
The Parliament of the Commonwealth of Australia

Report 404

**Review of Auditor-General's Reports 2003-2004
Third & Fourth Quarters; and First and Second Quarters of
2004-2005**

Joint Committee of Public Accounts and Audit

October 2005, Canberra

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Foreword

One of the important functions of the Joint Committee of Public Accounts and Audit, as prescribed by its Act, the *Public Accounts and Audit Committee Act 1951*, is to examine all reports of the Auditor-General, and report the results of the Committee's deliberations to the Parliament. Report 404 details the findings of the Committee's examination of 11 performance audits by the ANAO.

This is the first review of Auditor-General's reports to be undertaken by the Committee of the 41st Parliament. This review includes three ANAO reports which were selected for review by the Committee of the previous Parliament. That review was suspended upon the dissolution of the House of Representatives in August 2004.

In December 2004, the new Committee of the 41st Parliament resolved to complete the review of the three ANAO reports begun by the previous Committee, and also to undertake a busy program reviewing a further eight Audit Reports, selected from the 37 ANAO reports that had been presented to Parliament during and following the election period.

The eleven reviews undertaken by the Committee have covered a broad range of Government agencies, and have included subjects such as grants administration; customer service; regulatory functions; management of assets; contract management; and program implementation. In each chapter of the report we have made recommendations to improve agencies' efficiency and effectiveness in implementation of programs; and to ensure that the Auditor-General's recommendations are implemented.

Two of the Audit Reports, nos. 5 and 21 of 2004-05, have detailed major problems with financial management and project administration at the Department of Defence. The Committee held a number of public hearings on this subject, and is concerned to note that further Audit Reports tabled since the beginning of this current inquiry have revealed more problems.

The Committee also reviewed an Audit Report detailing Centrelink's management of customer debt. This report highlighted problems in planning, communication across regions, and consistency in managing customer debt across the Centrelink network. This report is just one of a series of Centrelink reviews undertaken by the ANAO. The

Committee has now embarked on a new review of seven ANAO reports which further detail some problems with Centrelink's customer service; and a review of another report which details the failed *Edge* information technology system.

Another theme emerging from our review of a number of the Audit Reports is a need for Government agencies to pay closer attention to their responsibilities under the Constitution and/or the *Financial Management and Accountability Act 1997* (the FMA Act); and other important issues such as implementation of appropriate risk strategies; proper project planning; and thorough record-keeping.

These are issues that the Committee intends to pursue throughout its reviews of Auditor-General's reports in this Parliament. We hope to see an improvement in agencies' adherence to their financial management, accountability and reporting responsibilities.

During the term of this inquiry Mr Pat Barrett AO retired as Auditor-General, following a ten-year term. On behalf of the Committee I would like to extend my thanks to Mr Barrett for his service to the Commonwealth, and wish him well in his retirement. For the first time, the Committee was involved in the selection of the new Auditor-General, due to the introduction of the *Auditor General Act 1997*. Following receipt of a nomination for Auditor-General from the Prime Minister, the Committee deliberated on the nomination, and was pleased to endorse Mr Ian McPhee PSM as the new Auditor-General. This process is outlined further in the Committee's annual report to Parliament, which will be tabled shortly.


The Committee extends its congratulations to Mr McPhee and looks forward to working with him.

Finally, I would like to acknowledge the work of the previous Committee in initiating the review of three Auditor-General's reports which was suspended due to the election in late 2004. I would like to thank my colleagues on the Committee of the 41st Parliament for the work they have undertaken in completing this large review of eleven Auditor-General's reports.

The Committee looks forward to continuing its reviews of Auditor-General's reports throughout this Parliament.



Bob Baldwin MP
Chair




Membership of the Committee (40th Parliament)

Chair Mr Bob Charles MP

Deputy Chair Ms Tanya Plibersek MP

Members	Senator Richard Colbatch (from 14/02/02, until 25/05/03)	Mr Steven Ciobo MP
	Senator Stephen Conroy (from 5/02/03, until 10/09/03)	Mr John Cobb MP
	Senator John Hogg (until 5/02/03, from 10/09/03)	Mr Petro Georgiou MP
	Senator Gary Humphries (from 25/02/03)	Ms Sharon Grierson MP
	Senator Kate Lundy (from 19/11/02, until 1/04/04)	Mr Alan Griffin MP
	Senator Claire Moore (from 1/07/02, until 19/11/02 and from 1/04/04)	Ms Catherine King MP
	Senator Andrew Murray	Mr Peter King MP
	Senator Nigel Scullion	The Hon Alex Somlyay MP
	Senator John Watson	



Membership of the Committee (41st Parliament)

Chair Mr Bob Baldwin MP

Deputy Chair Ms Sharon Grierson MP

Members Senator John Hogg

Hon. Bronwyn Bishop MP
(from 17/8/2005)

Senator Gary Humphries

Mr Russell Broadbent MP

Senator Claire Moore

Ms Anna Burke MP (to 14/9/2005)

Senator Andrew Murray

Dr Craig Emerson MP
(from 14/9/2005)

Senator Fiona Nash (from 7/9/2005)

The Hon Jackie Kelly MP

Senator Nigel Scullion (to 7/9/2005)

Ms Catherine King MP

Senator John Watson

Mr Andrew Laming MP

Senator Andrew Murray

Hon. Alex Somlyay MP (to 10/8/2005)

Mr Lindsay Tanner MP

Mr Ken Ticehurst MP

Membership of the Sectional Committee (40th Parliament)

Chair	Mr Bob Charles MP	
Deputy Chair	Ms Tanya Plibersek MP	
Members	Senator Andrew Murray	Ms Sharon Grierson MP
	Senator John Watson	Mr Catherine King MP
		Mr Peter King MP

Membership of the Sectional Committee (41st Parliament)

Chair	Mr Bob Baldwin MP	
Deputy Chair	Ms Sharon Grierson MP	
Members	Hon. Bronwyn Bishop MP (from 17/8/2005)	Mr Andrew Laming MP
	Mr Russell Broadbent MP	Mr Lindsay Tanner MP
	Ms Anna Burke MP (to 14/9/2005)	Senator John Hogg
	Hon. Jackie Kelly MP	Senator Claire Moore
	Ms Catherine King MP	Senator John Watson
	Hon. Alex Somlyay MP (to 10/8/2005)	

Committee Secretariat

40th Parliament

Secretary	Mr James Catchpole
Inquiry Secretary	Mr Frederick Cook
Research Officer	Mr Alex Stock
Administrative Officer	Ms Jessica Butler

41st Parliament

Secretary	Mr Russell Chafer
Inquiry Secretaries	Ms Bronwen Jagers Ms Rebecca Gordon
Research Officers	Mr Muzammil Ali Ms Penne Humphries
Administrative Officer	Ms Frances Wilson



List of abbreviations

ABS	Australian Bureau of Statistics
ADC	Australian Dairy Corporation
AFCP	Alternative Fuel Conversion Program
AGD	Attorney-General's Department
AGO	Australian Greenhouse Office
ANAO	Australian National Audit Office
ASO	Area Service Office
ATO	Australian Taxation Office
ATSIC	Aboriginal and Torres Strait Islander Commission
ATSIS	Aboriginal and Torres Strait Islander Services
CALD	Culturally and Linguistically Diverse
CBOs	Community Based Organisations
CEF	Container Examination Facilities
CEO	Chief Executive Officer
CFO	Chief Finance Officer
CIU	Cabinet Implementation Unit
CNG	Compressed Natural Gas
CRF	Consolidate Revenue Fund
CSC	Customer Service Centres
CSIRO	Commonwealth Scientific and Industrial Research Organisation
Customs	Australian Customs Service

DA	Dairy Australia Limited
DAA	Dairy Adjustment Authority
DAFF	Department of Agriculture, Fisheries and Forestry
DCITA	Department of Communications, Information Technology and the Arts
DEH	Department of Environment and Heritage
DIMIA	Department of Immigration, Multicultural and Indigenous Affairs
DMO	Defence Materiel Organisation
DNSDC	Defence National Storage and Distribution Centre
DOTARS	Department of Transport and Regional Services
DSAP	Dairy Structural Adjustment Program
DVA	Department of Veterans' Affairs
EXAMS	Examination Data Management System
FaCS	Department of Family and Community Services
FCoA	Family Court of Australia
Finance	Department of Finance and Administration
FMA Act	<i>Financial Management and Accountability Act 1997</i>
FMC	Federal Magistrates' Court
G-Gap	Greenhouse Gas Abatement Program
IP	Intellectual Property
JCPAA	Joint Committee of Public Accounts and Audit
KPI	Key Performance Indicator
LPG	Liquefied Petroleum Gas
LTO	Land Titles Office
MOU	Memorandum of Understanding
PBS	Portfolio Budget Statements
PDR	Primary Dispute Resolution services
PMKeys	Personnel Management Key Solution
PVRP	Photovoltaic Rebate Program

PwCC	Price Waters Coopers Consulting
RECP	Renewable Energy Commercialisation Program
REEF	Renewable Energy Equity Fund
SCA	Supply Customer Accounts
SDA	Supplementary Dairy Assistance Program
SDSS	Standard Defence Supply System Upgrade
SME	Specialised Military Equipment
SRLs	Self-Represented Litigants
TGA	Therapeutic Goods Administration



List of recommendations

Chapter 2: Intellectual Property Policies and Practices in Commonwealth Agencies

Recommendation 1

The Committee recommends that the Attorney-General's Department commence development of a whole-of-government approach and guidance for the management of the Commonwealth's intellectual property, for completion by May 2006. The Attorney-General's Department should consult widely with Commonwealth agencies, particularly those which are major generators of intellectual property.

Recommendation 2

The Committee recommends that the whole-of-government approach to the management of the Commonwealth's intellectual property within a framework for IP management should leave each Commonwealth agency free to optimise its role within the framework.

Recommendation 3

The Committee recommends that the Department of Finance and Administration, in consultation with the Attorney-General's Department, develop guidelines to assist agencies in developing valuation systems for their intellectual property.

Chapter 3: The Administration of Major Programs - Australian Greenhouse Office

Recommendation 4

The Committee recommends that the Australian Greenhouse Office provide to the Committee a copy of the guidelines for administration of the new greenhouse abatement programs announced in the Energy White Paper and the 2004-05 Federal Budget; and an outline of how the

new guidelines meet the ANAO's recommendations regarding assessment and selection procedures for project funding.

Recommendation 5

The Committee recommends that the Australian Greenhouse Office include the following elements in all future agreements for project funding:

- recognition of foreign exchange risks to enable increase or decrease of project grants according to currency variations (if projects involve components sourced from overseas);
- setting a time limit for completion of funding negotiations; and
- a requirement that milestone payments are directly linked to a demonstrable greenhouse benefit, to ensure program objectives are being met. This may include withholding a portion of funds, to be paid on completion of the project when testing proves the project has delivered a greenhouse gas abatement.

Chapter 4: *The Commonwealth's Administration of the Dairy Industry Adjustment Package*

Recommendation 6

The Committee recommends that the Department of Agriculture, Fisheries and Forestry ensure that future assistance packages have a clause in relevant legislation which allows for incorrect payments made in error to be reclaimed by the appropriate agency or authority.

Recommendation 7

The Committee recommends that the Government place an overall budget limit on the cost of implementing new assistance packages to encourage administrative cost efficiencies and effectiveness.

Recommendation 8

The Committee recommends that the Department of Agriculture, Fisheries and Forestry report back to the Committee on the progress and evaluation of the Dairy Structural Adjustment Package and the Supplementary Assistance Program by 30 June 2006. The report should outline progress against each program's original objectives and measurement indicators such as Key Performance Indicators. The report should also outline the Dairy Industry's progress in adjusting to the new economic environment, including exits from the industry.

Recommendation 9

The Committee recommends that the Department of Agriculture, Fisheries and Forestry ensure that all future agreements with Statutory Authorities include a clause allowing the ANAO access to premises and records, for auditing purposes.

Chapter 5: *Client Service in the Family Court of Australia and the Federal Magistrates Court*

Recommendation 10

The Committee recommends that as a matter of urgency, the Family Court of Australia introduce toll-free phone numbers for each of its registries.

Recommendation 11

The Committee recommends that both the Family Court of Australia and the Federal Magistrates Court:

- investigate best practice initiatives in client service which have worked successfully in individual court registries and implement these across all registries;
- investigate the appointment of Federal Magistrates specialising in family law in the Sydney Central Business District in order to alleviate work pressures;
- conduct more frequent surveys of client satisfaction to further enhance processes and levels of service;
- investigate methods of further assisting clients who are in positions of disadvantage in their dealings with the courts; and
- progress the initiative to identify and support clients with mental illness.

Recommendation 12

The Committee recommends that the Family Court of Australia and the Federal Magistrates Court continue to work towards minimising duplication in areas such as client processing, information available to the public via publications, websites and the like, and duplication of administration across the courts.

Recommendation 13

The Committee recommends that the Federal Magistrates Court:

- seeks to gain further performance information from Community Based Organisations, in order to assess their effectiveness in dispute resolution and their adherence to the government's Family Relationships Services guidelines ;
- undertakes further evaluation of the settlement outcomes from outsourced Primary Dispute Resolution providers; and
- investigates client satisfaction with Primary Dispute Resolution services provided by Community Based Organisations to understand why rates of settlement are low and how they could be increased to reach targets set in Portfolio Budget Statements.

Recommendation 14

The Committee recommends that the Family Court of Australia and the Federal Magistrates Court:

- report to the Committee by June 2006 on progress of both courts' evaluations of their outsourced PDR services and whether PBS targets have been met; and
- provides the Committee with feedback in regards to both courts' developing relationship with the new Family Relationship Centres.

Chapter 6: *Management of Federal Airport Leases*

Recommendation 15

The Committee recommends that in future privatisation programs, government agencies include a clause in all sales contracts which provides for the Commonwealth's cost-recovery of administrative expenses.

Government agencies should then ensure that they undertake cost-recovery of such expenses as a matter of course.

Recommendation 16

The Committee recommends that the Department of Transport and Regional Services adopts a procedure which ensures that follow up administration on all insurance reports from the audit contractor are finalised within a three month timeframe.

The Department's annual report should include a report on the status of all insurance reports from the audit contractor, including the date of the report, and date of any departmental actions arising from the report.

Recommendation 17

The Committee recommends that the annual report of the Department of Transport and Regional Services include a matrix reporting on each airport lease – including the status of annual lease reviews, insurance reports, development obligations, letters of comfort and cost recovery of administrative expenses.

Where time extensions for development obligations have been granted, DOTARS must provide a comprehensive explanation detailing why the extension has been approved.

Chapter 7: *Management of Customer Debt – Centrelink*

Recommendation 18

The Committee recommends that Centrelink prioritise the implementation of its payment integrity strategy, to ensure that payments are right in the first instance, rather than relying on reactive processes.

Centrelink should report to the Committee on its progress in implementing the payment integrity strategy in February 2006 and July 2006.

Recommendation 19

The Committee recommends that Centrelink proceed with data-matching activities with academic institutions and major employers, in an effort to prevent debts incurred when clients change study courses or employment.

Recommendation 20

The Committee recommends that Centrelink review its methods of identifying customer debt, with a view to improving current methods of debt identification, or increasing the resources dedicated to compliance reviews. Centrelink should also take into consideration the ANAO's suggestion that it consider other methods of debt identification, such as:

- cross-referencing customer behaviour and attributes with known debt factors to better target debt prevention strategies;
- drawing on the experience of other agencies such as the Australian Taxation Office and the Child Support Agency to develop best practice models for debt management; and
- increasing support for the national coordination unit to better manage debt prevention projects.

Recommendation 21

The Committee recommends that Centrelink provide training to all officers responsible for debt raising, on the correct circumstances in which to apply a debt waiver. The training should focus on empowering workers to make responsible decisions, and an emphasis on the importance of getting decisions right in the first instance, and not relying on downstream appeal mechanisms.

Centrelink should also introduce a standard operating procedure whereby debt raising officers refer any matter on which they are uncertain whether to apply a 'special circumstances' waiver, to a more senior officer for consideration.

Centrelink should undertake a review of the appropriateness of applying Debt Waivers throughout the Centrelink network, taking into account the matters raised in the ANAO report, as a matter of priority.

Recommendation 22

The Committee recommends that the debt waiver amount be raised from \$50 to not more than \$100. The Committee recommends that where small debts are raised and automatically waived, customers should be informed of this action and of steps they can take to prevent a debt being incurred in the future.

Where a customer continues to incur small debts of less than \$100, that are continually waived, Centrelink should retain the right to recover these debts if a pattern of behaviour is apparent whereby the customer is not making any effort to prevent the incursion of small debts.

Recommendation 23

The Committee recommends that Centrelink monitor the work of its debt recovery officers, and those employed by its debt recovery agent, to ensure that customers are encouraged to repay debts via means other than credit cards.

Chapter 8: Management of the Standard Defence Supply System Upgrade – Department of Defence

Recommendation 24

The Committee recommends that all Defence information system projects be subject to the appropriate levels of cabinet, ministerial or departmental approval, as per Defence's own internal procurement guidelines and the 2003 Kinnaird review.

Where project managers fail to ensure that their project receives the adequate levels of cabinet, ministerial or departmental approval, disciplinary action should be undertaken by Defence.

Recommendation 25

The Committee recommends that the Department of Defence and the Defence Materiel Organisation institute a formal policy which excludes external contractors from being appointed as project managers for IT systems. Any performance bonuses paid to project managers must be directly linked to project milestones being met on-time and on-budget.

Recommendation 26

The Committee recommends that Defence continue with its planned rollout of Radio Frequency Portable Data Entry Terminals (handheld scanners) for use with the SDSS system in warehouses.

However, this rollout must only be undertaken when Defence is confident that the system can adequately support the new technology, to ensure that the system is not circumvented because of users' frustrations at slow processing.

Defence must also ensure that adequate training is provided to all personnel who will be using the scanners.

Chapter 9: *ANAO Inability-to-form-an-Opinion on the Department of Defence financial statements 2003-04*

Recommendation 27

The Committee recommends that the Department of Defence report to this Committee every six months against the milestones of the 14 remediation plans outlined in the 2005-06 Portfolio Budget Statements. These reports are to continue until the end of the 41st Parliament.

Recommendation 28

The Committee recommends that Defence outline to the Committee its plan to ensure that the Julian date problem associated with the SDSS program will be fixed prior to May 2007. Defence's report to the Committee should include a project plan, costings, milestones, and details of the project management team.

Recommendation 29

The Committee recommends that Defence urgently review the security controls for the SDSS program to ensure that user access is set at the appropriate levels. Defence should report back to the Committee about its implementation of this recommendation by February 2006.

Recommendation 30

The Committee recommends that Defence and the ANAO conduct ongoing consultations to discuss areas of disagreement such as pricing within the SDSS system. Defence should aim to resolve the issue of pricing of items within SDSS by June 2006.

Recommendation 31

The Committee recommends that for Project JP 2077:

- the project must be managed from within the Defence Materiel Organisation;
- all appropriate cabinet-level, ministerial-level and departmental approvals must be sought prior to implementation of various phases of the project;
- the project must include defined project milestones;
- no project management bonus payments are to be made to any DMO personnel if the project milestones are not met on-time, and on-budget;
- there must be continued input from on-the-ground users of the logistics system; and
- the project must include sufficient upgrades to the technological hardware supporting the new logistics system to ensure that it will run efficiently.

Chapter 10: *Financial management of Special Appropriations***Recommendation 32**

The Committee recommends that the Department of Finance and Administration continues to provide ongoing advice to all Commonwealth agencies in relation to the accurate management and reporting of special appropriations.

Recommendation 33

The Committee recommends that the Attorney-General's Department and the Department of Finance and Administration resolve which agency is best equipped to administer the Special Appropriation in relation to Mirror Taxes.

Recommendation 34

The Committee recommends that all Chief Financial Officers' performance bonuses should be linked to a proven understanding and application of correct procedures for the management and reporting of all relevant special appropriations.

Chapter 11: *Container Examination Facilities – Australian Customs Service***Recommendation 35**

The Committee recommends that the Australian Customs Service:

- continues to rectify data integrity issues within EXAMS;
- creates clearly defined business rules for data entered in EXAMS 2 for consistency across regions; and
- ensures that the one-day Target Selection Officer x-ray training course is implemented across all regions.

Recommendation 36

The Committee recommends that the Australian Customs Service:

- report to the Committee by June 2006 of the progress and findings of the current review of contracts with service providers; and
- strengthen its reporting requirements within service providers contracts for ease of reconciliation and comparison.

Chapter 12: *Regulation of Non-prescription Medicinal Products - Department of Health and Ageing and Therapeutic Goods Administration***Recommendation 37**

The Committee recommends that the TGA provide this Committee with a copy of the audit frequency matrix, and any other documentation linked to determination of audits (such as procedures for undertaking an unannounced audit), when it is completed.

Recommendation 38

The Committee recommends that the Therapeutic Goods Administration document its procedures for implementation of enforcement action against manufacturers. This should include:

- a clear definition of different enforcement actions, the circumstances in which they are applied, and manufacturers' rights of submission or appeal;
- stipulation of management authorisation for enforcement actions;
- a definition of timelines for short-term reporting and TGA assessment of manufacturer reports; and
- a requirement that all manufacturers subject to an enforcement action will undergo a follow-up audit within three to six months of the initial action.

Recommendation 39

The Committee recommends that the Therapeutic Goods Administration increase its post-market laboratory testing for non-prescription medicinal products from overseas manufacturers, particularly with an emphasis on products from manufacturers who have not been subject to certification or audit in the past 18 months.

Recommendation 40

The Committee recommends that the Therapeutic Goods Administration urgently review its information management systems, including documentation of key decisions and correct electronic and hard copy filing of relevant documents. The importance of maintaining accurate and up-to-date records should also be communicated to all TGA staff.

Recommendation 41

The Committee recommends that the Therapeutic Goods Administration continue with its re-accreditation process for ISO 9000 and National Association of Testing Authorities (NATA) standards. When the TGA achieves these standards this information should be promulgated to manufacturers and other industry bodies.

Recommendation 42

The Committee recommends that the Therapeutic Goods Administration report to the Committee on the establishment and operation of the Trans-Tasman Therapeutic Products Agency, with regard to how the new agency will continue to regulate non-prescription medicinal products in accordance with the 26 ANAO recommendations. The TGA should also report on any changes to its governance and reporting arrangements.

These reports should be forwarded to the Committee in February and July 2006.

Introduction

Background to the review

- 1.1 The Joint Committee of Public Accounts and Audit (JCPAA) has a statutory duty to examine all reports of the Auditor-General that are presented to the Presiding Officers of the Australian Parliament, and report the results of its deliberations to both Houses of Parliament. In selecting audit reports for review, the Committee considers:
- the significance of the program or issues raised in the audit reports;
 - the significance of the audit findings;
 - the arguments advanced by the audited agencies; and
 - the public interest of the report.
- 1.2 Upon consideration of 18 audit reports presented to the Parliament by the Auditor-General between 1 February 2004 and 14 April 2004 (3rd quarter 2003-2004), the Committee selected three reports for further scrutiny at public hearings.
- 1.3 On 29 August 2004, the Prime Minister announced an election which resulted in the dissolution of the House of Representatives. On 31 August writs for the election were issued and Parliament was prorogued.
- 1.4 Parliament resumed on 6 December 2005, and the Joint Committee of Public Accounts and Audit was re-appointed for the 41st Parliament. On 8 December, a sectional committee was appointed to review Auditor-General reports. It resolved to review the three audit reports agreed to in the 40th Parliament. In addition, on 9 February 2005 a further eight audit reports were included in the Committee's review after consideration of a

total of 37 Auditor-General's reports tabled in Parliament between April – December 2004 (4th quarter 2003-2004, 1st and 2nd quarter 2004-2005).

1.5 The audit reports reviewed by the JCPAA are listed below:

- Audit Report No. 25, 2003–04, *Intellectual Property Policies and Practices in Commonwealth Agencies*;
- Audit Report No. 34, 2003–04, *The Administration of Major Programs, Australian Greenhouse Office*;
- Audit Report No. 36, 2003–04, *The Commonwealth's Administration of the Dairy Industry Adjustment Package, Department of Agriculture, Fisheries and Forestry, Dairy Adjustment Authority*;
- Audit Report No. 46, 2003-04: *Client Service in the Family Court of Australia and the Federal Magistrate's Court*;
- Audit Report No. 50, 2003-04: *Management of Federal Airport Leases*;
- Audit Report No. 4, 2004-05: *Management of Customer Debt (Centrelink)*;
- Audit Report No. 5, 2004-05: *Management of Standard Defence Supply System Upgrade*;
- Audit Report No. 21, 2004-05: *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004*;
- Audit Report No. 15, 2004-05: *Financial Management of Special Appropriations*;
- Audit Report No. 16, 2004-05: *Container Examination Facilities (Australian Customs Service)*; and
- Audit Report No. 18, 2004-05: *Regulation of Non-prescription Medicinal Product*.

1.6 The public hearings for the respective reports were held on:

- Monday 9 August 2004 (ANAO Audit Report No. 25);
- Monday 14 February 2005 (ANAO Audit Reports No. 34 and 36);
- Monday 7 March 2005 (ANAO Audit Report No. 50);
- Monday 4 April 2005 (ANAO Audit Reports No. 46 and No. 4);
- Tuesday 5 April 2005 (ANAO Audit Reports No. 15 and No. 18);
- Thursday 28 April 2005 (ANAO Reports No. 16, No. 5 and No. 21);
- Thursday 12 May 2005 (ANAO Report No. 21); and

- Monday 27 June 2005 (ANAO Reports No. 5 and No. 21).

1.7 A list of witnesses attending all public hearings is at Appendix D.

The Committee's report

1.8 This report of the Committee's examination draws attention to the main issues raised at the respective public hearings. Where appropriate, the Committee has commented on unresolved or contentious issues, and has made recommendations.

1.9 The Committee's report is structured as follows:

- Chapter 2 – Audit Report No. 25, 2003–2004, *Intellectual Property Policies and Practices in Commonwealth Agencies*;
- Chapter 3 – Audit Report No. 34, 2003–2004, *The Administration of Major Programs (Australian Greenhouse Office)*;
- Chapter 4 – Audit Report No. 36, 2003–2004, *The Commonwealth's Administration of the Dairy Industry Adjustment Package*;
- Chapter 5 – Audit Report No. 46, 2003–2004, *Client Service in the Family Court of Australia and the Federal Magistrates Court*;
- Chapter 6 – Audit Report No. 50, 2003–2004, *Management of Federal Airport Leases*;
- Chapter 7 – Audit Report No. 4, 2004–05, *Management of Customer Debt (Centrelink)*;
- Chapter 8 – Audit Report No. 5, 2004–05, *Management of Standard Defence Supply System Upgrade*;
- Chapter 9 – Audit Report No. 21, 2004–05, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004*;
- Chapter 10 – Audit Report No. 15, 2004–05, *Financial Management of Special Appropriations*;
- Chapter 11 – Audit Report No. 16, 2004–05: *Container Examination Facilities (Australian Customs Service)*, and
- Chapter 12 – Audit Report No. 18, 2004–05: *Regulation of Non-prescription Medicinal Products*.

1.10 The following appendices provide further information:

- Appendix A - Conduct of the Committee's review
- Appendix B - List of submissions authorised
- Appendix C - List of exhibits received
- Appendix D - List of witnesses who appeared at the public hearings
- Appendix E - Schedule of Airport Insurance Cover for Federally leased airports from 1997-2005
- Appendix F - Airport Development Commitment Expenditure as required under Airport Sale Agreements.

1.11 A copy of this report is available on the Committee's website at <http://www.aph.gov.au/house/committee/jcpaa/reports.htm>.

Audit Report No. 25, 2003-2004

Intellectual Property Policies and Practices in Commonwealth Agencies

Introduction

Background

- 2.1 Intellectual property (IP) refers to the rights granted by law in relation to the fruits of human intellectual activity. It includes all copyright, all rights in relation to inventions (including patent rights), plant varieties, registered and unregistered trade marks (including service marks), registered designs, circuit layouts, confidential information and all other rights resulting from intellectual activity in the industrial, scientific, literary or artistic fields. Each IP type is recognised and protected under Australian law.¹
- 2.2 In both the public and private sectors, IP is being recognised as an increasingly important resource, contributing to and enhancing both the operations of an organisation and its value. The Commonwealth government in particular, due to the breadth and diversity of its activities, is a significant generator, acquirer and user of IP.

¹ Australian National Audit Office (ANAO), Audit Report No. 25, 2003-2004, *Intellectual Property Policies and Practices in Commonwealth Agencies*, Commonwealth of Australia, p. 17.

- 2.3 The fact that IP assets are less tangible than physical assets makes managing, valuing and accounting for IP more difficult and complex.
- 2.4 However, there is a set of common principles that should underpin the management of IP in any organisation. During the audit, the Australian National Audit Office (ANAO) developed a framework for IP management, which comprises a number of integrated management activities. The framework was developed with specific reference to the public sector environment. It consists of a number of management elements that work together to comprise IP management.

The audit

- 2.5 In 2003 the ANAO conducted an audit of the IP policies and practices in Commonwealth agencies. The aim of the audit was to:
- form an opinion on whether Commonwealth agencies have systems in place to manage their IP assets in an efficient, effective and ethical fashion; and
 - identify areas for better practice in IP management by those agencies.
- 2.6 Case studies were conducted in seven agencies:
- Australian Bureau of Statistics (ABS);
 - Airservices Australia;
 - Department of Defence, including Defence Science and Technology Organisation;
 - Australian Nuclear Science and Technology Organisation;
 - Department of Employment and Workplace Relations;
 - Commonwealth Scientific and Industrial Research Organisation (CSIRO); and
 - Grains Research and Development Corporation.
- 2.7 The ANAO presented its report to the Parliament in February 2004.

Audit findings

- 2.8 The ANAO audit found that only 30 percent of agencies had developed specific policies or procedures for managing IP. The agencies involved in the case studies had varying systems in place to manage their IP.
- 2.9 At the time of the audit, the Commonwealth did not have a whole-of-government policy approach to managing IP. As a result, agencies were

responsible for devising their own approaches to the management of the IP they generated and/or acquired.

- 2.10 The ANAO noted that, although the Department of Communications, Information Technology and the Arts (DCITA) document *The Commonwealth IT IP Guidelines (2000)* provided useful guidance to agencies on the management of IT-IP (including consideration of ownership options for IP managed by an agency), there remained a need for broader guidance and support for agencies on IP management more generally.² The ANAO considered that the scheduled review of the *Commonwealth IT IP Guidelines* by DCITA could provide an opportunity for more detailed assessment of the need for further guidance and support for Commonwealth agencies on the management of IP in general, with input from other interested agencies.
- 2.11 The ANAO considered that the development of a whole-of-government policy on the management of IP by Commonwealth agencies could assist agencies to understand the importance of IP management and the issues involved.
- 2.12 A whole-of-government policy could also nominate an agency, or agencies, responsible for monitoring and reporting on the implementation of the policy and provision of appropriate support to agencies. The ANAO made two recommendations; the second of which aimed at developing a whole-of-government approach to address these areas.
- 2.13 The other ANAO recommendation aimed to improve the efficient, effective and ethical administration of agency IP.³ The ANAO also identified areas for improvement and better practice in agency management of IP.

ANAO recommendations

- 2.14 The ANAO made the following recommendations:

Table 2.1 ANAO recommendations, Audit report no. 25, 2003-04

1.	The ANAO recommends that, in order to ensure the effective and efficient management of intellectual property, agencies develop an intellectual property policy appropriate for agency circumstances and functions, and implement the required systems and procedures to support such a policy. <i>All agencies agreed or agreed in principle.</i>
2.	In order to ensure that the Commonwealth's interests are protected, the ANAO recommends that the Attorney-General's Department, the Department of Communications, Information

2 ANAO Audit Report no. 25, 2003-04, p. 22.

3 ANAO Audit Report no. 25, 2003-04, p. 24.

Technology and the Arts, and IP Australia (along with other relevant agencies), work together to develop a whole-of-government approach and guidance for the management of the Commonwealth's intellectual property, taking into account the different functions, circumstances and requirements of agencies across the Commonwealth, and the need for agency guidance and advice on intellectual property management.

All agencies agreed or agreed in principle.

The Committee's review

2.15 The Committee held a public hearing on 9 August 2004 to review the progress made against the audit's recommendations. Witnesses from the following agencies attended the public hearing:

- the ANAO;
- the ABS;
- Attorney-General's Department (AGD);
- CSIRO;
- DCITA;
- Department of Finance and Administration (Finance); and
- IP Australia.⁴

2.16 The Committee took evidence on the following issues:

- whole-of-Government approach;
- recognition and benefits for contributors; and
- classifying and valuing Intellectual Property.

2.17 The Committee notes that the ANAO's report was tabled over 18 months ago, in February 2004. The Committee acknowledges that given the lapse of time since the tabling of the ANAO's report, there may be some changes in the way Government agencies now manage their IP. The Committee has endeavoured to seek updates on the status of agencies' response to the recommendations. This information is reported where relevant throughout this chapter.

4 A full list of witnesses appearing at the hearing is at Appendix D.

Whole-of-Government approach

- 2.18 At the time of the ANAO's audit, the Commonwealth did not have a whole-of-government policy approach to managing IP. Agencies were responsible for devising their own approaches to the management of their IP.⁵
- 2.19 The audit noted the need for broad guidance and support for agencies on IP management. It recommended that the AGD, DCITA, and IP Australia, along with other relevant agencies, work together to develop a whole-of-government approach and guidance for the management of the Commonwealth's IP. This approach would take into account the different functions, circumstances and requirements of agencies across the Commonwealth, and the need for agency guidance and advice on IP management. All audited agencies agreed outright or in principle to the ANAO recommendation.⁶
- 2.20 The Committee asked all agencies at the public hearing for their views on the recommended whole-of-government approach to IP management. All agreed that it was a step in the right direction.⁷ Agencies explained that such an approach would:
- guide agencies to improve their management of their IP;
 - encourage government Chief Executive Officers to focus appropriate attention on IP management issues;
 - overcome agencies' lack of understanding of IP; and
 - acknowledge that IP management is an issue that needs to be addressed.⁸
- 2.21 The AGD told the Committee that the Commonwealth already has a whole-of-government approach to copyrighting. Copyright is a type of IP right that covers the expression of original ideas in material form. Copyright protection is provided by the *Copyright Act 1968* (Copyright Act). The AGD oversees provisions in the Copyright Act for government use of copyright material. Those provisions effectively set out a whole-of-government approach. The AGD feels that a whole-of-government

5 ANAO Audit Report No. 25, 2003-2004, p. 22.

6 ANAO, Audit Report No. 25, 2003-2004, pp. 22, 59.

7 *Transcript of Evidence*, 9 August 2004, pp. 2, 16.

8 ANAO, *Transcript of Evidence*, 9 August 2004, p. 3; Department of Communications, Information Technology and the Arts (DCITA), *Transcript of Evidence*, 9 August 2004, p. 15; IP Australia, *Transcript of Evidence*, 9 August 2004, p. 15.

approach to IP would complement the work that it is already doing on copyright.⁹

- 2.22 The ABS told the Committee that it has a substantial amount of IP in the form of internally-generated software, which it generally manages internally. The ABS also has external IP issues with its on-selling of data and statistical collections. It uses copyright to ensure that published data is only used for its intended purpose. The ABS told the Committee that it had given little thought to a whole-of-government approach.¹⁰
- 2.23 The CSIRO advised the Committee that it possessed significant experience of the creation, management and exploitation of intellectual property.¹¹
- 2.24 DCITA told the Committee that it had already begun working with IP Australia and AGD towards a whole-of-government approach to IP management. Its goal was to create a statement of principles that expressed good IP management practice. At the hearing in August 2004, DCITA advised the Committee that it expected the development of the IP principles to be completed by October 2004.¹²
- 2.25 The three responsible agencies would then develop an IP better practice manual to provide guidance and advice on how to implement these principles.¹³
- 2.26 In February 2005 the Committee sought an update on progress on the development of a whole-of-government approach to IP. DCITA advised that due to changes in portfolio responsibilities following the October 2004 Federal Election, IP matters are now handled by the AGD. The Committee was also advised that due to these portfolio changes, and reallocation of resources dedicated to the implementation of the Australia-United States Free Trade Agreement, work on progressing the development of IP principles had been delayed. In May 2005 AGD advised the Committee that 'options for progressing the response to the ANAO report are currently being considered'.¹⁴

9 Attorney-General's Department (AGD), *Transcript of Evidence*, 9 August 2004, p. 4; ANAO, Audit Report No. 25, 2003-2004, p. 31.

10 Australian Bureau of Statistics (ABS), *Transcript of Evidence*, 9 August 2004, pp. 2, 14.

11 Commonwealth Scientific and Industrial Research Organisation (CSIRO), *Transcript of Evidence*, 9 August 2004, p. 3.

12 DCITA, *Transcript of Evidence*, 9 August 2004, pp. 5, 10.

13 DCITA, *Transcript of Evidence*, 9 August 2004, pp. 5, 9, 10.

14 DCITA and Attorney-General's Department, Email correspondence to Committee secretariat, dated 9 February 2005, 6 May 2005, and 10 May 2005.

