

Principles of Responsibility

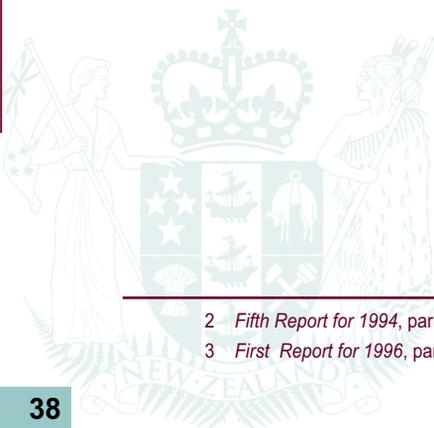
- 5.001 It is a fundamental principle of parliamentary control of government expenditure that no expenditure can be made unless Parliament has made an appropriation for the purpose. This principle is established in law by section 22 of the Constitution Act 1986 and section 4(1) of the Public Finance Act 1989.
- 5.002 To assist in ensuring compliance with that principle, Parliament makes appropriations to nominated ministers – who are thereby responsible for use of the appropriations. As a means of enforcing this responsibility, Parliament has established (by section 9 of the Public Finance Act 1989) two more key principles:
- for any one vote, only one minister is responsible for the appropriations in that vote; and
 - for any one department administering a vote (or votes), only one minister is responsible for the department’s administration of that vote (or votes).
- 5.003 The majority of departments administer only one vote, so that the one minister is responsible for both the vote and the department. The remaining departments administer between two and six votes – resulting in a corresponding number of ministerial relationships.
- 5.004 However, for those votes that include appropriations for non-departmental transactions¹ two other dimensions of relationship are created:
- between the minister responsible for the vote and the Crown entity or other third party involved; and
 - between the department administering the vote and the Crown entity or other third party involved.

1 The principal types of non-departmental transactions are the funding of Crown entities and other third parties for the supply of classes of outputs, and the payment of benefits and other unrequited expenses (see pages xi-xii in the Introduction to the *Estimates of Appropriations 1998/99*).

5.005 These additional relationships arising from appropriations for non-departmental transactions – especially for the supply of outputs by the third party – call for special consideration as to how the appropriations are managed. We have reported on this subject twice in recent years:

- In 1994 we reported on the results of a major review we had carried out of how a total of 139 appropriations were being managed.²
- In 1996 we reported on the results of a follow-up review, and suggested a “variable management model” by which to determine management arrangements best suited to the category of appropriation.³

5.006 In the course of the 1997-98 audits of government departments and related Crown entities we identified two instances of problems arising from the particular management arrangements being applied to appropriations for non-departmental transactions. In both instances the appropriations were for classes of outputs to be supplied by the third party concerned.



² *Fifth Report for 1994*, parliamentary paper B.29[94e], pages 35-63.

³ *First Report for 1996*, parliamentary paper B.29[96a], pages 27-33.

Ministry of Foreign Affairs and Trade and the New Zealand Trade Development Board

- 5.007 The Ministry of Foreign Affairs and Trade (MFAT) is the department responsible for administering Vote Foreign Affairs and Trade. In that vote Parliament appropriates money for three classes of outputs to be supplied by the New Zealand Trade Development Board (Trade NZ).
- 5.008 The Minister of Foreign Affairs and Trade is the responsible minister for Vote Foreign Affairs and Trade and for the MFAT's administration of that vote. The Minister for International Trade is the responsible minister for Trade NZ and, accordingly, the minister who agrees with Trade NZ what outputs it is to supply in exchange for the funds Parliament has appropriated.

Responsibility Relationships Created

- 5.009 These circumstances give rise to a set of relationships that are inconsistent with the principles of responsibility reflected in the law and described in paragraphs 5.002-5.004. That is:
- Trade NZ's use of the appropriated funds for the outputs it is to supply is under the control of the Minister for International Trade, rather than the Minister of Foreign Affairs and Trade who is responsible to Parliament for Vote Foreign Affairs and Trade; and
 - MFAT is responsible for disbursing the appropriations to Trade NZ but has no relationship basis against which it can be held to account by the Minister of Foreign Affairs and Trade, who is responsible to Parliament for MFAT's administration of Vote Foreign Affairs and Trade.
- 5.010 The involvement of two ministers in the spending of money from Vote Foreign Affairs and Trade raised issues about MFAT's obligations for:
- releasing appropriated funds to Trade NZ only in accordance with the purposes of the appropriations; and
 - monitoring Trade NZ's use of the funds.

