to the Treasurer to adjust the limit between programs within one agency or between agencies within the same portfolio. By that flexibility, were you thinking of the Treasurer's Advance or something additional if you were to have a net cost of services basis?

Mr SENDT: What I was thinking of there was something akin to the existing provision in the Appropriation Act each year which allows the Treasurer or someone delegated by him to spend additional—sorry, this was a provision in Appropriation Acts when they were still linked to programs. It now exists between agencies, but in going back to when the provisions of the Appropriation Act dealt with programs the Treasurer had the power to spend additional

resources on one program providing there was an equivalent saving on another program. It was a zero-sum gain. What it did was to recognise that within an agency there might be issues arising that called for additional expenditure in one year in a particular program but that there were some savings available in another program.

Maybe there were some savings available in emergency departments if that was a program in the Department of Health because the road toll was down but maybe because of an outbreak of influenza people were having to stay in hospital longer or more people were going in. So it would give some flexibility in relation to that. In the case of the Police Service it might give the Treasurer, the Minister for Police or the Commissioner of Police the authority to say, "There seems to be a bit more of a problem with criminal investigation as opposed to road traffic matters developing. I would like to save a bit of money on road traffic and put it into criminal investigation, but on a zero sum basis."

The Hon. J. F. RYAN: What is the limit? What is the disincentive on Treasury to simply set those limits of net cost of service at an artificially higher level? Then you have flexibility to move between them in any event so you could, by that sort of loophole, defeat the very purpose of having a maximum level.

Mr SENDT: I am not sure that treasuries generally like operating in a way of padding out appropriations. The Government is responsible not only for providing funds to meet particular services but also for macro financial management. If it pads out the estimates of every agency and every program, that will rapidly eat into services or drastically increase deficits, and the Government will be open to criticism by the ratings agencies, for example, and by others.

The Hon. J. F. RYAN: I suppose there is always the opportunity that the money could be spent even though it had not been attended to. In terms of the discussion we had earlier about the ordinary services of government, one of the other areas of flexibility is a parliamentary appropriation bill where that might not be considered part of the ordinary services of government. One of the areas that I think has been of continuing concern to the Parliament, particularly its managers, has been that as the various houses establish new committees that results in additional expenditure and there is some capacity on the part of the Executive to thwart that level of scrutiny by simply canning the expenditure of the Parliament. Do you see it as desirable to have the parliamentary appropriation determined by the Parliament and not by the Treasurer?

The Hon. A. B. KELLY: Is that an audit question?

The Hon. J. F. RYAN: I suppose the question I am getting to is that the within that definition—in fact, the previous Auditor-General almost raised that issue; in his submission he raised that as a possibility of one of the things that might well fall out. I think in the Commonwealth Parliament some agreement has been struck between the two houses, because obviously the Senate is never in control of the Government in the Commonwealth Parliament—that expenditure on committees does fall outside that definition of "ordinary services of government" and therefore the Parliament has a great deal more flexibility to adjust its appropriation so that it is able to properly fund its committees.

Mr SENDT: I am not sure if I understand why committees in particular fall outside the role of ordinary annual services.

The Hon. A. B. KELLY: I think John means the whole of the Parliament's operations.

The Hon. J. F. RYAN: The committees always seem to be the one. There is always a limited number of members of Parliament, so the budget for the remuneration of members and the remuneration of staff is a reasonably predictable event. The budget for the outfitting of members' offices and so on is reasonable. But one item that the Parliament cannot figure on which is determined by whatever occurs during the course of the year is the budget for committees, and that does seem to be the thing that puts a significant strain on how the Parliament is managed.

Mr SENDT: And your question is whether Parliament should have the right to set its own budget in respect of committees.

The Hon. J. F. RYAN: Do you believe the law allows that flexibility at the moment if the two houses can come to an agreement?

The Hon. A. B. KELLY: It would have to be in respect of Parliament as a whole, not just the committees.

The Hon. J. F. RYAN: Yes.

Mr SENDT: I am not sure of anything in the law that would stop Parliament from introducing its own appropriation bill. I think any bill has to be introduced either by a Minister or by—

The Hon. A. B. KELLY: Only by a Minister, is it not?

Mr SENDT: Or by leave of the Governor.

CHAIR: It would happen in the lower House, would it not?

The Hon. J. F. RYAN: If it is introduced in the lower House there is some discussion about whether the Legislative Council has the capacity to alter a bill. The constraint on the Legislative Council relates to whether expenditure falls within the definition of the "ordinary services of government". The theory goes that Parliament is not part of the ordinary services of government and therefore there is some capacity for the Legislative Council, when the Government does not have a majority or control—it often has a majority but it does not necessarily have control—to adjust the budget to suit the needs of the Parliament, but not always the same as the needs that the Executive Government would like to see.

Mr SENDT: I may have misunderstood your earlier question. I thought you were referring to a situation in which the two Houses had come to an agreement. If that were the case, a bill could be introduced in the lower House, providing it had appropriate leave or ministerial endorsement. I do not see any constraint on that at the moment. In relation to the power of the Legislative Council to change a bill if committees or the Parliament as a whole were not deemed to be an ordinary annual service, the Legislative Council would have an opportunity to change that bill. But, of course, the bill would still have to go back to the lower House where the Government has a majority. So I am not sure what that achieves.

The Hon. A. B. KELLY: Not a lot.

CHAIR: You cannot spend the money until the lower House approves the bill.

The Hon. J. F. RYAN: The Commonwealth Parliament is able to do exactly that.

Mr SENDT: The Senate does not have the same constraints on it.

The Hon. J. F. RYAN: My final question also relates to parliamentary committees. At the moment membership of the Public Accounts Committee is drawn solely from the Legislative Assembly. Do you see a useful role for members of the Legislative Council on a committee of that nature? Do you see yourself reporting differently to the Legislative Assembly as opposed to the Legislative Council?

Mr SENDT: To answer your second question first, the only difference I see is purely mechanical, in that when I have a report to be tabled I make an appointment to see the Speaker. If the Legislative Assembly is not sitting, I make an appointment to see the Clerk of the Legislative Assembly. The report is addressed to members of the Legislative Assembly. It would not be difficult to address the report to both the Speaker and the President or to members of both Houses. In effect, we provide reports to both Houses simultaneously, or to members simultaneously, so there is no issue so far as we are concerned. We see Parliament as our client—the Legislative Council as much as the Legislative Assembly. We do not distinguish between them. In relation to your first question as to whether there are benefits in having members of the upper House on the Public Accounts Committee, I will answer it the other way round. I do not see any disadvantages.

(The witnesses withdrew)

(The Committee adjourned at 3.48 p.m.)