- 2.27 The ANAO recommendation did not specify the involvement of other agencies in developing a whole-of-government approach to IP management. The ANAO told the Committee that the recommendation was not intended to focus on any particular line agency. However, it felt that AGD, DCITA and IP Australia should consult with line agencies like CSIRO and ABS while drafting the whole-of-government approach. This would give the development process the benefit of other agencies' experience of IP.¹⁵
- 2.28 The ABS and CSIRO are both major generators of IP. The ABS reported intangible assets, including IP, to a value of \$76.8 million in its 2002-03 Financial Statement, while CSIRO reported annual revenue from intellectual property of \$17.6 million in 2001-02. Both agencies told the Committee that they would be happy to contribute to the development a whole-of-government approach to IP management.¹⁶
- 2.29 A number of agencies told the Committee that a whole-of-government approach to IP management cannot adopt a uniform approach across all agencies. Agencies that are commercially oriented require IP management that cultivates the market for their IP, while agencies that are not commercially oriented do not. A whole-of-government approach should set a framework for IP management, but leave each agency free to optimise its role within the framework.¹⁷

Committee comment

- 2.30 The Committee is disappointed to note that more than 18 months after the ANAO's audit report was tabled, there is little progress towards developing a whole-of-government approach to IP management. DCITA and other agencies outlined plans to develop an IP strategy at the Committee's public hearing in August 2004, however it appears little has been done since that date.
- 2.31 The Committee believes that CSIRO and ABS should be involved in developing a whole-of-government approach to IP management, given that they are both major generators of IP.
- 2.32 The Committee feels that it is vital that line agencies that are major generators of IP contribute to developing the whole-of-government

15 ANAO, *Transcript of Evidence*, 9 August 2004, p. 8.

16 ANAO Audit Report No. 25, 2003-2004, pp. 21, 95; ABS, *Transcript of Evidence*, 9 August 2004, p. 2; CSIRO, *Transcript of Evidence*, 9 August 2004, p. 3.

17 CSIRO, *Transcript of Evidence*, 9 August 2004, p. 3; ANAO, *Transcript of Evidence*, 9 August 2004, pp. 3-4.

approach to IP management. Accordingly, the Committee makes the following recommendation:

Recommendation 1

2.33 **The Committee recommends that the Attorney-General's Department commence development of a whole-of-government approach and guidance for the management of the Commonwealth's intellectual property, for completion by May 2006. The Attorney-General's Department should consult widely with Commonwealth agencies, particularly those which are major generators of intellectual property.**

2.34 The Committee agrees that the whole-of-government approach to IP management needs to accommodate the different circumstances of each agency. Accordingly, it makes the following recommendation:

Recommendation 2

2.35 **The Committee recommends that the whole-of-government approach to the management of the Commonwealth's intellectual property within a framework for IP management should leave each Commonwealth agency free to optimise its role within the framework.**

Recognition and benefits for contributors

2.36 The Committee was interested in how IP management distributes benefits from any commercialisation of IP. Distributing benefits to the individuals involved in creating IP would reward creativity and innovation. This may, in some circumstances, encourage further innovation and help agencies to retain valuable employees.

2.37 The Committee understands that the traditional approach to distributing the benefits of IP commercialisation does not recognise the contribution of individuals. This approach recognises Commonwealth agencies as inventing, developing and commercialising IP, and all benefits are distributed to the agency. The individual is not regarded as important to the IP process.

- 2.38 AGD advised the Committee that the Copyright Act includes moral rights amendments that enable individuals to be acknowledged in copyright material that they produce for the Commonwealth as part of their employment. More generally, however, any IP produced by a Commonwealth employee is effectively owned by the Commonwealth.¹⁸
- 2.39 DCITA and IP Australia agreed with the Committee that agencies should recognise the contribution of individuals in IP development. The ANAO told the Committee that agencies should consider the issue while developing IP management policy.¹⁹
- 2.40 Agencies generally felt, however, that commercialising IP and recognising individual contributions were not primary goals of Commonwealth IP management. DCITA felt that IP management should facilitate public access to IP. CSIRO told the Committee that IP should be managed to maximise the benefit for Australia.²⁰
- 2.41 The Committee had heard of IP policies that distributed one-third of benefits to the inventing team, one-third to their division and one-third to the corporate organisation. Such policies produce uniform and outstanding results because they reward individuals for creating the IP, the division for making this possible and the organisation for commercialising the IP.²¹
- 2.42 The Committee asked CSIRO whether it had considered this sort of benefit distribution policy. CSIRO told the Committee that it was piloting a program that would make available to inventors a portion of the future income of their inventions. It had come up with this benefit distribution policy in order to recruit and retain talented employees. This is an issue because CSIRO must compete for employees with universities and the private sector, and would be disadvantaged if it could not offer incentives to top people.²²
- 2.43 CSIRO's benefit distribution system, however, is quite complicated to implement. Each inventor may have contributed a different amount of effort to the invention, and many other people are involved in making the

18 AGD, *Transcript of Evidence*, 9 August 2004, p. 8.

19 DCITA, *Transcript of Evidence*, 9 August 2004, p. 7; IP Australia, *Transcript of Evidence*, 9 August 2004, p. 9; ANAO, *Transcript of Evidence*, 9 August 2004, p. 7.

20 DCITA, *Transcript of Evidence*, 9 August 2004, p. 7; CSIRO, *Transcript of Evidence*, 9 August 2004, p. 5.

21 Joint Committee of Public Accounts and Audit (JCPAA), *Transcript of Evidence*, 9 August 2004, p. 6.

22 CSIRO, *Transcript of Evidence*, 9 August 2004, p. 6, 16.

- invention a reality. The contributions and appropriate rewards must be worked out for each of these people.²³
- 2.44 CSIRO told the Committee that it would probably not be possible to come up with a precise formula for recognising everyone's contribution. Instead, this would probably be worked out by management or by the members of the inventing group. Both of these solutions raise problems of their own.²⁴
- 2.45 CSIRO told the Committee that benefit distribution did not fit well with its present philosophy of rewarding employees. CSIRO employees are paid to be creative, and are currently rewarded through the promotion system. CSIRO employees generally earn less than their university colleagues, but CSIRO reports that their staff are generally happy with their situation.²⁵
- 2.46 Another difficulty with benefit distribution is that much of an invention's income is not realised immediately. CSIRO told the Committee that it usually takes between five and ten years for a patent to start earning money. Inventors would have to wait several years to receive the benefits of their invention.²⁶
- 2.47 The benefit distribution scheme also risks channelling talented people away from work that benefits Australia but does not generate an income. People will choose to work on projects that will make money rather than ones that will benefit Australia. CSIRO is currently determining how to operate its scheme to retain top people while avoiding this situation.²⁷
- 2.48 IP Australia told the Committee that Commonwealth IP management policy should not prescribe a distribution of benefits. Agencies should promote innovation amongst their employees, but it would be better to let each agency choose its own way of doing this. Different agencies conduct business differently, and the distribution of benefits will not be an appropriate or effective incentive in all of them.²⁸

Committee comment

- 2.49 The Committee believes that IP management is an important way to retain talented employees and promote an environment of innovation in

23 CSIRO, *Transcript of Evidence*, 9 August 2004, pp. 6, 11.

24 CSIRO, *Transcript of Evidence*, 9 August 2004, p. 11.

25 CSIRO, *Transcript of Evidence*, 9 August 2004, p. 10.

26 CSIRO, *Transcript of Evidence*, 9 August 2004, p. 10.

27 CSIRO, *Transcript of Evidence*, 9 August 2004, p. 16.

28 IP Australia, *Transcript of Evidence*, 9 August 2004, p. 9.

Commonwealth agencies. All agencies should consider a benefit distribution scheme when developing their IP management policies.

- 2.50 The Committee recognises that setting up a fair and practical benefit distribution scheme would be very difficult. Indeed, setting up such a scheme across all Commonwealth agencies would be almost impossible. Therefore, the Committee agrees with IP Australia that agencies should be free to choose their own way of promoting innovation and retaining talented employees.

Classifying and valuing Intellectual Property

- 2.51 The ANAO audit stated that agencies' IP policy will need to define the types of intellectual property that the agency will need to manage. Not all types of intellectual property generated or held by an agency will require active management. The report suggests that agencies' IP policy should outline how to classify IP, the types of IP that should be identified and further managed, how they are to be managed, and by whom.²⁹
- 2.52 The Committee asked agencies how they were planning to classify their IP.
- 2.53 DCITA told the Committee that it has made a complete stock-take of its IP production. This stock-take divided DCITA's IP into categories of low, medium and high importance, based on:
- operational significance;
 - strategic significance;
 - commercial potential; and
 - public significance.³⁰
- 2.54 The Committee was interested in how DCITA classifies its corporate email, which may have a high operational significance but generally has a low IP value. DCITA told the Committee that it classifies emails according to the importance of the work that they relate to.

An email that is contributing to work on a key decision may be operationally important, and that would be rated as 'high', but if it were just general work product thinking, prior to leading into

29 ANAO Audit Report No. 25, 2003-2004, pp. 49-50.

30 DCITA, *Transcript of Evidence*, 9 August 2004, p. 12.

further development of an idea, then they might rate that as 'low'.³¹

- 2.55 DCITA advised that it is focussing its management efforts on the 'high' category. However, the production of commercial or beneficial IP is not a significant part of DCITA's role. Most of its IP is in the 'low' category, in the form of papers, letters and email. This IP is protected by copyright, and requires little further management.³²
- 2.56 DCITA told the Committee that the stock-take was the first in the process of classifying its IP and locating its most important IP. So far, the stock-take had succeeded in raising staff awareness of IP classification, and staff were now thinking about how to classify the IP that they were producing.³³
- 2.57 CSIRO told the Committee that it understands that there are different types of intellectual property, and it has a different approach to each type. For example, publications are protected by copyright and the IP rights belong to the authors. Patents, on the other hand, are a fundamental part of CSIRO's mission of technology transfer, and IP rights are not assigned to individuals.³⁴
- 2.58 Finance told the Committee that categorising IP is very difficult because of complexities in evaluating the commercial potential of IP. The current rules for valuing research and development state that benefits must be able to be obtained beyond reasonable doubt. This sets a very high standard that is difficult to achieve. IP valuation requires a reliable measure, and IP that cannot be separated from an agency's core business cannot be valued. These accounting requirements are very difficult to meet.³⁵
- 2.59 ABS told the Committee that it had a method of classifying IP assets since 1997, and had been developing it with ANAO ever since. ABS is trying to develop a robust valuation process, but this is complicated by the fact that IP does not realise its full value immediately. Some ABS IP continues to generate returns for 10 to 15 years. Therefore, ABS is developing an IP

31 DCITA, *Transcript of Evidence*, 9 August 2004, p. 12.

32 DCITA, *Transcript of Evidence*, 9 August 2004, p. 12.

33 DCITA, *Transcript of Evidence*, 9 August 2004, p. 12.

34 CSIRO, *Transcript of Evidence*, 9 August 2004, p. 15.

35 Department of Finance and Administration (Finance), *Transcript of Evidence*, 9 August 2004, pp. 12-13.

valuation process that is sustainable over time and unaffected by large fluctuations in IP activity.³⁶

Committee comment

- 2.60 The Committee is pleased with the work to date in developing a system for classifying IP. All agencies should consider using the criteria developed by DCITA for classifying their own IP.
- 2.61 The Committee recognises that it is very difficult to assess the value of IP accurately. Agencies would be assisted in classifying their IP if they had access to guidelines on developing IP valuation systems. These guidelines would also improve the standard of reporting on IP in agencies' annual reports. The Committee makes the following recommendation:

Recommendation 3

- 2.62 **The Committee recommends that the Department of Finance and Administration, in consultation with the Attorney-General's Department, develop guidelines to assist agencies in developing valuation systems for their intellectual property.**
- 2.63 The Committee notes that the ANAO plans to undertake a performance audit of management of intellectual property in selected Commonwealth agencies during 2005-06. The Committee looks forward to reviewing this ANAO audit in due course and hopes that the audit reveals a comprehensive whole-of-government approach to intellectual property management, with agencies following agreed policies and procedures.

36 ABS, *Transcript of Evidence*, 9 August 2004, p. 13.

Audit Report No. 34, 2003-2004

The Administration of Major Programs (Australian Greenhouse Office)

Introduction

Background

- 3.1 Climate change is recognised as a major issue for all nations. New and stronger evidence that humans are having an influence on the global climate through greenhouse gas emissions was presented by the Intergovernmental Panel on Climate Change in 2001.¹
- 3.2 In 1997, and subsequently in 1999, the Australian Government introduced two major spending packages with a total value of almost \$1 billion. These packages, *Safeguarding the Future* (1997) and *Measures for a Better Environment* (1999), were designed to address the challenges posed by the issue of climate change and to meet Australia's domestic and international climate change commitments. The Australian Government has agreed to 'develop and invest in domestic programs to meet the target of limiting

¹ Australian Greenhouse Office, internet site: <http://www.greenhouse.gov.au/ago/index.html>, accessed May 2005.

greenhouse gas emissions to 108 percent of 1990 emissions over the period of 2008–2012' – the Kyoto Protocol target.

- 3.3 Since its inception in 1998, the Australian Greenhouse Office (AGO) has been responsible for the implementation of these two major packages and subsequent government greenhouse policies. The agency's mission is to lead Australia's greenhouse action to achieve effective and sustainable results. AGO seeks, amongst other things, to facilitate projects that maximise cost effective greenhouse gas abatement and reduce growth in greenhouse gas emissions.
- 3.4 The ANAO audit was conducted between May and August 2003. Since then, the administrative arrangements for the AGO have changed. Following the 2004 Federal Election, the AGO was moved to become part of the Department of Environment and Heritage (DEH). As such it ceased to operate as an Executive Agency and is now a division within DEH.

The audit

- 3.5 The objective of the audit was to examine and report on the administrative efficiency and effectiveness of significant programs administered through AGO. The audit examined seven programs across both the 1997 and 1999 packages, which accounted for 87 percent of total program cost estimates.
- 3.6 Since the ANAO's audit report was tabled, the government has announced a new suite of climate change responses as part of its energy white paper, *Securing Australia's Energy Future* (released June 2004), and also in the 2004-05 Federal Budget. While some existing AGO programs remained untouched, others were refined and some new programs were announced, such as the Solar Cities Programme. This new package is known as the government's Climate Change Strategy. Total funding under the Climate Change Strategy (including existing funding from the 1997 and 1999 programs) now totals \$1.8 billion.²
- 3.7 The programs reviewed in the ANAO's audit are outlined in the table below.

2 Australian Greenhouse Office, internet site: <http://www.greenhouse.gov.au/ago/index.html>, accessed May 2005.

Table 3.1 AGO programs examined in ANAO Audit Report no. 34

Program	Announced funds (\$ million)
1997 – Safeguarding the Future Package	
<u>Greenhouse Challenge Program (Challenge)</u> —a voluntary industry program to reduce greenhouse gas emissions, drive continuous improvement and enhance knowledge and understanding of cost effective ways of managing greenhouse gas emissions.	27.1
<u>Renewable Energy Equity Fund (REEF)</u> —an investment program to encourage the commercialisation of research and development in renewable energy technologies by addressing capital and management constraints.	21.0 A
<u>Renewable Energy Commercialisation Program (RECP)</u> —a grant program to support innovative renewable energy equipment, technologies, systems or processes that have strong commercial application and the prospect of significant abatement of greenhouse gas emissions over the longer term.	29.6
1999 – Measures for a Better Environment Package	
<u>Greenhouse Gas Abatement Program (GGAP)</u> —a grant program to support activities likely to result in substantial emissions reductions or substantial sink enhancement, particularly in the first Kyoto commitment period 2008–2012.	400.0
<u>Renewable Remote Power Generation Program (RRPGP)</u> —a grant program to increase the uptake of renewable energy technologies in remote areas, assist in developing the renewable energy industry, help meet the energy needs of indigenous communities and lead to long-term greenhouse gas reductions.	264.0 B
<u>Photovoltaic Rebate Program (PVRP)</u> —a grant program to encourage the long-term use of photovoltaic technology, increase renewable energy in Australia, reduce greenhouse gas emissions, assist in the development of the photovoltaic industry and increase public awareness of renewable energy.	31.0 C
<u>Alternative Fuels Conversion Program (AFCP)</u> —a grant program to reduce greenhouse gas emissions and significantly improve urban air quality by facilitating heavier commercial road vehicle and public transport buses to operate on compressed natural gas (CNG) or liquefied petroleum gas (LPG).	75.0 D
<u>Extension of RECP</u> —as per 1997 package with additional funding for industry development component.	26.0 E
Total Value of Programs Evaluated	873.70
A Subsequent revised estimate of \$19.5 million.	
B Subsequent revised estimate of \$179.9 million.	
C Subsequent revised estimate of \$34.6 million.	
D Subsequent revised estimate of \$71.4 million.	
E The audit only examined the \$20 million extension of the RECP not the \$6 million allocated to the industry development component.	

Source ANAO Audit Report No. 34 2003-04, p. 28.

Audit findings

3.8 The ANAO found that the administration of greenhouse programs had been characterised by substantial challenges.

- 3.9 The ANAO reported that administrative processes could have been better focused at the planning stage on comprehensive risk assessment, as well as in designing programs with more measurable objectives and targets. The absence of these factors made it difficult to measure results against program objectives and exposed some programs to risks that could have been better identified and treated in the early stages of the programs.
- 3.10 The ANAO found that catch-up administrative improvements had been put in place to overcome initial shortcomings in planning. Project appraisal and selection was generally rigorous and based on merit. AGO had put in place sound and well drafted agreements to manage residual risk at the program level. Monitoring and evaluation were also given sufficient priority. Linking payments to milestones assisted in the efficient management of funding allocations.
- 3.11 Nevertheless, ANAO concluded that substantial risks remained – particularly in terms of the timely achievement of program objectives. Areas for further improvement included refining performance measurement, including the use of intermediate measures and/or assessments to gauge progress towards longer term objectives. The ANAO also found that a more consistent approach to project appraisal and selection would also assist in improving the transparency of decision-making. Attention also needed to be given to the timeframes of negotiations over funding agreements. Finally, the ANAO reported that improvements to performance reporting were necessary to enable Parliament to come to a more informed view on the progress and effectiveness of AGO in implementing programs of national significance.

ANAO recommendations

- 3.12 The ANAO made five recommendations:

Table 3.2 ANAO recommendations, Audit Report no. 34, 2003-04

1. In order to maximise value for money from grant expenditure and minimise the potential for any adverse impacts on program effectiveness, the ANAO recommends that, prior to consideration of any future funding assistance programs, the AGO conduct a comprehensive program risk assessment. If this timing is not achievable in practice, then the ANAO recommends it should occur as early as possible and certainly, before the commitment of any substantial resources.
2. In order to assist in measuring and/or assessing program results, the ANAO recommends that prior to implementation of any future funding assistance programs, the AGO consider incorporating clearly defined and measurable intermediate outcomes and operational targets (where possible) to underpin program objectives.
3. In order to improve the measurement and the consistency of performance reporting across programs, the ANAO recommends that the AGO give high priority to the completion of an integrated performance information system for measurement of greenhouse gas abatement.

4. In order to improve the rigour and transparency of the appraisal and selection process, the ANAO recommends that the AGO seek Ministerial approval to apply, where appropriate, across competitive programs:
 - (a) an order of merit rating scheme; and
 - (b) recommendations on selection that highlight projects that are most likely to achieve program objectives.
 5. In order to enhance public reporting through the use of performance information to improve the quality and consistency of reports, the ANAO recommends that AGO annual reports include:
 - (a) consistent reporting against performance targets for programs;
 - (b) analysis of significant trends and changes over time; and
 - (c) analysis of identified challenges, risks and priorities.
-

3.13 The AGO agreed with each of the recommendations and reported to the Committee on its progress in meeting each recommendation.

The Committee's review

3.14 The Committee held a public hearing on 14 February 2005 to review the progress made against the audit's recommendations. Witnesses from the ANAO, AGO and Commonwealth Scientific & Industrial Research Organisation (CSIRO) attended the hearing.

3.15 The Committee took evidence on the following major issues:

- risk assessment;
- measuring outcomes;
- selection and appraisal of projects;
- management and monitoring of agreements; and
- performance reporting.

Risk assessment

3.16 The ANAO's publication *Administration of Grants Better Practice Guide* notes that effective planning is the cornerstone of an economic, efficient and effective program. The ANAO's review of the 1997 and 1999 greenhouse funding packages found 'substantial shortcomings in the

initial risk assessments'.³ While this lack of risk assessment did not have significant 'downstream' implications for most of the programs examined by the ANAO, it had important consequences for two programs – the Photovoltaic Rebate Program (PVRP) and the Alternative Fuels Conservation Program (AFCP).

Photovoltaic Rebate Program

- 3.17 Photovoltaic systems convert sunlight into electricity. Under the Photovoltaic Rebate Program (PVRP), domestic householders and small community organisations could apply for a rebate of \$8,250 against the costs of installation of a photovoltaic system.⁴
- 3.18 The ANAO found that the announcement of the PVRP created an immediate expectation in the market for the pending subsidy. However, the AGO was not ready to distribute subsidies, because appropriations and delivery agreements were not in place. As a result, there was an initial slump in sales of photovoltaic units prior to the introduction of the program.⁵
- 3.19 When the program became operational in January 2000, the pent up demand then exceeded supply. The AGO ran out of funds for the PVRP program, and was forced to reallocate resources from another greenhouse program to cover liabilities. This was undertaken with Ministerial approval. In order to slow down demand, the rebate amount was also reduced to \$4 per watt, and a cap of \$4,000 per domestic household was put on the rebate.⁶
- 3.20 The ANAO reported that the AGO had responded to the program challenges within a reasonable timeframe. However, ANAO stated:
- ...these findings highlight the importance of undertaking an early risk assessment. In this case, a risk assessment may have assisted in identifying the level for demand for the program and the need for strengthened controls on expenditure.⁷
- 3.21 The Committee notes that while the PVRP program was due to be phased out, the 2005-06 budget provided for an extra two years of PVRP, at a cost
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3 ANAO Audit Report no. 34, 2003-04, *The Administration of Major Programs (Australian Greenhouse Office)*, Commonwealth of Australia, March 2004, p. 32.

4 Minister for Environment and Heritage, *Media Release* 8 February 2000, available at: <http://www.deh.gov.au/minister/env/2000/mr8feb00.html>, accessed May 2005.

5 ANAO Audit Report no. 34, 2003-04, p. 33.

6 ANAO Audit Report no. 34, 2003-04, p. 34.

7 ANAO Audit Report no. 34, 2003-04, p. 34.

of \$5.7 million per year. The extra funding is intended to provide a 'bridge' between the PVRP program and the new Solar Cities program announced in the Energy White Paper, which is due to commence in June 2006.⁸ The bridging program will help to allay solar energy industry fears of a consumer slump leading up to the introduction of the Solar Cities program, as was experienced prior to the introduction of the PVRP in 1999/2000.

Alternative Fuel Conversion Program

- 3.22 The ANAO also found that poor risk assessment affected the operation of the Alternative Fuel Conversion Program (AFCP). Under its original design, the AFCP aimed to reduce greenhouse gases and improve urban air quality by facilitating heavier commercial road vehicles and public transport buses to operate compressed natural gas (CNG) and liquefied petroleum gas (LPG). The program was initially funded for \$75 million from 2000 – 2008, and was intended to provide a rebate of up to 50 per cent of the cost price of converting an existing commercial vehicle to CNG or LPG, or upgrading to a new CNG or LPG engine.
- 3.23 However, the ANAO found that although the AGO had consulted with industry in designing the scheme, the assessment proved to be optimistic and unrealistic, given the low uptake of available grants.
- 3.24 A key factor in the low uptake (particularly for CNG conversions or upgrades) was an absence of refuelling infrastructure to support CNG, and low consumer and industry confidence in CNG and LPG for heavy vehicles.
- 3.25 The AGO undertook a review of the program in November 2001, 15 months after the program commenced. This review was praised by the ANAO. However the ANAO did conclude that had AGO undertaken a more thorough risk assessment in the early stages of the program, some of the later issues could have been avoided:

In particular, the need to have a robust consultation and analysis to test the accuracy of sectoral industry advice is a key lesson learned from this program.⁹

8 Department of Environment and Heritage, *Portfolio Budget Statements 2005-06*, Fact Sheet, available at: <http://www.deh.gov.au/about/budget/2005/factsheet-solar.html>, accessed May 2005.

9 ANAO Audit Report 34, 2003-04, p. 35.

- 3.26 The AGO stated that its review of the AFCP program had resulted in better targeting of the available funds. AGO reported that the redesigned AFCP program:

...focuses on pilots with significant fleet operators – for example, PO, Coates, Murray Goulburn and a couple more. We have agreements with those companies to actually work with them to develop a business case and to pilot the technology to facilitate import of engines, and the revamped program is actually working very well.

So we actually consider AFCP to be case of best practice where we monitored, we identified slow uptake, we undertook a review, we put the findings of the review and proposed redesign to our minister and that was then taken to the budget and the program was redesigned. We are now effectively progressing the development of those technologies.¹⁰

AGO response

- 3.27 In response to the ANAO's recommendation regarding risk assessment, the AGO developed a Risk Management Policy. According to the AGO's 2003-04 Annual Report, the Risk Management Policy recognises that risk management is a key component of effective corporate governance. In response to Committee questioning on risk assessment, the AGO advised that it has conducted comprehensive program risk assessment for all new climate change measures announced in the 2004-05 Federal Budget and the Australian Government's energy white paper, *Securing Australia's Energy Future*.¹¹

Measuring outcomes

- 3.28 As noted by the ANAO, measurable and precise objectives provide a solid foundation for effective performance management and accountability.¹² The ANAO found that the key objectives for most AGO programs were broad and not easily measurable. However, there were several good examples, such as the Greenhouse Gas Abatement Program (G Gap).

10 Australian Greenhouse Office (AGO), *Transcript of Evidence*, 14 February 2005, p. 6.

11 Australian Greenhouse Office, *Annual Report 2003-04*, pp. 66-67; and Australian Greenhouse Office, Submission no. 5.1, p. 1.

12 ANAO Audit Report no. 34, 2003-04, p. 36.

- 3.29 The G Gap program aims to reduce Australia's net greenhouse gas emissions by supporting activities that are likely to result in substantial emissions reductions or activities to offset greenhouse emissions, particularly in the period 2008-2012. The G Gap program provides assistance to private sector projects which will lead to greenhouse savings or offsets.¹³ At the time of the ANAO's audit, two rounds of the G Gap program had been completed, with a third and final round now nearing finalisation (at April 2005).¹⁴
- 3.30 The ANAO praised the G Gap program for including operational targets which underpinned broad objectives. ANAO commented that this was good practice and particularly useful in providing an indication of progress towards objectives.¹⁵
- 3.31 Other programs with operational targets included Greenhouse Challenge and the AFPC. However, for other programs, ANAO found that it was difficult to gauge to what extent programs could be achieved, particularly where there were long lead times involved. For example, for the PVRP there was no measurement of:
- to what extent the PVRP would assist in the development of the Australian photovoltaic industry; or
 - by how much the PVRP would increase the use of renewable energy in Australia and reduce greenhouse gas emissions.
- 3.32 The AGO agreed with the ANAO's recommendation to incorporate clearly defined and measurable intermediate outcomes and operational targets, where possible. However, in the ANAO's report and also before the Committee, the AGO noted the difficulties in doing this:
- For a large number of these projects – for example, with the development of renewable energy technologies – it is not possible to measure any greenhouse outcome or any other interim measure except where a milestone, be it the delivery of a boiler or the construction of a component of plant, has actually been met. It is not until the commissioning or the end of a project when different technologies are linked together that you can actually start to measure the greenhouse outcomes.¹⁶

13 Australian Greenhouse Office, *Annual Report 2003-04*, p. 24.

14 Australian Greenhouse Office *Annual Report 2003-04*, p. 25.

15 ANAO Audit Report no. 34, 2003-04, p. 37.

16 AGO, *Transcript of Evidence*, 14 February 2005, p. 4.

- 3.33 However, AGO reported that the ANAO's recommendation had been taken into account in measures announced in the 2003-05 budget, and in measures in the Energy White Paper.¹⁷

Selection and appraisal of projects

- 3.34 Appraisal and selection processes for grants must be transparent and lead to the selection of projects which represent value for money against program objectives and outcomes. The ANAO praised the AGO's appraisal system for the programs covered by the audit. ANAO found that the AGO brought in specialist advice where needed.¹⁸
- 3.35 The ANAO noted one problem in project appraisals, where a grant of nearly \$1 million was awarded for a project that was near completion. Although the funding was not critical to the implementation of the project, AGO advised the Minister that the grant should still go ahead, as there was nothing in the program guidelines to preclude funding for projects which are already fully committed.¹⁹ The AGO re-worded its guidelines for subsequent funding rounds.
- 3.36 The ANAO stated that the appraisal process for all future projects should contain a criteria related to a project's need for financial assistance to proceed. If there is no need for financial assistance, the ANAO argued,
- ...funds paid in such circumstances provide no added value and represent an opportunity cost to the Australian Government.²⁰
- 3.37 The Committee agrees with the ANAO's argument and calls for the AGO and other agencies to ensure that they support only those projects which genuinely require government assistance to proceed.
- 3.38 The ANAO found a problem in documentation of decisions in selecting projects for the Greenhouse Gas Abatement Program (GGAP). While the AGO grouped projects into risk categories when presenting them to the Minister for decision, unlike other programs, the AGO provided no recommendations for Ministerial decision makers. This was specifically because of a Ministerial request to not provide recommendations on GGAP projects.²¹
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17 AGO, Submission no. 5.1, p. 1.

18 ANAO Audit Report no. 34, 2003-04, p. 50.

19 ANAO Audit Report no. 34, 2003-04, p. 50.

20 ANAO Audit Report no. 34, 2003-04, p. 50.

21 ANAO Audit Report no. 34, 2003-04, p. 55.

- 3.39 The ANAO found that Ministerial decisions for G Gap funding allocations could have been better documented. Greater detail in the reasons for decisions would have assisted in explaining why some projects received funding given the level of risks raised in the appraisal brief. The ANAO recommended that the AGO apply an order of merit rating scheme for projects, and recommendations on selection that highlight projects that are most likely to achieve project objectives.
- 3.40 The Committee asked the AGO whether it knew the reasons why the Ministerial Council had requested that selection briefs for GGAP programs not provide recommendations on projects or a suggested order of merit. The AGO replied that the minutes of the Ministerial Council meeting at which decision-making procedures were set down (16 February 2000) do not record an explanation for the Council's decision.²²
- 3.41 The AGO advised the Committee that the ANAO's recommendation, regarding advice to Ministers on proposed project funding, was undertaken for the third and final round of the GGAP program.²³
- 3.42 The AGO also advised that, at the time of the Committee's hearing, the guidelines for administration of the new greenhouse abatement programs arising out of the Energy White Paper were still being signed off by Ministers. The Committee would like to ensure that the guidelines for these programs reflect the ANAO's recommendations on assessment and selection procedures for project funding.

Recommendation 4

- 3.43 **The Committee recommends that the Australian Greenhouse Office provide to the Committee a copy of the guidelines for administration of the new greenhouse abatement programs announced in the Energy White Paper and the 2004-05 Federal Budget; and an outline of how the new guidelines meet the ANAO's recommendations regarding assessment and selection procedures for project funding.**

22 AGO, Submission no. 5.1, p. 3.

23 AGO, Submission no. 5.1, p. 2.

Management and monitoring of agreements

3.44 The ANAO found that, in general, the agreements between the AGO and program participants were well designed and appropriate for the specific design of each program. However the ANAO noted a number of specific examples where agreements could be strengthened. These included:

- the need to recognise foreign exchange risks in agreements to enable increase or decrease of grants according to currency variations;²⁴
- lengthy negotiations over funding agreements. The circumstances in which the project won funding approval (for example, market conditions) may change over a long period. The ANAO considered that one option was to set a deadline for negotiations to be completed with particular applicants, after which time funds would be reallocated to future funding rounds or alternative projects;²⁵ and
- strengthening the link between milestone payments and program outputs. In a \$1.75 million AFPC project involving a bus company purchasing new Compressed Natural Gas (CNG) buses to replace a diesel fleet, payments were made against milestones which did not ultimately provide a greenhouse benefit, although they did result in improvements to air quality. The ANAO considered that in future, the AGO should withhold a portion of the grant funds, to be released at the end of the project when testing proves that greenhouse gas abatement has occurred as a result of the project.²⁶

3.45 The Committee believes the ANAO's points are important to ensure the effective administration of project funds and that taxpayers are receiving maximum value for money. Accordingly, the Committee makes the following recommendation:

24 ANAO Audit Report no. 34, 2003-04, p. 60.

25 ANAO Audit Report no. 34, 2003-04, p. 61.

26 ANAO Audit Report no. 34, 2003-04, p. 65.

Recommendation 5

- 3.46 **The Committee recommends that the Australian Greenhouse Office include the following elements in all future agreements for project funding:**
- **recognition of foreign exchange risks to enable increase or decrease of project grants according to currency variations (if projects involve components sourced from overseas);**
 - **setting a time limit for completion of funding negotiations; and**
 - **a requirement that milestone payments are directly linked to a demonstrable greenhouse benefit, to ensure program objectives are being met. This may include withholding a portion of funds, to be paid on completion of the project when testing proves the project has delivered a greenhouse gas abatement.**
- 3.47 The ANAO analysed the performance monitoring of each AGO program included in its audit. The ANAO found that ‘performance monitoring to date has been thorough and given the necessary priority. It is too early to tell if programs such as GGAP, RECP, REEF will achieve their objectives in the longer term.’²⁷

Performance reporting

- 3.48 The ANAO found that there was room for improvement in the AGO’s annual reporting. The AGO’s annual reports were largely focused on inputs and activities, rather than reporting against targets for programs and reporting of trends and changes over time. For example, the AFCP had a target of 800 buses and 4,000 commercial trucks to be converted to CNG or LPG gas in each of the four years of the program. The AGO’s 2002-03 annual report stated that 568 buses had converted or been purchased, and that this represented a 150 per cent increase since the program’s inception. However, the AGO did not report against the original target of 800, which ANAO felt ‘could give the reader a misleading impression about the achievements of the program’. The actual

27 ANAO Audit Report no. 34, 2003-04, p. 78.

performance on the number of trucks converted (or purchased) is not reported.²⁸

- 3.49 The ANAO also found that the AGO's annual reports had a lack of year-by-year comparisons on performance. The ANAO felt these comparisons were particularly important given the long lead times involved in achieving results of between three and 13 years.
- 3.50 The ANAO noted that the suite of programs managed by the AGO have a target of abating 67 Mt of CO₂ each year. The ANAO would like the AGO's annual report to include a progress report towards the target from all the programs funded by AGO.
- 3.51 The AGO agreed with the ANAO's recommendation to enhance public reporting, and told the Committee that its 2003-04 annual report included the following improvements:
- a profile of the Government's climate change measures, with expected abatement;
 - a summary table showing results against performance measures for each output;
 - case studies to highlight the practical application of government program funds (including an analysis of a program which did not meet expectations); and
 - more contact and analysis of the climate change issues, government policy/program response, and challenges facing the organisation.²⁹
- 3.52 At the hearing, the AGO also told the Committee that it had improved its performance reporting via new performance standards in the 2004-05 Portfolio Budget Statements (PBS), which will be reported against in the 2005-06 Department of Environment and Heritage annual report. For example, the AGO's OutPut Group 2 - Emissions Management, includes the Renewable Remote Power Generation Programme, Photovoltaic Rebate Programme, Renewable Energy Commercialisation Programme, Greenhouse Gas Abatement Programme and others which were not reviewed by the ANAO's audit. These programs will now be subject to performance reporting against criteria such as those outlined in the table below.

28 ANAO Audit Report no. 34, 2003-04, p. 81.

29 AGO, Submission no. 5.1, p. 3.

Table 3.3 Australian Greenhouse Office Portfolio Budget Statement 2004-05 – Emissions Management

AGO Output Group 1.2 – Emissions Management

Objective: To lead action on Australia's commitment to the 108% target and a lower greenhouse signature in the longer term

QUALITY	<ul style="list-style-type: none"> Reporting systems are appropriately targeted and high quality Implementation of consistent measurement of abatement across programmes Risks to programme delivery identified and managed Effectiveness of support for greenhouse response within sectors Measurable behaviour change within sectors Effectiveness in relevant interjurisdictional processes on issues for which the AGO has lead responsibility Effectiveness of financial administration
QUANTITY	<ul style="list-style-type: none"> Reported abatement activity including emissions reductions and/or energy savings Estimated cost (Government funds) of greenhouse abatement (\$ per tonne) Investment dollars (or contributory funding) leveraged from other parties by projects and programmes Extent of engagement of key stakeholders Extent of support for long-term low emission technology uptake.

Source Australian Greenhouse Office, Portfolio Budget Statement 2004-05, pp. 188 – 189.

3.53 The Committee looks forward to more detailed performance reporting from the AGO in the 2005-06 Annual Report from DEH.

Audit Report No. 36, 2003-2004

The Commonwealth's Administration of the Dairy Industry Adjustment Package

Introduction

Background

- 4.1 The Australian dairy industry was deregulated by all States and Territories on 1 July 2000. This removed price guarantees and restrictions on inter-state sales of drinking milk. In response to requests from the industry, the Commonwealth established the Dairy Industry Adjustment Package (the Package), to assist dairy farmers to make the transition to a deregulated environment.
- 4.2 The Department of Agriculture, Fisheries and Forestry (DAFF) was responsible for advising the Government on the establishment of the Package.
- 4.3 There were two major elements to the Package, established by the *Dairy Industry Adjustment Act 2000*. The first was the Dairy Structural Adjustment Program (DSAP), introduced in May 2000. This provided \$1.63 billion in payments to dairy farmers. The second was the Supplementary Dairy Assistance Program (SDA), introduced in September 2001. This provided \$120 million in payments to dairy farmers.