4 See our *Third Report for 1997*, parliamentary paper B.29[97c], pages 37-42.

5.011 Similar obligations were the subject of legal opinions obtained in 1997 in connection with other votes.⁴ The minimum position is that:

- Public money must be used only to purchase the outputs for which it has been appropriated.
- Accordingly, a government department should ensure that the relevant purchase agreement is consistent with the appropriation(s) and the description of the output class(es) given in the *Estimates of Appropriations*.
- The department must spend money only in accordance with appropriations. Therefore, if the money it pays out is for the supply of outputs of a class other than those for which Parliament made the appropriation, the department breaches appropriation and acts illegally.

5.012 Since Trade NZ was set up in 1988 successive Ministers for International Trade have not requested advice from MFAT about the outputs purchased from Trade NZ – he has obtained advice, when required, from other sources. Nor has MFAT carried out any monitoring of the purchase agreement between the Minister for International Trade and Trade NZ – a position which MFAT has always been open and explicit about.

5.013 As a result of the legal opinions referred to in paragraph 5.011, the Treasury stipulated that for the 1997-98 financial year payments for non-departmental output classes could be made only when purchase agreements were in place. MFAT met that obligation by noting, before making payments to Trade NZ, that a purchase agreement was in place between the Minister for International Trade and Trade NZ. However, that step alone was insufficient to meet the second and third requirements listed in paragraph 5.011.

5.014 The terms of the purchase agreement between the Minister for International Trade and Trade NZ for 1998-99 were not finalised until some months after the contents of the *Estimates* for the year were settled. Although the total expenditure covered by the purchase agreement does not exceed the total in the *Estimates* for the three output classes taken together, the terms of the purchase agreement are nevertheless not consistent with the output classes and appropriations set out in the *Estimates*. We have pointed

out this discrepancy to both Trade NZ and MFAT, and they have undertaken to seek to remedy the matter by alteration of either the appropriations or the purchase agreement.

5.015 However, assuming that the Minister for International Trade continues to be the responsible minister for Trade NZ, the two more important steps that need to be taken are:

- The appropriations for classes of outputs to be supplied by Trade NZ should be put in a separate vote for which the Minister for International Trade can be made responsible.
- The Minister of Foreign Affairs and Trade, the Minister for International Trade, MFAT, and Trade NZ should agree on and enter into the appropriate management arrangements contemplated by our “variable management model”. Those arrangements are –
 - a supply contract between the Minister for International Trade and Trade NZ for each output class appropriation; and
 - one or more management services agreements specifying the roles, responsibilities, and relationships of the two ministers, MFAT, Trade NZ, and (if MFAT is not to monitor Trade NZ’s use of the appropriated funds) the monitoring agent.

Taking Account of Goods and Services Tax

5.016 Trade NZ supplies some of its outputs overseas, and the Crown funding of the expenditure relating to these outputs is zero-rated for GST purposes. Nevertheless:

- The amounts of the appropriations in Vote Foreign Affairs and Trade have been set on the basis that Trade NZ was paying GST on the value of the outputs it supplied overseas.
- Trade NZ, until the end of its 1997-98 financial year, did pay GST on the value of the outputs it supplied overseas. (The effect of doing so, of course, was that part of its Crown funding was being returned to the Crown in the form of GST.)

5.017 However, in August 1997 Trade NZ lodged an application with the Commissioner of Inland Revenue to recover the GST it had paid in respect of the expenditure it had incurred outside New Zealand since 1 July 1996. Trade NZ disclosed the fact that it had made the application in the Notes to its 1996-97 financial statements, but did not quantify the amount it expected to recover. The 1997-98 financial statements report a recovery of \$6 million.

5.018 An argument can be made that the \$6 million should be returned to the Crown because:

- the money was provided by the Crown in the first place; and
- the cost to Trade NZ of supplying the outputs in question is now effectively \$6 million less than the funding paid to it to meet that cost.

