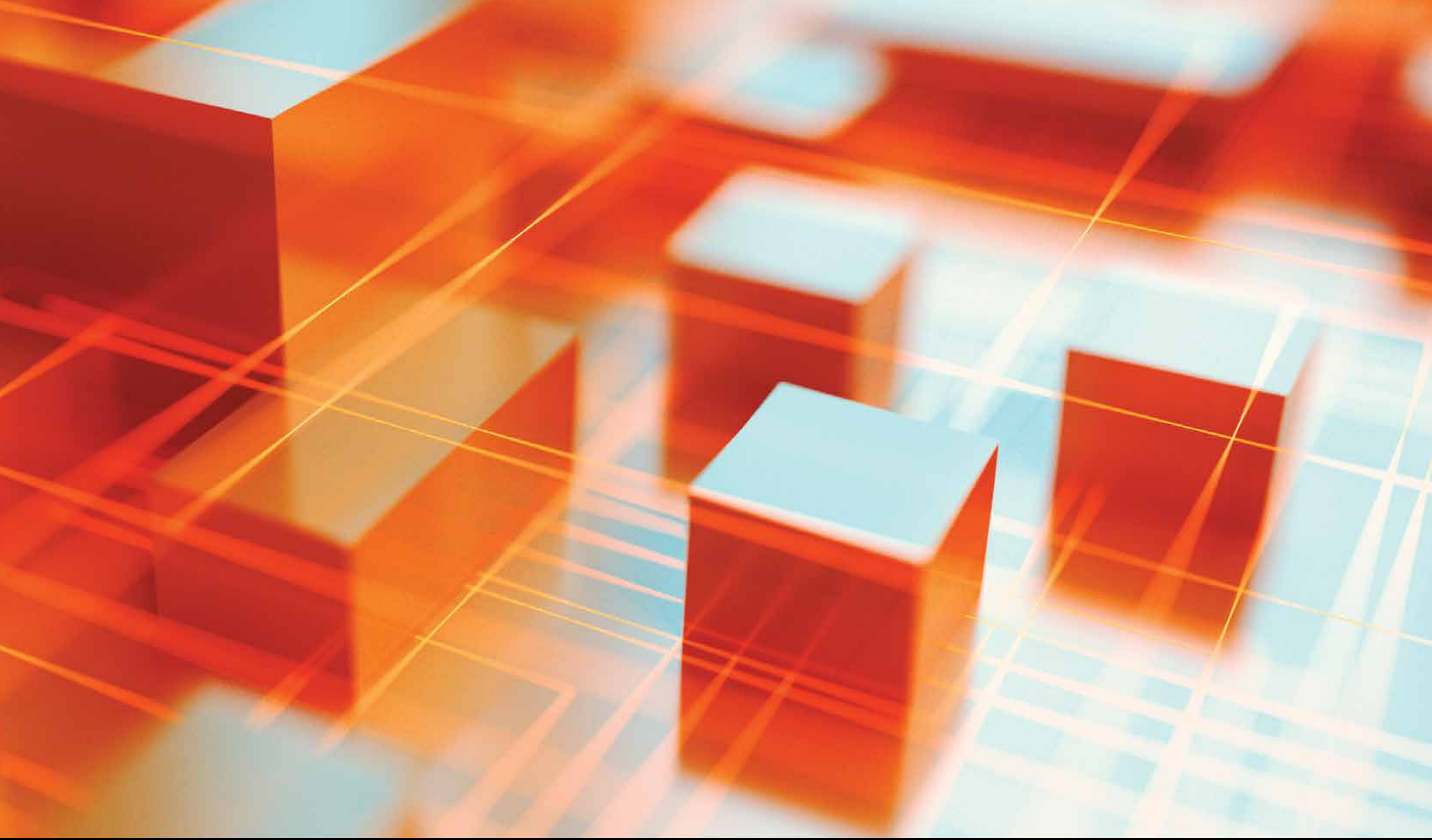

SageBush public finance resources

Making appropriations easier to manage

SageBush's public finance resources support public sector leaders to understand and manage financial challenges.

sagebush.co.nz

SAGEBUSH
STRATEGIC (FINANCE) PARTNERS

Appropriations enable but also constrain

Appropriations enable government agencies to spend, but they also constrain spending, so it is not surprising that they are often criticised:

'They make it difficult to manage costs.'