- 4.4 The Package is funded by a levy of 11 cents per litre on retail sales of milk.
- 4.5 DSAP and SDA are delivered by a new Commonwealth agency, the Dairy Adjustment Authority (DAA). The DAA was established in April 2000. The Australian Dairy Corporation (ADC) provided support to the DAA in making payments. The ADC also undertook development work for the Package prior to the DAA's establishment, at the request of DAFF.
- 4.6 DAA's administrative responsibilities will continue until the last of the Dairy Structural Adjustment Program and Supplementary Dairy Assistance payments are made in 2008.¹
- 4.7 The ADC was initially responsible for the Dairy Structural Adjustment Fund, from which payments were made to farmers. The ADC was privatised on 1 July 2003, and became Dairy Australia Limited (DA).² DA continues to discharge the functions previously undertaken by the ADC, through contractual arrangements with DAFF.

The audit

- 4.8 The objective of the audit undertaken by the ANAO was to assess the Commonwealth's administration of the Dairy Structural Adjustment Program (DSAP) and the Supplementary Dairy Assistance Program (SDA). To this end, the audit addressed:
- planning for implementation of the programs;
 - governance arrangements in the DAA;
 - implementation and delivery of DSAP and SDA; and
 - management of the Dairy Structural Adjustment Fund.

Audit findings

- 4.9 The ANAO findings concluded that the Dairy Industry Adjustment Package was implemented consistent with Government policy. The ANAO commented that the delivery of the Package by the Commonwealth agencies involved was a considerable achievement. It was a substantial task, with a short timeframe for implementation, and was subject to a number of unanticipated challenges.

1 Dairy Adjustment Authority, *Annual Report 2003-2004*, p. 1.

2 Dairy Australia (DA) is a public company limited by guarantee. DA operates within rules and laws set by its Constitution, the *Corporations Act 2001* (Cth) and a Statutory Funding Deed with the Australian Government. DA has a Board of nine Directors.

- 4.10 However, the ANAO report did find that the nature, scale and obstacles to timely and effective implementation were underestimated in planning for the Package. This had an adverse impact on the timeliness of program payments, and on administrative costs.
- 4.11 In terms of governance arrangements, the DAA developed an appropriate business plan, financial management charter, strategic plan and chief executive instructions. However, the arrangements for the audit committee weakened the assurance framework, as they lacked the demonstrable independence necessary for such committees.
- 4.12 The DAA effectively identified, and communicated with, farmers potentially eligible for payments. Program payments were calculated accurately. However, delays in processing of DSAP claims, and higher than expected costs, reflected the implementation planning difficulties that became apparent for DAA.

ANAO recommendations

- 4.13 The ANAO made three recommendations, all of which were agreed to by DAFF.

Table 4.1 ANAO recommendations, Audit Report no. 36, 2003-04

1. The ANAO recommends that the Department of Agriculture, Fisheries and Forestry's planning for future major new initiatives include better identification and analysis of the risks, costs and challenges of implementation, to enable greater assurance of timely and cost effective program delivery.
 2. The ANAO recommends that the Department of Agriculture, Fisheries and Forestry seek to amend its contract with Dairy Australia to enable the department to require performance measures from all agencies able to draw administrative moneys from the Fund. This would assist the department to justify the value for money of the costs of administering the Package for greater accountability for performance.
 3. The ANAO recommends that the Department of Agriculture, Fisheries and Forestry reconsider amending its contract with Dairy Australia to add standard clauses providing for ANAO access to premises, records, information and assets associated with Dairy Australia's responsibilities under the Dairy Industry Adjustment Package.
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The Committee's review

- 4.14 The Committee held a public hearing in Canberra on 14 February 2005 to review the progress made against the audit's recommendations. Witnesses from the following agencies attended the public hearing:
- Australian National Audit Office (ANAO);

- Department of Agriculture, Fisheries and Forestry (DAFF);
 - Dairy Adjustment Authority (DAA); and
 - Dairy Australia Limited (DA).
- 4.15 At the public hearing the main issues addressed by the Committee included: planning and implementation of the Dairy Industry Adjustment Package; the delivery of the program; governance issues; and management issues including performance reporting. The Committee also discussed the progress that had been made on the implementation of the recommendations from the audit report.

Planning and implementation

- 4.16 The Dairy Structural Adjustment Program (DSAP) was introduced in May 2000. Prior to that, initial policy developments had been carried out by the DAFF in mid-1999 and had focussed on assisting the government to address the dairy industry's request for assistance. This resulted in the development of options for Ministers that had the support of relevant stakeholders, particularly those in the industry.
- 4.17 The ANAO findings revealed that DAFF did not develop a detailed implementation plan nor did it identify key implementation risks for the assistance package. After the basic framework had been agreed by Ministers, DAFF developed legislative proposals and refined its risk and task plans, which focussed on the need for stakeholder management and the development of appropriate legislation.
- 4.18 These plans did not systematically address the challenges and obstacles for effective implementation of the assistance Package. For example, the planning did not set out in any depth the full range of necessary tasks, how these were to be implemented, potential obstacles, nor how these obstacles might be overcome.³
- 4.19 During the public hearing, the Chairman of the DAA reinforced the ANAO's viewpoint in relation to poor planning. He stated:

Certainly, the need for more comprehensive planning that came out of the ANAO report is absolutely vital for this type of thing,

3 ANAO Audit Report no. 36 2003-04, *The Commonwealth's Administration of the Dairy Industry Adjustment Package (Department of Agriculture, Fisheries and Forestry – Australia and Dairy Adjustment Authority)*, Commonwealth of Australia, March 2004, p. 12.

and to identify potential obstacles, because we had a lot of obstacles to overcome to make this thing work.⁴

- 4.20 DAFF considered these matters to be the responsibility of the ADC and DAA. However, the DAA was not formally established until 3 April 2000, only six weeks before application forms needed to be sent to farmers.
- 4.21 At the public hearing DAFF defended its actions by stating that 'there was no real indication that deregulation would actually take place from 1 July 2000 until the state governments agreed to do so at a meeting in March 2000.' Therefore DAFF considered that 'there really was not that much time available to us'.⁵
- 4.22 However DAFF also told the Committee that it accepted the findings of the ANAO report in terms of 'ensuring that we have better planning processes in place so we are able to implement such programs more effectively.'⁶
- 4.23 The Committee was informed that the ADC was expected to provide much of the preparatory work and delivery infrastructure for the Package. However, DAFF did not negotiate a formal agreement with the ADC for the detail of preparatory work to be conducted, nor its cost. Neither did DAFF explicitly identify those tasks that the ADC could not perform, and how these might be performed without unduly hampering the implementation or timing of the Package.⁷
- 4.24 One of the first tasks of the DAA was to complete an information pack and claim form for the program. This was given limited piloting with farmers, because there was insufficient time. ANAO considered that:
- ...earlier and greater emphasis on user friendliness and usability of the form would have assisted in identifying obstacles to timely implementation.⁸
- 4.25 As a result, only 14 per cent of claims could be processed without further investigation because of errors in data entered on the form, or because farmer data did not match that held by DAA. These errors reflected the difficulties farmers had in understanding the form. Between one-third and one-half of the 96 DAA staff were engaged in investigating and resolving these issues. As a result, claims processing also took longer than expected.

4 Dairy Adjustment Authority (DAA), *Transcript of Evidence*, 14 February 2005, p. 18.

5 Department of Agriculture, Fisheries and Forestry Australia (DAFF), *Transcript of Evidence*, 14 February 2005, p. 20.

6 DAFF, *Transcript of Evidence*, 14 February 2005, p. 20.

7 ANAO Audit Report no. 36 2003-04, pp. 12-13.

8 ANAO Audit Report no. 36 2003-04, p. 15.

4.26 The Committee was concerned with the lack of 'road testing' of the application form with farmers. During the public hearing, the Committee was informed that the ADC together with the Dairy Industry Council had put the DSAP application form together and road-tested it before it was passed on to the DAA.⁹ DAA's current Chairman, Mr Patrick Musgrave, told the Committee that the initial DAA Chairman working on the DSAP application form was a lawyer, who changed the document significantly due to potential legal problems. At the public hearing the DAA conceded that:

...the application form became a bit more unwieldy than the one we inherited, and that, I have to accept, was not sufficiently road-tested, because there wasn't time. We had a deadline; we had to get the application form out. But I do not think anybody foresaw that there would be quite so many errors and omissions, and that we would need to get so much information.¹⁰

4.27 Furthermore, the initial Chair of the DAA resigned in late May 2000, stating that:

Whilst it might have been envisaged that the DAA board was to have operated essentially as an overseeing organ of a fully equipped management team, the actual circumstances has made it necessary that the board members undertake executive functions of the most pressing kind.¹¹

4.28 The Committee asked whether it would have been possible to use an existing proforma application form. The DAA responded that:

...there was no precedent. This is quite a new scheme and it is a new operation. The questions we had to ask were not the usual questions you would have to ask – about milk supplies; did you have a shed on your property that you were milking from; the number of partners you have in your enterprise – there was no pre-existing form out there for that. However, we did follow the principles of how you would lay out a form – there was just an awful amount of specific information we actually required to get someone across the line.¹²

9 DAA, *Transcript of Evidence*, 14 February 2005, p. 24.

10 DAA, *Transcript of Evidence*, 14 February 2005, p. 20.

11 ANAO Audit Report no. 36 2003-04, p. 13.

12 DAA, *Transcript of Evidence*, 14 February 2005, p. 24.

Administration costs

- 4.29 The Committee expressed concerns about the significant increases in administration costs for the Package. The expected cost of implementation grew substantially as the DAA determined how it would implement the Package. An initial budget estimate for 2000-01 of some \$3 million, supplied by DAFF to the DAA, was revised upwards several times. The DAA's final budget for 2000-01 was \$13 million; staff numbers peaked at around 100 in the same year. An additional \$2 million was incurred by the other agencies for that year.¹³
- 4.30 The DAA noted in its submission to the Committee that the 'ANAO findings ...serve to illustrate the enhancements in administrative efficiency that should follow from allowing a greater time period to implement a structural adjustment program.'¹⁴
- 4.31 DAFF agreed with ANAO's first recommendation, regarding better planning for future new initiatives, and stated that for future major new initiatives it would seek to better identify and analyse the risks, costs and challenges of implementation, to enable more timely and cost effective program delivery. DAFF also informed the Committee that it now has a robust risk management framework which is linked to planning and reporting at the corporate, business and project level.¹⁵
- 4.32 In addition to DAFF's new procedures in place in response to recommendation one, DAFF told the Committee that:
- Following the establishment of a Cabinet Implementation Unit (CIU) in the Department of Prime Minister and Cabinet, the Department is now incorporating implementation issues into the Cabinet and Budget submission process. The new framework for Cabinet and Budget submissions ensures early consideration of implementation issues and provides a framework for reconciling expectations. Furthermore, the Department's quarterly reporting procedures ensure the Secretary is aware of progress on implementation of policy initiatives.¹⁶
- 4.33 DAFF has also recently released guidelines for policy and program development and implementation to improve timeliness and responsiveness of policy initiatives, with feedback and case studies to be reported in 2004-05. The guidelines include better practice principles
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13 ANAO Audit Report no. 36 2003-04, p. 13.

14 DAA, Submission no. 2, p. 1.

15 DAFF, Submission no. 4, p. 2.

16 DAFF, Submission no. 4, p. 2.

across a range of policy activities related to planning and implementation, including resourcing and capability.¹⁷

SDA payments

- 4.34 DAA undertook a rigorous and resource intensive approach to assessing claims for SDA discretionary payments. However the ANAO concluded that a more risk-based process would have directed resources proportionately to higher risk claims.
- 4.35 The arrangements for achieving value for money for expenses incurred in administering the Package, while consistent with the legislation, provided less oversight and accountability overall than was the case in some other programs. The ANAO concluded that 'better reporting to Parliament and DAFF on these expenses would strengthen accountability and related assurance, in this case.'¹⁸

Committee comment

- 4.36 It is clear that both DAFF and DAA have had to learn some major lessons in relation to project planning and implementation as a result of managing the Dairy Industry Adjustment Package. The Committee considers it important that in future, both entities will be able to demonstrate to Parliament a more efficient and effective program delivery.
- 4.37 The Committee agreed with the ANAO's conclusion that DAFF underestimated the nature and scale of the delivery task. However, the Committee was pleased to note that DAFF has several new initiatives that it believes, in future, will assist in improving the Department's project analysis, risk assessment and cost, prior to its implementation of a new project.
- 4.38 The Committee strongly supports the principle of quarterly reporting to the Secretary of DAFF to ensure that progress of new policy initiatives is transparent and timely. The Committee also believes that the guidelines published by the department which outline better practice for new program and policy development, especially in relation to planning and implementation, will be of great value.

17 DAFF, Submission no. 4, p. 2.

18 ANAO Audit Report no. 36 2003-04, p. 19.

Management issues

- 4.39 The Dairy Structural Adjustment Fund was administered consistent with the legislation. The ANAO reported that 'cash flows have been managed to ensure the Fund remains solvent and is able to meet claims for payment.'¹⁹
- 4.40 The Committee was concerned, however, about the arrangements in place to achieve value for money for expenses incurred in administering the Package. The Committee learned that while the Dairy Structural Adjustment Fund was vested within Dairy Australia, it did not have the authority to refuse to pay invoices on the grounds that they did not represent value for money.
- 4.41 The ANAO informed the Committee that 'As long as the claimant is one of the eligible agencies, and the expenditure is consistent with the Act, Dairy Australia must pay the claim. There is no overall budget limit or cap for costs of administration.'²⁰
- 4.42 The DAA was acutely aware of the legislation which stated that payments made in error could not be claimed back. Hence this attributed to the DAA being overcautious which resulted in less than efficient management of the program. During the public hearing the DAA informed the Committee that
- ...the whole of the DSAP scheme entailed that if the DAA made a mistake when it made a payment, it could not claim the money back. So we could not claim our money back if the DAA made an error. That was enshrined in the Act...²¹
- 4.43 The risk to be managed in these circumstances is that agencies may make decisions that are more risk averse and less cost effective than might be the case if there were more typical budgetary controls on the costs of administering the Program.

Committee comment

- 4.44 The Committee strongly supports the notion of providing value for money when administering Commonwealth programs.
- 4.45 The Committee agrees with the ANAO that better reporting to Parliament and DAFF on these expenses would assist in strengthening accountability
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19 ANAO Audit Report no. 36 2003-04, p. 19.

20 ANAO Audit Report no. 36 2003-04, p. 18.

21 DAA, *Transcript of Evidence*, 14 February 2005, p. 21.

and related assurances about the management of the program. The Committee was pleased to note that the DAA reported on its expenditure of \$2.3 million in operational costs in its Annual Report for 2003-2004.

Supplementary Dairy Assistance (SDA) Package

- 4.46 The Supplementary Dairy Assistance (SDA) included two types of supplementary assistance for dairy farmers. The largest of these, Market Milk Payments, was targeted at those in the dairy industry who were most severely affected by movements in the price of market milk following deregulation. It provided payments in addition to those already granted under DSAP.
- 4.47 The DAA was able to administer Market Milk Payments using information already collected for DSAP. This enabled it to identify farmers who might be eligible for the payments, and to calculate their likely payment. The ANAO found that the DAA did this accurately and promptly. The DAA despatched virtually all notices of decision within three months of the announcement of the package, meeting its target. Some \$100 million in payments will be made to 7735 farmers.
- 4.48 In contrast, administration of the second type of payment was complex. These Discretionary Payments were targeted at those farmers whose entitlement for DSAP was unintentionally limited. Eligibility for the Discretionary Payments was based on farmers having experienced a significant event, crisis, or other anomalous circumstances that adversely affected DSAP entitlement.
- 4.49 The DAA met its target that 90 per cent of potentially eligible entities would be identified within three months of commencement of the SDA. However, the process was resource intensive. For example, all applications were reviewed by DAA internal audit and its legal review team. All DAA Members participated in decision-making for an application.
- 4.50 The DAA advised that it adopted this approach as it had limited ability to recover payments that it had made in error, and to ensure consistency of decision-making. However, the ANAO noted that a more risk-based process would have focussed for example on internal audit involvement and legal review for those claims assessed as higher risk.

4.51 In total, 1361 farmers applied for a Discretionary Payment, of whom 641 were granted a payment, at an average amount of \$27 900.²²

Value of payments made in error

4.52 The Committee was concerned about the value of payments that were made in error as part of the Dairy Industry Adjustment Package. At the public hearing the DAA advised the Committee that the total 'overall payout entitlements is \$1.63 billion...'²³

4.53 In its submission the DAA informed the Committee that the total value of the combined DSAP and SDA overpayment was \$242 625 making the average overpayment \$12 131. The figure of \$242 625 equates to 0.01% of all payment rights granted.²⁴

4.54 The highest overpayment made was to a total of \$38 327 through the DSAP scheme, as a result of incorrect application of eligibility criteria.²⁵

4.55 The table below was submitted to the Committee by the DAA and details the total number of overpayments.

Table 4.2 Overpayments made to farmers by the DSAP and SDA schemes

ENTITIES	AMOUNT OVERPAID	COMMENT
<i>DSAP Scheme – Section 36</i>		
1	\$3,254	Incorrect treatment of sharefarmer ECC
2	\$3,254	Incorrect treatment of sharefarmer ECC
3	\$1,026	Incorrect treatment of annualised lease
4	\$24,321	Incorrect treatment of ownership of partners
5	\$9,997	Incorrect treatment of lessee ECC
6	\$9,997	Incorrect treatment of lessee ECC
7	\$15,504	Incorrect treatment of quota lease
8	\$15,504	Incorrect treatment of quota lease
9	\$17,868	Incorrect treatment of Section 29 adjustment
10	\$17,868	Incorrect treatment of Section 29 adjustment
11	\$17,868	Incorrect treatment of Section 29 adjustment
12	\$38,327	Incorrect application of eligibility criteria
13	\$3,263	Incorrect application of eligibility criteria

22 ANAO Audit Report no. 36 2003-04, pp. 16-17.

23 DAA, *Transcript of Evidence*, 14 February 2005, p. 22.

24 DAA, Submission 2.1, p. 1.

25 DAA, Submission 2.1, p. 1.

14	\$3,022	Incorrect treatment of sharefarmer ECC
	\$181,074	Sub total
<i>SDA scheme – section 22</i>		
1	\$17,269	Incorrect MMP flowing from incorrect DSAP Section 29 adjustment
2	\$17,269	Incorrect MMP flowing from incorrect DSAP Section 29 adjustment
3	\$17,269	Incorrect MMP flowing from incorrect DSAP Section 29 adjustment
4	\$3,249	Incorrect treatment of DSAP milk calculations
5	\$3,248	Incorrect treatment of DSAP milk calculations
6	\$3,248	Incorrect treatment of DSAP milk calculations
	\$61,551	Sub total
20	\$242,625	Total entities & \$value of DSAP & SDA overpayments

ECC = Essential Capital Contribution. MMP = Market Milk Payment Right

Source Dairy Adjustment Authority, Submission no. 2.1, p. 1.

What were the payments used for?

- 4.56 During the public hearing the Committee was interested to find out how the money from the adjustment package had been spent by farmers. An article in the *Weekend Australian* newspaper suggested that the grants had been used as income 'instead of making their operations more efficient.'²⁶
- 4.57 When the Committee questioned the DAA whether this point was valid the DAA responded:

Farmers made decisions to take the money in one lot rather than over quarterly instalments over eight years. It does not draw any conclusions as to what they were actually using that money for. There are a range of appropriate decisions that farmers would make in order to assist with the adjustment process.²⁷

²⁶ McKinnon, Michael, "Dairy farm grants used as income", *The Weekend Australian*, 13 February 2005.

²⁷ DAA, *Transcript of Evidence*, 14 February 2005, p. 30.

- 4.58 In addition, the Committee was told that '...the criteria of the program did not actually tell farmers what they had to spend money on. Nor did it say that you, a farmer, were better off paying off your debt, buying more cows, buying more land or upgrading your factory or processing.'²⁸
- 4.59 DAA advised the Committee that the criteria set out for the farmers in terms of using the payments was very broad:

The money was spent by farmers to meet the criteria in broad terms. As was set out, that was related to the amount of milk they produced and the impact of the changes to the state based arrangement. That was the criteria.²⁹

Committee comment

- 4.60 The Committee recommends that future assistance packages should not have a legislative clause which prevents agencies from claiming back payments made in error.
- 4.61 In addition, the Committee recommends that DAFF should place an overall budget limit on the cost of administration when implementing assistance packages. The Committee believes this would force the agency or authority to be more responsible for managing the program more efficiently.

Recommendation 6

- 4.62 **The Committee recommends that the Department of Agriculture, Fisheries and Forestry ensure that future assistance packages have a clause in relevant legislation which allows for incorrect payments made in error to be reclaimed by the appropriate agency or authority.**

Recommendation 7

- 4.63 **The Committee recommends that the Government place an overall budget limit on the cost of implementing new assistance packages to encourage administrative cost efficiencies and effectiveness.**

28 DAA, *Transcript of Evidence*, 14 February 2005, p. 30.

29 DAA, *Transcript of Evidence*, 14 February 2005, p. 31.

Data matching and checking for fraudulent claims

- 4.64 During the public hearing the Committee questioned the witnesses in relation to fraudulent claims. The Committee asked DAA whether there had been any detection of fraudulent claims during the administration of the Package.
- 4.65 The DAA informed the Committee that:
- ...there has been no fraud perpetrated... it is my responsibility to report to the board any fraud matters, and I report that we have not had any fraud matters.³⁰
- 4.66 The Committee further pursued this point asking whether DAA was aware of any potential fraud. The DAA commented:
- Yes, we had a couple of queries brought to us that some people were indicating might look like fraud. We investigated those cases and concluded that there was no fraud or error whatsoever. For example, it might be one farmer reporting on another farmer saying, 'Why did this farmer get a payment? I do not believe they ought, in those circumstances' and we would check that application and file and follow through, and they all turned out to be okay.³¹
- 4.67 In addition, the DAA informed the Committee that:
- both schemes had very strong powers to cancel where there was a false statement made to the authority. The statement did not have to be intentional – just when incorrect information was provided by the applicant, there were powers to cancel. So in terms of the ability to recover moneys in the case of fraud, a deliberate misstatement, the powers are very strong.³²
- 4.68 The DAA provided the Committee with evidence stating that a total of 205 cancellation decisions were undertaken.³³ The Committee asked DAA how accurate its data checking processes were to check that claims were accurate. DAA responded that:
- There is an enormous amount of data across the whole spectrum. The key piece of the data is the milk production, and milk production is brought in from the companies to the Australian
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30 DAA, *Transcript of Evidence*, 14 February 2005, p. 24.

31 DAA, *Transcript of Evidence*, 14 February 2005, pp. 24-25.

32 DAA, *Transcript of Evidence*, 14 February 2005, p. 25.

33 DAA, Submission 2.1, p. 2.

Dairy Corporation who prepared a database of milk. That was then passed on to us as the authority, and that was a key piece of the production—

...No entity got out of the system unless they matched with the milk database, and that was a great control process we had. The board also had the auditors audit that milk production.³⁴

Committee comment

- 4.69 The Committee was pleased to hear that DAA had strong measures in place in order to prevent fraudulent claims. The Committee was satisfied that both schemes' powers to cancel claims at any time were effective in preventing fraudulent behaviour.

Governance issues

- 4.70 Audit committees have an important role in scrutinising agency operations, and providing independent assurance to agency management about the overall control environment in the agency. In July 2000, DAA approved an audit strategy, including an audit charter, and established an audit committee. The ANAO found that the arrangements for the audit committee did not sufficiently support its intended independent role. The audit committee's membership comprised all DAA members and it was chaired by the Chair of the DAA. It did not have an external independent member.
- 4.71 The role of the audit committee was also different to that usually assigned to audit committees in public sector governance arrangements. For example, the committee had oversight of quality assurance in DAA, made some operational decisions, and guided and monitored the implementation of key systems. These functions are not usually the responsibility of an independent audit committee.
- 4.72 The DAA acknowledged that the audit committee arrangements were not better practice. However, it advised that alternative arrangements, whereby the audit committee included members from outside the DAA, would have necessitated time consuming communication to the other DAA members and would not have been efficient given the short timeframe to implement the Package.

34 DAA, *Transcript of Evidence*, 14 February 2005, p. 25.

- 4.73 During the public hearing the Chairman of DAA defended the actions of the audit committee, commenting that:

Instead of being a situation where a board is completely independent of management and the management reports to the board, I had no alternative but to assign different board members different executive responsibilities to make sure that we could do things within the time frame. So you did not have a situation of management doing things, reporting to a board; there was no time to do that, so the members had to take on individual responsibilities, which is not the best in terms of governance, but when you have a job to do, you have to do it.³⁵

I decided that we would have an audit committee and it would meet concurrently with the board. We had board meetings once every week, sometimes twice a week. So, instead of an audit committee which was meeting four times a year, this was going to be an audit committee which would have to meet every time the board met.³⁶

- 4.74 The DAA submission commented that the ANAO findings and observations in relation to governance issues have lead to improvements in the '...role and composition of the Authority's audit committee...'³⁷

Committee comment

- 4.75 The Committee was concerned that DAA's audit committee did not follow better practice principles, which stress the importance of audit committees providing independent advice, and being seen to do so. The audit committee also made some operational decisions, which reflected its membership composition but not better practice to assist with sound governance.
- 4.76 The Committee strongly advocates the importance of demonstrating good governance practices. The Committee believes that all government entities should adhere to the *Better Practice Guides on Corporate Governance and Audit Committees* published by the ANAO.³⁸ The Committee agrees with the ANAO findings that the challenges facing the DAA did not prevent it

35 DAA, *Transcript of Evidence*, 14 February 2005, pp. 20-21.

36 DAA, *Transcript of Evidence*, 14 February 2005, p. 26.

37 DAA, Submission no. 2, p. 1.

38 ANAO, *Better Practice Guides (Governance and Accountability)*, available at: <http://www.anao.gov.au/WebSite.nsf/ViewPubs!ReadForm&View=BetterPracticeGuidesByTheme&Title=Better+Practice+Guides+by+Theme&Cat=Accountability+and+governance&Start=1&Count=10>; accessed August 2005.

from following better practice principles more closely. The DAA audit committee should have included an independent member. It may also have been appropriate for a person other than the Chairman of the DAA Board, to chair the audit committee.

- 4.77 The Committee is pleased to note that DAA has made improvements to the role and composition of its audit committee.

Performance measures and reporting

- 4.78 The Committee was concerned about the lack of transparency of funding arrangements for Australian Government agencies able to draw administrative costs from the Dairy Structural Adjustment Fund. In relation to this the ANAO recommended that DAFF seek to amend its contract with Dairy Australia to enable the department to require performance measures from all agencies able to draw administrative moneys from the fund (recommendation 2).

- 4.79 During the public hearing the Committee asked DAFF about the status of implementation for this recommendation. DAFF responded that:

...the department has taken legal advice and has consulted with ANAO in order to determine the most appropriate course of action to implement this recommendation. Whilst the recommendation refers only to amending the statutory funding agreement between the Commonwealth and Dairy Australia, the department has determined it necessary to also amend its program protocol with Centrelink, which administers other parts of the program, and to establish a memorandum of understanding with the Dairy Adjustment Authority.³⁹

- 4.80 Taking into account this legal structure, the Department is currently working with Dairy Australia to amend the Statutory Funding Agreement (SFA), and with other agencies (Centrelink and the Dairy Adjustment Authority) to develop appropriate protocols for the reporting of claims on the Fund against agreed performance benchmarks.

- 4.81 At the hearing [February 2005], DAFF told the Committee that 'The department expects that all matters in regard to implementing the recommendations will be resolved within the next month.'⁴⁰

39 DAFF, *Transcript of Evidence*, 14 February 2005, p. 19.

40 DAFF, *Transcript of Evidence*, 14 February 2005, p. 19.

- 4.82 DAFF, as the identified lead agency in the ANAO report, is responsible for developing the performance benchmarks, along with assessing financial outcomes against these benchmarks. It is envisaged that both these benchmarks and performance outcomes, along with a description and explanation of any variances, will be reported in the Dairy Australia Annual Report which is required under the Act to be tabled in Federal Parliament.⁴¹
- 4.83 It is also important to note that DAFF, in implementing this approach, is seeking to establish clear lines of accountability for reporting and performance assessment. Specifically, DAFF is seeking to establish appropriate benchmarks, and will require reports to be provided by Dairy Australia to the department on administrative claims made on the Fund, in order for the department to objectively assess performance outcomes on an aggregate and individual agency/company basis. It is envisaged that these reports will be provided quarterly for internal monitoring purposes and the results published annually as indicated.⁴²
- 4.84 DAA has liaised with DAFF and the industry services body – Dairy Australia Limited – regarding the implementation of Recommendation 2. Recommendation 2 stated that DAFF amend its contract with Dairy Australia to enable the department to require performance measures from all agencies able to draw administrative moneys from the Fund. DAA supports DAFF in taking steps to require performance measures of the DAA and other agencies able to draw administrative monies from the Dairy Structural Adjustment Fund. DAA commented in its submission that it had exchanged information with the department regarding the development of performance measures.⁴³
- 4.85 In its submission, DA told the Committee that ‘DA and DAFF have had several discussions relating to changes to the Statutory Funding Agreement in order to report on performance measures from all agencies able to draw administrative moneys from the Fund.’⁴⁴
- 4.86 Additionally, the DAA informed the Committee that the ANAO findings and observations ‘have led to improvements ... in the formulation of and reporting against Key Performance Indicators.’⁴⁵

41 DAA, Submission no. 2, p. 2.

42 DAA, Submission no. 2, p. 2.

43 DAA, Submission no. 2, p. 1.

44 Dairy Australia (DA), Submission no. 3, p. 1.

45 DAA, Submission no. 2, p. 1.

Committee comment

- 4.87 The Committee is pleased with the action that DAFF has taken in relation to improving performance measures and reporting for itself and the relevant agencies able to draw administrative moneys from the Dairy Structural Adjustment Fund.

Evaluation of the Package

- 4.88 At the public hearing the Committee was interested to find out what, if any, evaluations had been carried out thus far, to assess the success of the Package.
- 4.89 DAFF informed the Committee that an independent evaluation of the Dairy Structural Adjustment Program and supplementary dairy assistance measures had been finalised in late December 2003. DAFF told the Committee that the evaluation looked at how efficiently the DAA made payments, generally what payments were being used for and how the industry appeared to be adjusting to deregulation, specifically referring to the DSAP and SDA payments. DAFF made the following comment in relation to the findings of this evaluation:

That evaluation found that the package has been highly successful so far in assisting farmers adjust to deregulation. However, the process of adjustment to deregulation is quite a long process, so we will have to continue to monitor how well the industry does adjust.⁴⁶

- 4.90 When pressed further about whether DAFF was aware of any positive indicators for the dairy industry, the department commented that 'There is data available to show that it is growing, that it is increasing its exports. It is going through an adjustment period which is entirely to be expected.'⁴⁷

Committee comment

- 4.91 The Committee is keen to follow the progress of the Package as payments continue to be made up until 2008. The Committee recommends that DAFF provide feedback to the Committee on further evaluations undertaken to monitor the success of both DSAP and SAP.

46 DAFF, *Transcript of Evidence*, 14 February 2005, p. 28.

47 DAFF, *Transcript of Evidence*, 14 February 2005, p. 29.

Recommendation 8

- 4.92 The Committee recommends that the Department of Agriculture, Fisheries and Forestry report back to the Committee on the progress and evaluation of the Dairy Structural Adjustment Package and the Supplementary Assistance Program by 30 June 2006. The report should outline progress against each program's original objectives and measurement indicators such as Key Performance Indicators. The report should also outline the Dairy Industry's progress in adjusting to the new economic environment, including exits from the industry.

ANAO access to premises

- 4.93 The Committee whole-heartedly endorses the *Commonwealth Procurement Guidelines* which state that all Commonwealth contracts must allow for ANAO access. At the public hearing the Committee was interested to find out why there was no contractual allowance for ANAO officers to access DA's premises and records.
- 4.94 DAFF noted in its submission to the Committee that 'Dairy Australia provided the ANAO with unlimited access during the course of its performance audit, along with all assistance required of it.'⁴⁸ Whilst the Committee commends DA for providing unlimited access to ANAO auditors during the course of the audit, the Committee was concerned that this access was not explicitly spelt out in the contract.
- 4.95 DAFF made the following comment at the public hearing:
- ...the statutory funding agreement is based on a long-term relationship with a body that undertakes marketing and R&D services on behalf of dairy farmers and on behalf of the government. Further, in relation to its management of the dairy structural adjustment fund, it is really an agent of the Commonwealth for that purpose. For that reason, we did not see that it related strictly to the procurement guidelines. It was not just a vague consultancy that a lot of government departments have with individual companies. So we actually examined that and thought it was different. However, the ANAO's recommendation

48 DAFF, Submission no. 4, p. 3.

is that, despite that, there should be a separate clause for the ANAO, and we accept that.⁴⁹

- 4.96 In relation to Recommendation 3, providing for ANAO access to premises and records, DAFF informed the Committee at the public hearing that 'the wording of this amendment has been agreed between the department and Dairy Australia, and will be finalised in conjunction with the other changes to the statutory funding agreement.'⁵⁰

Committee comment

- 4.97 The Committee is pleased that changes will be made to the Statutory Funding Agreement that DAFF has with DA, adding a clause in the contract allowing for ANAO access to DA's premises and records for auditing purposes. The Committee believes that ANAO access should be standard clause in such contracts.

Recommendation 9

- 4.98 **The Committee recommends that the Department of Agriculture, Fisheries and Forestry ensure that all future agreements with Statutory Authorities include a clause allowing the ANAO access to premises and records, for auditing purposes.**

49 DAFF, *Transcript of Evidence*, 14 February 2005, p. 24.

50 DAFF, *Transcript of Evidence*, 14 February 2005, p. 19.

Audit Report No. 46, 2003-2004

Client Service in the Family Court of Australia and the Federal Magistrates Court

Introduction

Background

- 5.1 For many couples undergoing a divorce, negotiating the complexity of Australia's Family Law environment is a daunting and emotional task. Divorce applications are handled by both the Family Court of Australia (FCoA) and the Federal Magistrates Court (FMC) where workloads are heavy, especially given the highly sensitive and emotive nature of cases. The Australian Bureau of Statistics (ABS) reported that in 2003, 53,100 divorces were granted nationally. This was the third-highest number in the last 20 years.¹

1 2001 had the highest number of divorces in 20 years (55,300), followed by 2002 (54,000). This represents a 22 per cent increase over the past 20 years. Australian Bureau of Statistics (2003) Feature Article: *Marriages and Divorces, Australia 2003*, available at <http://www.abs.gov.au/Ausstats/abs@.nsf/0/7F31BF47DCE50135CA256FCE000007E6?Open>, accessed June 2005.

- 5.2 The Family Court of Australia was established in 1976 and aims to resolve disputes as a result of family separation. The court is responsible for the administration of a number of pieces of legislation, including the *Family Law Act 1975* and the *Child Support (Assessment) Act 1989*.²
- 5.3 The Federal Magistrates Court was established by the *Federal Magistrates Act 1999* and heard its first cases in July 2000. The FMC's jurisdiction includes family law and child support, administrative law, bankruptcy, unlawful discrimination, consumer protection law, privacy law, migration and copyright. The court shares those jurisdictions with the Family Court of Australia and the Federal Court of Australia.
- 5.4 The objective of the Federal Magistrates Court is to provide a simpler and more accessible alternative to litigation in the superior courts and to relieve the workload of those courts. Over half of all migration matters and more than 40 per cent of family law children's and property applications are now completed in the FMC. Approximately 80 per cent of the court's workload is in the area of family law.³

The audit

- 5.5 The ANAO conducted an audit on the client service arrangements of both the FCoA and FMC in November 2003 and the report was tabled in Parliament in May 2004.
- 5.6 The audit concentrated on the effectiveness of the client service arrangements for their clients, the effectiveness of coordination between the courts, and the courts' administration of Primary Dispute Resolution (PDR) services.

Audit findings

- 5.7 The ANAO found that both courts were working towards implementing many promising initiatives to better serve their clients.
- 5.8 In relation to client service, the ANAO found that there were issues of inconsistency in service to some of the courts' clients, especially those

2 A full list of the legislation administered by the Family Court of Australia is available at its internet site:
<http://www.familycourt.gov.au/presence/connect/www/home/judgments/legislation/>; accessed August 2005.

3 Federal Magistrates' Court, internet site:
<http://www.fmc.gov.au/html/introduction.html>, accessed August 2005.

who are unable to attend a registry in person. Some of these concerns are being alleviated by way of building further partnerships with stakeholders and recognising and meeting challenges in relation to management of cases and cultural diversity. The ANAO also found that improvement could be made in the area of receiving feedback from clients to further improve service delivery.

- 5.9 The ANAO recognised that although the courts are separate, much of their work and service provision are similar owing to the sharing of jurisdiction within family law. The ANAO found that integration of core functions could help ease the administrative workload on both courts, while reducing the confusion felt by clients in relation to which court was being dealt with. The ANAO felt that initiatives which had proved successful at a local level should be implemented registry-wide.
- 5.10 The ANAO found inconsistencies with PDR services between the court registries and Community Based Organisations (CBOs) who administer them contractually. Lack of qualitative data was also found to hinder a complete evaluation of outsourced PDR services. PDR services should improve with new approaches to quality assurance yet to be implemented by the FCoA.

ANAO recommendations

- 5.11 The ANAO made eleven recommendations:

Table 5.1 ANAO recommendations, Audit Report no. 46, 2003-04.