5.019 The Government, after considering Trade NZ's latest business plan, has agreed that:

- Trade NZ has to repay \$2 million; and
- with effect from the 1998-99 financial year, Trade NZ will be funded only for output prices that include GST payable in respect of outputs supplied in New Zealand.

5.020 Two lessons can be learned from these events:

- Both those who set the amounts of appropriations for non-departmental transactions – especially to pay for outputs to be supplied – and those who receive the appropriated funds should be clear about what cost elements the amount being paid is intended to cover. Once the amount has been agreed (for outputs, on the basis of quantity and unit price), liability for GST should no longer be of any concern to the Crown since – consistent with the scheme of the Goods and Services Tax Act 1985 – liability rests with the party carrying out the taxable activity for which it is being paid.
- A properly functioning monitoring arrangement should have noted Trade NZ's decision to try and recover the GST it had paid on its zero-rated activities and at least put those responsible for setting the appropriations on enquiry as to the need for corrective action. The failure to

B.29[99a]

do so reinforces the need (referred to in paragraph 5.015) to institute a management services agreement providing for monitoring Trade NZ's use of the appropriations.

5.021 We will continue to pursue with the relevant parties resolution of the matters raised in paragraphs 5.015 and 5.020.



Ministry of Health, the Health Funding Authority, and the Waiting Times Fund

Our Concerns

- 5.022 We have two concerns about the management arrangements applied to the money appropriated in Vote Health to the Waiting Times Fund:
- the adequacy of those arrangements to ensure that the amount of money being spent by the service providers is being monitored (with the objective that the amount spent does not exceed the amount of the appropriation in any year); and
 - whether the nature of the funding agreements entered into by the Minister of Health (the Minister) with the Health Funding Authority (HFA)⁵, together with the contracts for services between the HFA and the service providers, may have put the Crown at risk of incurring a liability without appropriation – contrary to section 4(2) of the Public Finance Act 1989.

Background to the Waiting Times Fund

- 5.023 For the three years 1996-97 to 1998-99 Vote Health has included an appropriation for a non-departmental output class called *Elective Services Backlog Reduction*. The money appropriated constitutes the “Waiting Times Fund”.
- 5.024 The most recent description of the output class is given in the *Estimates of Appropriations 1998/99*:

This output class will be used to purchase additional specialist assessments and elective diagnostic treatment services (the Waiting Times Fund). The Fund is specifically targeted at clearing the backlog in elective services as at 7 May 1996. This is so that, with the establishment of booking systems based on clinical assessment criteria, people requiring additional first specialist assessments and elective diagnostic and treatment services can be either booked for a procedure to occur within six months, or

⁵ For convenience, references to the HFA include (as necessary) reference to its predecessors – the relevant regional health authority or the Transitional Health Authority.

be directed back to their referrer for continuing care and management of their condition. The appropriation for the 1998/99 financial year is the third part of a four-year (1996/97 to 1999/2000) initiative.⁶

5.025 As the service provider performs the agreed services it invoices the HFA, whereupon the service provider is entitled to be paid. When the HFA has paid the service provider the HFA looks to the Ministry of Health (the Ministry) to cover the payment under its funding agreement with the Minister. The Ministry can respond to the HFA to the extent that the terms of the funding agreement and the unspent portion of the current appropriation allow.

What Caused Our Concerns

5.026 In 1997-98, the value of services performed by service providers – for which the HFA had paid or was liable to pay the providers – exceeded by approximately \$23 million the appropriation of \$96 million for the Waiting Times Fund for the year. As a result, at 30 June 1998:

- the HFA was in debt to the service providers for the excess (and therefore had to report a liability in its financial statements);
- the HFA could report a counterbalancing asset because (in accordance with generally accepted accounting practice) it had a reasonable expectation of receiving an equivalent sum from the Ministry within the next financial year; but
- the Ministry could not contemplate reporting a corresponding liability to the HFA because it had no power to pay or commit money in excess of the \$96 million appropriated for the year.

5.027 One of the criteria for administering the Waiting Times Fund is that *all contracts with providers will be written and monitored to ensure delivery of the services as agreed*. Nevertheless, the contracts entered into by the HFA with service providers before 1 January 1998 contained no provisions:

6 Parliamentary paper B.5 Vol.II, 1998, page 303.

- as to when the services were expected to be performed; or
- for monitoring progress against the contract by the HFA (although it can be argued that monitoring could be effected without an explicit contractual right⁷).