'They limit the Minister's ability to reprioritise funding.'

'The compliance and administration costs are too high.'

All of these criticisms are valid, but government agencies must manage their expenditure within appropriations. Overspending is a serious issue. Unfortunately, the combination of robust approval and monitoring processes and poorly designed appropriations can make this difficult.

This guide looks at ways to make it easier to manage appropriations and reduce the risks of overspending. It proposes four approaches:

- Use existing mechanisms.
- Refine costing and funding processes.
- Simplify appropriations.
- Review the appropriation structure.

What is an appropriation?

Appropriations provide authority for the government to spend public money. In simple terms, Parliament says: "You are authorised to spend up to this amount ... You must spend it on these things ... and show us what you have done by achieving these targets."

Appropriations are specified in terms of amount (how much can be spent), scope (what it can be spent on) and period (when it can be spent). These limits are legally binding. Responsibility for each appropriation is allocated to a Minister and is administered by a department on behalf of the Minister. The job of the department is to ensure that any expenditure is within the *amount*, *scope* and *period* of the appropriation.

If expenditure is incurred without an appropriation or is not in accordance with the amount, scope or period, unappropriated expenditure is said to have occurred. Unappropriated expenditure is unlawful, and there is a series of procedures that must be followed to legitimise the overspend.

Appropriations must be approved each year under an Appropriations Act[1] and are subject to a process of parliamentary scrutiny. Without parliamentary authority, the government is unable to spend and cannot govern. Appropriations are therefore an important part of both the constitutional framework of New Zealand and the state sector management system.

Making appropriations easier to manage

There are four approaches to make appropriations easier to manage and reduce the risk of overspending.

Use existing mechanisms

There are a number of existing mechanisms that can be used to adjust funding levels during the financial year or to shift funding across financial years:

- **Fiscally Neutral Adjustments (FNAs)** – FNAs are used to transfer funding between appropriations and/or departmental capital within a single financial year. The funding must have no impact on the operating balance or debt – that is, they must offset each other so that they are fiscally neutral. Transfers may be between expense appropriations, between expense and departmental capital, between capital injections and withdrawals and where increases to expense appropriations are fully offset by increases in third-party funding.
- **Retention of Underspends (RoUs)** – underspends are defined as funding remaining at the end of the financial year as a result of savings made by the department through gains in efficiency or other savings initiatives where the department has delivered the output or service in full. To encourage agencies to make savings through efficiency, joint Ministers can approve RoUs, which allow unused funding to be transferred to the next financial year. RoUs should be sought and agreed prior to or as part of the March Baseline Update, so that the full amount of the underspend can be retained. If approval is sought and agreed after the March Baseline Update, only half the underspend may be retained.
- **Front Loading of Spending (FLoS)** – FLoS can be used to bring forward funding from a departmental output expense appropriation for specific activities that will permanently and sustainably reduce spending in outyears. Proposals to front-load significant amounts of funding may need to be submitted to Cabinet.
- **Expense and Capital Transfers (ECTs)** – ECTs are used to transfer funding from an appropriation in one financial year to the same appropriation in one or more of the next three financial years where there is no change to the output or capital asset being purchased and/or the total amount of spending across the affected years. ECTs can only be used where a factor outside the department's control has caused a delay in a specific and discrete project and the costs cannot be met from the baseline of the year(s) to which the transfer is proposed.

[1] There are some exceptions to this. Multi-year Appropriations (MYAs) continue for a specified period, which may be more than 1 year and less than 5 years. Permanent Legislative Authorities (PLAs) are authorised in Acts other than the Appropriation Act.

- **In-Principle Expense and Capital Transfer (IPECT)** – if the final amount to be transferred is not known before the end of the financial year, Ministers may seek approval in principle for a maximum amount to transfer. This is known as an in-principle expense and capital transfer (IPECT). The actual amount for transfer is then confirmed once known, usually as part of the October Baseline Update (after audited financial results for the previous financial year have become available). Approval for IPECTs are usually sought in the March Baseline Update process.
- **Technical adjustments** – there is a range of technical adjustments that may be necessary in response to accounting adjustments, rate changes or to effect other decisions. There are too many to cover in this paper, but details are available on the Treasury website (see *Further information* section).

Most of these changes will require joint ministerial approval (i.e. the Appropriation Minister and the Minister of Finance). If the changes include significant policy issues, controversial matters, proposals that affect the government's financial position or important financial commitments, they must be approved by Cabinet. Agencies will need to consult with and provide a copy of the submission to their Treasury Vote team.