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|----|---|
| 1. | <p>The ANAO recommends that, in order to improve the quality of service currently offered to clients, the FCoA and the FMC should actively seek to identify and better understand the needs of their various client groups, and implement a range of measures to address those needs.</p> <p>FCoA response: Agree. FMC response: Agree.</p> |
| 2. | <p>The ANAO recommends that, in order to improve complaints handling procedures, the FCoA should:</p> <ul style="list-style-type: none"> a) ensure that its complaints handling policy is implemented consistently across the registry network; b) collect information on the types of complaints received and their outcomes, analysing any trends, and regularly reporting on complaints activity to registry managers; and c) report on complaints activity to the FMC, where complaints raised and/or resolved within the registries involve FMC clients. <p>FCoA response: Agree. FMC response: Recommendation does not directly affect the FMC.</p> |
| 3. | <p>The ANAO recommends that the FCoA and the FMC enhance the effectiveness of</p> |

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- monitoring and reporting on client service, by: examining their business processes and case management models; developing data quality review systems and improved inter-court performance reporting on FCoA services to FMC clients; and regularly surveying clients on their satisfaction with court processes.
- FCoA response: Agree. FMC response: Agree.**
4. The ANAO recommends that, in order to continuously improve services offered to clients, the FCoA and FMC should have an integrated approach to:
- (a) remaining responsive to changes in technology by coordinating the development and implementation of electronic forms and filing technology, where appropriate;
 - (b) ensuring that the information offered to clients in the registries is relevant, up-to-date, and provides sufficient information regarding both courts to allow clients to make informed choices about their individual matters;
 - (c) developing and distributing information on the courtroom to those clients whose matters cannot be resolved, and providing regular courtroom familiarisation opportunities for these clients; and
 - (d) providing information to clients who have finished their business in the courts on the significance of the orders they have received, and their options for the future should they wish to seek further counselling, appeal, or if their circumstances change.
- FCoA response: Agree. FMC response: Agree in-principle.**
5. The ANAO recommends that both the FCoA and the FMC identify examples of better practice in coordination within court registries, and systematically apply these practices across all registries.
- FCoA response: Agree. FMC response: Agree in-principle.**
6. The ANAO recommends that, in order to facilitate planning and assess and monitor ongoing cost-effectiveness, the FCoA and the FMC jointly develop an agreed model for calculating the cost of providing services to their clients.
- FCoA response: Agree. FMC response: Agree.**
7. The ANAO recommends that, in order to better assist family law clients in making more informed filing decisions, the FCoA and the FMC jointly develop and publish family law information for clients.
- FCoA response: Agree. FMC response: Agree.**
8. The ANAO recommends that, in order to reduce confusion for clients and inefficiencies in court processes, the FCoA and the FMC investigate the possibilities for a common entry point into the family law system and the consequent distribution of workload to each court.
- FCoA response: Agree. FMC response: Agree in-principle.**
9. The ANAO recommends that, in order to facilitate ongoing assessment and evaluation of their PDR services, the FCoA and FMC regularly:
- a) obtain qualitative data on client satisfaction with their PDR services; and
 - b) evaluate this data in conjunction with quantitative data on settlement rates to identify better practice and areas for improvement.
- FCoA response: Agree. FMC response: Agree in-principle.**
10. The ANAO recommends that the FMC obtain performance information from CBOs, through regular monitoring and review activities, to provide itself and stakeholders alike with data on the quality of CBO PDR services, or to identify any deficiencies
-

in PDR services.

FCoA response: No response. FMC response: Disagree.

11. The ANAO recommends that the FCoA and FMC conduct evaluations of their PDR services on a regular basis, in order to provide information that will allow the courts to continuously assess and improve their PDR services.

FCoA response: Agree. FMC response: Agree.

The Committee's review

- 5.12 On 4 April 2005, the Committee held a public hearing to review the progress made against the recommendations that came from the ANAO's audit. The public hearing was attended by representatives of:

- Family Court of Australia (FCoA); and
- Federal Magistrates Court (FMC).

- 5.13 The Committee took evidence on the following issues:

- Integration of the courts' processes, publications, forms and fees;
- Court registries;
- Delays in processing, especially for rural and regional clients;
- Family Relationship Centres;
- MOU between the courts;
- Implementation and role of the FMC;
- Services to clients with special needs, such as children and self-represented litigants; and
- Primary Dispute Resolution.

Client service

- 5.14 The provision of effective client service is paramount to the needs of service-based organisations such as the FCoA and FMC. Therefore the Committee examined whether the courts were utilising their client service capabilities effectively and efficiently, taking into account recommendations made by the ANAO. The ANAO found that there

were areas in which both courts could improve their service, particularly to those clients for whom accessing the courts' services required specific assistance.

Current client service arrangements

- 5.15 The FCoA and FMC have numerous arrangements for the provision of information to their clients. Some of the initiatives include access to court registries around Australia and publishing useful information sheets which are made available to potential litigants. The FCoA advised that it had undertaken a Client Satisfaction Survey to gauge levels of satisfaction of processes from its clients.⁴
- 5.16 The Committee was informed by the courts on their progress in implementing new initiatives and enhancing existing arrangements for the provision of information to clients. The Committee was particularly interested in clients who require specific assistance, such as self-represented litigants and children.

Registries

- 5.17 One of the core elements of the courts' client service are the 19 court registries located around Australia. There are 11 in metropolitan areas and a further eight in regional and rural areas. The aim of the registries is to assist clients in filing matters which are to appear before the courts or be referred to mediation.
- 5.18 Although the registries are managed by the FCoA, in theory they are all able to accept filings for the FMC (under the auspices of a MoU between the two courts). The Committee was told that there are some FCoA registries at which matters pertaining to the FMC cannot be lodged. The FMC informed the Committee that the reason for this was:

...because we do not have enough federal magistrates to do the work. But that is changing over time. When we started off, our initial complement was about 12. We now have 31 federal magistrates, but on average only about 19 of those federal magistrates do family law; the balance do general federal law work – migration and things like that.... We do not currently have a capacity to do family law in the Sydney CBD. We do not have any federal magistrates appointed

4 Family Court of Australia (FCoA), *CEO's Report on the Court's Recent Activities*, Exhibit No. 5, p 5.

there. But that is a matter we have made representations to the government about, and I understand the government is actively considering those representations.⁵

- 5.19 Both courts have recently begun staff consultation in response to calls for a combined registry system. The Committee viewed an information kit for staff which outlines the proposed project and intended timeframe. The kit also contains several information sheets along with staff discussion topics and a feedback sheet.⁶

Single point of entry to the family law system

- 5.20 To ease the complication for litigants, the FCoA has begun to explore the notion of a single point of entry to the legal system which would be applicable to any court under Commonwealth jurisdiction, including state courts. Called the *Commonwealth Courts Portal*, it will help reduce the confusion felt by clients entering the system.⁷
- 5.21 While this initiative will be beneficial nationally, one of the recommendations arising from the ANAO report was in relation to the courts finding a common entry point to the family law system.⁸ A number of other reports in recent years have also called for a single point of entry for family law clients.⁹
- 5.22 At the public hearing, the FCoA advised the Committee of the court's work in the area of service integration which advocated, '...one file, one form, one fee...'¹⁰ This integration would lead to working towards combined registries, where the majority of applications would be filed in the FMC initially.

Publications, forms and websites

- 5.23 One of the issues highlighted in the ANAO report was the lack of consistent information available to clients of both courts. At the time of the audit, both courts offered a wide range of publications
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5 Federal Magistrates Court (FMC), *Transcript of Evidence*, 4 April 2005, p. 5.

6 FCoA, *Combined Registry Project*, Exhibit no. 13.

7 FCoA, *CEO's Report on the Court's Recent Activities*, Exhibit no. 5, p. 23.

8 ANAO Audit Report No 46, 2003-2004, *Client Service in the Family Court of Australia and the Federal Magistrates Court*, Commonwealth of Australia, May 2004, p. 78.

9 House of Representatives Standing Committee on Family and Community Affairs, *Every Picture Tells A Story: Inquiry into child custody arrangements in the event of a family separation*; Parliament of Australia; December 2003.

10 FCoA, *Transcript of Evidence*, 4 April 2005, p.1.

including booklets, pamphlets and information sheets. However, this information was court-specific making it difficult to compare the services and pricing structure between courts.

- 5.24 An example from these pamphlets is the cost of obtaining a divorce in each court. The audit report highlighted the cost differentiation between FCoA's 'Application for Divorce' pamphlet which cost \$574, while in the FMC a 'Dissolution of Marriage' only cost \$273. Applying for either of these will lead to the same result.¹¹
- 5.25 Both courts also currently maintain individual websites. This only serves to add further confusion to clients requiring information on the processes and structure of both courts.

Committee comment

- 5.26 The Committee agrees with the ANAO and other previous reports that the above problems with two points of entry to the family law system, differing forms and fees between the courts, and a lack of consistent information across courts' publications require significant change.
- 5.27 The Committee notes that in May 2005 the Government announced a range of changes to the family law system, including a proposed Combined Registry for family law matters. Under this plan, family law clients will lodge one form, initially at the FMC, and there will be one fee and one file, even if matters are transferred to the FCoA for resolution.¹² Legislation has also made other changes, such as simplifying language – the term 'divorce' is now used across both courts, rather than 'dissolution of marriage' as was previously used in the FMC.
- 5.28 In August 2005 the House of Representatives Standing Committee on Legal and Constitutional Affairs examined the Government's exposure draft of the Family Law Amendment (Shared Parental Responsibility) Bill 2005. This Bill includes new counselling and mediation services prior to the courts' intervention in child custody matters (see below for further information on Family Relationship Centres).

11 ANAO Audit Report No 46, 2003-2004, p. 74.

12 The Hon. Phillip Ruddock MP, Attorney-General, Media Release 25 May 2005: *Easier, Quicker, Simpler: a Clearer Pathway in Family Law*; available at: http://www.ag.gov.au/agd/WWW/MinisterRuddockHome.nsf/Page/Media_Releases_2005_Second_Quarter_Easier_Quicker_Simpler_-_A_clearer_pathway_in_family_law_-_0992005, accessed August 2005.

- 5.29 The Legal and Constitutional Affairs Committee largely endorsed the Bill, stating that it implemented the key family law reforms announced by the Government in May 2005. The Committee recommended a number of changes to the legislation, including some changes to the operations and evaluation of the Family Relationship Centres.¹³

Clients requiring special assistance

- 5.30 One of the major factors identified by the ANAO and reinforced during the Committee's public hearing was the need to identify and cater for the requirements of the courts' clients. The Committee heard that there were many groups within the court's client base who require special assistance from the court. The Committee heard that many initiatives had been progressed in this area since the release of the audit report.

Rural and regional clients

- 5.31 One of the largest groups of clients served by the courts are those living in rural and regional areas. The ANAO outlined several areas in which courts could improve their service to this group of clients.
- 5.32 The ANAO's report was critical of delays by the FCoA in processing applications in the Lismore registry.¹⁴ However, the FCoA argued that:

This is one thing that we took issue with the ANAO over, because they were critical of our service in Lismore for not processing some divorce applications, if my memory serves me correctly. We were saying that it is about priorities and that there was not going to be a circuit for hearing those matters so there was not any great urgency to process them.¹⁵

13 House of Representatives Standing Committee on Legal and Constitutional Affairs, *Report on the Exposure Draft of the Family Law Amendment (Shared Parental Responsibility) Bill 2005*; at: <http://www.aph.gov.au/house/committee/laca/familylaw/report.htm>, accessed September 2005.

14 ANAO Audit Report No 46, 2003-2004, p. 41.

15 FCoA, *Transcript of Evidence*, 4 April 2005, p. 12.

- 5.33 Another concern raised by the ANAO was the inequality of telephone access faced by clients living in rural and regional areas. The report stated that:

Even contacting the registries by telephone to make enquiries can be a challenge for rural and regional clients, as they must pay long distance telephone charges to contact the courts, as the registries do not have toll-free numbers. Telephone waiting times can also be lengthy, with some clients reporting being kept on hold for up to thirty minutes at a time.¹⁶

- 5.34 The FCoA advised the Committee of its intention to set up a “1300” number to assist these clients so that their level of telephone access mirrors that of their metropolitan counterparts.¹⁷ The Committee was pleased to hear of this positive step in reducing the financial burden and improving access to the court for rural and regional clients. However, at October 2005 it appears that this initiative is yet to be implemented.¹⁸

Recommendation 10

- 5.35 **The Committee recommends that as a matter of urgency, the Family Court of Australia introduce toll-free phone numbers for each of its registries.**

Indigenous clients

- 5.36 The FCoA’s indigenous clientele is spread throughout Australia in a variety of metropolitan, regional and remote areas. In order to facilitate indigenous people’s involvement with the court, the FCoA has employed several Indigenous Family Consultants (IFCs) who are based in Cairns, Alice Springs and Darwin. Their role is to assist indigenous families in dealing with the FCoA in the Northern Territory and North Queensland. Each IFC is also assigned to assist particular registries with the needs of local indigenous clients.

16 ANAO Audit Report No 46, 2003-2004, p. 38.

17 FCoA, *Transcript of Evidence*, 4 April 2005, p. 12.

18 Telephone contact numbers for individual registries are advertised on the FCoA’s internet site. At October 2005, these are not toll-free numbers (with the exception of the Townsville and Darwin registries, which list a 1800 number as well as a regular telephone number).

5.37 At the public hearing the Committee heard favourable remarks in relation to the response by the community to the IFCs. The FCoA commented:

We are convinced that, when people are able to deal with an Indigenous worker who supports them and assists them in their dealings with the court, certainly people do come to the court when needed.¹⁹

5.38 The ANAO noted that there have been varying degrees of success in establishing links with local indigenous communities. The Committee shares the ANAO's concern that staff at the FCoA registries had not received recent training in dealing with indigenous clients.²⁰ The ANAO was also concerned with the lack of information directed specifically at indigenous clients available at registries. FCoA informed the Committee that they now have a system in place whereby '...the managers and team in each registry are required to set up links with local indigenous communities and agencies'.²¹

5.39 On a related matter, the Committee recently tabled a report titled *Access of Indigenous Australians to Law and Justice Services*.²² The Committee anticipates that the report's recommendations will assist in improving access to legal services by indigenous Australians.

Culturally and linguistically diverse clients

5.40 As a result of a multicultural society, organisations must be able to cater to clients from different cultural and linguistic backgrounds. In 1999, the FCoA initiated a review of the services provided by the court to clients who are culturally and linguistically diverse (CALD). Results of the review found that further work could be done by the court to improve the experience of these clients.²³ Since this review, the FCoA has implemented a range of initiatives to improve services to these clients.

5.41 The most pertinent of these initiatives is the FCoA's 2004-2006 Cultural Diversity Plan.²⁴ The Plan's purpose is to '...provide a

19 FCoA, *Transcript of Evidence*, 4 April 2005, p. 17.

20 ANAO, *Audit Report No 46, 2003-2004*, p. 42.

21 FCoA, *Transcript of Evidence*, 4 April 2005, p. 17.

22 JCPAA, *Report 403: Access of Indigenous Australians to Law and Justice Services*, Parliament of Australia, June 2005.

23 ANAO, *Audit Report No 46, 2003-2004*, p. 42.

24 FCoA, *National Cultural Diversity Plan 2004-2006*, Exhibit no. 6, p. 1.

framework for a comprehensive approach by the Court to meeting the needs of its diverse client groups'.²⁵ Key elements of the plan include:

- adopting a policy of providing a welcoming and non-threatening environment for clients;
- review of the information and communication strategies for CALD clients;
- inclusion of quality standards on future tenders for court interpreter services;
- develop cross-cultural training for staff;
- review all publications and information sources to ensure their relevance to CALD clients including the translation of these materials;
- ensuring that new audio-visual material is culturally appropriate;
- implement data collection procedures to keep the court informed on its CALD clientele and seek feedback on progress from CALD clients; and
- develop Local Action Plans at registry level to enhance partnerships with local communities.²⁶

Self-represented litigants (SRLs)

5.42 Another prominent group was that of Self Represented Litigants (SRLs). The FCoA told the Committee that nearly 40 percent of litigants were self-represented at some stage of their dealings with the court.²⁷

5.43 SRLs are those litigants who choose to navigate the complexity of the family law system without obtaining legal representation. These clients come from diverse backgrounds and have to consider their future financial and emotional security. In many cases the welfare of children is also at stake.

5.44 The FMC detailed a two-step evaluation undertaken by the court of the services provided to SRLs:

25 FCoA, *National Cultural Diversity Plan 2004-2006*, Exhibit no. 6, p. 1.

26 FCoA, *National Cultural Diversity Plan 2004-2006*, Exhibit no. 6, p. 1.

27 FCoA, *Transcript of Evidence*, 4 April 2005, p. 9.

During the first phase, three independent consultants were engaged to pose as self-represented litigants in the court and provide feedback about their experience. This was a bit like the mystery shopper that some companies use. In effect, they were asked to step into the shoes of a self-represented litigant. Each was given a scenario that basically involved making telephone inquiries, browsing the web site, obtaining information about primary dispute resolution, identifying documents required for filing, completing an application or request for information at the registry counter, and attending and observing a duty list in the court. During the second phase, 70 self-represented litigants were surveyed. The survey covered topics such as contact with the court, primary dispute resolution, preparing documents, the court hearing and their overall experience with the court.²⁸

- 5.45 The 12 recommendations from the evaluation focussed on 'public information, data recording, the court's web site, self-help kits, forms, signage, training for the judiciary and staff, and ongoing monitoring and research.'²⁹ The FMC told the Committee:

Things that we have progressed in the short term include an increase in the number of brochures and fact sheets – these have been developed in a plain English, less legalistic format – and an increase in the amount of information on our web site targeted at self-represented litigants. With the assistance of the Family Court we have obtained more information about brochures and fact sheets that need to be translated, and we are just about to get those translated. We are also reviewing signage in conjunction with the Family Court.³⁰

- 5.46 The FCoA have also developed initiatives to assist their SRL clients. Mr Richard Foster told the Committee that initiatives being pursued include an electronic learning package for staff and a joint SRL management plan with the FMC. The FCoA are also considering a research project in conjunction with the Australian Institute of Family

28 FMC, *Transcript of Evidence*, 4 April 2005, p. 9.

29 FMC, *Transcript of Evidence*, 4 April 2005, p. 9.

30 FMC, *Transcript of Evidence*, 4 April 2005, p. 9.

Studies into the characteristics of serial litigants (repeat litigants) who are becoming 'an increasing problem in many jurisdictions'.³¹

Children

- 5.47 The rights and needs of children involved in family separations are another aspect which both courts carefully consider. The Committee heard about initiatives to aid the courts' work with children.
- 5.48 In the *CEO's Report on the Courts' Recent Activities*³², several programs involving the management of cases involving children were outlined. One of the initiatives, *Magellan*, involves management of cases relating to serious child abuse. The system has currently been implemented across all registries except those in NSW, due to reservations expressed by the Department of Community Services. The Committee was told:

I think there is a willingness from both parties for Magellan to be implemented in New South Wales, but I must admit that I am not entirely certain what the department's concerns are. There have been no real concerns expressed by any other department of the various states and Magellan has been successful everywhere. To be fair, the Department of Community Services in New South Wales is keen to implement Magellan as soon as possible. It is the biggest state and it is not happening in New South Wales.³³

- 5.49 Another initiative by the FCoA is the *Children's Cases Program* (CCP). The CCP is currently being trialled in several registries and involves a less adversarial approach with a judicial officer determining which issues are in dispute, and what evidence is used in support of those issues. This then allows for parents (through the family separation process) to gain a clearer understanding of their future with their children, rather than focus on past issues.

Other client groups

- 5.50 Other groups which have been considered by the FCoA include service provision to men and also those with mental health issues.

31 FCoA, *Transcript of Evidence*, 4 April 2005, p. 10.

32 FCoA, *CEO's Report on the Court's Recent Activities*, Exhibit no. 5, p. 8.

33 FCoA, *Transcript of Evidence*, 4 April 2005, p. 20.

- 5.51 In terms of the courts relations with mens' groups, the FCoA informed the Committee of preliminary research currently being conducted to gauge the experience of male clients. Both courts have also run a staff training program in association with Crisis Support Services and Mensline, which was deemed highly successful.³⁴
- 5.52 The FCoA has also initiated a pilot project on mental health with the assistance of funding received from the Department of Health and Ageing. The FCoA told the Committee:

...The original intent was to try and identify whether there was any causal link between the court and its processes, and male suicide. But it is called the mental health project, so there are much wider implications for staff. Part of the project will be providing some training for staff to perhaps recognise when people may have a mental health problem, and providing the staff with information about where they might be referred... We are initially going to set up a pilot project in Adelaide and Darwin. We do not have the resources and the skills to deal with it. That is why we have been partnering with the Department of Health and Ageing. I guess at the conclusion of the pilot there will be some evaluation and decisions made about what happens next.³⁵

Committee comment

- 5.53 The Committee would like to stay informed of progress in relation to the implementation of a toll-free telephone number, and also of the progress with various projects aimed at helping certain groups of the courts clientele, especially the implementation of the *Magellan* project in NSW.

34 FCoA, *Transcript of Evidence*, 4 April 2005, p. 20.

35 FCOA, *Transcript of Evidence*, 4 April 2005, p. 16.

Recommendation 11

- 5.54 **The Committee recommends that both the Family Court of Australia and the Federal Magistrates Court:**
- **investigate best practice initiatives in client service which have worked successfully in individual court registries and implement these across all registries;**
 - **investigate the appointment of Federal Magistrates specialising in family law in the Sydney Central Business District in order to alleviate work pressures;**
 - **conduct more frequent surveys of client satisfaction to further enhance processes and levels of service;**
 - **investigate methods of further assisting clients who are in positions of disadvantage in their dealings with the courts; and**
 - **progress the initiative to identify and support clients with mental illness.**

Coordination between the courts

- 5.55 The ANAO audit highlighted problems in coordination between the two courts. The ANAO outlined several key areas where coordination between the courts would enable clients to have a greater understanding of the objectives of each court. At the public hearing both courts advised the Committee of detailed initiatives that would enable this to occur.
- 5.56 Chief among these was the consideration being given to a single point of entry to the family law system, a more streamlined approach to administrative matters and joint information dissemination services. Recently, both courts agreed to an updated Memorandum of Understanding to formalise the processes being implemented, especially in regards to resource allocation and service provision by the FCoA to the FMC.

A new approach to client service in family law

5.57 As already highlighted, one of the major concerns expressed by clients of either court was information on the courts and the choice of court in which to file their matter. Even though litigants may choose to file their matter in either court, as a typical benchmark, the establishment of the FMC was to:

... provide a faster, simpler and less expensive forum for the resolution of less complex disputes. Typically, less complex disputes would not involve allegations of serious child abuse or domestic violence, or property in dispute worth more than \$700 000.³⁶

Collaborated information dissemination

5.58 As outlined previously, the ANAO found it difficult to reconcile the separate information provided by the individual courts for the benefit of their clients. Both courts outlined to the Committee the extensive work that has been undertaken to streamline information on the courts and their respective processes.

5.59 The FCoA informed the Committee that it had reviewed all of its publications:

That was something that the ANAO commented on. We reviewed every publication, every brochure and every document that we had to ensure as far as is possible that where we can put out a joint publication we do. We have been working very closely with the FMC and their communications area in that regard.... We have also reviewed every form letter that we use – firstly, to reduce the number of them and, secondly, to ensure that there is some consistency with the FMC in relation to form letters. We have also made our intranet available to the FMC...³⁷

5.60 The FCoA also stated that the courts were working to develop a joint family law website to further reduce confusion, especially over the court process. A major emphasis of the new website would be on self-represented litigants who form the majority of website users.³⁸

36 ANAO Audit Report No 46, 2003-2004, p. 17.

37 FCoA, *Transcript of Evidence*, 4 April 2005, p. 4.

38 FCoA, *Transcript of Evidence*, 4 April 2005, p. 4.

Recommendation 12

- 5.61 **The Committee recommends that the Family Court of Australia and the Federal Magistrates Court continue to work towards minimising duplication in areas such as client processing, information available to the public via publications, websites and the like, and duplication of administration across the courts.**

Funding / resource allocation

- 5.62 The ANAO noted the differences in funding and resources between the two courts. The FCoA informed the Committee that at the time of the audit report:

...we provide a number of services free of charge to the Federal Magistrates Court, which are in the budget. I think currently we provide \$12.5 million of services to the FMC free of charge.³⁹

- 5.63 The FMC added:

...the Family Court budget ... was around \$120 million and ours is around \$15.7 million or thereabouts. At the time this report was done we had about 82 staff, including magistrates, and I think the Family Court had just under 700 staff.⁴⁰

Memorandum of understanding

- 5.64 The disproportionate size of the courts and their budgets lead to the new Memorandum of Understanding (MoU) between the Courts. Key elements of the MoU include management of cases in the FMC and provision of services by the FCoA to the FMC.⁴¹
- 5.65 The new shared services agreement will be administered by '...a board comprising the Chief Justice, the Chief Federal Magistrate and the two CEO's' which came into force on 1 July 2004.⁴²

39 FCoA, *Transcript of Evidence*, 4 April 2005, p. 5.

40 FMC, *Transcript of Evidence*, 4 April 2005, p. 6.

41 FCoA, *Memorandum of Understanding between the Family Court of Australia and the Federal Magistrates Court for the Provision of Services*, Exhibit no. 11, p. 6.

42 FCoA, *Transcript of Evidence*, 4 April 2005, p. 6.

Service provisions by the FCoA to the FMC

5.66 A significant part of the MoU is directed at outlining the services that the FCoA will provide to the FMC.⁴³ The main services which will be provided are:

- registry services, including filing services;
- mediation services, provided by lawyers or FCoA mediators and mediation reporting services;
- litigation support, including FCoA Deputy Registrars to hear divorce matters in support of the FMC;
- provision of all Information Technology and related support services;
- knowledge management services;
- physical and personnel security services; and
- accommodation services, including chambers, courtrooms and office services.⁴⁴

5.67 A section of the MoU also outlines the obligations of the FMC under the agreement. Key elements of the FMC's responsibility include the provision of training for FCoA staff on the requirements of the FMC and the publication of information for relevant stakeholders.

Committee comment

5.68 The Committee is pleased to note the working relationship between the two courts given the difference in resource allocation and budgetary differences. The Committee strongly advocates the use of MoUs. The Committee considers that the MoUs that have been established between FCoA and the FMC play an important role in ensuring that both courts are operating well together.

43 FCoA, *Memorandum of Understanding between the Family Court of Australia and the Federal Magistrates Court for the Provision of Services*, Exhibit no. 11, p. 14-33.

44 FCoA, *Memorandum of Understanding between the Family Court of Australia and the Federal Magistrates Court for the Provision of Services*, Exhibit no. 11, pp 14-33.

Primary Dispute Resolution

- 5.69 The major focus of Primary Dispute Resolution (PDR) is to assist litigants to resolve disputes without judicial intervention. The FCoA provides PDR services for its clients through a combination of court mediators, Deputy Registrars with expertise in property matters and outsourced Community Based Organisations (CBOs). The FMC's PDR services are provided by the FCoA and CBOs.
- 5.70 The MoU between the courts includes provisions for mediation and conciliation services through lawyers (FCoA Deputy Registrars also acting as FMC Registrars) and court mediators. FCoA Deputy Registrars are also able to make orders and may direct unresolved issues back to the court. Court mediators are able to resolve situations between parties or if matters are unresolved, may provide written advice to the Federal Magistrate.⁴⁵

Outsourced services

- 5.71 As noted above, both courts are able to outsource their mediation services to Community Based Organisations (CBOs). The ANAO report highlighted the fact that FMC settlement rates for mediation (relating to children) or conciliation (relating to financial matters) conducted by CBOs are relatively low and do not meet the targets set in each agency's Portfolio Budget Statements (PBS). The FCoA aims to have 75 per cent of referred matters resolved through PDR and the FMC aims to have 60 per cent of referred matters resolved.
- 5.72 Only 20.8 per cent of mediation and 42.7 per cent of conciliation matters were fully settled in the 2002-03 year. A further 20.4 per cent of mediation and 6.6 per cent of conciliation matters were partially settled. A large proportion of mediation and conciliation cases (46.5 per cent and 39.4 per cent respectively), were not settled at all. The FCoA's rate of settlement aggregated across registries was 69 per cent, also falling short of the prescribed PBS target. However the majority of cases were settled by court mediators.
- 5.73 The Committee was told that when the FMC was established, the court contracted 35 CBOs to provide mediation services. These organisations were required to adhere to the '...quality framework and approval requirements established by the Department of Family

45 FCoA, *Memorandum of Understanding between the Family Court of Australia and the Federal Magistrates Court for the Provision of Services*, Exhibit no. 11, p. 20-24.

and Community Services under their Family Relationships Services Program'.⁴⁶ Due to the nature of the program, the FMC '...considered that it was reasonable to rely on the requirements of that program'.⁴⁷

Recommendation 13

5.74 **The Committee recommends that the Federal Magistrates Court:**

- **seeks to gain further performance information from Community Based Organisations, in order to assess their effectiveness in dispute resolution and their adherence to the government's Family Relationships Services guidelines ;**
- **undertakes further evaluation of the settlement outcomes from outsourced Primary Dispute Resolution providers; and**
- **investigates client satisfaction with Primary Dispute Resolution services provided by Community Based Organisations to understand why rates of settlement are low and how they could be increased to reach targets set in Portfolio Budget Statements.**

Family Relationship Centres

5.75 In 2003, a report tabled by the House of Representatives Standing Committee on Family and Community Affairs recommended significant changes to the family law system. One of the recommendations involved the formation of a single entry point of entry for families to resolve shared parenting issues.⁴⁸

5.76 In the 2005-06 Federal Budget, the Government announced funding of \$199 million over four years to fund 65 new *Family Relationship Centres* Australia-wide. These Centres aim to help couples facing separation resolve issues relating to child custody in a less adversarial setting.

46 FMC, *Transcript of Evidence*, 4 April 2005, p. 21.

47 FMC, *Transcript of Evidence*, 4 April 2005, p. 21.

48 House of Representatives Standing Committee on Family and Community Affairs, *Every Picture Tells A Story: Report on the inquiry into child custody arrangements in the event of family separation*, Parliament of Australia, December 2003, paragraph 4.156.

5.77 The FCoA expressed its views regarding the new Centres and its likely level of involvement with them. The FCoA told the Committee that it is considering the ways in which its services will best complement the new Centres. As the FCoA may in future require that litigants have a certificate of attendance from a Centre prior to further judicial determination, it proposes:

...that we not continue to provide the privileged services that we currently do – that is, the confidential services to clients. We think that the family relationship centres will in fact take over what we have described in the past as our resolution phase in the Family Court...⁴⁹

Recommendation 14

5.78 **The Committee recommends that the Family Court of Australia and the Federal Magistrates Court:**

- **report to the Committee by June 2006 on progress of both courts' evaluations of their outsourced PDR services and whether PBS targets have been met; and**
- **provides the Committee with feedback in regards to both courts' developing relationship with the new Family Relationship Centres.**

Conclusion

5.79 The Committee welcomes the substantial changes to family law introduced since the ANAO completed its audit. The Committee believes that after a settling-in period, it would be appropriate for the ANAO to conduct a follow-up audit on client service in the two courts, to ensure that the changes to family law in Australia have brought about significant improvements for clients.

49 FCoA, *Transcript of Evidence*, 4 April 2005, p. 22.

Audit Report No. 50, 2003-2004

Management of Federal Airport Leases

Background

6.1 Between 1997 and 2003, a total of 22 airports owned and operated by the Commonwealth were privatised. The sales were conducted in five stages and raised aggregate proceeds of \$8.5 billion. The ANAO conducted performance audits of the sales of 17 of these airports and tabled its report in Parliament (Audit Report No. 50 2003-2004, *Management of Federal Airport Leases*) in June 2004.

6.2 The ANAO analysis of airport leases covered the following airports:

Adelaide	Canberra	Jandakot (WA)	Mount Isa
Alice Springs	Coolangatta	Launceston	Parafield (SA)
Archerfield (Qld)	Darwin	Melbourne	Perth
Brisbane	Hobart	Moorabbin (VIC)	Tennant Creek
			Townsville

- 6.3 The airports privatisation program involved leasehold, rather than freehold sales. As a result, the Commonwealth has an ongoing involvement in airport operations. The Department of Transport and Regional Services (DOTARS) is responsible for administering the Commonwealth's ongoing interests in the operation and management of Federal airports under both the statutory regulatory framework of the *Airports Act 1996* (Airports Act), and the contractual arrangements entered into as part of the sales processes.
- 6.4 A number of legal agreements were used to facilitate each of the sales. In terms of ongoing Commonwealth involvement in airport operations, the major sale documentation comprised:
- a Sale Agreement between the Commonwealth, the lessee and its parent entities;
 - an Airport Lease between the Commonwealth and an airport lessee company; and
 - for the major airports, a tripartite deed between the Commonwealth, the lessee and the lessee's financiers.
- 6.5 The focus of the audit was on DOTARS' administration of these agreements.

The audit

- 6.6 The objectives of the audit were to assess whether DOTARS had developed and implemented an appropriate framework and the procedures to administer lessee obligations entered into as part of the 1997 and 1998 leasehold sales of 17 Federal airports. In particular, the audit sought to:
- review DOTARS' monitoring of lessee compliance with the Airport Leases and supporting sale documentation;
 - examine the effectiveness of the framework and procedures developed by DOTARS to administer lessee development commitments; and
 - assess the impact of changes in the aviation environment on the management and monitoring of lessee obligations.
- 6.7 The scope of the audit included assessing the Department's management of lessees' development obligations under the sale documentation and its management of lessee compliance with other contractual obligations.

Audit findings

- 6.8 Since the sales, significant changes have occurred in the Australian aviation market, which have increased the challenges facing DOTARS in its regulatory and contract management roles.
- 6.9 In terms of the audit objective, the ANAO found that DOTARS took some time to develop procedures to administer important aspects of lessees' contractual obligations. DOTARS indicated to the ANAO that the approach taken was influenced by the impact of changes in the aviation environment.¹ Commencing in 2002, the Department took steps in a number of areas to improve its contract management approach. The ANAO considered that further attention was required in a number of areas, including:
- reasonable cost recovery for lease administration;
 - more regulated lease reviews, including more efficient follow-up work on outstanding issues resulting from lease reviews; and
 - improvements in relation to effective monitoring and reporting on airport development commitments.
- 6.10 The ANAO also commented that it had identified inaccuracies in DOTARS' reporting on its performance in managing the Airport Leases and Sale Agreements.

ANAO recommendations

- 6.11 The ANAO made nine recommendations in total. DOTARS agreed to six recommendations, and agreed with qualification to the remaining three recommendations:²

Table 6.1 ANAO recommendations, Audit Report no. 50, 2003-04

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|----|--|
| 1. | <p>ANAO recommends that DOTARS assure itself that the required insurance policies are in place at privatised Federal airports by:</p> <ul style="list-style-type: none"> (a) adopting contracting procedures that provide the Department with ongoing access to expert, independent advice on lessees' insurance policies; and (b) promptly resolving any uncertainty where it is not clear that the required insurance is in place. |
|----|--|

DOTARS response: Agreed.

1 Since the commencement of the airports privatisation process, significant changes have occurred in the aviation environment. This has included successive aviation industry shocks caused by the Asian economic crisis of 1998-99, the events of September 11 2001, the collapse of Ansett on 12 September 2001, the October 2002 Bali bombing, the SARS pandemic during 2002-03, and the Iraq war.

2. ANAO recommends that DOTARS record the letters of comfort issued in relation to airport sub-lessees on the Department's Register of Contingencies and implement appropriate safe custody arrangements for the instruments.
DOTARS response: Agreed.
 3. ANAO recommends that, consistent with the Commonwealth's cost recovery policy for regulatory agencies, DOTARS implement a rigorous system for quantifying the reasonable costs of its administration of the 22 Federal Airport Leases, in order to:
 - (a) identify the amount of resources required to administer the contracts entered into at the time of the various sales; and
 - (b) consider the merits of exercising the Commonwealth's contractual rights to recover from lessees the Department's lease administration costs.***DOTARS response:*** Agreed.
 4. ANAO recommends that DOTARS improve its management of the Airport Leases by developing and implementing reliable systems for the scheduling and conducting of annual lease review meetings, and reporting on its performance in conducting these reviews.
DOTARS response: Agreed with qualification.
 5. ANAO recommends that DOTARS enhance its conduct of lease review meetings by, at the conclusion of each review:
 - (a) documenting review outcomes, including the Department's assessment of the degree to which the lessee complies with the sale documentation requirements; and
 - (b) providing a written response to the lessee specifying outstanding issues that are to be addressed.***DOTARS response:*** Agreed.
 6. ANAO recommends that DOTARS include in future Annual Reports comprehensive and accurate performance information on the timeliness and completeness of receipt of expenditure plans and audited reports on Development Commitment expenditure from relevant airport lessees.
DOTARS response: Agreed with qualification.
 7. ANAO recommends that DOTARS more closely analyse annual expenditure reports when they are provided in order to promptly advise lessees of any items that the Commonwealth would not accept as expenditure towards the Development Commitment obligations.
DOTARS response: Agreed.
 8. ANAO recommends that, having regard to the delays that occurred for Period One, DOTARS expedite the finalisation of Period Two Development Commitment outcomes, currently due in 2007 and 2008, by taking early administrative action to obtain, analyse and assess financial reports prepared by Approved Auditors.
DOTARS response: Agreed.
 9. ANAO recommends that DOTARS report achievement against the Period One Development Commitment for each airport in its next Annual Report.
DOTARS response: Agreed with qualification.
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The Committee's review

- 6.12 On 7 March 2005, the Committee held a public hearing in Canberra to review DOTARS' progress in light of the nine recommendations made in the ANAO audit report. The public hearing was attended by DOTARS and the ANAO.
- 6.13 The Committee took evidence on the following issues:
- DOTARS' resourcing and cost recovery;
 - lease management;
 - lease reviews; and
 - aeronautical infrastructure development.