5.028 Similarly, the related funding agreements made before 1 January 1998 between the Minister and the HFA provided for payment to the HFA for the full value of the services to be performed by the service providers, without express regard for the implicit limit of the annual amount appropriated for the Waiting Times Fund.

5.029 However, the 1997-98 principal funding agreement between the Minister and the HFA contained provisions that effectively made the separate funding agreements part of, and subject to, the principal funding agreement. This means that the principal funding agreement requires the HFA:

- to operate a financially sound and sustainable business within appropriated funding levels, and be able to assure the Government of this; and
- to track expenditure, ensure it operates within the limits of funding provided, and report to the Crown findings of any excess likely to be incurred.

5.030 With effect from 1 January 1998, the separate funding agreements for payments to the HFA from the Waiting Times Fund have been consolidated into the principal funding agreement between the Minister and the HFA. Concurrently, the rights and obligations of the Crown under the separate funding agreements have been transferred to the HFA with effect from that date.

5.031 The obligations on the HFA set out in paragraph 5.029 apply to expenditure of the Waiting Times Fund. Nevertheless, the HFA failed to meet those obligations for 1997-98, as demonstrated by the situation described in paragraph 5.026.

⁷ By reason of the HFA's statutory function [T]o monitor the performance of service agreements or other arrangements by persons with whom it has entered into such agreements or arrangements.

What Issues Are Raised?

- 5.032 This case highlights the care that needs to be given to the administrative arrangements in circumstances where:
- the Government decides to fund a programme of services over a multi-year period; and
 - the Crown enters into contracts to give effect to the programme over the whole period; but
 - the Crown seeks appropriation from Parliament to fund the necessary expenditure only on a year-by-year basis.
- 5.033 What is not at issue here is the Government’s power to determine policy or the Crown’s power to enter into long-term contracts. Nevertheless, exercise of the latter power ought not to have the effect of diminishing Parliament’s right to control government spending. The potential for that effect appears to be the principle of section 4(2) of the Public Finance Act prohibiting the Crown incurring a liability other than in accordance with an appropriation by Act of Parliament. Whether a liability has been incurred is to be judged by reference to generally accepted accounting practice.⁸
- 5.034 One option for reducing the potential for conflict between long-term contracting by the Crown and the rules on appropriation is to consider using the provision in section 4(6) of the Public Finance Act for multi-year appropriations. In our view an appropriation of that kind would have been well suited to the Waiting Times Fund – providing a basis for funding the expenditure that is compatible with the multi-year nature of the initiative.

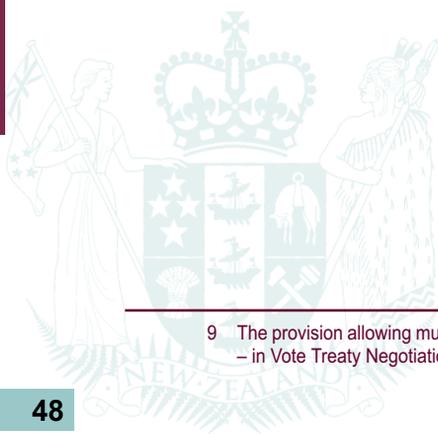
What Should Happen Next

- 5.035 It may be too late to conveniently change the formal management arrangements applied to the Waiting Times Fund to overcome their intrinsic shortcomings. Nonetheless (and without ascribing “blame” to any party), we think that the Ministry and the HFA should recognise their respective responsibilities for the good management of the

8 See the definition of “liability” in section 2 of that Act.

public money involved. To that end they need to find a way to ensure that the Government's objectives for the Fund are achieved effectively and in a manner that is consistent with the rules for appropriations.

- 5.036 We suggest that the Treasury consider the provisions of the Public Finance Act relating to incurring liabilities with a view to reconciling the benefits of long-term contracting with Parliament's right to control government expenditure. The Treasury may also wish to consider greater use of multi-year appropriations in suitable cases.⁹
- 5.037 We would be pleased to assist the Ministry, the HFA, and the Treasury in those endeavours.



⁹ The provision allowing multi-year appropriations appears to have been used only once – in Vote Treaty Negotiations for *Historical Treaty of Waitangi Settlements*.