Refine costing and funding processes

Appropriation management can be made easier by ensuring that costs are correctly allocated to funding sources, funding is linked to volumes where appropriate and opportunities are taken to recover costs from consumers of services through fees where appropriate. These steps are outlined below:

- **Cost allocations** – the allocation of costs can have a significant impact on funding, particularly if costs have been incorrectly allocated to appropriations that are under stress or to Crown-funded instead of fee-funded appropriations. For example, operational policy is often charged to policy advice, which is Crown-funded, rather than to the activity or service that is being delivered. If the activity or service is funded from fees or levies, the Crown will be bearing a disproportionate share of the funding burden. It is recommended that cost allocations be reviewed regularly to ensure that costs are allocated correctly in order to make appropriations easier to manage by reducing the pressure on Crown funding.
- **Link appropriations to demand** – where costs are driven by demand and a clear link can be made between volumes and costs, it may be possible to link revenue and expenditure appropriations to the demand for services. An example of this is social welfare benefits where funding is adjusted through baseline update processes to reflect changes in the volume of benefits paid. Cabinet must approve the linking of revenue and funding to volumes for specific activities or services. Approval is not automatic, and the agency will need to demonstrate that it is unable to meet the increased costs from within baselines. Agencies will need to discuss their proposal with Treasury first.
- **Cost recovery** – where a good or service is primarily used or the benefits are primarily enjoyed by an individual, it may be appropriate to recover the cost of the service by charging a fee or levy. The advantage from an appropriation management perspective is that fees or levies (particularly when memorandum accounts are in place) are a more flexible source of funding than Crown revenue. Fees and levies should also fund operational policy and any support activities required to deliver the good or service. Implementing cost recovery would be a significant policy change and would need to be approved by Cabinet. As with other changes, agencies will need to discuss their proposal with Treasury first.

Simplify appropriations

Simplifying appropriations can make it easier to manage costs and funding and may reduce compliance and administration costs. It may be possible to simplify the existing appropriation structure relatively easily using these options:

- **Simplify scope and measures** – scope statements are often overly specific, and performance measures can be too many or too complicated. Simplification will make it easier to manage input costs by clarifying the type of costs that can be charged to an appropriation and reducing compliance and administration costs.
- **Reduce the number of appropriations** – consolidating appropriations that contribute to a similar purpose will reduce the number of appropriations. This will increase financial flexibility and reduce the risk of unappropriated expenditure while reducing compliance and administration costs.
- **Increase the size of appropriations** – larger appropriations that include a number of activities or services increase the ability of Ministers to reprioritise funding, reduce the risk of unappropriated expenditure and further reduce compliance and administration costs.

- **Align appropriations with outcome framework** – this will ensure that appropriations support outcomes. Closer alignment increases the accountability of groups and managers for financial performance and will reduce the risk of unappropriated expenditure. It will also reduce the need for appropriation adjustments during the year.
- **Clear line of sight between input costs and output costs** – the ability of managers to manage input costs can be improved by reducing the number of outputs supported by cost centres. Ideally, there would be a one-for-one match between outputs and cost centres because this would ensure clear lines of responsibility, although this may be impracticable.

Review the appropriation structure

A more fundamental (and demanding) approach to making appropriations easier to manage is to review the existing appropriation structure to ensure that it aligns with the services and outcomes being purchased by government. The following components of the appropriation structure should be considered:

- **Scope** – the scope statement establishes the legal boundary of what an appropriation can be used for and, by omission, what it cannot. It should be clear, comprehensive and balanced and provide a defined boundary. Agencies should review their scope statements to ensure that they are up to date and include all activities and costs that are incurred in delivering the agreed activities or services. Well defined scope statements make it easier to manage appropriations by providing clarity around what is included, what isn't and possible reprioritisation choices.
- **Departmental or non-departmental** – outputs can be supplied either by a department (in which case they are labelled departmental) or by another organisation (in which they are labelled non-departmental). Agency chief executives are responsible for what is achieved and spent under both departmental and non-departmental appropriations. However, they have less direct control over outputs supplied by an external provider. For accountability and management control purposes, it is therefore important that outputs are in the right bucket. Agencies should regularly consider whether outputs are correctly classified. This may lead to efficiency savings if opportunities are identified to switch to external provision of activities or services.
- **Multi Category Appropriations (MCAs)** – MCAs group together a number of separate appropriations that contribute to a single overarching purpose. This can increase financial flexibility by allowing Ministers to shift funding across categories within the MCA provided the total approved funding is not exceeded. In addition, any other agency may incur expenses against an MCA either at the direction of the appropriation Minister, or with the agreement of the appropriation administrator. This provides further opportunities for agencies to pool resources and reduce overall costs. The key is to define and agree a single overarching purpose for the MCA that covers the range of activities and costs that support the outcome. The more existing appropriations that can be included under this MCA scope, the greater the benefits.
- **Multi-year Appropriations (MYAs)** – most appropriations are limited to 1 year. However, Ministers may be given authority to incur expenditure over a number of years to a maximum of 5 financial years. This is called a Multi-year Appropriation (MYA). MYAs are generally used in situations where well defined and self-contained outputs or capital expenditure fall across two or more financial years but the timing of expenditure between the years is uncertain. MYAs can increase flexibility around when expenditure can be incurred and reduce administration processes that would otherwise be needed to shift funding between years.

Unappropriated expenditure

Even after implementing the steps outlined in this guide, an agency may still be at risk of overspending. If this happens, the agency will have incurred unappropriated expenditure, which is unlawful. As far as possible, approval to incur expenditure in excess of appropriation should be obtained before the expenditure is incurred. If an agency risks unappropriated expenditure, it should contact Treasury as soon as possible to discuss the options.

The Public Finance Act 1989 provides mechanisms for agencies to avoid unappropriated expenditure by transferring funding within prescribed limits:

- **Section 26A** allows funding to be transferred between output expense appropriations within a single vote, provided the transfer does not increase the recipient output expense appropriation by more than 5% and approval by Order in Council is received prior to 30 June.

- **Section 26B** allows the Minister of Finance to approve expenditure in excess of appropriations provided it is within the appropriation scope, the overspend occurs within the last 3 months of the financial year and the overspend is less than $10,000 or 2% of the appropriation.

If these options do not resolve the problem, **Section 26C** requires the Minister of Finance to seek validation by Parliament of any overspend.

Next steps: planning and resourcing for change

Of course, changing appropriations and/or funding regimes is not as easy as it sounds. Any changes will need the support of Ministers and Treasury and be approved by Parliament. They also need to follow established financial management processes, and depending on the nature of the change, they usually take effect at the start of a financial year and must receive final approval through the Estimates process. The lead times are therefore long, and the process from project initiation to implementation may take up to 12 months. An illustrative timeline is set out below:

- **August:** Planning and initiation phase.
- **September/October:** Develop proposals.
- **November:** Consult with Treasury.
- **December:** Consult with Minister.
- **February:** Develop papers.
- **March:** Changes approved (through the March Baseline Update or Cabinet process).
- **April/May:** Estimates processes.
- **1 July:** Changes take effect.

Any significant proposed changes to appropriations therefore need to be carefully planned and resourced. It may be useful to establish a small project team and develop a high-level project plan.

Further information

- A Guide to Appropriations, The New Zealand Treasury, November 2013, https://treasury.govt.nz/publications/guide/guide-appropriations-html#section-4
- Cabinet Office circular CO (18) 2 - Proposals with Financial Implications and Financial Authorities, Department of the Prime Minister and Cabinet, July 2018, https://dpmc.govt.nz/publications/co-18-2-proposals-financial-implications-and-financial-authorities
- Overview guidance on the administration and use of appropriations, The New Zealand Treasury, July 2013, https://treasury.govt.nz/information-and-services/state-sector-leadership/guidance/planning/appropriations-and-reportable-outputs/overview-guidance-administration-and-use-appropriations
- Putting It Together: An Explanatory Guide to New Zealand's State Sector Financial Management System, The New Zealand Treasury, September 2011, https://treasury.govt.nz/publications/guide/putting-it-together-explanatory-guide-new-zealands-state-sector-financial-management-system-html

Please contact us
if you would like to talk
about specific challenges
your agency is facing.

Ben Bush 021 208 5432
ben.bush@sagebush.co.nz

Brian Sage 027 223 0541
brian.sage@sagebush.co.nz

SAGEBUSH STRATEGIC (FINANCE) PARTNERS

SAG7902 August 2020