Cost recovery for administering airport leases

- 6.14 The ANAO report concluded that DOTARS had given insufficient attention to resourcing important aspects of managing the Airport Leases and Sale Agreements. With limited budget-funded resources available to DOTARS for both regulatory and contract management functions, the ANAO suggested that DOTARS needed to identify other means of appropriately resourcing its contract management responsibilities. This included considering the merits of exercising the power provided by the lease for DOTARS to recover its reasonable lease administration costs.³
- 6.15 Recommendation three in the audit report asked that DOTARS quantify the reasonable costs of its administration of the 22 airports in order to:
- identify the amount of resources required to administer the contracts entered into at the time of various sales; and
 - exercise the contractual rights to recover from lessees the Department's lease administration costs.
- 6.16 DOTARS updated the Committee on the progress of its implementation of this recommendation. The Committee was advised that it was the Department's understanding that 'potential purchasers of the airport leases had been advised prior to purchase that these

3 ANAO Audit Report no. 50, 2003-2004, *Management of Federal Airport Leases*, Commonwealth of Australia, June 2004, p. 10.

costs would not be recovered.⁴ Further to this DOTARS commented that:

Legal advice relating to the difficulty of recovery of lease administration costs has been received and a paper is now being prepared for consideration by the Department's Audit Committee.⁵

- 6.17 During the public hearing DOTARS reiterated this view and commented that the results from the Department's audit committee could be provided to the Committee.

We have just finalised a review that is currently under consideration by the department's audit committee about a revised policy towards recovery of reasonable costs on leases. We go to our audit committee this Thursday. I am happy to provide you with the results of that.⁶

- 6.18 At the public hearing DOTARS informed the Committee that there would be no retrospective cost recovery.⁷

- 6.19 The Committee asked DOTARS whether they had an estimation of the cost to the Department for administering the leases. DOTARS commented that Acumen Alliance had looked at this particular question of lease management functions and had made an estimate of the staffing and departmental administrative costs of this particular function of \$242,000 per annum across the 22 airports.⁸

- 6.20 In breaking down the estimate per annum, the relevant DOTARS manager commented that:

There are 35 people within my branch who have oversight responsibility for the 22 airports. It is split across four different sections...The lease management function I would say is a minor component of the overall work of the organisation, as reflected by that \$242,000 cost. We do annual lease reviews. That would take one or two people part of their time per annum.⁹

4 DOTARS, Submission no. 7, p. 2.

5 DOTARS, Submission no. 7, p. 2.

6 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 7.

7 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 9.

8 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 7.

9 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 7.

- 6.21 In short, DOTARS confirmed that 'To put that in context, it is around 1½ staff, full-time equivalent, employed on this activity in the course of a year.'¹⁰
- 6.22 The Committee raised the concern that the cost of recovering administrative costs may be expensive. DOTARS agreed that this was a concern flagged by Acumen Alliance, a consulting firm DOTARS had contracted to advise them on cost recovery. During the public hearing DOTARS commented:
- That is certainly the view of Acumen Alliance. For the amount of costs involved, \$242,000, to separate out the function within the overall branch administration would require time sheets and billing arrangements to be put in place. So there certainly would be costs involved.¹¹
- 6.23 On 17 June 2005, the Committee received advice from DOTARS on the outcome of the Department's review in relation to the recovery of airport lease administration costs. In summary, the review did not support the recovery of airport administration costs.
- 6.24 The two main arguments put forward against the recovery of airport lease administration costs were:
- that advice provided to airport bidders during the Phase 2 sale process 'would seriously undermine the Clause 11.2 contractual right to recover lease administration costs...'; and
 - that the 'work undertaken by external consultants suggests there is some uncertainty on the cost effectiveness of a compliant cost recovery regime should it be introduced'.¹²
- 6.25 Furthermore, DOTARS advised the Committee that it had received legal advice from the Australian Government Solicitor (AGS) which stated that for Phase 2 airports 'there would be legal arguments of substance available to the airport lessees to support the contention that the Commonwealth is not entitled to recover those costs'.¹³
- 6.26 However, AGS did make a comment in relation to Phase 1 of airports which stated that:

10 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 8.

11 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 22.

12 DOTARS, Submission no. 7.1, p.1.

13 DOTARS, Submission no. 7.1, p.2.

...unless similar statements were made in the context of the phase 1 airport sales, there is nothing to suggest that the Commonwealth is not, in reliance upon clause 11.2, able to recover internal departmental administrative costs from those airports.¹⁴

Committee comment

- 6.27 The Committee notes that Phase 1 of the airports privatisation program involved the sale of Brisbane, Melbourne and Perth Airports. With consideration given to the cost of DOTARS billing these airports for the recovery of administration costs, and the fact that the estimated amount recoverable for all 22 airports was \$242 000, the Committee does not consider it worthwhile for DOTARS to pursue the lease administration costs for only three airports.
- 6.28 However the Committee believes it is in the interest of both DOTARS and the Commonwealth in future to embrace cost recovery initiatives, particularly where a clause is initially inserted into the sales contract as it was with the Federal sale of airport leases.

Recommendation 15

- 6.29 **The Committee recommends that in future privatisation programs, government agencies include a clause in all sales contracts which provides for the Commonwealth's cost-recovery of administrative expenses.**

Government agencies should then ensure that they undertake cost-recovery of such expenses as a matter of course.

Lease management

Airport insurance

- 6.30 Appropriate insurance cover for the privatised airports is important to the Commonwealth for a number of financial and other (public
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14 DOTARS, Submission no. 7.1, p.2.

interest) reasons. These include protecting the Commonwealth against claims made against it as landlord, and having the proceeds of insurance claims used to rebuild damaged or destroyed structures. The insurance requirements of lessees are set out in both the Airport Leases and the Sale Agreements.

- 6.31 DOTARS contracts a firm, currently AON¹⁵, to advise on whether insurance taken out by the lessees is in accordance with the Commonwealth's requirements. Between December 2002 and August 2003 insurance reports were completed in relation to each of the seventeen airports included in the audit. The findings revealed that not all the necessary information had been provided to the contractor therefore resulting in most of the insurance reports being qualified. In addition, the contractor found that certain insurances were not in place.
- 6.32 The Committee was greatly concerned about these deficiencies in some of the insurance policies held by the lessees and was disappointed to learn that DOTARS had not followed up on these insurance reports in a timely manner, with two airport insurance reports taking over a year to be followed up.
- 6.33 The table below documents the time taken by DOTARS to follow up on Insurance adviser reports during the time of the audit.

Table 6.2 DOTARS follow-up of Insurance Advisor Reports

Airport	Date of Insurance Advisor Report	Date of DOTARS follow-up	Delay (months)
Adelaide & Parafield	December 2002	February 2004	14
Perth	May 2003	April 2004	11
Brisbane	June 2003	February 2004	8
Darwin, Alice Springs & Tennant Creek	June 2003	March 2004	10
Melbourne & Launceston	July 2003	March 2004	8
Archerfield	August 2003	March 2004	7
Moorabbin	August 2003	December 2003	4
Townsville & Mt Isa	August 2003	February 2004	6
Canberra	August 2003	February 2004	6
Hobart	August 2003	March 2004	7

15 AON is a provider of risk management services, insurance and reinsurance broking, financial planning and employee risks and benefits solutions. At the time of the hearing, AON was contracted to DOTARS until 30 June 2005.

Coolangatta	August 2003	March 2004	7
Jandakot	January 2004	April 2004	4

Source: ANAO analysis of DOTARS information (Audit Report no. 50, 2003-04, p. 41).

6.34 During the public hearing the Committee asked the ANAO to comment on its findings in relation to lack of insurance coverage. ANAO told the Committee:

...in the first series of reports we looked at, which were provided by AON [DOTARS' insurance contractor], across a number of the airports there were either instances where the adviser was unable to conclude that all the required insurances were in place because insufficient information had been provided to the adviser to be able to make a conclusion or some instances where insurances did not appear to be in place.¹⁶

6.35 The Committee sought an assurance from DOTARS that there were no longer any shortfalls in lessees' insurance policies. DOTARS informed the Committee that it was currently awaiting this year's report from AON and told the Committee that this report would identify any existing gaps.¹⁷

6.36 In relation to public liability insurance, DOTARS advised the Committee:

It is my understanding that the airports have had public liability insurance in place. We conduct an annual review and we are in the middle of the current review at the moment. AON, our contractor, is discussing that with all the airports.¹⁸

6.37 In a supplementary submission, DOTARS informed the Committee that 'the Sale Agreements for all leased Federal airports require insurance cover in relation to structures, plant, machinery, revenue loss and legal liability.'¹⁹ See Appendix E for up-to-date *Schedule of Airport Insurance Cover for Federally leased airports from 1997-2005*.

6.38 Recommendation one in the ANAO's report called for a review of procedures in place to ensure that DOTARS kept in place an ongoing insurance contractor to provide advice on lessees' insurance policies.

16 ANAO, *Transcript of Evidence*, 7 March 2005, p. 3.

17 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 3.

18 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 2.

19 DOTARS, Submission no. 7, p. 1.

The recommendation also called for appropriate and timely follow-up action.

6.39 DOTARS advised the Committee of the following action currently in progress in relation to recommendation one:

- The responsibility for airport insurance arrangements has been consolidated with one dedicated officer in the Airport Planning and Regulation Branch.
- The current insurance contract has been reviewed and a decision was scheduled by the end of April 2005.
- The 2004-2005 insurance review is currently underway and is on schedule. To date (26 April 2005), the audit contractor has submitted reports for 15 airports to the Department and they have been/are currently being assessed and follow up action initiated where necessary. However, one airport has not yet provided the required information to the audit contractor for assessment.
- The Department has acted to resolve uncertainty in relation to insurance status. DOTARS advised the Committee that the Sale Agreements for all leased Federal airports require insurance cover in relation to structures, plant and machinery, revenue loss and legal liability. For details of airports' insurance cover from 1997-2005, see Appendix E.²⁰

Committee comment

6.40 The Committee is satisfied that DOTARS is alerted to the need to assure itself that the required insurance policies are in place at privatised Federal airports. However, it urges the Department to follow up immediately on outstanding information related to the insurance review process.

6.41 The Committee recommends that DOTARS adopt a procedure which ensures that all follow up actions required in relation to the audit contractor's insurance reports are finalised within a three month period.

²⁰ DOTARS, Submission no. 7, Attachment B, p. 1.

Recommendation 16

- 6.42 **The Committee recommends that the Department of Transport and Regional Services adopts a procedure which ensures that follow up administration on all insurance reports from the audit contractor are finalised within a three month timeframe.**

The Department's annual report should include a report on the status of all insurance reports from the audit contractor, including the date of the report, and date of any departmental actions arising from the report.

Tripartite deeds

- 6.43 The tripartite deed document was developed late in 1997, during the Phase 1 sales process. The document was prepared to address the concerns of financiers to the bidders for each of the major airports. In the absence of such a document, the financiers considered that they could lose all of their debt funds if a termination event occurred and the Commonwealth cancelled the Airport Lease (over which they had taken security). Tripartite deeds are in place for each of the 12 core regulated airports.²¹

- 6.44 The Committee discussed the issue of Tripartite Deeds during the public hearing. DOTARS outlined when a tripartite deed would be actioned:

Effectively, when a company no longer has the capacity to run an airport, and financiers cannot step in and rectify the situation, the airport returns to the Commonwealth. The Commonwealth's liabilities are limited to the asset value of the airport.²²

- 6.45 The ANAO commented that :

It is probably also a bit more complex in the sense that having adequate insurance in place is not solely a matter of having a policy; one of the requirements of the lease is that the

21 The 12 core regulated airports are: Sydney, Melbourne, Brisbane, Perth, Canberra Coolangatta, Townsville, Adelaide, Hobart, Launceston, Darwin and Alice Springs.

22 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 6.

Commonwealth be named under that policy so that, for example, if we do have to step into the airport, the Commonwealth has the benefit of that lease. Whilst you might have a policy in place today, if that policy does not extend to the Commonwealth, the Commonwealth will not have the benefit of the policy.²³

- 6.46 The tripartite security deeds have been disclosed by DOTARS as a remote administered contingent liability in the Department's financial statements, but without the Commonwealth's exposure being quantified. During the course of the audit, the ANAO canvassed with DOTARS the possibility of quantifying the extent of the Commonwealth's exposure.
- 6.47 DOTARS advised ANAO that it intended to discuss the treatment of the tripartite deeds as a contingent liability with its financial statement auditors in preparation for settling the Department's 2003-04 audited statements.
- 6.48 During the public hearing DOTARS confirmed that they had discussed the issue of tripartite deeds with its financial statement auditors. The Committee noted the following information was included in the DOTARS Annual Report 2003-04 Financial Statements:

The Tripartite deeds between the Commonwealth, airport lessees and lessees' financiers provide for limited step in rights for the financiers in circumstances where the airport lease is terminated. Assuming the financiers' step in rights are not triggered, the potential liability of the Commonwealth can vary under the Tripartite Deed, depending on whether the airport lease is able to be sold on to a third party or not.

The Commonwealth's potential liability to the lessees' financiers is limited to the value received for the affected airport lease or the valuation of the airport site. Where the Commonwealth is able to sell on the airport lease, secured financiers have a limited ability to recover their loans from funds obtained by the Commonwealth from selling on the airport lease, subject to higher ranking claims being met first. Where the airport lease is not sold on, the Commonwealth is required to obtain a valuation of the airport site that will

23 ANAO, *Transcript of Evidence*, 7 March 2005, p. 6.

determine the limit for a repayment (or partial repayment) of financiers' loans again subject to higher ranking claims being met. If the Commonwealth enters into possession of an airport site, it would seek to recover costs from a number of sources, including airport revenues and the airport lessee company, in addition to funds obtained from selling the airport lease.²⁴

Letters of comfort

- 6.49 A letter of comfort is an instrument that is used to facilitate an action or transaction but is constructed with the intention of not giving rise to legal obligations. Commonwealth policy on letters of comfort is that they should be avoided. This is because a letter of comfort may lead to an actual liability, even where this is not the intention.
- 6.50 Between December 1998 and January 2004, DOTARS issued five letters of comfort in relation to the Commonwealth allowing sub-lessees to remain on the airport site as a lessee in the event of early termination by the Commonwealth of the Airport Lease.
- 6.51 During the public hearing the Committee asked DOTARS whether it had issued any other letters of comfort since the audit report. DOTARS officials reported that one further letter of comfort had been issued making a total of six letters of comfort having been issued by the department in relation to airport leases.
- 6.52 Recommendation two in the audit report called for DOTARS to record all letters of comfort on a register of contingencies and implement safe custody arrangements for the instruments. DOTARS agreed with the recommendation and advised the ANAO in April 2004 that these procedures had been implemented. DOTARS stated that the:
- ...letters of comfort have been recorded on the department's register of contingencies, and there are safe-custody arrangements in place for them. So there is a central holding of information, plus a copy in the [Aviation and Airports Security] work area.²⁵

24 DOTARS, *Annual Report 2003-04*, p. 267.

25 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 13.

- 6.53 The Committee was interested to know why letters of comfort were still being issued when it was Commonwealth policy that they should be avoided. DOTARS responded:

Because the airports are on a leasehold basis, financiers and people who want to enter into long-term commitments with them are often nervous, not having dealt with leasehold arrangements and the security, or lack of it that potentially goes with that. The letter from our point of view essentially describes the legal framework and, in describing it, gives some level of comfort in the broad sense as to what that framework does, which would enable someone intending to invest to come to a view about what they are entering into.²⁶

- 6.54 DOTARS reassured the Committee that the letters of comfort are effectively just correspondence to the airport lessee sublease holders. They commented further that:

...the legal advice we have is that they do not constitute letters of comfort in the sense that is normally addressed by this committee, in that they actually do not enter into any binding commitments on the Commonwealth.²⁷

Committee comment

- 6.55 The Committee believes DOTARS should limit the number of letters of comfort issued, in line with Commonwealth policy which states that they should be avoided. Where it is necessary for the Department to issue such a letter, it is important that they be placed on the Department's Register of Contingencies and that safe custody arrangements for the instruments be put in place.

Lease documentation

- 6.56 The Committee was concerned that the ANAO report had identified that there were several original lease documents unaccounted for. The audit report noted an absence of lease documentation for Brisbane, Moorabin, Hobart and Townsville airports.

²⁶ DOTARS, *Transcript of Evidence*, 7 March 2005, p. 15.

²⁷ DOTARS, *Transcript of Evidence*, 7 March 2005, p. 13.

- 6.57 During the public hearing DOTARS told the Committee that the Department held all copies of the leases on its premises and that the originals were held by the Australian Government Solicitor (AGS).

My clear understanding, which I will verify, is that we hold copies of all the leases...²⁸

- 6.58 However, the audit report had verified that there were cases of missing documentation of original leases. When asked about the importance of ensuring that there are copies of the original lease documentation, the ANAO reported to the Committee:

Something we try to point out to all departments is the importance of actually keeping any original documentation where the Commonwealth has sent it in, for the rights and obligations that need to be protected. When we first came up against this in the 1998 report, we made the recommendation that they should be looked after. So, from our point of view, we were just following up to see that they had been looked after. The fact that they cannot be found is a less desirable position.²⁹

- 6.59 After the public hearing, DOTARS advised the Committee in a supplementary submission of the following status in relation to original lease documentation.

The AGS has confirmed that it holds originals of all airport leases except for those of Hobart, Brisbane and Townsville, for which it has obtained copies issued by the Tasmanian and Queensland Land Titles Offices (LTOs). The AGS has advised the Department that copies issued by an LTO are as good as the original.

Originals or electronic copies of originals are held at the LTOs of the state or territory in which the lease was registered. Melbourne airport is the only airport which does not have its lease registered. The AGS is currently making arrangements for the Melbourne Airport Lease to be registered with the Victorian LTO.

At the time of leasing, the AGS provided printed and bound "Administrators' Versions" of the Airport Leases to the Department. The Administrators' Version is not a signed

28 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 11.

29 ANAO, *Transcript of Evidence*, 7 March 2005, p. 11.

copy of the lease, but contains the precise wording of each clause of the lease, with explanations by AGS of the meaning and intention of clauses.³⁰

Annual lease reviews

6.60 The Committee asked DOTARS about changes to its annual lease reviews of airports as a result of the audit report recommendations.

6.61 DOTARS advised the Committee:

We have recently reviewed those in the light of the audit recommendation. I think we have made some improvements there. We developed a new set of guidelines, including checklists and templates for each of the stages of the review, including written responses to the lessees. We have undertaken some training internally as well for our staff. We will be using this new set of guidelines for the next round of lease reviews, including one which will take place in a few weeks time.³¹

6.62 At the public hearing the Committee accepted an exhibit document from DOTARS outlining a list of all the lease reviews conducted in 2003-04 and ones that have been scheduled for 2005. DOTARS stated that 'Essentially they have all been done.'³²

6.63 In addition, DOTARS stated that 'an internal assessment of the risks associated with the management of lease obligations has been undertaken and appropriate risk treatments [have been] included in the new draft Branch Guidelines.'³³

Annual reporting on review performances

6.64 In terms of future reporting on annual lease reviews, DOTARS agreed with the recommendation of the ANAO that the most appropriate focus for such reporting should be through the Department's Annual Report. DOTARS commented that:

30 DOTARS, Submission no. 7, p. 2.

31 DOTARS, *Transcript of Evidence*, 7 March 2005, pp. 12-13.

32 The list of lease reviews is part of DOTARS submission no. 7, Schedule C. DOTARS, *Transcript of Evidence*, 7 March 2005, p. 9.

33 DOTARS, Submission no. 7, p. 3.

We have been consulting with the airports to deal with the very questions you have been raising about the balance between transparency and commercial sensitivity, to find the right balance for reporting.³⁴

- 6.65 DOTARS informed the Committee that the next annual meeting with all the airport lessees was scheduled for May 2005. DOTARS told the Committee:

The Branch will brief the 22 airport lessees on the form of future performance reporting on lease reviews at the Airport Consultative Forum to be held on 5 May 2005.³⁵

Committee comment

- 6.66 The Committee will note with interest the future performance reporting on lease reviews in DOTARS' Annual Report for 2004-2005. The Committee stresses the importance of open and transparent reporting of performance in annual reports to ensure optimal accountability for all Commonwealth entities and the Australian public.

Aeronautical infrastructure development

- 6.67 The ANAO made several recommendations in relation to the delayed reporting of development commitments and the lack of performance reporting of these airports by DOTARS. The Sale Agreements for ten of the airports included a commitment from the lessee to a specified amount of capital expenditure on aeronautical infrastructure development over the first 10 years of the lease. Total Development Commitments of \$699.8 million were specified across the various Sale Agreements.
- 6.68 The 10-year Development Commitments were divided into two five-year periods, defined in the Sale Agreement as Period One and Period Two. For the three Phase 1 airports, Period One was originally specified to end on 30 June 2002. For the seven Phase 2 airports that have Development Commitments, Period One was originally specified to end on 30 June 2003.

34 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 12.

35 DOTARS, Submission no. 7, p. 4.

- 6.69 The ANAO found that DOTARS' development of procedures to administer these Commitments was not timely. In particular, the Department did not commence the development of procedures until 2003, more than five and a half years after the Phase 1 sales were completed.
- 6.70 DOTARS acknowledged to the ANAO in February 2004 that, without agreeing that its flexible approach was inappropriate, earlier implementation of standardised processes and guidelines would have been beneficial. DOTARS further commented that measures are now in place to remedy the issue.
- 6.71 At the public hearing, the Committee accepted an exhibit document from DOTARS titled, *Airport Development Commitment Expenditure as required under Airport Sale Agreements*.³⁶ This exhibit provided the Committee with the most up to date information DOTARS had in relation to Period 1 Airport Development Commitment Expenditure Status. See Appendix F.

Performance reporting

- 6.72 At the public hearing the Committee asked DOTARS to comment on how performance reporting in relation to airport development expenditure was progressing.
- 6.73 DOTARS made the following comment:
- The obligations are split up into two five-year periods determining a total expenditure commitment over a 10-year period between period 1 and period 2. My understanding is that we provided some information in this year's annual report and that we are looking to provide further information in next year's annual report after discussion with the airports.³⁷
- 6.74 DOTARS had some concerns about the appropriateness of the content of the information included in its annual report in terms of performance indicators for each airport lessee. The Department wanted to be sure it did not reveal any commercial-in-confidence material. DOTARS stated:

36 DOTARS, *Airport Development Commitment Expenditure as required under Airport Sale Agreement*, Exhibit no. 3.

37 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 16.

One of the issues we are confronted with effectively on a daily basis is the question of what we actually release in regard to any information provided by the airports. Obviously the fact is that they are commercial entities. Whilst we may consider the information is not something which would be an issue from the point of view of the airport, they do have some concerns from their shareholders and from the question of how it might impact on their business in the way in which it is reported, because it can be misconstrued. Therefore we want to be very careful in regard to how we actually provide further and more elaborate detail to ensure that they are comfortable with the release of the information, given that sensitivity.³⁸

6.75 At the hearing DOTARS commented that:

some information was provided on period 1 development commitment outcomes and was included in our 2003-04 annual report. But, as I said, we are now looking forward to next year's annual report and to what level of information we provide in that.³⁹

6.76 The Committee noted that the only information available in the DOTARS' Annual Report 2003-04 in relation to performance indicators for airport development commitments, confirmed that 'six airport lessees had met their period one development commitment obligations worth more than \$186 million.'⁴⁰

6.77 In a supplementary submission, DOTARS stated that 'the most appropriate format and content of performance reporting for Development Obligations in future Departmental Annual Reports is scheduled to commence at the end of April 2005.'⁴¹

6.78 At the public hearing, DOTARS added the following comment:

It is important to note that the actual amount in total that has been spent by airports in regard to development obligations is far in excess of what was originally required under their agreements. ...Our concern is really more with the fact that the total amount that is acquitted against that five-year period

38 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 16.

39 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 17.

40 DOTARS, *Annual Report 2003-04*, p. 53

41 DOTARS, Submission no. 7, p. 5.

is legitimate expenditure in regard to what is required under the contract.⁴²

6.79 At the end of the public hearing the Committee sought to clarify with DOTARS whether the needs of aviation will be well served in the future in terms of development commitments and growth. DOTARS replied:

...stability and growth have returned to the aviation industry, so the drivers that lead to infrastructure investment at airports are now back in place. You can see across the board at the airports we are dealing with that they all have capital plans that would enable them to meet the sorts of commitments we are talking about.⁴³

Committee comment

6.80 It is important to acknowledge that the Commonwealth has a significant residual interest in the federal airports now leased to private companies and consortiums. The government, through DOTARS, must ensure that these leases are managed properly and in accordance with the lease agreements.

6.81 The Committee understands that DOTARS is responsible for ensuring that the airport development obligations are carried out in a timely manner and that they meet the obligations set out in the Sale Agreements.

6.82 The Committee recommends that DOTARS report more fully on whether or not the ten airport lessees have met their airport development obligations in a timely manner. This includes reporting on lessees who have not provided the Department with the information required or have not supplied the Department with information in a timely manner. This would include DOTARS reporting on extension dates that have been granted to lessees.

42 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 19.

43 DOTARS, *Transcript of Evidence*, 7 March 2005, p. 18.

Recommendation 17

- 6.83 **The Committee recommends that the annual report of the Department of Transport and Regional Services include a matrix reporting on each airport lease - including the status of annual lease reviews, insurance reports, development obligations, letters of comfort and cost recovery of administrative expenses.**

Where time extensions for development obligations have been granted, DOTARS must provide a comprehensive explanation detailing why the extension has been approved.

Audit Report No. 4, 2004-2005

Management of Customer Debt – Centrelink

Background

- 7.1 Centrelink is the government agency responsible for delivering a range of government payments to individuals such as retirees, families, carers, parents, people with disabilities, Indigenous people, and people from diverse cultural and linguistic backgrounds. Since October 2004 Centrelink has come under the umbrella of the new Department of Human Services, which aims to 'direct, coordinate and broker improvements to service delivery'.¹
- 7.2 Debt management forms part of Centrelink's core operations, and has links to programs targeting payment correctness and customer compliance.
- 7.3 Debts arise primarily because customers fail to notify Centrelink of changes in circumstances, or provide incorrect information. Debts can also result from Centrelink's own administrative error. Where a debt arises solely from Centrelink error, and where the customer could not

1 Department of Human Services internet site:
http://www.humanservices.gov.au/what_is_DHS.htm, accessed June 2005.

reasonably be expected to know they were being overpaid, the debt must be waived.

- 7.4 Managing customer debts related to income support and pension payments is a major issue for Centrelink. At 30 June 2003, outstanding 'benchmark' debt was \$967 million, owed by approximately 600,000 individual social security recipients. The magnitude of this debt, and the burden often placed on the financial capacity of affected customers, means that it is important that Centrelink manages debt efficiently and effectively.
- 7.5 The debt management process comprises four main elements – prevention, identification, raising, and recovery.

Audit objectives

- 7.6 In August 2004 the ANAO tabled its audit report titled *Management of Customer Debt*. The objective of the audit was to assess whether Centrelink effectively managed its benchmark customer debt consistently across its network, ensuring integrity of payments made on behalf of the Department of Family and Community Services (FaCS), while also providing appropriate levels of customer service.

Overall conclusion

- 7.7 The ANAO concluded that Centrelink had significantly improved the effectiveness of many debt management processes and practices over the previous one to two years. However, the ANAO noted that customer debt continues to increase rapidly, making it important that Centrelink further improve its debt prevention, identification, raising and recovery activities in order to safeguard the Government's expenditure on, and effectiveness of, its social welfare programs.
- 7.8 The ANAO concluded that Centrelink did not manage debt consistently across its network. While Centrelink's debt identification and raising functions generally used similar processes, producing similar results, debt prevention and recovery varied widely in application and performance across the Centrelink Areas examined.
- 7.9 Centrelink was not able to inform the ANAO about the standard of service it provided to customers with debts, as it did not collect information about customer satisfaction with debt servicing activities. This lack of monitoring also made it more difficult for Centrelink to ascertain whether its debt recovery activities placed customers in 'real financial hardship'. As well, it impeded Centrelink's capacity to develop strategies to improve

the service it provides to customers, when managing their social welfare debts.

ANAO recommendations

7.10 The ANAO made nine recommendations to improve Centrelink's debt management functions:

Table 7.1 ANAO recommendations, Audit Report no. 4, 2004-05

- | | |
|----|---|
| 1. | <p>The ANAO recommends that, in developing a replacement for Centrelink's current <i>Debt Servicing Strategy</i>, the agency:</p> <ul style="list-style-type: none"> ○ continues to improve communication flows between teams within Centrelink responsible for debt prevention, identification and recovery; and ○ aligns debt risks to compliance and service delivery risks, enabling greater efficiencies in debt management activities. <p>Centrelink response: Agree.</p> |
| 2. | <p>The ANAO recommends that FaCS, in consultation with Centrelink, review the external performance monitoring regime for debt management in Centrelink to promote better practices and performance improvements. In particular, the ANAO recommends that the review consider the benefits of:</p> <ul style="list-style-type: none"> ○ replacing the current debt key performance indicators in the FaCS–Centrelink Business Partnership Agreement with indicators that measure the effectiveness of the four major phases of debt management (prevention, identification, raising and recovery); and ○ revising the Outcome–Output measures in both FaCS and Centrelink Portfolio Budget Statements to encompass these measures, which would then be reported against in the agencies' respective Annual Reports to the Parliament. <p>Centrelink response: Agree with qualification. FaCS response: Agree with qualification.</p> |
| 3. | <p>The ANAO recommends that Centrelink monitor customer satisfaction with the administration of its debt raising and recovery activities, and use those results to improve debt service delivery.</p> <p>Centrelink response: Agree.</p> |
| 4. | <p>The ANAO recommends that Centrelink review the implementation, including funding arrangements, of debt prevention activities across its network, and determine whether this implementation supports effective leadership and coordination of debt prevention and management initiatives by Centrelink's Debt Services Team.</p> <p>Centrelink response: Agree.</p> |
| 5. | <p>The ANAO recommends that, to help support debt prevention initiatives, Centrelink develop a set of internal performance indicators that accurately measure, and/or assess, the effectiveness of its debt prevention activities.</p> <p>Centrelink response: Agree.</p> |
| 6. | <p>The ANAO recommends that Centrelink undertake a review of the accuracy of the value of debts determined and raised by its Compliance Teams. If the results of this analysis identify low rates of accuracy, immediate remedial action is advisable.</p> <p>Centrelink response: Agree.</p> |

7. The ANAO recommends that Centrelink analyse the appropriateness of applying debt waivers throughout its network, especially at the Original Decision-Maker level in Specialist Debt Raising Teams. If the results of this analysis identify low rates of appropriateness or consistency, immediate remedial action is advisable.

Centrelink response: Agree.

8. The ANAO recommends that, to increase the efficiency and effectiveness of debt recovery operations, as well as customer service, Centrelink:
- proceed with the planned implementation of a nationally-based approach to its recovery operations, which provides guidance to Areas about recovery structures, processes and practices; and
 - upgrade the recovery infrastructure, including the telephonic and online systems, to ensure customers can readily access Recovery Officers.

Centrelink response: Agree.

9. The ANAO recommends that Centrelink continue with the development of:
- a national training program for Recovery Officers to provide consistency of approach as well as adequacy of skills, and which would support a high level of performance, throughout the Centrelink network; and
 - debt recovery scriptors for use by Recovery Officers, to improve consistency of advice and decision-making.

Centrelink response: Agree.

- 7.11 The agencies' qualified response to recommendation two is further outlined later in this chapter.

Characteristics of Centrelink debt

- 7.12 The ANAO listed the major characteristics of Centrelink customers' debt. Understanding the characteristics of debt enables a risk-based approach to debt prevention and identification. Centrelink debt was characterised by:

- the incidence of debt being strongly linked to the type of payment;
- customers in 'non-stimulus' programs – those which do not require regular reporting to Centrelink, such as the age pension – have larger debts than customers in 'stimulus' programs such as NewStart;
- a large number of small debts, and a small number of large debts that represent a significant proportion of the value of total debt;
- the majority of the total number of outstanding debts is less than a year old; and

- nearly 75 per cent of all debts were under some type of recovery arrangement.²

7.13 Over half of all debts are between \$0 - \$500. Around 30 per cent of debts are between \$500 - \$2,000. Just under 10 per cent are between \$2,000 - \$4,000, and another 10 per cent comprises debts greater than \$4,000.³

7.14 The Committee was concerned to note that people on the Age Pension, Disability Support Pension and Sickness Allowance have a higher average size of debt. Some programs, such as Sickness Allowance, also have a much higher incidence of debt than others. An ANAO table outlining outstanding debt per program is reproduced below:

Table 7.2 Centrelink outstanding FaCS Portfolio debt, by program

<i>Program</i>	Outstanding value of debt 30 June 03 (\$'000)	Share of total debt (%)	Average size of debt per debtor (\$)
Age Pension	65 729	6.8	3 293
Disability Support Pension	112 553	11.6	2 970
Sickness Allowance	8 002	0.8	1 815
Newstart Allowance	285 471	29.5	899
Parenting Payment Single	105 631	10.9	1 341
Parenting Payment Partnered	53 126	5.5	1 186
Youth Allowance	113 389	11.7	1 014
Austudy	19 971	2.1	2 086
Special Benefit	7 131	0.7	2 262
Family Tax Benefit	24 039	2.5	461
Other FaCS	172 643	17.8	3175
TOTAL	967 684	100	1 312

Note: Average size of debt per debtor is calculated by total value of debt divided by the number of program customers with debts.

Source: ANAO Audit Report no. 4, 2004-05, p. 137, from Centrelink data 2003.

7.15 Centrelink acknowledged that while many debts are relatively small, at less than \$500, this can still place a significant burden on the individual.

² ANAO Audit Report No. 4, 2004-05, *Management of Customer Debt (Centrelink)*, Commonwealth of Australia, August 2004, p. 34.

³ ANAO Audit Report no. 4, 2004-05, Figure A1.3, p. 139.

It is never pleasant to get notice of a debt, whatever the size. The size of the debt really is relevant only to the individual...a small debt can cause a great deal of stress to a person, as can a large one.⁴

Frameworks and processes to manage customer debt

- 7.16 The way Centrelink manages customer debt is largely determined by:
- social security law and the Social Security Guide;
 - directions from FaCS as the policy agency;
 - Centrelink's own policies regarding accuracy and correctness of customer payments; and
 - Centrelink's administrative structures, including national-level structure of debt management, and network structure and administration arrangements.
- 7.17 Centrelink's debt management is segmented to the National Office, Area Support Offices⁵, or Customer Service Centres (CSCs), according to each task – policy or management tasks are overseen by a National Office team, while more operational and processing functions are undertaken by the ASOs or CSCs.
- 7.18 The following table outlines the major debt management processes in the Centrelink network (at the time of the audit).

4 Centrelink, *Transcript of Evidence*, 4 April 2005, p. 27.

5 The Customer Service Centres provide shopfront facilities for Centrelink customers. The CSCs are grouped into 15 geographical areas, known as Area Support Offices. These ASOs provide management, administrative and operational support to each CSC in their area.

Table 7.3 Debt management processes in the Centrelink network

Program	National Support Office (NSO)	Area Support Office (ASO)	Customer Service Centre (CSC)	Call Centre
General Processing Processing customer information	Provide guidance	Specialist advice to CSCs and Call centres on National Support Office directions	Implement NSO and ASO policies and processes	Implement NSO and ASO policies and processes
Overall responsibility for debt Guidance and performance monitoring	Debt Services Team – monitors debt performance for all ASOs	Monitor debt performance for all CSCs	Obligated to meet key performance indicators and internal targets	None.
Prevention Debt Prevention and Monitoring Officers	Debt Services Team provides leadership and coordination	ASO employees, with NSO and ASO direction	Out-posted to some CSCs but no line responsibility to CSC managers Debt Prevention Officers undertake presentations and outreach to customers and third parties	None.
Other specific prevention work	Debt Services Team undertakes analysis of database and works with consultation with other teams to develop debt prevention strategies	Dependent on individual Area	Seminars and advice to customers about debt prevention and customer notification obligations	General debt prevention messages to customers
Working Credit	Central rollout	Coordination selection and training of staff and provide guidance to CSCs on policies	Deliver program	None
Identification Data-matching	Undertakes datamatching tasks	ASO teams action cases identified through data matching	None	None
Service Profiling	Provides guidance about	Manage resources to CRCs	Profiling interviews are	Answer queries

	resourcing and approach to payment accuracy, participation strategies and service updates		undertaken at CSCs	regarding reasons for Centrelink contact.
Debt Raising				
Specialist debt raising teams	Project managed by Debt Services Team	Determine which debt raising model to use	Raising generally undertaken by CSCs	None
Debt raised by compliance teams	Compliance teams are expected to raise debts	Raise debts	CSCs do not usually include compliance teams	None
Debt recovery				
Specialist debt recovery teams	Manage the recovery system	13 Area teams at the time of the Audit	Generally no recovery teams	None
Recovery by Customer Service Officers in CSCs and Call Centres as part of normal business	Provide recovery guidelines	Manage repayment offers that do not fall within the CSC and Call Centre guidelines for acceptance	Accept offers that fall within guidelines. Refer other cases to ASO.	Accept offers that fall within guidelines. Refer other cases to ASO

Source ANAO Audit Report No. 4, 2004-05, pp. 147 – 149.

