

## Chapter Three: Dividing the Pie

The Public Finance Act continues and strengthens the historical requirement for appropriation by Act of Parliament before public resources can be consumed. This chapter examines the changes the Act makes to the appropriation system. It explains the possible types of appropriation, the modes of appropriation and the information required in the Estimates.

### Types of Appropriation:

There are separate appropriations for each type of resource use. Departments need to recognise the purpose to which an appropriation will be put, and how this relates to the Government's different roles in their activities. Appropriations can be for **outputs**, **capital** or **transfer payments**.

- As purchaser of goods and services, the Government wants high quality outputs; outputs (goods or services) which will contribute to the outcomes it is pursuing. Appropriations are made for each class of output (or programme in Mode A).
- As owner of a department, the Government is responsible for providing capital to purchase assets, that is, to increase its investment in a department. Appropriations are made for each capital contribution.
- Departments act as agents, paying benefits and grants on behalf of Government. Appropriations are made for each category of benefit or grant.

Departments will not have the authority to transfer funds between each of the types of appropriation without the consent of Parliament. That is because when Parliament gives authority for money to be used for a particular purpose, it must be able to have confidence that the money will be used for this purpose.

However, to allow a degree of managerial flexibility, the Public Finance Act allows for the transfer of up to 5% of an appropriation between classes of output. Such transfers can take place only within a Vote and must be approved by the Minister and Governor-General and authorised by Order in Council.

### Votes

The Appropriation Bill consists of Votes, one or more for each Ministerial Portfolio. Parliament "votes" money and resources to Ministers which they:

- Use to purchase outputs.
- Invest as capital in their own department (the department for which they are Responsible Minister.)
- Pass on to a department to be administered as benefits or grants.

### Modes of Appropriation

There are now three modes of appropriation. These are based on:

- a department's financial management systems.
- the department's statutory role.

**Mode A:** Mode A focuses on inputs.

Parliament authorises the supply of cash to meet departmental costs: to acquire inputs, purchase assets or pay benefits/grants. The only change from the previous method of appropriation is:

- operating costs (programmes) and capital expenditure need to be appropriated and reported separately. This gives Parliament some ability to differentiate between the "purchaser" and "owner" roles of the Government.

Mode A gives departments time to change the way they are managed. All departments must move from Mode A by 1st July 1991.

**Mode B:** With Mode B, the focus shifts to the consumption of resources.

Departments report the full cost, (including depreciation) of the resources they require to produce outputs. Parliament authorises:

- the incurrence of the costs of producing outputs.
- the supply of cash to increase the level of capital investment so that departments can function effectively.
- the supply of cash to pay benefits/grants.

Chief Executives will have the authority to sell unwanted assets and to buy new assets with the capital, to manage working capital and to determine and manage inputs.

**Mode B (Net)** is used when departments are earning trading revenue in a contestible environment. They are authorised to use the amount that they estimate they will earn from the sale of departmental outputs to fund the production of those outputs. For example, if a department expects to earn \$10,000 from sales, it will be authorised to incur costs up to \$10,000 without further Parliamentary approval.

If departments are not earning trading revenue, the total cost will be appropriated. This is known as **Mode B (Gross)**.

### Trading Revenue

Trading revenue is money earned from the sale of goods or services in a contestible environment. What, you may ask, is a contestible environment? A contestible environment exists when a department faces actual or potential competitors in the sale of outputs.

**Mode C:** Mode C also focuses on outputs and is for departments that operate in competition with other suppliers. Such departments will need, like other departments, to provide information on the price and quality of their outputs. But because their prices must be easily compared with their competitors, they must have a capital structure, and they must pay notional interest, tax and dividends.

Ministers will make purchase decisions after comparing similar goods and services available from other suppliers. If Ministers decide to buy from a department, Parliament will make an appropriation to purchase those outputs required.

Capital appropriations will be similar to those in Mode B, but will be made with reference to the department's expected financial return. There will also be appropriations for the payment of benefits and grants.

For Chief Executives, the advantage of Mode C is that it will allow

departments the maximum freedom in how they manage the production of goods and services.

From July 1991, all departments will be funded by either Mode B or Mode C appropriations or by a mix of Mode B and Mode C.