- 7.19 The ANAO found that Centrelink and FaCS had developed a framework that provided the opportunity to effectively manage customer debt.⁶ However, communication between the two organisations could be improved, especially in determining and implementing debt prevention and identification programs. Similarly, the ANAO found that Centrelink could improve communication flows between the various teams within the agency responsible for debt prevention, identification and recovery.
- 7.20 The basis of the relationship between Centrelink and FaCS was initially defined in the *FaCS-Centrelink Business Partnership Agreement 2001-2004* (BPA). In July 2004, FaCS and Centrelink subsumed the BPA into a broader relationship, *Alliance 2004*. The aim of the Alliance 2004 project was to better align five major projects: Centrelink Funding Model; Outcomes and Outputs Framework; Business Partnership Agreement; Business Assurance Framework; and Information and Evidence Base.
- 7.21 The ANAO was unable to assess the extent to which Alliance 2004 would improve debt management in Centrelink, as the project had not been implemented at the time of research for the audit. However, the ANAO supported the objectives of the program.
- 7.22 One of the major platforms of Centrelink's debt management framework is the *Getting it Right* strategy. *Getting it Right* is aimed at improving payment and decision accuracy and eliminating any preventable re-work. Through the *Getting it Right* strategy, Centrelink aims to ensure it pays the right person, under the right program, at the right rate, for the right date, every time it makes a payment. This strategy is called the 'four pillars'. The strategy was endorsed by the Centrelink Board in April 2000, while implementation commenced in November 2000.
- 7.23 The ANAO commented favourably on Centrelink's *Debt Servicing Strategy 2001-2004*, and found that it had raised the profile and importance of debt management in Centrelink, and provided valuable guidance to debt management initiatives. The ANAO noted that at the time of the audit, a new strategy was due to be developed, and

6 The ANAO produced a detailed table on Centrelink's key strategies, policies and processes for managing debt – see Figure A2.2 in Appendix 2, ANAO Audit Report no. 4, 2004-05.

that this provided an opportunity for strengthening the guidelines and integration of Centrelink's debt management processes.

- 7.24 The ANAO recommended (no. 1) that in redeveloping its debt servicing strategy, Centrelink improve the communication flows between debt management teams within the agency, and align debt risks to compliance and service delivery risks.⁷
- 7.25 The Centrelink submission to the Committee reported that the organisation has embarked upon a process to reform all aspects of compliance (termed by Centrelink as payment integrity). This reform would include a redevelopment of the debt servicing strategy.
- 7.26 The three core principles of Centrelink's development of its Payment Integrity Strategy are:
1. that payment integrity is fundamental to program design and implementation, not a separate operational activity;
 2. that the payment integrity model should coordinate Centrelink's people, processes and technology so that 'integrity-driven performance is embedded into the operating core'; and
 3. the organisation's culture must be appropriate to the new focus.⁸
- 7.27 In August 2005 Centrelink advised the Committee that its Payment Integrity Strategy had been finalised. Part of the Strategy is that Centrelink implement the ANAO's recommendation regarding communication flows. Centrelink reported that overall responsibility for business integrity is now under one General Manager.⁹

Committee comment

- 7.28 The Committee is pleased to note progress towards implementation of this recommendation and looks forward to a progress report from Centrelink on the implementation of its new payment integrity strategy.

7 ANAO Audit Report no. 4, 2004-05, p. 41.

8 Centrelink, submission no. 3, p. 1.

9 Centrelink, supplementary submission no. 3.1, p. 1.

Recommendation 18

- 7.29 **The Committee recommends that Centrelink prioritise the implementation of its payment integrity strategy, to ensure that payments are right in the first instance, rather than relying on reactive processes.**

Centrelink should report to the Committee on its progress in implementing the payment integrity strategy in February 2006 and July 2006.

Debt prevention

- 7.30 The ANAO found that Centrelink had improved the profile and importance of debt prevention in the agency, particularly by clearly articulating its objectives in the *Debt Servicing Strategy 2001-04*.
- 7.31 Similarly, the ANAO noted recent improvement in Centrelink's debt prevention strategy development, involving a move away from reliance on anecdotal information that led to disjointed and ad-hoc efforts in the past. At the time of the audit, Centrelink had also recently developed and begun to implement a debt prevention project.
- 7.32 The ANAO found that Centrelink's Debt Services Team was facing difficulties in coordinating debt prevention and management initiatives across the agency, including monitoring the performance of debt prevention activities in Area Support Offices (ASOs), and encouraging ASOs to adopt better debt prevention practices. The ANAO found that if Centrelink identified better practice in individual Debt Services offices, this could help to improve leadership and coordination of debt prevention and management across the network.
- 7.33 The ANAO found that Centrelink did not effectively measure the impact of its debt prevention activities (recommendation 4). At the time of this Committee's report, Centrelink is in the process of revising internal indicators of debt prevention performance.

- 7.34 At the hearing the Committee asked a number of questions relating to debt prevention.
- 7.35 Centrelink told the Committee of new measures being introduced to bolster debt prevention. For example, many Youth Allowance debts are created because students change courses or the number of hours they attend a course, which affects their payment entitlement. However, students do not often advise Centrelink of these changes. Centrelink is now working to undertake data-matching with academic institutions in order to avoid debts. This strategy is also being trialled with major employers.¹⁰ The Committee believes strategies such as these are vital in ensuring that clients do not accumulate a Centrelink debt.

Recommendation 19

- 7.36 **The Committee recommends that Centrelink proceed with data-matching activities with academic institutions and major employers, in an effort to prevent debts incurred when clients change study courses or employment.**
- 7.37 Centrelink also outlined a new project called *Keeping the System Fair*, in which 15 Centrelink employees are embedded throughout the network, whose job is to provide more strategic focus for debt prevention activities and to undertake local level analysis to inform marketing campaigns. These people will also be responsible for developing external output measures for debt prevention.¹¹
- 7.38 Centrelink told the Committee that it is progressing towards full online access for customers. When this system is fully operational, Centrelink customers will be able to view the information held by Centrelink about them (ie, income level, assets, etc). Customers will be able to inform Centrelink about changes to their circumstances via the internet, rather than needing to visit a Centrelink office or make a telephone call. Centrelink advised that the most popular piece of information currently accessed on its internet site is customers' debt.¹²

10 Centrelink, *Transcript of Evidence*, 4 April 2005, p. 13.

11 Centrelink, *Transcript of Evidence*, 4 April 2005, p. 5.

12 Centrelink, *Transcript of Evidence*, 4 April 2005, p. 13.

Centrelink is also planning to run a media campaign to tell people about their notification obligations.¹³

- 7.39 The Committee notes that many of the new measures outlined by Centrelink to improve debt prevention may primarily be accessed by younger Centrelink customers. For example, customers on the Age Pension may be less likely to use the internet to check on the information held by Centrelink about their income and assets. Unfortunately it is this group of people who are more likely to have a large Centrelink debt, because they are not in regular contact with the agency. The Committee asked Centrelink what it is doing to try to inform these people of the need to check their Centrelink details. Centrelink responded that it sends regular newsletters to all Age Pensioners, and they use other methods such as financial advisors, to convey information to these customers. Centrelink is trying to ascertain how people would prefer to receive information:

We want to try and make the services that Centrelink delivers a lot more personalised, in that, when we first deal with the customer, our conversation will be around how people understand information, because now we are getting the technology which enables us to provide a lot more choice in the way that citizens deal with us. So we will ask customers about how they understand information, how they can better access it and how they want us to communicate with them. Do they prefer it in writing, would they like to have it on the internet, would they like us to talk to them personally?

...it [will be] more cost-effective to take the time at the front of the process, help customers through and determine the best ways they understand information, rather than leaving it to one methodology or one medium and then obviously having lots and lots of phone calls down the track because people have not understood or they have missed the need to do something.¹⁴

Committee comment

- 7.40 The Committee was encouraged to hear of Centrelink's work in a number of areas to improve debt prevention. However many of these improvements, such as internet access to information, may not reach

13 Department of Family and Community Services (FaCS), *Transcript of Evidence*, 4 April 2005, p. 12.

14 Centrelink, *Transcript of Evidence*, 4 April 2005, p. 14.

some of those Centrelink customers who are accumulating the largest debts – Age Pensioners, those on Sickness Allowance, and others on long-term payments that do not require regular customer contact with Centrelink.

- 7.41 The Committee urges Centrelink to continue its work on how to best communicate with these groups of customers, in an effort to prevent the accumulation of large debts.

Identification of overpayments

- 7.42 Centrelink identifies debts through its compliance framework, which includes:
- compliance reviews - comprising data matching, tip-offs, investigations and surveillance;
 - program reviews - an activity initiated by Centrelink to ascertain whether a customer is receiving his/her correct entitlement, for example, cyclic reviews (such as every four weeks) and event-based reviews (such as the birth of a child);
 - Service Profile reviews - a means of identifying which customers need a more targeted level of service to assist them to meet program outcomes. When fully implemented, Service Profiling will replace all former program reviews for all payments; and
 - customer initiated re-assessments - where a customer voluntarily advises Centrelink of a change in his/her personal circumstances.

- 7.43 The ANAO found that these procedures were generally effective in identifying debts. However, compliance reviews accounted for 76 per cent of the debts identified through reviews, while representing only 19 per cent of the number of reviews, in 2002–03.

Tip-offs

- 7.44 The National Tip-off Reporting Centre provides an additional compliance and identification tool, as it allows Centrelink to identify activities that other compliance or program reviews would not detect. Common activities subject to tip-offs include customers living in marriage-like relationships, without declaring this relationship to Centrelink, and customers undertaking 'cash in hand' work, that

would not be detected by Centrelink's data matching programs with the Australian Taxation Office.

- 7.45 Centrelink told the Committee that it processes around 100,000 tip-offs per year and that the number of debts resulting from those tip-offs would be a smaller number. However, it is a valuable tool both in terms of actual debts raised and also as a deterrent. An analysis of tip-offs also gives Centrelink an insight into people who are not caught by their data-matching activities.¹⁵

Other methods of debt identification

- 7.46 The ANAO stated that Centrelink may be able to improve the effectiveness of identification activities by either focussing more intensively on compliance reviews, or improving the performance of other methods of review.

- 7.47 Some of the methods suggested by the ANAO included:

- cross referencing customer behaviour and attributes with known debt factors (such as size, frequency, geographic, seasonal and demographic factors) to better target debt prevention strategies;
- drawing on the experience of other agencies such as the Australian Taxation Office and the Child Support Agency to develop best practice models for debt management; and
- better support required for the national coordination unit (the Debt Services Team), to increase its monitoring and approval role in the work of Area debt prevention projects.¹⁶

Committee comment

- 7.48 The Committee is concerned that Centrelink appears to be putting a lot of effort into identification activities that do not yield a high level of results. The ANAO reported that although compliance reviews account for only 19 per cent of Centrelink's identification activities, they account for 76 per cent of all debts identified. The Committee agrees with the ANAO's assessment that Centrelink either needs to lift its level of compliance reviews, or improve other identification strategies.

15 FaCS, *Transcript of Evidence*, 4 April 2005, p. 20.

16 ANAO Audit Report no. 4, 2004-05, pp. 65-68.

Recommendation 20

7.49 **The Committee recommends that Centrelink review its methods of identifying customer debt, with a view to improving current methods of debt identification, or increasing the resources dedicated to compliance reviews. Centrelink should also take into consideration the ANAO's suggestion that it consider other methods of debt identification, such as:**

- **cross-referencing customer behaviour and attributes with known debt factors to better target debt prevention strategies;**
- **drawing on the experience of other agencies such as the Australian Taxation Office and the Child Support Agency to develop best practice models for debt management; and**
- **increasing support for the national coordination unit to better manage debt prevention projects.**

Debt Raising

7.50 The ANAO considered that Centrelink's restructuring of the non-compliance debt raising process in mid-2003, which involved the introduction of specialist debt raising officers and teams, has the potential to significantly improve the agency's administration of this aspect of debt management. The ANAO found that together with improved technical support tools for debt raising officers, restructuring the non-compliance debt raising process within Centrelink appeared to have improved the timeliness and accuracy of debt raising.

7.51 In August 2005 Centrelink told the Committee that an internal audit had reviewed the accuracy of debts raised by Centrelink staff. A number of issues were identified, pointing to differences in the effectiveness of debt raising strategies within Centrelink. The submission from Centrelink stated that it would further review the

recommendations of the internal review in order to develop an appropriate response.¹⁷

- 7.52 While Centrelink has undertaken major restructuring of its non-compliance debt raising functions, the ANAO found that there had been no accompanying reform of its compliance-based debt raising processes. This is despite compliance debt representing a significant proportion of benchmark debt, and the adverse results of Centrelink's own October 2002 review of debts raised by Compliance Officers for ABSTUDY payments, which found high rates of error for compliance debts.

Debt waiving

- 7.53 During fieldwork for this audit, the ANAO interviewed a number of Centrelink's Authorised Review Officers and also held discussions with external stakeholders. The ANAO noted the view held by Centrelink Authorised Review Officers, and external stakeholders, that Centrelink Customer Service Officers are often reluctant to waive debts, with the exception of the most obvious of cases, where Centrelink had been at fault. However, interviews with the Customer Service Officers themselves revealed that they felt they were waiving debts as appropriate.
- 7.54 The ANAO found that Customer Service Officers chose not to waive debts for a number of reasons. These included a lack of confidence in their own ability to interpret the Centrelink guidelines on 'good faith' and 'special circumstances', and also a belief that the downstream appeal process would correct any incorrect decision.
- 7.55 While acknowledging that it is difficult to have complete consistency in applying concepts such as 'good faith', the ANAO was strongly critical of staff decisions to raise a debt in the belief that a mistake would be corrected by the downstream appeal process. The ANAO commented:

This assumes that all customers have the same ability to understand their rights, and have the same capacity and motivation to question a decision to raise a debt against them.

Interviews with external stakeholders identified that it is

17 Centrelink, supplementary submission 3.1, p. 2.

often the customers in the worst possible circumstances who are those least able to appeal against debts. In many cases, the debt-raising officer is well aware of these customers' circumstances.¹⁸

- 7.56 Centrelink responded that it is considering raising the automatic waiver threshold above the current \$50 limit (discussed further at paragraph 7.65). This would significantly reduce the number of waiver decisions to be exercised by staff.
- 7.57 In August 2005, Centrelink stated that it had completed a work plan to review the appropriateness of how debt waivers are applied throughout the network, as recommended by the ANAO. However, 'the availability of appropriately skilled staff will determine the specific timing of this activity.'¹⁹

Committee comment

- 7.58 The Committee agrees with the ANAO's assessment that Centrelink officers must not rely on the appeals process to pick up any mistakes they may have made in raising a debt. The ANAO found clear evidence that Centrelink debt-raising staff do not feel they have the confidence to make correct decisions on the appropriate circumstances in which to authorise a debt waiver.
- 7.59 The Committee is concerned to hear that Centrelink does not know when it will complete a review of the appropriateness of how debt waivers are applied throughout the network, despite having agreed to implement the ANAO's recommendation to undertake this review.
- 7.60 It is of primary importance to ensure that Centrelink staff are capable of making appropriate decisions, and are encouraged to refer cases in which they are in doubt, to a more senior staff member for decision. Centrelink should undertake the debt waiver review, as recommended by ANAO, as a matter of priority. This should help to ensure consistency across the network in applying debt waiver measures.

18 ANAO Audit Report no. 4, 2004-05, p. 109.

19 Centrelink, supplementary submission no. 3.1, p. 2.

Recommendation 21

- 7.61 **The Committee recommends that Centrelink provide training to all officers responsible for debt raising, on the correct circumstances in which to apply a debt waiver. The training should focus on empowering workers to make responsible decisions, and an emphasis on the importance of getting decisions right in the first instance, and not relying on downstream appeal mechanisms.**

Centrelink should also introduce a standard operating procedure whereby debt raising officers refer any matter on which they are uncertain whether to apply a 'special circumstances' waiver, to a more senior officer for consideration.

Centrelink should undertake a review of the appropriateness of applying Debt Waivers throughout the Centrelink network, taking into account the matters raised in the ANAO report, as a matter of priority.

Debt recovery

- 7.62 The Audit Report found that Centrelink had inconsistent debt recovery structures and processes across its network. At the time of the audit, recovery was left to individual Area Support Offices to administer. As a result, there were significant differences across the network in the levels of skills of Debt Recovery Officers, the likely levels of customer service, and the performance of Debt Recovery Teams.

New Debt Recovery structure

- 7.63 At the time of the audit, the ANAO noted that Centrelink was planning a restructure of its recovery operations. Centrelink reported to the Committee that centralised debt recovery arrangements were implemented on 1 October 2004. There are now six specialised debt recovery sites. Three teams deal with debts of up to \$5,000, two with debts over \$5,000, and one team is dedicated to indigenous payments. The new arrangements included the introduction of a dedicated telephone number for customers contacting Debt Recovery; an upgrade of the telephone system by June 2005 to route calls to the best team based on current workloads; training for all existing and new

debt recovery staff; and transcripts to assist staff to be professional in their approach to customers.²⁰

- 7.64 The ANAO found that Centrelink's arrangement with its contracted mercantile agent (Dun and Bradstreet) was an effective way of recovering older debts that are not cost effective for Centrelink to pursue with internal resources. Centrelink responded to the ANAO's finding by increasing the number of debts forwarded to Dun and Bradstreet for management, and by replicating Dun and Bradstreet's telephone routing system (described above).²¹

Cost of debt recovery

- 7.65 The Committee questioned the cost-benefit of debt recovery operations. Centrelink advised that at the moment, it does not take any action on a debt that is below \$50. Although the debt is calculated and raised, it is waived automatically without the customer being informed. Centrelink is currently undertaking a review of the cost-effectiveness of recovering debts less than \$100, and expects to raise the waiver limit to somewhere between \$50 and \$100. Centrelink told the Committee that 50 per cent of all debts raised are less than \$100.
- 7.66 The Committee agrees that small debts should be waived rather than spending resources in trying to recover these debts. The Committee supports Centrelink moves to increase the debt waiver amount from \$50 to a maximum of \$100.
- 7.67 However, the Committee believes that it would be beneficial to inform Centrelink customers that they did incur a small debt, which has been waived. This would inform customers about debt prevention and help to prevent the accumulation of such small debts in the future.

20 Centrelink, submission no. 3, pp. 6-7.

21 ANAO Audit Report No. 4, 2004-05, p. 117; and Centrelink, *Transcript of Evidence*, 4 April 2005, p.7.

Recommendation 22

- 7.68 **The Committee recommends that the debt waiver amount be raised from \$50 to not more than \$100. The Committee recommends that where small debts are raised and automatically waived, customers should be informed of this action and of steps they can take to prevent a debt being incurred in the future.**

Where a customer continues to incur small debts of less than \$100, that are continually waived, Centrelink should retain the right to recover these debts if a pattern of behaviour is apparent whereby the customer is not making any effort to prevent the incursion of small debts.

Repayment method

- 7.69 Centrelink customers may repay their debt via Post Office or Rural Transaction Centres, direct debit from a bank account, or voluntary deduction from wages. Customers may also choose to pay via credit card.
- 7.70 In 2003, Centrelink policy was for Recovery Officers to not offer the credit card payment option to customers, unless the customer specifically requested it. However, the ANAO visits to field offices observed a lack of adherence to this guideline. This applied to Centrelink Recovery Officers and staff of Dun and Bradstreet.
- 7.71 Centrelink subsequently advised the ANAO that from March 2004, Centrelink staff could no longer accept credit card payments. Customers wishing to pay by credit card could still do so via Australia Post. As the audit fieldwork was concluded by this stage, the ANAO could not test whether Centrelink staff were adhering to this new policy.²²
- 7.72 However, Dun and Bradstreet debt collection officers continue to accept payment by credit card, although they are required to offer the credit card option last on this list, and not encourage it above other payment methods. ANAO suggested that that Centrelink and Dun and Bradstreet continue to monitor adherence to the guidelines regarding credit card payments.

22 ANAO Audit Report no. 4, 2004-05, p. 126.

Committee comment

- 7.73 The Committee notes that Australia's credit card debt now stands at over \$30 billion, with an average debt of over \$2,500 per account.²³ One of the objectives of Centrelink's debt recovery is to recover the money owing without causing 'real financial hardship' to the customer. The Committee believes that encouraging customers to transfer their government debt to a credit card with potentially high interest rate could, in some circumstances, lead to the customer experiencing real financial hardship. For some people, what may seem like an easy solution in the short term could compound their financial difficulties over the longer term. However, the Committee acknowledges that individuals must have the right to manage their financial affairs according to how they see fit.
- 7.74 The Committee believes that it is important that Centrelink and Dun and Bradstreet staff emphasise the advantages of other payment methods over a credit card which may attract high interest rates.

Recommendation 23

- 7.75 **The Committee recommends that Centrelink monitor the work of its debt recovery officers, and those employed by its debt recovery agent, to ensure that customers are encouraged to repay debts via means other than credit cards.**

Performance monitoring of debt management in Centrelink

- 7.76 The ANAO's recommendation number two called for FaCS, together with Centrelink, to review the external performance monitoring regime for debt management in Centrelink, to promote better practices and performance improvements. The ANAO called for an overhaul of the debt Key Performance Indicators and the associated outcomes-outputs framework that is reported in yearly Portfolio Budget Statements.²⁴ FaCS agreed with qualification, stating that new debt raising and debt recovery output measures were developed and
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23 Reserve Bank of Australia, Bulletin May 2005, Table C1, at: <http://www.rba.gov.au/Statistics/Bulletin/index.html>, accessed June 2005.

24 ANAO Audit Report no. 4, 2004-05, p. 154.

agreed by FaCS and Centrelink by July 2004. The new measures were that:

- debt raising: that debts determined be 65 per cent of the undermined debt base; and
- debt recovery: that value of debts under recovery be 65 per cent of the debt base.

7.77 Centrelink argued that identifying a target dollar figure for debt identification would run counter to the objective to prevent debt. FaCS similarly argued that 'setting balanced KPIs for social security debt is extremely complex...each of the stages of debt management is affected by factors that are outside the control of Centrelink.' FaCS also argued that very specific KPIs could lead to unintended consequences, 'for example, setting dollar targets for debt identification could undermine debt prevention objectives'.²⁵

7.78 FaCS and Centrelink have agreed with the ANAO's suggestion to improve debt key performance indicators (KPIs) by supplementing the recently revised set of KPIs with measures of the effectiveness of debt prevention and identification, and the accuracy of debt raising, as well as reporting on the magnitude of outstanding debt.

7.79 In August 2005 Centrelink reported that it had agreed with all key agencies that the foundation principle for measuring debt prevention is the level of payment correctness. As a trial, Centrelink will measure this payment correctness via Random Sample Surveys during 2005-06. The appropriateness of this measurement tool will be assessed before finalising a measure for debt prevent to be included in the Centrelink Business Partnership Agreements for 2006-07.²⁶

7.80 The Committee is pleased with this progress in developing new output measures. The Committee agrees with FaCs and Centrelink that there must be careful consideration in setting KPIs to ensure that any targets do not undermine another Centrelink objective (such as debt prevention).

Further reviews

7.81 The ANAO found that Centrelink did not monitor customer satisfaction with its debt management services, nor fully measure its

25 ANAO Audit Report no. 4, 2004-05, p. 157.

26 Centrelink, supplementary submission no. 3.1, p. 1.

debt management resourcing and cost, to ascertain relative productivity and cost efficiency, and achieve future savings.

- 7.82 The Committee is now undertaking a further review of a number of ANAO reports related to Centrelink customer satisfaction.
- 7.83 The ANAO's audit excluded debts relating to Family Tax Benefit payments. The ANAO considered that 'due to continuing changes occurring in the Family Tax Benefit program, a future separate, comprehensive audit would be better placed to consider debts relating to the Family Tax Benefit Program.' The Committee notes that the ANAO plans to undertake this audit in the 2005-06 financial year.

Audit Report No. 5, 2004-05

Management of the Standard Defence Supply System Upgrade

Introduction

8.1 The Standard Defence Supply System (SDSS) *version 4* is a computer program that spans the three Services in its coverage of logistics management. SDSS is intended to be a key information system for financial management of Defence assets, and equally importantly, to facilitate Defence's materiel management capability. Some key characteristics of the SDSS system are that it includes:

- 1.7 million items catalogued;
- \$2.0 billion in Inventory;
- \$7.5 billion in Assets;
- over 14,000 registered users (8,000 active users, approximately 1,600 concurrent daily users);
- 144 Districts (separate geographic business units);
- 1,200 warehouses;

- 600,000 transactions per day, 5,000 picking slips per day, 6,800 batch runs per day, 76,000 demands per week; and
 - 250,000 purchase/transfer/workshop orders per year.¹
- 8.2 In keeping with Defence policy, the ANAO has assessed that the system qualifies as a strategic system. The initial SDSS program (then titled the Supply System Redevelopment Project) was rolled out in 1992, as the first joint logistics management process for the ADF. In 1992, the Joint Committee of Public Accounts reported on the Supply System Redevelopment Project, and found that there was poor administration and management of the project, the result of which was that sub-elements of the project continuously fell behind schedule.
- 8.3 In July 2000, the SDSS version 4 Upgrade Project (the Project) was initiated with an approved budget of \$15.87 million with the main aim of delivering a Standard Supply Chain System across Defence by June 2002. The Project incorporated a new version of the operating software and improvements to the management of the Defence supply chain and its infrastructure. The aim was to provide a system for the management of the Defence spares inventory, valued at \$1.9 billion.
- 8.4 As of November 2003, the Project had incurred costs of \$49.9 million excluding \$5.1 million in contract residuals contributed by e-Procurement and SDSS *version 3* legacy training projects. Defence advised the ANAO that the formal Project closure was dependent on the delivery of the financial reporting functionality expected of the SDSS *version 4* system.

Audit objectives

- 8.5 The objective of the audit was to undertake a performance audit of the project management environment governing delivery of Defence business information system projects, with specific reference to the SDSS Upgrade Project. The audit addressed the scope of the system being delivered, with specific regard to its ability to meet end user capability requirements. The audit was presented to Parliament in August 2004.

Audit conclusions

- 8.6 The ANAO found that the Project has not delivered value for money to Defence. The Project exhibited extensive scope reduction and the final schedule (at June 2004) was more than two years over the planned schedule. SDSS *version 4* was intended to provide Defence with improved finance functions, tighter controls over data integrity and transaction processing,

1 Department of Defence, *An Overview of Standard Defence Supply System (SDSS)*, Exhibit no. 17.

and improved reconciliation and reporting. The ANAO concluded that the Project failed to materially deliver many of the outcomes for which it was funded.

- 8.7 At the time of the ANAO's report (August 2004), the project was still incomplete. The escalating cost of the project (excluding \$5.1 million in contract deliverables from legacy training and e-Procurement projects) required a further allocation of \$34 million towards what had originally been approved as a \$15.87 million project. By November 2003, the Project had already exceeded its initial approved budget by more than 200 per cent. This excluded further funds earmarked for the SDSS Get Well Program. Defence has advised the ANAO that the anticipated delivery date for the Get Well Program remediation activity is December 2005.
- 8.8 The ANAO found that the delivered system did not satisfy many of the end user expectations. Significantly, the system was ineffective in its ability to manage Defence stock holdings to the extent originally envisaged, and restricts Defence's ability to fully account for them. The system did not adequately alert appropriate Defence logistic management staff that strategically important stock holdings had fallen below levels able to support Defence operational requirements. Reports of this nature were not automatically routed to materiel managers responsible for replacing used stores. The ANAO believed that without appropriate workarounds, these shortcomings compromised Defence's ability to assure operational Force Element Groups that the stores necessary to implement their stated operational requirements could be delivered as required to support operational readiness.²
- 8.9 A Department of Defence minute to the Defence Minister dated March 2004 stated that:

the current operational status of SDSS indicates that it is below minimal levels of functionality...the SDSS version 4 upgrade, supposedly completed in July 2003, is non-performing and for some reason has actually taken progress backwards.³

ANAO recommendations

- 8.10 The ANAO made the following recommendations:

2 ANAO Audit Report no. 5, 2004-05: *Management of the Standard Defence Supply System Upgrade (Department of Defence)*; Commonwealth of Australia; August 2004; p. 23.

3 ANAO Audit Report no. 5, 2004-05, p. 78.

Table 8.1 ANAO recommendations, Audit Report no. 5, 2004-05

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1. The ANAO recommends that Defence adopt approval processes for business information management systems that align with processes used for other major capital acquisitions.
Defence response: Agreed for future projects.
 2. The ANAO recommends that Defence review the Management Information Systems Division traffic light reporting methodology to ensure that, project progress is assessed in terms of both current and original baseline information.
Defence response: Agreed.
 3. The ANAO recommends that Defence develop and promulgate a Standard Operating Environment upgrade plan. This plan would describe the technical, system, and operational standards to be adopted for management information systems over the short, and medium term.
Defence response: Agreed.
 4. The ANAO recommends that Defence:
 - a) develop specific policy to define, and manage effectively, actual and perceived conflicts of interest arising from the engagement of a Contractor to conduct the scoping phase of a project that provides the basis of a much larger tender; and
 - b) review the use of a time and materials style contract for the performance of management functions associated with high-risk software development projects dependent on Defence specific deliverables.
Defence response: Agreed.
 5. The ANAO recommends that, where the use of an Earned Value Management System is stipulated by extant policy, Defence consider adopting Australian Standard 4817-2003, the Australian Standard for Project Management Using Earned Value, to provide robust performance assessment information to senior management.
Defence response: Agreed.
 6. The ANAO recommends that Defence:
 - a) review the responsibility for SDSS system management and development in the 'In Service' domain, against the responsibility to fund the development and validation of training products for delivery to the user environment;
 - b) review the requirement to establish a centralised Defence Training Authority to accept responsibility for the management and delivery of all required SDSS training;
 - c) ensure that the chosen Training Authority has adequate and relevant experience in the delivery of information system training ware;
 - d) review the regulation and suitability of the training at regular intervals; and
 - e) ensure that training is included as a standing agenda item at a Senior User Group, or similar executive forum, where the authority to expend funds for training development activities can be endorsed for implementation.
Defence response: Agreed.
 7. The ANAO recommends that Defence regularly review user acceptance of, and compliance with, the Defence Supply Chain Manual and associated management directives.
Defence response: Agreed.

8. The ANAO recommends that Defence manage the recently developed SDSS Get Well Program within the framework of the Defence Information Environment, including wide end user involvement (with Joint Logistics Command representation) at the Governance Board level.

Defence response: Agreed.

Establishment of the project

- 8.11 The project commenced in June 2000 as an Equipment Acquisition Strategy to upgrade the existing operating system upon which the Defence logistics management system was based while, concurrently, upgrading the business rules to roll out a Single Supply Chain Management System, and introducing changes to the financial records of the system to enable it to comply with accrual accounting standards. The Equipment Acquisition Strategy was approved with an estimated project cost of \$27 million, and work began on the system upgrade in November 2000.
- 8.12 Defence manages acquisition projects under two main categories: Major Capital Equipment, which, at the time the SDSS upgrade was undertaken, was centrally located and managed by the Defence Acquisition Organisation in Canberra; and Minor Capital Equipment projects, which were controlled by any of the then 14 Defence Groups, which included the Support Command Group.
- 8.13 The ANAO found that the SDSS upgrade satisfied the conditions for classification as a strategic procurement activity (meaning it would deliver an outcome critical to Defence's ability to meet its core objectives), and thus treatment as a Major Capital Equipment Procurement activity. The risks of program failure were high, and the costs associated with delay were also high. The procurement activity was very complicated, extending across more than 50 individual contracts of varying nature and complexity.

Approvals

- 8.14 Despite the complexity outlined above, the SDSS upgrade was raised as a Minor Capital Equipment acquisition project from operating funds. This decision was taken irrespective of the Equipment Acquisition Strategy, which estimated the cost associated with implementing the stated upgrade outcomes as being \$27 million which would, at the time, have required the upgrade project to be approved by Cabinet, and managed as a Major Capital Equipment procurement activity. The following table details the approval

required by the Defence procurement manual (CEPMAN-1), and the actual level of SDSS approvals:

Table 8.2 Defence procurement manual project approval guidelines

Estimated Project Cost	Business Rules	SDSS Upgrade Project Compliance
	<i>For an Estimated Total Project Cost</i>	<i>Approval Authority</i>
\$27 million – Equipment Acquisition Strategy July 2000	Greater than \$20 million	Cabinet
	Less than or equal to \$20 million	Minister for Defence with the concurrence of the Minister for Finance
	\$8 million or less	Minister for Defence
	\$5 million or less	Secretary, Chief of the Defence Force and Program Managers
		The project did not obtain Cabinet approval
		The project did not obtain Ministerial approval at any level
		The project did not obtain Ministerial approval to commence
		The project received project approval, in writing, from the Support Commander, Australia

Source *Audit Report no. 5, 2004-05; p. 40.*

8.15 The ANAO report stated that Defence governance procedures have recently been strengthened to ensure that all strategic capability procurement exceeding designated limits will be referred for Ministerial consideration.

Governance

8.16 The SDSS upgrade project was established without a formally appointed Project Board, even though this was required by the Defence Equipment Acquisition Strategy. The Board was eventually established by July 2001. Defence reported to the ANAO that the original Board membership did not include a wide representation of user interests, or representation of Boards governing interdependent projects. However, Defence reported that it had made changes to the project governance board for the Get Well project (discussed further below).

Project scoping and management

8.17 PricewaterhouseCoopers Consulting (PwCC) undertook a scoping study in 1999, outlining proposals for upgrading the SDSS system. The Equipment Acquisition Strategy (June 2000) was based on the PwCC report.

8.18 Defence has since identified inadequate scoping as one of the main reasons for the cost blowout in the SDSS project. The Chief Executive Officer of DMO told the Committee:

It would appear that the project was not adequately scoped. It would appear that there was a march off into the grey never-never...without knowing quite what was out there. There was also an element of 'wish list', where the project was underscoped. In other words, people said 'I wish I had this; I wish I had that'. Part of the cost blow-out was because some of those wishes were granted.⁴

8.19 In the Equipment Acquisition Strategy (based on the PwCC scoping study), Defence identified that it did not have the staff required to manage the project. Support Command Australia therefore approved the outsourcing of the project management to a Project Management Organisation (PMO).

8.20 Following a competitive tendering process involving three firms, PwCC was engaged as the PMO for the Project, and Dimension Data was engaged as the training development and delivery contractor. In November 2002 the PMO role was novated to IBM Business Consulting Services (IBM BCS) to coincide with the IBM acquisition of PwCC.

8.21 Under the PMO contract won by PwCC, project management costs increased from a projected cost of \$5.2 million (July 2000) to \$26.3 million by November 2003. This represented 47 per cent of the final project costs.

8.22 The Committee was concerned to learn that PwCC had scoped the SDSS project and then won the tender for project management. Defence later acknowledged that the initial scoping study was inadequate, which largely led to the blow-out in the management costs. Defence acknowledged the problems inherent in such an arrangement:

Yes, there is a potential for conflict in that sort of arrangement. That is why we will not be doing that sort of arrangement in the future.⁵

8.23 Defence advised the Committee that future projects such as the JP2077 replacement logistics system (discussed further in this chapter), will be project-managed internally by DMO staff rather than by a contracted company.

Contract management

8.24 The ANAO found that the contractual construct chosen for the project was deficient. The decision to retain a contracted PMO, on hourly rates, for a

4 Defence Materiel Organisation (DMO), *Transcript of Evidence*, 28 April 2005, p. 55.

5 DMO, *Transcript of Evidence*, 28 April 2005, p. 45.

high-risk software development and roll out program during Phase 2 of the Project, proved to be inappropriate, and did not shift adequate risk to the PMO. A large proportion of the costs associated with the delays experienced by the Project were consumed by the PMO.

- 8.25 The PMO had no direct contractual authority over any of the internal, Defence suppliers to the Project, and limited contractual control over commercial suppliers, yet was expected to accept responsibility for the management of deliverables.
- 8.26 Defence acknowledged that there were insufficient numbers of project management staff to perform all the tasks required to ensure that internal suppliers delivered the required information to the PMO, and that the staff available did not have the skill sets necessary to complete Project tasks on time.
- 8.27 ANAO found that had the project been run as a Major Capital Equipment procurement activity, the documents required to manage the internal defence suppliers would have been produced as a matter of course during the approvals process.
- 8.28 According to ANAO, 'the inability for the contracted PMO to effectively direct Defence identities, and the lack of required service by Defence suppliers, contributed to a large degree to Project delays.'⁶

Time and cost increases

- 8.29 The escalation of costs associated with the project required additional funding. Defence took the decision to fund the Project from disparate sources, initially from Support Command operational funding, and then from the emerging Project JP 2077 (designed to streamline the logistics support to the ADF through improvements to logistics information management systems).
- 8.30 When it became obvious that the available Project funds were not sufficient to complete the Project, further funding of \$15 million was approved by the Minister for Defence with the Minister for Finance's concurrence in October 2002. When rollout threatened system operability during the Defence deployment to Iraq in early 2003, Defence delayed rollout, on two separate occasions, which increased the Project cost by a further \$8 million. The Minister for Defence approved the further \$8 million cost increase.
- 8.31 The ANAO found that Defence reduced the scope of the project to ensure that Ministerial approval was secured in time to meet its existing contracts. If

6 ANAO Audit Report no. 5, 2004-05, *Management of the Standard Defence Supply System upgrade - Department of Defence*, Commonwealth of Australia, August 2004, p. 68.

Defence had sought funding in excess of \$20 million, Cabinet approval would have been required. By requesting \$15 million, Ministerial approval (by the Minister for Defence and the Minister for Finance), was sufficient.

- 8.32 The ANAO found that the reduction in scope served to diminish the system's capability at delivery. The ANAO also found that 'management decisions to redirect allocated resources to cover increases in management expenses eventually contributed to poor network performance, loss of functionality, and loss of system acceptance by end users.'⁷

Committee comment

- 8.33 Throughout this inquiry the Committee has been extremely concerned to learn of the poor planning, implementation and management of this project. Many of the problems stem from the fact that it was initially raised as a Minor Capital Acquisition Project, rather than as a Major Capital Acquisition Project, as was fitting given the amount of money initially budgeted, and the importance of the system to Defence's logistics management.
- 8.34 Approvals were not initially sought at Cabinet, Ministerial, or even Departmental head level, despite the project being estimated at \$27 million. The project was scoped by an external provider (PriceWaterhouseCoopers Consulting), which eventually won the contract to undertake the SDSS upgrade. It has since been acknowledged that a major problem with the entire project was that it was poorly scoped in the first place. The contract allowed major cost blowouts to the Project Management Organisation, because of hourly rates for a high-risk software and rollout program.
- 8.35 When cost began to become a major problem, Defence 'down-scoped' parts of the project to ensure that the extra funding required came in under \$20 million, and therefore did not require Cabinet approval. This downgrading of some parts of the project directly contributed to end-user problems such as slow network speeds. These problems subsequently needed to be fixed in the Get Well project.
- 8.36 The problems uncovered by the ANAO and again investigated by this Committee are simply unacceptable. Defence has assured the Committee that for future projects, planning and project management will be better managed. The Committee believes that in particular, proper approvals at Ministerial or Cabinet level must be obtained. Failures in this respect, in the Committee's view, warrant that someone be held accountable and appropriate disciplinary action be undertaken.

7 ANAO Audit Report no. 5, 2004-05, p. 17.

- 8.37 The Committee would also be extremely concerned if project management functions were outsourced to an external provider, particularly on flexible contracts with provisions for hourly rates and other costly measures.

Recommendation 24

- 8.38 **The Committee recommends that all Defence information system projects be subject to the appropriate levels of cabinet, ministerial or departmental approval, as per Defence's own internal procurement guidelines and the 2003 Kinnaird review.**

Where project managers fail to ensure that their project receives the adequate levels of cabinet, ministerial or departmental approval, disciplinary action should be undertaken by Defence.

Recommendation 25

- 8.39 **The Committee recommends that the Department of Defence and the Defence Materiel Organisation institute a formal policy which excludes external contractors from being appointed as project managers for IT systems. Any performance bonuses paid to project managers must be directly linked to project milestones being met on-time and on-budget.**

Delivery management and ongoing support

- 8.40 The ANAO found that the cultural changes required to bring about adoption of the new SDSS system were not accomplished by either the Defence Project Office or the Senior User Group. As a result, Defence told Senate Estimates hearings this year that many ADF personnel are not using the upgraded system.

...[SDSS] is working where it works – that is, where the management of the warehouse, the workforce, is prepared to use the system

properly it can do the job, but it is the training and discipline issue that has to back it up.⁸

...during the upgrade process the system performance degraded, the willingness of people to use the system directly dropped off and there was also a problem with very low staff morale because of the DIDS (Defence Integrated Distribution System) transition, so there was reasonably high absenteeism during that period.⁹

- 8.41 The ANAO found that Defence had no single training authority responsible for managing the scope of the training required to educate SDSS operators. There were different delivery methods for each ADF service, and no formal certification of SDSS operator competency. The training was not easily planned or implemented for all end users.¹⁰
- 8.42 The contract to Dimension Data for training had a value 'not to exceed \$7 million'. The final costs associated with discharging the contract escalated to \$13.35 million. The Committee asked Defence why the costs had escalated by over \$6 million.
- 8.43 Defence responded that delays in roll-out of the SDSS upgrade (due to operational activities in Iraq) had led to a need for re-training for some officers. The ANAO report found that Defence's reliance on external training contractors meant that when the roll-out delays occurred, Defence was exposed to large contractor 'maintenance costs'.¹¹ In other words, Defence was paying training contractors when the work could not be carried out, due to roll-out delays.
- 8.44 The ANAO recommended that Defence establish a centralised Defence Training Authority to take responsibility for the management and delivery of all required SDSS training.¹²
- 8.45 At a public hearing, the Committee questioned Defence about its SDSS training. Defence advised that the Director General of Materiel Information Systems is now responsible for the delivery of training to SDSS users. A nominated contact within each Group is responsible to the Manager Joint Training for identifying annual training liability and requirements. New developments include an online training tool. SDSS training is also part of the wider Defence remediation plans under implementation in response to

8 Department of Defence (Defence), Senate Foreign Affairs, Defence and Trade Legislation Committee, *Additional Estimates, Transcript of Evidence*, 18 February 2005, p. 9.

9 Defence, Senate Foreign Affairs, Defence and Trade Legislation Committee, *Additional Estimates, Transcript of Evidence*, 18 February 2005, p. 9.

10 ANAO Audit Report no. 5, 2004-05, p. 79.

11 ANAO Audit Report no. 5, 2004-05, p. 80.

12 ANAO Audit Report no. 5, 2004-05, p. 26.

the ANAO's adverse finding on the 2003-04 financial statements (see chapter 9 for further information).¹³

Get Well Program

8.46 In 2004 Defence put in place a remediation program for the SDSS project entitled SDSS 'Get Well'. In June 2005 Defence advised the Committee that the Get Well program included the following enhancements to the SDSS v. 4 project:

- Systems performance
 - ⇒ significant mainframe performance improvement (up to 10 times quicker);
 - ⇒ improvement at specific sites - network upgrades which were dropped from the original SDSS upgrade;
- Financial capability
 - ⇒ new functionality to provide improved financial information;
 - ⇒ major enhancements to three key reports;
 - ⇒ five new exception reports;
 - ⇒ seven new management reports;
- Data quality
 - ⇒ coordination of resolution of Supply Customer Account ownership and loading of details onto SDSS;
 - ⇒ data cleanup in several key areas - 100,000 records archived;
 - ⇒ data ownership charters;
- Business Process Compliance
 - ⇒ ANAO provided 113 review reports covering 16 operational segments;
 - ⇒ 114 recommendation areas, resulting in a total of 132 individual recommendations;
 - ⇒ responsible officers assigned across Defence;
 - ⇒ summary document linking recommendations to ANAO findings;
- Software defects
 - ⇒ redesign of Problem Reporting and Support Centre Procedures;
 - ⇒ management Dashboard reporting;

13 Defence, submission no. 11, p. 3.

- ⇒ new supply and equipment reports;
 - Change and communication
 - ⇒ development of intranet site and regular newsletters;
 - ⇒ specific end-user communications; and
 - ⇒ visits to key sites.
- 8.47 One of the first elements of the Get Well program was to make network improvements to allow the program to run quicker in the field. These network upgrades had been dropped from the original SDSS upgrade in order to limit the budget blowout.
- 8.48 Defence advised the ANAO that the Get Well program was established with a Program Governance Board. However, the ANAO audit noted that the Governance Board did not include any representatives of end users, a problem that had occurred in the SDSS v. 4 upgrade project.¹⁴ The ANAO recommended that Defence manage the Get Well Program within the framework of the Defence Information Environment, including wide end user involvement (with Joint Logistics Command representation) at the Governance Board level.
- 8.49 The Committee questioned Defence about whether it had changed the Get Well governance board to include end user representation. Defence replied that the project board, and the user group which sits below the board, now represented the groups that are day-to-day users of the system. Each Defence Base also now has a local site administrator, to whom users can relay their concerns in the first instance.¹⁵
- 8.50 Defence advised that the total expenditure on SMS/KPMG contractors for the Get Well program was \$1,179,538. This expenditure covered the Program Management Office, including change and communications.¹⁶
- 8.51 Defence spends \$20 million per year sustaining SDSS, including 68 full-time personnel who undertake training, run help desks, rewrite codes, increase functionality, and put new tools on the system.¹⁷

Tenix Toll Defence

- 8.52 In 2003 Tenix Toll Defence won a major 10-year contract for delivery of Defence's national warehousing and distribution services. The contract is

14 ANAO Audit Report no. 5, 2004-05, p. 90.

15 Defence, *Transcript of Evidence*, 28 April 2005, p. 44.

16 Defence, submission no. 11, p. 4.

17 Defence, submission no. 11.1, p.1, and *Transcript of Evidence*, 27 June 2005, p. 43.

worth up to \$920 million over 10 years.¹⁸ The contract was estimated to save the Government up to \$40 million, and allow for re-assignment of around 500 Defence personnel onto other activities.

- 8.53 In June 2005 the Committee undertook an inspection at the Defence National Storage and Distribution Centre (DNSDC) at Moorebank, Sydney. Tenix Toll Defence took over operations at the DNSDC (under Defence direction) in 2004. The Committee was keen to see the SDSS system in operation, and talk to personnel on the ground who were using the system.
- 8.54 The Committee was also interested to hear from Tenix Toll about the changeover in providing the warehouse and distribution services at DNSDC, and asked a number of questions on notice. Tenix Toll Defence advised that it employs 413 permanent staff and 157 casual staff in warehouse management in support of Defence activities (at June 2005). Within Defence's Joint Logistics Command, around 900 people have direct or indirect involvement in a number of contracts, including the Tenix Toll contract.¹⁹
- 8.55 The Committee asked whether the original tender documents and contract for Defence warehouse management accurately reflected the asset and warehouse system that Tenix Toll took over. Tenix Toll responded that it did, with the exception of the introduction of handheld data processors, which will be provided by the Government by February 2006 (see paragraph 8.52 for further detail). Tenix Toll provided additional, and unforeseen, support to Defence's efforts to improve its stocktaking methods as part of the remediation plans. Additional costs incurred by Tenix Toll in supporting these activities are claimable under the contract.²⁰

Handheld scanners

- 8.56 At DNSDC Moorebank, the Committee observed the SDSS program in operation in one of the 12 DNSDC warehouses. The storeman was using a handheld data processor, known as a Radio Frequency Portable Data Entry Terminal, to scan a barcode on items. The handheld processor communicated with the SDSS system to verify the item in front of the storeman, and told him how many items [bolts, in this case] should be in the container. He was then to enter into the system any bolts that he removed from the box.

18 Senator the Hon. Robert Hill, *Defence Integrated Distribution System Contract Signed Today*, Press Release 18 December 2003, at: <http://www.minister.defence.gov.au/Hilltpl.cfm?CurrentId=3399>, accessed September 2005.

19 Defence, Submission 11.2, p. 1.

20 Defence, Submission no. 11.2, p. 2.

- 8.57 The system on demonstration to the Committee at Moorebank was operating at a very slow speed. In one instance, the barcode was not able to be read because it had been entered incorrectly.
- 8.58 At the hearing later that day, Defence told the Committee that it intends to roll out this technology to all warehouses by the end of 2005. Defence acknowledged that the system witnessed by the Committee was slow in operation, however argued that it was a pilot system being tested before a full rollout to other warehouses.²¹
- 8.59 The Committee was pleased to be able to inspect the DNSDC facility at Moorebank, Sydney. The tour brought home to the Committee the complexities of the logistics management undertaken by Defence in partnership with Tenix Toll Defence. Several Committee members had the opportunity to talk to storeman on the ground and witness the use of the SDSS system. The Committee is concerned that the on-the-ground experience of warehouse personnel may not be taken into consideration by Defence when planning SDSS upgrades and rollouts of new technologies such as the handheld scanner.

Recommendation 26

- 8.60 **The Committee recommends that Defence continue with its planned rollout of Radio Frequency Portable Data Entry Terminals (handheld scanners) for use with the SDSS system in warehouses.**

However, this rollout must only be undertaken when Defence is confident that the system can adequately support the new technology, to ensure that the system is not circumvented because of users' frustrations at slow processing.

Defence must also ensure that adequate training is provided to all personnel who will be using the scanners.

Previous Committee review

- 8.61 The Joint Committee of Public Accounts reviewed the predecessor to the SDSS, the Supply Systems Redevelopment Project, in 1992 (*Report 317: A champagne appetite but only a beer income*). The Committee found that the achievements of the project were not encouraging, and that the project had

21 Defence, *Transcript of Evidence*, 27 June 2005, p. 20.

continuously fallen behind schedule due to 'poor administration and management of the Project at a global level'.²² One of the Committee's recommendations was:

That the operation and management of the Supply Systems Redevelopment Branch be reviewed to ensure that appropriate project controls and procedures are now in place, especially in the area of quality assurance.²³

Other Defence projects

- 8.62 The Committee notes that the Audit Office has recently tabled its Audit Report No. 8, 2005-06, *Management of the Personnel Management Key Solution (PMKeyS) Implementation Project*. This new report highlights many of the same problems experienced with the SDSS upgrade project – the project did not receive the proper approvals, it ran over time and over budget, and the system is still not working effectively.
- 8.63 The Committee has yet to formally review Audit Report no. 8, 2005-06, but is most concerned to note that the problems highlighted in the ANAO's report on the SDSS upgrade are not limited to that project. These two reports indicate systemic problems in project management at Defence, particularly for IT systems. The Committee intends to further examine these problems in a wider-ranging inquiry, commencing in 2006.

22 Joint Committee of Public Accounts, Report 317: *A champagne appetite but only a beer income – Defence's Supply Systems Redevelopment Project*; Parliament of the Commonwealth of Australia; June 1992, p. xvi.

23 Joint Committee of Public Accounts, Report 317; Recommendation 13; p. xx.

Audit Report No. 21, 2004-05

ANAO Inability-to-form-an-Opinion on the Department of Defence financial statements 2003-04

Introduction

- 9.1 At the close of each financial year the Government prepares two key financial reports: the Consolidated Financial Statements of the Australian Government (CFS); and the Final Budget Outcome Report (FBO Report) – required by the *Charter of Budget Honesty Act 1998*.
- 9.2 Under the *Financial Management and Accountability Act 1997* (FMA Act), the Auditor-General is required to report each year to the relevant Minister(s) whether government entities' financial statements give a true and fair view of the matters required by applicable legislation, Accounting Standards and other mandatory financial reporting requirements in Australia.
- 9.3 Audit Report no. 21 , 2004/05 provides a summary of the results of the ANAO's audits of the financial statements of all Australian government reporting entities, including the Consolidated Financial Statements for the Australian Government.

- 9.4 Audit Report no. 21 is the second report on these audits for the financial year ended 30 June 2004, and complements Audit Report No.58 2003/2004. The latter outlined audit findings relating to government departments' control structures, including governance arrangements, information systems and control procedures, which supported the reporting of public sector financial performance and accountability, through to March 2004.
- 9.5 As outlined above, the ANAO is responsible for the audit of the financial statements of 245 Australian Government entities. For the 2003/04 financial year, the ANAO issued:
- 217 unmodified audit opinions (clear opinions);
 - 12 'qualified' audit opinions (pp. 45 – 50 of Audit Report);
 - 7 audit opinions containing an 'emphasis of matter' (pp. 51 – 53 of Audit Report); and
 - 7 opinions, some qualified and others unmodified, containing an 'other statutory matter' (pp. 53 – 54 of Audit Report).

Defence Financial Statements

- 9.6 One of the 12 'qualified' audit opinions was for the Department of Defence. The qualification was expressed as an Inability-to-form-an-Opinion. Notably, the accompanying letter from the Secretary of Defence stated that he was unable to conclude that the financial statements were 'true and fair'.
- 9.7 This was the first time that the ANAO had expressed an Inability-to-form-an-Opinion on a government entity's financial statements.
- 9.8 The ANAO stated that
- in short, Defence management practices and systems are not robust enough for both Defence and the ANAO to conclude that the Defence financial statements were both 'true-and-fair' in 2003-04. These issues go well beyond accrual accounting matters.
- 9.9 The ANAO's inability to form an opinion arose from a series of significant 'audit scope limitations' on key financial systems within Defence. Due to these limitations, the ANAO could not validate \$7.12 billion of Defence assets and \$1.23 billion of Defence liabilities, including:
- General Stores Inventory totalling \$2.03 billion – due to weaknesses in the stocktaking, record-keeping systems and pricing data (including the SDSS v 4 system);

- \$845 million of Explosive Ordnance Inventory – due to lack of documentation to support the prices used to value that portion of the recorded balance;
- \$2.86 billion reported written-down value of Repairable Items – due to weaknesses in stocktaking and recording keeping as for General Stores Inventory;
- \$1.39 billion of the Land and Buildings Infrastructure, Plant and Equipment balances – due to some assets being excluded from revaluation processes, and other deficiencies in record-keeping; and
- \$1.23 billion for the Australian Defence Force leave provision – due to lack of supporting documentation for leave entitlements.

9.10 These problems are further elaborated below. The above scope limitations affected five line items on the Defence Statement of Financial Position: Inventories; SME (Specialist Military Equipment); Land and Buildings; Infrastructure; Plant and Equipment; and Employee Provisions.

Quantities for General Stores Inventory and Repairable Items

9.11 The ANAO identified material weaknesses in Defence's stocktaking system, recording of physical asset quantities, and accuracy of data. These systems are managed on the SDSS system, which as outlined in Audit Report No. 5, was found to have key weaknesses. Significant failures included:

- inability to identify owners, and subsequently the failure to manage and account for Repairable Items. Defence needs to have significant amounts of equipment repaired each year. These items are classed as Supply Customer Accounts (SCAs). These SCAs include assets that may be held by the ADF, external contractors or repair agents. The SDSS cannot accurately record the assets held in the SCAs;
- material discrepancies identified through the counting of physical stock at key Defence establishments; and
- poor management reporting and review of stocktake results.

9.12 These findings resulted in uncertainty around the General Stores Inventory balance and the Repairable Item balance (which is a component of SME).

Pricing for General Stores Inventory and Explosive Ordnance

9.13 This problem was largely linked to the problems with the SDSS program. Under financial accounting standards, inventory items must be given a

valuation. Within the SDSS system, many items are priced at zero or a notional price (eg one cent).

- 9.14 The ANAO reported that the allocation of incorrect or notional prices to transactions results in the misstatement of the General Stores Inventory balance. The ANAO also found a lack of evidentiary documentation to support the prices used to value \$845 million of Explosive Ordnance Inventory.
- 9.15 Defence is undertaking a price remediation and verification project aimed at correcting recorded values. Defence told Senate Estimates this year that it wants to use an American military catalogue (FEDLOG) to price its inventory equipment, but that ANAO does not approve of this method.

Military and Civilian Leave Processes and Systems

- 9.16 This problem was identified by the ANAO in its 2002-03 audit, resulting in a defence remediation program. As the program was still underway in 2003-04, Defence self-qualified its Military leave provision in 2003-04.
- 9.17 The problems with PMKEYS (civilian payroll, and leave for both civilian and military personnel) and ADFPAY (military pay system) included insufficient supporting documentation to verify leave provisions, and significant rates of error where documentation did exist.

Land and Buildings, Infrastructure, Plant and Equipment

- 9.18 The ANAO found significant uncertainty surrounding the value of Land and Buildings and Infrastructure, Plant and Equipment, due to 'inadequate management direction, analysis and review'. Some assets were excluded from revaluation processes, or the results of valuations were incorrectly reflected in Defence's asset register and financial statements.

Other significant Audit findings

- 9.19 The ANAO found other problems with the Defence depreciation calculation, ROMAN (General Ledger) financial system; commitments and receivables.

- 9.20 The ANAO commented that

...A major contributor to the number of audit findings and the associated delay in finalising the 2003-04 financial statements was an apparent lack of adequate management review of the administrative and accounting processes and records within Defence....the production of reliable financial statements is fundamentally a by-

product of good governance arrangements, reliable information systems and an effective internal control environment.¹

9.21 The ANAO stated that if Defence were to meet the Government reporting deadline in future years, remediation processes will need to be brought forward.

ANAO audit ratings

9.22 The ANAO rates its audit findings according to a risk scale. Audit findings which pose a significant business or financial risk to the entity and which must be addressed as a matter of urgency, are rated as 'A'. Issues that pose a moderate business or financial risk are rated as 'B'. Issues that are procedural in nature, or reflect relatively minor administrative shortcomings are rated as 'C'.

9.23 The following table outlines the ANAO's ratings for Defence throughout 2004 .

Table 9.1 Status of Category A and B issues, Department of Defence to November 2004

Rating	Issues outstanding at August 2004	Issues resolved prior to November 2004	New issues to November 2004	Closing position, November 2004
A	14	0	7	27
B	45	10	15	48
Total	59	10	22	75

Source ANAO Audit Report no. 56, 2004-05, *Interim Phase of the Audit of Financial Statements of General Government Sector Entities for the Year Ending 30 June 2005*; p. 106.

9.24 In its Interim Report on Defence's Financial Statements, the ANAO illustrated that most of the category A and B audit findings were related to management oversight and control, rather than technical accounting issues:

1 ANAO Audit Report no. 21, 2004-05, *Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004*, Commonwealth of Australia, January 2005, p. 112.

Table 9.2 Summary: source of Category A and B audit findings, Department of Defence

Balance Sheet Audit Issues	Technical Issues		Management/Control Issues		
	<i>Differences in accounting estimates</i>	<i>Non- compliance with legislation</i>	<i>Management controls and oversight</i>	<i>IT Controls</i>	<i>Business Process Controls</i>
General Stores Inventory			X	X	X
Explosive Ordnance Inventory			X		X
Repairable Items			X	X	X
Military Provisions			X	X	X
Land and Buildings, Infrastructure, Plant and Equipment			X	X	X
Executive Remuneration			X		X
Special Accounts		X	X		X

Source ANAO Audit Report no. 56, 2004-05; p. 107.

How did the situation occur

- 9.25 The Committee questioned the ANAO and Defence about what had happened in the 2003-04 year to send the Defence financial statements 'over the edge' into a state where the ANAO was unable to verify the accounts. Both agencies replied:

ANAO:

For a couple of years prior to 2004, we had what we call an 'exception qualification' on the Defence accounts in some areas. But what actually happened in 2004 is that the collective exceptions crossed a line or jumped over a hurdle. For auditing standards that means that we had to come to an inability to form an opinion on the accounts, so 2004 was just a particularly bad culmination of a lot of problems that we had had previously.²

Defence:

Some of that was the accumulated effect of the issues that had been the subject of exception for a number of years, some of it was the greater depth and more rigorous assessment, I believe, on behalf of our own auditors and ANAO and, frankly, some of it probably

2 ANAO, *Transcript of Evidence*, 27 June 2005, p. 14.

resulted from some deterioration in that year in some areas due to a higher operational tempo against inadequate systems.³

- 9.26 Defence also argued that the introduction of accrual accounting in 1999-2000 for government agencies had placed additional strains on its financial systems:

By any standards, [Defence is] one of Australia's biggest corporations. Unlike all the other corporations anything like this size, though, Defence does not exist to make a profit; it exists for quite different reasons. Nevertheless, we are being asked to achieve exactly the same accounting standards as other corporations. We accept that challenge. We also accept that, at present, we are quite some way from achieving those standards.⁴

- 9.27 The ANAO conceded that the requirements of accrual accounting, introduced in 1999-2000, had placed an additional load on the SDSS system, for which it was not originally designed:

It was not built as a financial system. There was no requirement to produce a financial opinion. So immediately that that requirement changed, it became an issue. We are using a system that was not designed as a modern financial management system.⁵

Defence remediation programs

- 9.28 In response to the problems highlighted in Audit Report 21, Defence has established a number of remediation programs aimed at resolving the problems identified in its various financial management systems.
- 9.29 A Financial Statements Project Board has been established, comprising the Secretary of Defence, the CEO of the Defence Materiel Organisation, the Vice Chief of the Defence Force and the three service chiefs, the Defence Chief

3 Defence, *Transcript of Evidence*, 27 June 2005, p. 14.

4 Defence, evidence to Joint Standing Committee on Foreign Affairs and Trade, *Transcript of Evidence*, 11 March 2005, p. 44.

5 ANAO, *Transcript of Evidence*, 27 June 2005, p. 17.

Financial Officer and a representative from the Department of Finance and Administration.

- 9.30 There are three General remediation plans aimed at fixing the problems in Defence financial management and reporting framework and systems; and 12 Specialised remediation plans aimed at specific line responsibilities. The plans, G 1 - 3 and S1 - S12 were outlined in the 2005-06 Portfolio Budget Statements, along with expected outcomes for 2004-5 and 2005-06. The PBS table is reproduced below.

Table 9.3 Defence Remediation Strategies – Portfolio Budget Statement 2005-06

REMEDIATION PLAN	ACTIVITY	MAJOR OUTCOMES
<p>G3: Financial Management and Systems Training – Financial and Business Management</p> <p>A consistent theme in the Australian National Audit Office audit findings is the requirement for enhanced skills in the execution of financial management procedures and adherence to approved procedures in the use of Defence corporate information technology systems. The Australian National Audit Office makes some targeted recommendations with regard to enhanced training to address the lack of knowledge in accounting, financial and business management (ROMAN), transactor knowledge (PMKeyS), and the supply system (Standard Defence Supply System). These are complemented by a number of other observations about failures in the application of policy and procedures.</p> <p>Accountable officers: Chief Finance Officer and Director-General Defence Education and Training Development</p>	<p>Develop the following courses to improve officers' underpinning knowledge and skills:</p> <ol style="list-style-type: none"> business capability workshops; accrual accounting; Diploma of Government (Financial Management); Graduate Certificate in Professional Management (Finance); and financial management processes for Senior Executive Service and Executive Level 1 and 2 officers. 	<p>2004-05:</p> <p>Conduct:</p> <ol style="list-style-type: none"> business capability workshops; course evaluations; Senior Executive Service and Executive Level courses; and training and competency assessments. <p>2005-06:</p> <ol style="list-style-type: none"> implement training as prerequisite for systems access; and modularise training delivery.
<p>S1: Stores Record Accuracy</p> <p>Defence 'self-qualified' stock quantities relating to general stores inventory and repairable items in 2003-04, following adverse stocktake results.</p> <p>The Australian National Audit Office noted material weaknesses in the internal controls over stocktaking, failure to accurately record and report physical asset quantities, and inadequate system controls to safeguard the accuracy of data. This resulted in a significant range of uncertainty around general stores inventory and repairable items balances.</p> <p>Accountable officer: Commander Joint Logistics</p>	<p>Remediate the general stores inventory and repairable items qualification by:</p> <ol style="list-style-type: none"> conducting 100 per cent stocktakes at Joint Logistics Command warehouses; correcting errors in stores record quantities in the Standard Defence Supply System; and promulgating and ensuring compliance with stocktaking policy to improve stocktaking practices and reporting. 	<p>2004-05:</p> <ol style="list-style-type: none"> implement compliance and assurance audit methodology; and complete 100 per cent stocktake of Defence National Storage and Distribution Centre (Moorebank). <p>2005-06:</p> <ol style="list-style-type: none"> complete 100 per cent stocktake of Joint Logistics Unit (Victoria); and finalise audit findings (subject to extent of additional work from S10 and S11).

REMEDIATION PLAN	ACTIVITY	MAJOR OUTCOMES
<p>S2: General Stores Inventory Pricing and Accounting</p> <p>The 2003-04 Financial Statement had a limitation of scope qualification of approximately \$2,026m with regard to uncertainty around the general stores inventory balance, of which \$600m relates to uncertainty around general stores inventory pricing.</p> <p>At issue was Defence's inability to produce, in a timely manner, invoice and contract documentation to validate the prices in the Standard Defence Supply System. The concerns of the Australian National Audit Office also included the lack of accounting policy in place to ensure the correct treatment of general stores inventory.</p> <p>Inventory pricing issues will need to be assessed in light of the pending Australian Equivalent to International Financial Reporting Standards. The implementation of an even more onerous reporting requirement places greater long-term uncertainty across inventory pricing issues.</p> <p>Accountable officer: Chief Finance Officer, Defence Materiel Organisation</p>	<p>Remediate the general stores inventory pricing and accounting qualification by:</p> <ol style="list-style-type: none"> developing a statistical model to validate legacy (pre-1997) priced items; implementing an exception reporting regime to provide quality assurance; establishing policies and procedures for inventory pricing controls on the Standard Defence Supply System; and establishing policy to ensure the correct treatment of general stores inventory. 	<p>2004-05:</p> <ol style="list-style-type: none"> remediate audit issues relating to Provision for Obsolescence, Asset Purchase Accounts, Defence Materiel Organisation Clearing Accounts, Reclassification Corrections, and Standard Defence Supply System Version 4 Upgrade; ascertain the level of inventory pricing uncertainty to be quarantined; establish an exception reporting regime to provide quality assurance of in-year inventory prices; and establish financial accounting general stores inventory policy. <p>2005-06:</p> <ol style="list-style-type: none"> remediate the audit issue relating to Limitation of Scope – Inventory pricing carried forward to 1999-00; complete an option study for a single financial and asset management system; and review Australian Equivalent to International Financial Reporting Standards implementation to determine system and data retention impacts for multiple pricing records.

REMEDIATION PLAN	ACTIVITY	MAJOR OUTCOMES
<p>S3: Supply Customer Accounts</p> <p>A Supply Customer Account is a location indicator within the Standard Defence Supply System to track and manage assets and accountable inventory moving through the supply chain, predominantly outside a warehouse structure.</p> <p>The 2003-04 financial statements had a limitation of scope qualification of \$2,857m with regard to the uncertainty around the repairable items balance, of which Supply Customer Accounts are a subset (\$1,000m). The Australian National Audit Office concerns rested with the controls and management of Supply Customer Accounts, including repairable items, and adherence to stocktake procedures.</p> <p>Accountable officer: Chief Operating Officer, Defence Materiel Organisation</p>	<p>Remediate the Supply Customer Account element of the repairable item quantities qualification by:</p> <ol style="list-style-type: none"> allocating all Supply Customer Accounts an accountable owner; ensuring all Supply Customer Account balances on the Standard Defence Supply System are correct; and improving business processes and controls for Supply Customer Accounts. <p>Note: these include improvements to data creation, maintenance and reporting to ensure accurate quantity, ownership and location details are entered and maintained for all Supply Customer Accounts on the Standard Defence Supply System.</p>	<p>2004-05:</p> <ol style="list-style-type: none"> allocate an accountable owner to all Supply Customer Accounts; start stocktaking of Supply Customer Accounts and record correct balances on Standard Defence Supply System for those stocktaked. <p>2005-06:</p> <ol style="list-style-type: none"> stocktake all Supply Customer Accounts and correct balances recorded on the Standard Defence Supply System; and improve business processes and transition controls into standard corporate governance activities of all Groups.

REMEDIATION PLAN	ACTIVITY	MAJOR OUTCOMES
<p>S4: Explosive Ordnance</p> <p>The 2003-04 financial statements had a limitation of scope qualification of \$845m relating to uncertainty around Explosive Ordnance pricing. At issue was Defence's inability to produce, in a timely manner, invoice and contract documentation to validate the Explosive Ordnance inventory prices recorded in the Explosive Ordnance procurement management system, COMSARM.</p> <p>The qualification represented approximately 38 per cent of Explosive Ordnance inventory and relates to all items acquired before 1996 and items acquired as part of asset under construction contracts between 1997-2000.</p> <p>Accountable Officer: Head Electronic and Weapon Systems Division, Defence Materiel Organisation</p>	<p>Remediate the Explosive Ordnance inventory pricing qualification by:</p> <ol style="list-style-type: none"> sourcing (where possible) original documentation to substantiate Explosive Ordnance inventory prices; developing tools to substantiate Explosive Ordnance inventory values when appropriate supporting documentation cannot be located to support prices; and improving Explosive Ordnance inventory pricing policies and procedures to address reconfigurable items, to value identical items and to establish the link between COMSARM and Defence's financial management system, ROMAN. 	<p>2004-05:</p> <ol style="list-style-type: none"> remediate approximately \$440m of the \$845m Explosive Ordnance pricing qualification; and improve Explosive Ordnance inventory processing and reconciliation policies and procedures. <p>2005-06:</p> <ol style="list-style-type: none"> continue remediation of the remainder of the \$845m Explosive Ordnance inventory pricing qualification; and complete implementation of Explosive Ordnance inventory processing and reconciliation policies and procedures to ensure Defence's ongoing ability to accurately price Explosive Ordnance inventory items.

REMEDIATION PLAN
S5: Military Leave Records

The 2002-03 financial statements had a limitation of scope for military leave provisions because insufficient supporting documentation was available for leave records and, where documentation was available, unacceptable error rates existed in the recording of leave transactions. These shortcomings were mainly attributed to inadequate controls and processes within the military personnel systems and the inability to locate source documentation.

The prior year limitation had resulted in a wide-ranging military leave remediation program but Defence did not expect to resolve the problems before 2005. Defence again 'self-qualified' the military leave provision in 2003-04.

Accountable officer: Head Defence Personnel Executive

ACTIVITY

Remediate the military leave provisions qualification by:

- a. implementing a risk stratification and sampling methodology to quantify the risk to Defence accounts;
- b. providing an accurate representation of the military leave liability by ensuring the integrity of military leave data captured and recorded in PMKeyS; and
- c. applying quality assurance to business processes, record keeping strategies, reporting structures, relevant policy foundations, training initiatives and a controls framework.

MAJOR OUTCOMES**2004-05:**

- a. obtain in-principle support from the Australian National Audit Office to the variable sampling methodology; and
- b. complete the pilot phase of leave stratification, i.e. set 7 strata with 30 individuals in each and undertake variable sampling.

2005-06:

- a. to be advised – as determined by outcomes from variable sampling.

S6: Civilian Leave Records

In 2003-04, the the Australian National Audit Office noted problems with civilian leave and payroll processing. The systems issues identified in the management of military leave provisions also affect civilian leave balances.

Accountable officer: First Assistant Secretary Personnel, Defence Personnel Executive

Remediate the civilian leave provisions qualification by:

- a. implementing a risk stratification and sampling methodology to quantify the risk to Defence accounts;
- b. providing an accurate representation of the civilian leave liability by ensuring the integrity of civilian leave data captured and recorded in PMKeyS; and
- c. applying quality assurance to business processes, record keeping strategies, reporting structures, relevant policy foundations, training initiatives and a controls framework.

2004-05:

- a. obtain in-principle support from the Australian National Audit Office to the variable sampling methodology; and
- b. complete the pilot phase of leave stratification, i.e. set 7 strata with 30 individuals in each and undertake variable sampling.

2005-06:

- a. to be advised – as determined by outcomes from variable sampling.
-

REMEDATION PLAN	ACTIVITY	MAJOR OUTCOMES
<p>S7: Executive Remuneration</p> <p>The Executive Remuneration Note (containing information pertaining to civilian and military leave provisions) is 'material-by-nature', as required by the Finance Minister's Orders, and could not be reliably certified because of the limitation of scope within the Australian National Audit Office 2002-03 audit report regarding military leave provisions.</p> <p>A separate limitation of scope was applied to the Executive Remuneration Note in respect of any accrual effects arising from the military leave balances. During the 2003-04 period, Defence focused on improving the accuracy of leave records for the Senior Executive Service and military equivalents by reviewing source documentation.</p> <p>As a significant amount of supporting documentation remained outstanding, the note was again qualified for the same reason as in 2002-03.</p> <p>Accountable officer: First Assistant Secretary Personnel, Defence Personnel Executive</p>	<p>Remediate the Executive Remuneration Note qualification by:</p> <ol style="list-style-type: none"> completing the 2004-05 Senior Executive Service and military equivalents leave audit; and implementing a new system for reporting Executive Remuneration that includes applying quality assurance to business processes, record keeping strategies, reporting structures, relevant policy foundations and training initiatives, and a controls framework. <p>Note: the leave audit for executive leave is under way and is programmed for completion early in 2005-06. The Executive Remuneration Note audit qualification may continue if the starting balances of both military and civilian leave provisions are not accepted as accurate.</p>	<p>2004-05:</p> <ol style="list-style-type: none"> start review of leave for Senior Executive Service and military equivalents; and start implementation of revised Executive Remuneration Note management system. <p>2005-06:</p> <ol style="list-style-type: none"> finalise audit finding; and finalise implementation of revised Executive Remuneration Note management system.