### Periods of Appropriation

Most appropriations are annual. Each year, the Minister must request an appropriation for every class of outputs. Once negotiated and approved these are included in the Estimates and, once passed by Parliament, become part of an Appropriation Act. Multi-year appropriations are possible. An example of a circumstance which would warrant such an appropriation would be where a long-term contract for the supply of outputs required funding over a period longer than one year. The maximum term of a multi-year appropriation is five years.

Permanent appropriations (operating under permanent legislative authority) are used in three circumstances:

- for situations where a measure of independence from Parliamentary control is constitutionally desirable—for example, Judges' salaries.
- for expenditure having a priority charge on public funds, such as debt servicing.
- for certain departments which are providing outputs on the open market (to parties other than Ministers) in competition with other potential suppliers. In this case, a permanent appropriation allows a department to incur costs up to the amount of estimated trading revenue.

### Understanding the new Estimates format:

The Estimates must now contain higher standards of information than ever before.

In the past, requests in an Estimate have been grouped by programme—frequently a client group or departmental function. For example, the Ministry for the Environment might have requested an appropriation for their “corporate services” function.

Requests will now be grouped by classes of output. Classes of output in the Ministry for the Environment's Estimates include: "Policy Advice, Resource Management Law Reform", "Advisory Services, General" and "Administration of Grants."

The Estimates must include:

- the title of the Minister responsible for the Vote.
- the title of the Minister responsible for the financial performance of the department (the Responsible Minister).
- the name of the Department administering the Vote.
- for each class of outputs (or, in Mode A, each programme):
  - a description of the class.
  - the Mode or Modes of appropriation applicable.
  - the proposed expenditure and the expected revenue.
  - the link between each class of outputs and the desired outcomes.
  - the quality/quantity/cost/time of outputs.
  - comparative budgeted figures for the previous year.  
(If a department supplies outputs to more than one Minister, those of the Responsible Minister will be shown first, followed by those for other Votes.)
- the value of capital assets to be purchased or developed, or the amount of any change, including reductions, in the Crown's net asset holding.
- the estimated statement of financial position (balance sheet) for the beginning of the year and projected statement for the end of the year.
- an estimated statement of cash flow.
- the financial performance to be achieved by the department as a whole.

The Estimates format for Mode B and C will place the money appropriated in a wider financial context than previous Estimates documents by providing a full picture of the activities of a department. Its five parts are:

**Part A: Annual Appropriations.** You will remember that appropriation types and modes vary. Check earlier sections to see exactly how. Part A deals only with amounts that are to be appropriated annually. The total may be less than total expenses if the department is permitted to spend some of its revenue from third parties or if some of its expenses are funded through permanent legislative authority.

**Part B: Statement of Projected Performance.** This part summarises what a department does, sets out the accountability relationship with its Minister or Ministers and outlines the performance expected during the year. It states a projected performance for each output, which includes a description, the outcome the Government wishes to achieve and performance standards—quality, quantity, cost and time information. Finally, it includes a statement of projected financial performance.

**Part C: Budget Information.** This includes an operating statement, a statement of financial position and a cash flow statement.

**Part D: Output Operating Statements.** This part provides details of the cost of producing each class of output and of receipts and payments associated with the output class.

**Part E: Other Relevant Information.** This will contain the statement of net fiscal impact, which summarises the department's net cash flows.

In addition, during the changeover period the Estimates will include:

**Part F: Voted and Actual Data for the previous financial year.** It would be misleading for some departments to include comparative data from earlier years in Parts A, B, C and D. Such data is therefore shown in this part.

The Estimates, as part of the set of Budget documents, must be presented to Parliament by 31 July (unless Parliament approves a later Budget).

## *Key Points*

Appropriations can be for outputs, capital or transfer payments. There are three modes:

**Mode A:** This is substantially the same as the previous system. Parliament authorises the supply of funds to meet costs.

### **Mode B (Gross):**

Parliament authorises:

- incurrence of full costs of output production.
- supply of funds for capital investment.
- supply of funds for benefits or grants.

### **Mode B (Net):**

Parliament authorises:

- expenditure of income from commercial sale of outputs (a permanent legislative authority).
- incurrence of other costs of output production.
- supply of funds for capital investment.
- supply of funds for benefits or grants.

### **Mode C:**

Parliament authorises:

- the purchase of outputs.
- supply of funds for capital investment.
- supply of funds for benefits or grants.

### **The new Estimates format will include:**

- appropriation requests grouped by class of output, not programme.
- quality, quantity, cost and time-frame information for each class of output.
- financial information to give a comprehensive picture of the activities of the department.