REMEDATION PLAN	ACTIVITY	MAJOR OUTCOMES
<p>S8: Property Valuations</p> <p>The Australian National Audit Office issued a 'limitation of scope' for Land, Buildings and Infrastructure and Other Plant and Equipment as significant flaws were identified in associated project management, reporting practices and management review functions. The requirements to be met by the Australian Valuation Office were not fully and adequately documented and Defence was considered to have misinterpreted the results of revaluations and incorrectly applied depreciation. A particular consequence has been the misapplication of remaining useful life data provided by the independent valuer. This affected both the valuation adopted by Defence and the reported depreciation expense.</p> <p>Accountable officer: Deputy Secretary Corporate Services</p>	<p>Remediate the Land, Buildings and Infrastructure and Other Plant and Equipment qualification by:</p> <ol style="list-style-type: none"> revising the Australian Valuation Office engagement letter to clarify valuation policy, procedures and outcomes; contracting the Australian Valuation Office to revalue all Land, Buildings and Infrastructure and Other Plant and Equipment assets to fair value in accordance with policy guidance; undertaking quality assurance on Australian Valuation Office site reports to ensure completeness; entering revaluation data into the financial system (ROMAN) and completing revised depreciation calculations; and 	<p>2004-05:</p> <ol style="list-style-type: none"> complete all Land, Buildings and Infrastructure valuations by 30 June 2005; complete Other Plant and Equipment valuations by 30 June 2005; undertake quality assurance of valuation data and progressively load the data into the financial system (ROMAN); and engage the valuation contractor for the next three year cycle, ie 2005-06 to 2007-08, and issue letter of engagement detailing data requirements. <p>2005-06:</p> <ol style="list-style-type: none"> complete the loading of valuation data into the financial system (ROMAN); and

REMEDIATION PLAN	ACTIVITY	MAJOR OUTCOMES
	e. engaging a valuation contractor for the next 3 year cycle, i.e. 2005-06 to 2007-08.	b. complete the depreciation calculations.
<p>S9: Preventing the Escalation of Category A and B Findings</p> <p>The 2003-04 Financial Statement Audit Closing Audit Report identified 95 findings that required resolution. The 67 audit findings not allocated to a General or Specific Remediation Plan were grouped under Remediation Plan S9 to ensure each finding is remediated. Any audit findings that are not resolved could escalate from Categories B and C to the most serious category, Category A. Defence has recognised the clear need to improve the outcome, focus and management of the implementation of solutions to Australian National Audit Office findings.</p> <p>Accountable officer: Chief Finance Officer</p>	<p>Prevent the escalation of Category A and B findings by:</p> <p>a. assigning responsibility across Defence for remediation of each of the 67 audit findings not already allocated to a Remediation Plan;</p> <p>b. establishing a project-based management system for tracking and managing resolution of these Australian National Audit Office audit findings; and</p> <p>c. undertaking progressive and final quality assurance of the remediation outcomes.</p>	<p>2004-05:</p> <p>a. master task list completed; and</p> <p>b. 14 audit findings completed and forwarded to Australian National Audit Office.</p> <p>2005-06:</p> <p>a. finalise 52 audit findings.</p> <p>2006-07:</p> <p>a. finalise one audit finding.</p>
REMEDIATION PLAN	ACTIVITY	MAJOR OUTCOMES
<p>S10: Stock Holding Controls</p> <p>Items first found are items of either asset or inventory that do not have a corresponding Defence register record on any Defence register. Where a check of stock holdings shows that the Defence register record varies from the physical quantity, an investigation into the discrepancy will be required and the outcome may be an adjustment to the Defence Register record, and/or a corresponding financial adjustment.</p> <p>While it is accepted that the normal stock adjustment process will require a certain level of adjustment activity, current levels of adjustment are considered too high and indicate poor adherence to currently approved business processes.</p> <p>Accountable officer: Chief Operating Officer, Defence Materiel Organisation</p>	<p>Improve stock holding controls by:</p> <p>a. preventing or reducing the instance of items first found and write-offs; and</p> <p>b. accounting for and monitoring those instances first found and write-offs considered legitimate or expected.</p> <p>Note: The remediation activities will focus on preventing errant transactions on the Standard Defence Supply System through improvements in policy, procedure, system process, and the introduction of investigative reporting to measure compliance.</p>	<p>2004-05:</p> <p>a. project schedule under development.</p> <p>2005-06:</p> <p>a. to be advised.</p>

REMEDIATION PLAN	ACTIVITY	MAJOR OUTCOMES
S11: Standard Defence Supply System Items Not-in-Catalogue	<p>Address the potential Not-in-Catalogue issues as they may affect the financial statements by:</p> <ul style="list-style-type: none"> a. addressing policy issues to better support an effective purchasing process; b. developing improved processes in conjunction with units, the Supply Chain Systems Program Office, the National Codification Bureau and the Directorate of Logistics and Processes; c. undertaking systems-based investigations, coupled with targeted site visits, to determine the value breakdown of Items Not-in-Catalogue; d. agreeing a methodology to transition Not-in-Catalogue items into the Standard Defence Supply System and the standard financial management regime, including development of a value proposition for the management of legacy items; e. coordinating Group activity to identify and transition Not-in-Catalogue items at Defence locations across Australia; and f. developing an ongoing compliance monitoring and reporting regime. 	<p>2004-05:</p> <ul style="list-style-type: none"> a. define and promulgate items that will be subject to codification and assigned a NATO Stock Number (i.e. procurement routing rules); b. clarify catalogue and codification policy and procedures; c. undertake systems investigation and data mining to obtain a value breakdown and establish a materiality index; d. undertake and complete investigative site visits to verify value breakdown; and e. finalise ADF Logistics Manager roles and responsibilities, including resourcing issues and the process for ADF Logistics Manager assignment. <p>2005-06:</p> <ul style="list-style-type: none"> a. to be advised – outcomes not available until 2004-05 activities completed and project schedule finalised.
<p>Defence is investigating the extent to which items may have been incorrectly accounted for in the Statement of Financial Position. This may occur when an item is purchased via the ROMAN financial system and then not recorded and managed on the Standard Defence Supply System. Such items are managed and tracked locally with no central visibility. It may lead to the incorrect recording and treatment of an item's value.</p>		
<p>Accountable officer: Chief Operating Officer, Defence Materiel Organisation</p>		

Source *Portfolio Budget Statements 2005-06, Defence Portfolio, pp. 198-207.*

Committee comment

- 9.31 The Committee notes the ANAO's comment that the effectiveness of the remediation plans will not be known for some time. Most of the plans were approved in February 2005, however their implementation is a work-in-progress. The ANAO noted that some of the plans have not progressed enough to have a major impact on the 2004-05 financial statements, however it did expect to see improvements over time. The ANAO has undertaken to closely monitor the progress of the Defence remediation plans over the next few years.⁶
- 9.32 In June 2005 the ANAO found that, at the end of the 2004-05 financial year, there had been limited completed remediation or agreement on key audit issues. However, ANAO acknowledged that considerable work by Defence was progressing. The ANAO stated:
- The current momentum, which has been supported by the Secretary and the CFO, individually and via the Financial Statements Project Board, is essential in progressing and realising the remediation, cultural and structural changes necessary to sustain the required Defence outputs in the current financial reporting environment.⁷
- 9.33 The Committee welcomes the detailed remediation plans outlined by Defence in response to its financial reporting problems. We recognise that this problem will not be completely resolved in the short-term, and that cultural change within Defence is one of the major challenges of this reform process.
- 9.34 Given the past problem with projects slipping past their deadlines, and being delivered over-budget, the Committee is keen to ensure that the remediation plans are implemented efficiently and effectively, taking into account the lessons learned through the SDSS upgrade and other projects over recent years. The Committee welcomes the ANAO's commitment to auditing Defence over coming years on the implementation of a new financial reporting regime. The Committee also intends to closely monitor Defence's work in this area.

6 ANAO Audit Report no. 56, 2004-05, p. 111.

7 ANAO Audit Report no. 56, 2004-05, p. 125.

Recommendation 27

- 9.35 **The Committee recommends that the Department of Defence report to this Committee every six months against the milestones of the 14 remediation plans outlined in the 2005-06 Portfolio Budget Statements. These reports are to continue until the end of the 41st Parliament.**

More recent ANAO findings

- 9.36 As the Committee's inquiry progressed, the ANAO tabled in Parliament another of its regular financial audits which detailed further challenges for Defence financial management. This report, *ANAO Audit Report no. 56, 2004-05: Interim phase of the audit of financial statements of general government sector entities for the year ending 30 June 2005*, includes a chapter on the Department of Defence. The Committee resolved to include this new report in its review of the Department of Defence financial management.

Julian Date

- 9.37 Audit Report no. 56, 2004-05 highlighted a problem within SDSS similar to the Y2K issue confronted by many companies leading up to the year 2000. SDSS had a start date of 1 January 1980, and a boundary date of 9,999 days from then on. This date will be 17 May 2007. There is a danger that when the system hits 17 May 2007, the date will revert to 0000, potentially causing a system failure.
- 9.38 Defence told the Committee that it had been aware of the problem for a number of years, but initially believed that JP 2077 project would come into effect before May 2007. However, given that JP 2077 will not be implemented by then, Defence has now asked MINCOM to correct the problem. Defence acknowledged that the Julian Date "...it is a catastrophic effect on version 4 of the MIMS software which we are currently running on SDSS."⁸
- 9.39 Defence advised that they are in the initial stages of planning a technical fix for the Julian Date problem, and that MINCOM had agreed to fix the software at their own expense. The ANAO stated that a problem with the Julian Date issue is that the extent of the problem is largely unknown. The ANAO also noted that SDSS v. 4 is a highly customised system, and

8 Defence, *Transcript of Evidence*, 27 June 2005, p. 2.

therefore any technical fix is going to be more complicated than running a 'patch' for an off-the-shelf system.⁹

- 9.40 The Committee only became aware of this problem at its final public hearing for this inquiry. The Committee notes the ANAO's concern that the problem is largely unknown at this stage, and the danger is that the entire SDSS system could collapse in May 2007, without the replacement JP2077 ready to take over logistics management.

Recommendation 28

- 9.41 **The Committee recommends that Defence outline to the Committee its plan to ensure that the Julian date problem associated with the SDSS program will be fixed prior to May 2007. Defence's report to the Committee should include a project plan, costings, milestones, and details of the project management team.**

Security of SDSS

- 9.42 Audit Report no. 56, 2004-05 also raised concerns about the security of access to the SDSS system. The ANAO found that the Get-Well program did not appear to be addressing concerns such as:
- the use of generic user ID's;
 - a high number of users with access to all system functions – that is, with full administrative access to the system;
 - users being able to perform incompatible activities (assignment of duties/activities that are incompatible with the principle of segregation of duties);
 - weaknesses over the user access management process, in particular the authorisation of user access to the system;
 - user access is often not commensurate with the officer's duties;
 - no formal review mechanisms to review user access related issues; and
 - issues around the method by which access is gained to SDSS – that is, whether the graphical user interface is used or not.
- 9.43 The ANAO commented:

9 ANAO, *Transcript of Evidence*, 27 June 2005, p. 3.

...even in a fluid operational environment, the current management process surrounding the security environment in SDSS, in the ANAO's view, was deficient.¹⁰

- 9.44 Defence conceded that the ANAO had not been able to get the necessary level of controls reliance on SDSS in order to trust its data. Regarding security and access controls, Defence commented:

...we acknowledge that we have not been careful enough in understanding, cataloguing and recording the levels of access that different users of the system have had. That has in part been due to things that the operation imperative – of simply needing to get things done and giving people in deployed forces the levels of access they need to do the job without asking the types of 'segregation of duties' questions that we might have asked.

One point I would make is that up to now we have not had a standard against which to be audited, and one of the things we are discussing with the Audit Office is an agreed standard for a controls framework so that in future we know the measure that we need to achieve to be able to determine for ourselves whether we have met it or not.¹¹

- 9.45 Defence stated that its aim was to achieve controls compliance within SDSS by 2005-06, so that rather than Defence and the ANAO needing to undertake intensive stocktake activity every six months to confirm the accuracy of the system, there will only be a requirement to test the controls environment once a year in order to confirm the system's accuracy.¹²
- 9.46 The Committee was most concerned to hear about the apparent lack of controls over access to the SDSS system.

Recommendation 29

- 9.47 **The Committee recommends that Defence urgently review the security controls for the SDSS program to ensure that user access is set at the appropriate levels. Defence should report back to the Committee about its implementation of this recommendation by February 2006.**

10 ANAO Audit Report no. 56, 2004-05, p. 116.

11 Defence, *Transcript of Evidence*, 27 June 2005, p. 7.

12 Defence, *Transcript of Evidence*, 27 June 2005, p. 31.

Pricing issues

- 9.48 The ANAO also found ongoing problems with pricing in the SDSS. The ANAO found that zero price and notional prices are continuing to be entered into SDSS, despite this being identified as a major concern in the 2003/04 audit of financial statements.
- 9.49 The ANAO advised that because of the problems it found with SDSS, both in terms of security of the system and pricing issues, it had to conduct a significant stocktake at year-end 2004/05, to ensure the accuracy of financial reports generated by the system. At the public hearing on 27 June 2005 the Audit Office told the Committee it had ten per cent of its total staff in the field doing stocktakes in Defence warehouses, in order to verify the SDSS figures.¹³
- 9.50 Defence replied that it was also very concerned about the pricing issue:
...people who do not enter correct prices are taking the system too lightly. This is important to us.¹⁴
- 9.51 Defence told the Committee that they are now modifying the SDSS system to ensure that users must enter an accurate price for inventory.¹⁵

Future challenges

Defence Materiel Organisation

- 9.52 The Defence Materiel Organisation (DMO) was established as a prescribed agency with effect from 1 July 2005. As part of this process, DMO is required to establish its own books and records and prepare separate financial statements for audit. Consequently, the issues pertaining to Defence accounts, including the ANAO's inability to form an opinion, will impact on the transfer of balances and information to the new entity. Defence outlined some of the complications involved in the demerger:

To ensure the complete separation of the financial transactions and accounts for the two organisations, we should not have agents who are able to operate with the accounts of both Defence and DMO...we need to be very careful with the access that people have, the delegations they use and the cost codes that they are able to use to

13 ANAO, *Transcript of Evidence*, 27 June 2005, p. 4.

14 Defence, *Transcript of Evidence*, 27 June 2005, p. 11.

15 Defence, *Transcript of Evidence*, 27 June 2005, p. 10.

make sure that every individual is operating very carefully inside either the Defence organisation or the DMO.¹⁶

- 9.53 In order to manage this problem, Defence advised that at 30 June 2005 all dual access to both the Defence and DMO financial management systems was removed, and new applications were made with justification of why dual access was required. At 15 July 2005, 44 DMO personnel had access to the Defence ROMAN financial system, and some 190 Defence personnel had access to the DMO accounts. Defence stated that the access approvals were managed at Branch Head level, and would be regularly reviewed.¹⁷

International Financial Reporting Standards

- 9.54 The Australian Accounting Standards (AAS) have been revised to include the International Financial Reporting Standards issued by the International Accounting Standards Board (IASB). Australian Government entities, which are required to comply with AAS by the Finance Minister's Orders, will need to plan for the changes resulting from this process.
- 9.55 Government entities will first apply the International Financial Reporting Standards (IFRS) in their 2005-06 statutory financial reports. Because the standards require retrospective restatement of comparative information, this will require entities to:
- prepare a balance sheet as at 1 July 2004 based on IFRS;
 - restate their 2004-05 comparative figures as if IFRS had applied in that year;
 - prepare, as part of the 2005-06 financial report, an additional financial statement, the Statement of Changes in Equity; and
 - include, in the notes to the 2005-06 financial statements, a reconciliation of the changes resulting from the application of IFRS to the 2004-05 operating result and to equity as at 1 July 2004 and 1 July 2005.

Agreement between Defence and the ANAO

- 9.56 Over a number of hearings the Committee detected a tension between the standards imposed by the ANAO and what Defence believes it can actually achieve. The Secretary of Defence told the Committee:

16 Department of Defence, *Transcript of Evidence*, 27 June 2005, p. 9.

17 Correspondence from Dr Stephen Gumly, DMO, to Committee Secretary, dated 15 July 2005.

I accept that the ANAO is the champion of the ultimate...that is something that we should aspire to. I think that with the best of systems and the best of training, given our activity levels, the continuing focus on effectiveness, and frankly, the absence of the sort of incentive that the private sector has, it is going to be quite difficult to achieve at the best of times. But it remains the aspiration.¹⁸

- 9.57 The Secretary of Defence also foreshadowed that the Department (with Ministerial approval) may eventually decide that it cannot fulfil all the requirements being placed on its financial record-keeping by the ANAO. The Secretary told the Committee:

There will come a point when we will say 'this is an issue of importance to accountants but it does not seem to affect our operations and therefore not worth \$100 million to fix'. That might have to be a management decision. I am not isolating any particular project or proposal in that regard, but if that is the kind of decision we have to take as a management decision – do we spend \$100 million or do we bear a scar on our accounts – then the good management decision might be the second one.¹⁹

- 9.58 Defence acknowledged that it faces a cultural problem in encouraging many of its staff to recognise the seriousness of the financial reporting problems current facing Defence, and the need to be vigilant in accurate record-keeping and financial management. Defence stated that while many of its members were remarkably adaptable when it came to taking on new ways of war fighting and new equipment, financial management issues are not seen by many as the core business of the organisation.²⁰

Committee comment

- 9.59 The Committee believes it is most important that the international accounting standards adopted by the Australian Government are applied to all government agencies, without exception. However, the Committee recognises that Defence faces some particular difficulties in meeting all the financial reporting requirements imposed by these standards, and audited by the ANAO. These difficulties include the size of the organisation and the fact that financial systems designed up to two decades ago do not have the technical capacity to provide the level of financial reporting required. The Committee believes that the problem of pricing within the SDSS, particularly the ongoing use of zero or notional pricing, must be resolved as a matter of

18 Defence, *Transcript of Evidence*, 27 June 2005, p. 33.

19 Defence, *Transcript of Evidence*, 16 March 2005, p. 6.

20 Defence, *Transcript of Evidence*, 12 May 2005, p. 4.

urgency. The Committee urges Defence and ANAO to agree on a resolution for this matter as soon as possible:

Recommendation 30

- 9.60 **The Committee recommends that Defence and the ANAO conduct ongoing consultations to discuss areas of disagreement such as pricing within the SDSS system. Defence should aim to resolve the issue of pricing of items within SDSS by June 2006.**

Project JP 2077

- 9.61 Project JP 2077 is identified as a major capital equipment purchase in the *Defence Capability Plan 2004-2014*. Under the project outline in the Capability Plan, Project JP 2077 Phase 2B is for the acquisition and roll-out of the Improved Logistics Information System. In other words, JP 2077 will be a comprehensive upgrade of the SDSS system.
- 9.62 Australian technology company MINCOM was identified in the Capability Plan as a Defence Alliance partner to develop the new logistics management system. The project is due for delivery from 2007-2009. The Capability Plan outlines a budget of between \$100 - \$150 million.²¹
- 9.63 In June 2005 the Government announced that Cabinet had granted First Pass approval for project JP 2077 Phase 2B. Initial expenditure is to be \$13.4 million, to develop and refine options and costs for the project. The Defence Minister announced that the project will include:
- an upgrade of the core transaction system of SDSS, which currently uses a MINCOM application;
 - development of an enhanced deployable logistics capability;
 - an improved financials package; and

21 Department of Defence, *Defence Capability Plan 2004-2014 Public Version*, Defence Materiel Organisation, Defence Publishing Service, 2004, p. 101.

- an integrated In-transit Visibility System, which will allow Defence to track the movement of stores and components across the country and at overseas locations.²²
- 9.64 Expenditure to date on JP 2077 has included \$37.1 million on Phase 1, approved July 2001; and \$15.9 million approval for Phase 2A.²³ The project is due to go before Cabinet for 'Second Pass' approval – authorising the go-ahead for the project – by the end of 2005.
- 9.65 The Committee questioned Defence on project management for JP 2077, given the ANAO's past findings about the problems of past IT projects such as the SDSS upgrade. In particular, the Committee was concerned that Defence does not out-source project management for future IT projects. Defence stated that a DMO employee will be the JP 2077 project manager.²⁴ Defence advised that there were 11 full-time and 54 part-time Defence personnel, and seven contract personnel, engaged with JP2077 who had prior involvement with SDSS and inventory management.²⁵
- 9.66 Defence provided the following information regarding JP2077 Phase 2B (the current phase of the project):

Table 8.4 Defence JP2077, Phase 2B

Project Phase	Deliverables	Timeframes
2B.1	○ Core software upgrade to implement the next generation of Mincom software, Ellipse.	Second Pass approval 1 st Quarter 2006
	○ Enhanced financial functionality, to enable interface with ROMAN, and to meet financial reporting and auditing requirements.	Implementation 2 nd Quarter 2007
	○ Military off-the-shelf enhancements will incorporate defence modifications into the standard COTS product, enabling significantly reduced maintenance and support costs.	
2B.2	○ Integrated in-transit visibility, to provide SDSS users with accurate information on the location of equipment in transit within the supply system.	Second Pass approval 2 nd /3 rd Quarter 2006
	○ Enhanced deployability capability to allow SDSS to operate independently of a fixed communications link – particularly relevant for reliable logistics support to operational units overseas.	Implementation 4 th Quarter 2009

Source Department of Defence, submission no. X, p. 2.

22 Senator the Hon. Robert Hill, Minister for Defence, *Plan to upgrade Defence logistics system*, Press Release 24 June 2005, available at:

<http://www.minister.defence.gov.au/Hilltpl.cfm?CurrentId=4952>, accessed July 2005.

23 Defence, *Transcript of Evidence*, 27 June 2005, p. 39.

24 Defence, *Transcript of Evidence*, 27 June 2005, p. 44.

25 Defence, submission no. 11.1, p. 1.

9.67 The Committee questioned Defence about any involvement of Tenix Toll Defence, the contracted warehouse management organisation, in development of the JP 2077 project. Defence replied that to date, Tenix Toll had not had any involvement with the project. However, Defence advised that the Integrated Project Team would seek defence industry input, including from Tenix Toll, prior to seeking second pass approval from Cabinet.²⁶

Recommendation 31

9.68 **The Committee recommends that for Project JP 2077:**

- **the project must be managed from within the Defence Materiel Organisation;**
- **all appropriate cabinet-level, ministerial-level and departmental approvals must be sought prior to implementation of various phases of the project;**
- **the project must include defined project milestones;**
- **no project management bonus payments are to be made to any DMO personnel if the project milestones are not met on-time, and on-budget;**
- **there must be continued input from on-the-ground users of the logistics system; and**
- **the project must include sufficient upgrades to the technological hardware supporting the new logistics system to ensure that it will run efficiently.**

Final comments

9.69 The finding by the ANAO, and concurrently the Secretary of the Department of Defence, that they had an inability to form an opinion on the status of the Defence Financial Statements, was unprecedented. It was the culmination of a number of years of poor record-keeping, information systems failure, and a failure to fully recognise the impact of accrual accounting.

26 Defence, submission no. 11.2, p. 3.

- 9.70 Given the move to International Financial Reporting Standards, and the scale of problems that Defence needs to overcome, it is likely to be several years before Defence moves from an 'inability' to a 'qualified' audit opinion in the Financial Statements.
- 9.71 The Committee recognises the significant work begun by Defence to address these problems. A major cultural change is required at Defence, from the lowest to most senior levels, to place an appropriate emphasis on financial management and reporting requirements.
- 9.72 The Committee would also like to recognise the significant resources provided by the ANAO dedicated to auditing the Defence financial statements. The Committee understands that at one stage this year, most of the ANAO's financial auditing staff were on the ground at Defence undertaking stocktaking activities.
- 9.73 The Committee intends to closely monitor Defence's remediation plans and the Department's progress in improving its financial reporting status. This may include a more detailed Committee inquiry on Defence financial management during 2006.

Audit Report No. 15, 2004-2005

Financial Management of Special Appropriations

Background

- 10.1 The Australian Constitution provides for a Consolidated Revenue Fund (CRF), formed from all revenues and moneys raised or received by the Government. Payments from the CRF are required to be authorised by an appropriation, made by law.
- 10.2 Special appropriations are made in Acts that deal with particular purposes of spending. In 2002-03, more than \$223 billion was spent from the CRF under the authority of special appropriations. This represented more than 80 per cent of all appropriation drawings for the year.
- 10.3 The Department of Finance and Administration (Finance) is responsible for developing and maintaining the financial framework for the Commonwealth public sector. However, individual Commonwealth entities are responsible for managing particular special appropriations. This management responsibility includes: adherence to the requirements of the financial framework and

relevant laws; maintaining proper accounts and records on each special appropriation; financial reporting on the use of special appropriations; and, as appropriate, performance information in annual reports.¹

Audit objectives

- 10.4 The ANAO performance audit objectives were to:
- identify all special appropriations and ascertain which entities were responsible for their financial management and reporting; and
 - assess entities' financial management and reporting of special appropriations against the Commonwealth's financial management and reporting frameworks.

ANAO's overall conclusion

- 10.5 Overall, the ANAO considered that there were significant shortcomings in the financial management of various special appropriations. The sound governance, management and reporting of appropriations requires certainty, clarity and consistency in the application of the Commonwealth's financial management framework. The ANAO findings indicated that the manner in which the financial framework had been interpreted and implemented was not consistent with those characteristics. While many of the issues were quite technical, in a legal sense there were important considerations of appropriate accountability, including transparency, in relation to the Parliament.
- 10.6 Given the fundamental importance of appropriations to Parliamentary control over expenditure, the ANAO suggested that changes were required to secure proper appropriation management in the Commonwealth. In particular, there was inadequate attention by a number of entities, with the responsibility to ensure that a correct, valid appropriation to support a particular payment had been identified before spending funds from the CRF, and to accurately disclose their use of special appropriations.
- 10.7 The ANAO concluded that in order to achieve the necessary improvements to the management of special appropriations, a greater

1 ANAO Audit Report no. 15, 2004-2005, *Financial Management of Special Appropriations*, Commonwealth of Australia, November 2004, p. 11.

understanding of and increased care and attention to legislative requirements and appropriation management practices were required. In that respect, there was evidence that, in response to the ANAO's audit activities, entities have increased their focus on those obligations. In addition, during the course of the audit, Finance issued guidance to Chief Financial Officers and provided four Circulars to *Financial Management and Accountability Act 1997* (FMA Act) agencies relating to particular aspects of appropriation management by agencies subject to the FMA Act.

- 10.8 Furthermore, the ANAO commented that the provision of additional guidance on appropriation management and disclosure, would assist entities to manage and report appropriations in a better and more consistent manner across the Commonwealth.

ANAO recommendations

- 10.9 The ANAO made six recommendations in total:

Table 9.1 ANAO Recommendations, Audit Report no. 15, 2004-05

- | | |
|----|---|
| 1. | <p>ANAO recommends that relevant entities consult with the Department of Finance and Administration on the need to liaise with the Senate Appropriations and Staffing Committee about which Annual Appropriation Bill should be used where it is proposed to move funding for particular payments from Special Appropriations to Annual Appropriations.</p> <p>All responding agencies agreed.</p> |
| 2. | <p>ANAO recommends that Portfolio Departments review their processes for providing information to the Department of the Prime Minister and Cabinet for the purpose of updating, consolidating or amending the Administrative Arrangements Order, in order to confirm that the information provided is accurate and includes all relevant legislation administered by their Ministers.</p> <p>All responding agencies agreed.</p> |
| 3. | <p>ANAO recommends that accountability for Special Appropriations be improved by the Department of Finance and Administration reviewing financial reporting requirements and related guidance to provide entities with greater clarity about:</p> <ul style="list-style-type: none"> (a) the disclosure requirements for Special Appropriations that have not been used in a given financial year and/or have been exhausted; (b) the disclosure obligations that apply where entities access Special Appropriations that are the administrative responsibility of another entity; and (c) the approach to be taken to achieving a clear read between budgeted and actual use of Special Appropriations. <p>All responding agencies agreed.</p> |
| 4. | <p>ANAO recommends that the Department of Finance and Administration promulgate advice on the management and disclosure of Special Appropriations used by, or paid to, entities subject to the <i>Commonwealth Authorities and Companies Act 1997</i>. This should include advice on the particular roles and responsibilities of Finance, Portfolio Departments and the CAC Act entities.</p> |

All responding agencies agreed.

5. ANAO recommends that:
- (a) the Department of Finance and Administration examine options for promoting greater consistency across Commonwealth entities in the management of Special Appropriations;
 - (b) where more than one entity draws on a Special Appropriation, relevant entities agree on appropriate arrangements to effectively coordinate the administration and disclosure of its use.

All responding agencies agreed.

6. ANAO recommends that, to meet their accountability obligations in respect of Section 83 of the Constitution, entities that draw amounts from the Consolidated Revenue Fund establish and maintain accounts and records that accurately link expenditure with a specific valid appropriation.

All responding agencies agreed.

The Committee's review

- 10.10 The Committee held a public hearing in Canberra on 5 April 2005 to review the progress made against the audit's recommendations.

Witnesses from the following agencies attended the public hearing:

- The ANAO;
- Attorney-General's Department (AGD);
- Department of Veterans' Affairs (DVA);
- Department of Finance and Administration (FINANCE);
- Aboriginal and Torres Strait Islander Services (ATSIS); and
- Australian Taxation Office (ATO).

- 10.11 At the public hearing the main issues addressed by the Committee included: management and reporting of special appropriations, training and guidance from Finance, and processes in place for better management of special appropriations. The Committee also discussed the progress that had been made on the implementation of the recommendations from the audit report.

Management of special appropriations by Commonwealth entities

- 10.12 The commencement on 1 January 1998 of the FMA Act and related Acts resulted in important changes in Finance's appropriation

management role. Under the revised financial framework, individual agencies became responsible for the control and management of their own finances, including the management of special appropriations.

- 10.13 Such responsibilities for Government entities include the management of records to ensure moneys are expended correctly without exceeding limits of the appropriation. Entities are also responsible for disclosing appropriations they are responsible for and disclosing the payments made against the appropriations in their annual financial statements.
- 10.14 The Committee was deeply concerned by the ANAO's findings which revealed that only one agency out of the 43 audited was able to satisfy all the audit objectives for the financial management of special appropriations. This agency was the Australian Industrial Registry, which only had to manage one special appropriation.
- 10.15 The main finding from the ANAO report revealed widespread non-compliance with legislative requirements. The ANAO explained to the Committee its concern that Commonwealth agencies were not paying enough attention to make sure there was adequate knowledge of legislative requirements.²
- 10.16 During the public hearing the Committee heard evidence from a number of agencies in relation to their incorrect reporting and or use of special appropriations and asked them to comment on what action they had taken to remedy the situation.
- 10.17 The Attorney-General's Department (AGD) told the Committee:
- The issues for the department were that we had not reported our expenditures against the correct appropriation...With regard to the ongoing issue – reporting the special appropriations with regard to former solicitors general – an oral report was provided to the department's audit committee. The report explained what action had been taken in order to remedy that particular reporting issue. The action advice was that a separate ledger code had been established and that all expenditures were being reviewed monthly.³
- 10.18 The Department of Veterans' Affairs (DVA) told the Committee that the points raised in the ANAO report were immediately looked at by its national audit and fraud control committee.

2 ANAO, *Transcript of Evidence*, 5 April 2005, p. 6.

3 AGD, *Transcript of Evidence*, 5 April 2005, p. 5.

We sought legal advice and immediately commenced discussions with Finance about the quantum of any amount that may have been inappropriately used by the department and, as I mentioned earlier, we have since repaid \$250,000 of the \$1.5 million total amount that was in dispute. On the overdrawn bank accounts, we have instituted measures within the department. I believe there is a Finance circular that has just come out which is drawing agencies' attention to this, and I think that accords with the actions we have already taken within the department. The DSH Insurance matter has now been fully rectified and the department is very aware of the requirements for reporting.⁴

- 10.19 Whilst the Aboriginal and Torres Strait Islander Commission (ATSIC) no longer exists, two representatives from Aboriginal and Torres Strait Islander Services (ATSIS), which is now situated within the Department of Immigration and Multicultural and Indigenous Affairs (DIMIA), attended the public hearing. The Committee heard the following evidence from ATSIS in relation to the incorrect drawing arrangements made over a period of nine years.

On the actions taken to rectify the situation, firstly ATSIS determined what were the correct indexation factors to have been used across the term of that nine years. We worked out what the correct indexation factors were and from that flows the amount of money which was then overcredited to the land fund and passed on to the Indigenous Land Corporation. ... in total, it is approximately \$21 million in aggregate between the land fund itself, ATSIC and the Indigenous Land Corporation. Having determined what we believe was the correct indexation factor and therefore the correct amount of money, we then agreed, with the Department of Finance and Administration, as to the amount, and that amount was repaid in full.⁵

- 10.20 ATSIS moved from ATSIC to DIMIA which resulted in ATSIS shifting its financial management obligations away from the *Commonwealth Authorities and Companies Act 1997*, (CAC Act) to the FMA Act.⁶

4 DVA, *Transcript of Evidence*, 5 April 2005, p. 5.

5 ATSIS (DIMIA), *Transcript of Evidence*, 5 April 2005, pp. 5-6.

6 The CAC Act sets out the financial management, accountability and audit obligations on Commonwealth statutory authorities and companies in which the Commonwealth has at least a direct controlling interest. The FMA Act provides the framework for the proper management of public money and public property by the Executive arm of the

Following this change, DIMIA informed the Committee that the following measures were underway to ensure a smooth transition:

DIMIA has commissioned an accounting firm to do a due diligence on the whole governance arrangements around the land fund to ensure that it complies with the FMA and so that any subsequent uses of indexation factors, albeit not for drawing down into the land fund but for on-paying to the Indigenous Land Corporation, are then done correctly.⁷

10.21 Finance informed the Committee that 'The errors identified for the Department of Finance and Administration in the report were errors in reporting, and those errors have now been corrected.'⁸

10.22 The Australian Taxation Office (ATO) told the Committee that:

A number of the errors in reporting by the ATO were fixed in the 2003-04 financial statements, because clearly we had information from the Audit Office about those issues before the report was published. The problem around one of the appropriations was related to our disclosure in the budget papers which we then used in our financial statements. That was fixed in the 2004-05 budget, and therefore the comparison of budget estimate and actual in the 2004-05 financial statements will now be appropriate. To the extent that we needed delegations and drawing right authority from the Department of Family and Community Services, that was received in 2004, and appropriate delegations issued in the tax office related to that authority from FaCS.⁹

Incorrect drawings from the Consolidated Revenue Fund (CRF)

10.23 Appropriation laws must specify the purpose for which the money is to be spent. Spending money contrary to the purpose of an appropriation, or in excess of the amount appropriated, contravenes Section 83 of the Constitution. The ANAO identified in its audit one instance where funds had been drawn from the CRF for a purpose that was contrary to the purpose of the special appropriation that was

Commonwealth. Public money and public property is defined in the Act as money and property in the custody or control of the Commonwealth.

7 DIMIA, *Transcript of Evidence*, 5 April 2005, p. 6.

8 Finance, *Transcript of Evidence*, 5 April 2005, p. 6.

9 ATO, *Transcript of Evidence*, 5 April 2005, p. 6.

debited. This involved the *Compensation (Japanese Internment) Act 2001* (Compensation Act) administered by DVA.

10.24 As a result, DVA drew \$1.5 million from the CRF under the Compensation Act special appropriation for the purpose of meeting its estimated departmental costs for the future administration of the compensation payments. The ANAO was advised that the component of that drawing that was expected to relate to administration of compensation payments made under the *Veterans' Entitlements Act 1986* (VEA Act) could have been paid using the VEA special appropriation. Therefore, the balance was not within the purposes of either special appropriation, thereby representing a contravention of Section 83 of the Constitution.¹⁰

10.25 The Committee invited the DVA to comment on this finding during the public hearing. DVA advised the Committee on the following:

The ANAO report reported on the use of funds for payments to prisoners of war of the Japanese. We drew down \$1.5 million from consolidated revenue under the CJI special appropriation. At the time, we understood that that was appropriately used for departmental expenses, including promoting the availability of the payments, assessing claims and making system changes to expedite those payments. The audit report subsequently took a different view. We have since had discussions with both A-G's and DOFA and an amount of \$250,000 has been repaid as the sum total of the amount that was in dispute.¹¹

10.26 It was apparent to the Committee that there was a lack of understanding of the legislation which had caused DVA to contravene Section 83 of the Constitution despite the fact that DVA was responsible for drawing up the legislation. The Committee questioned DVA as to how this lack of understanding of the legislation could occur. DVA replied 'At the time we felt that it was correct legislation and that it gave us the authority to do what we needed to do.'¹²

10.27 The main problem was that the Act did not split the administered money from the departmental funding – it just had one figure which included both. During the public hearing, DVA conceded that:

10 ANAO Audit Report no. 15, 2004-2005, p. 86.

11 DVA, *Transcript of Evidence*, 5 April 2005, p. 2.

12 DVA, *Transcript of Evidence*, 5 April 2005, p. 9.

The legislation was not explicit enough so, yes, that is correct. It was a section 83 breach because the legislation did not provide the authority to draw down the money. The money was not the full \$1.5 million.¹³

10.28 The Committee was interested to know whether an incorrect drawing down from the CRF consequently meant a loss of interest to the Commonwealth on that fund.

10.29 Finance replied:

If money is incorrectly drawn from the consolidated revenue fund – that is, it is drawn without an appropriation – does that involve loss of interest? Potentially, yes, it does involve loss of interest. But frequently there are other valid appropriations which are available to meet the requirements of section 83.¹⁴

Disclosing refunds as special appropriations to the Consolidated Revenue Fund

10.30 The ANAO identified 12 entities that had been making refunds of taxes, levies and charges without disclosing those refunds as a use of relevant special appropriations. In total they amounted to \$1.25 billion.

10.31 As a result of the ANAO audit, the ANAO was pleased to inform the Committee that improvements had been made in relation to the correct disclosure of special appropriations for refunds to the CRF. At the hearing the ANAO commented:

We certainly found that in the 2003-04 financial statements there was a great deal more reporting of the use of the refund appropriation provided by the FMA Act.¹⁵

10.32 The Committee asked the ATO to comment on changes they had implemented since the ANAO report identified them as having not disclosed \$19.525 million correctly in 2002-03. The ATO advised the Committee:

Certainly we made changes in the 2003-04 financial statements and we got legal advice from the Australian Government Solicitor that confirmed that section 28 of the

13 DVA, *Transcript of Evidence*, 5 April 2005, p. 10.

14 Finance, *Transcript of Evidence*, 5 April 2005, p. 12.

15 ANAO, *Transcript of Evidence*, 5 April 2005, p. 30.

FMA Act was the appropriate power under which to make those refunds. That is now reported as such in note 25(c) of the ATO's annual financial statements.¹⁶

- 10.33 The AGD, which had not disclosed \$4.014 million between 1998-99 to 2002-03 told the Committee 'We have similarly made changes to our process to ensure that they are properly recorded.'¹⁷

Non-disclosure of special appropriations

- 10.34 Section 39 of the FMA Act provides the authority for the investment of public money by the Finance Minister and the Treasurer (for debt management purposes only). A special appropriation authorising the drawing of money from the CRF for the purposes of Section 39 investments is provided by sub-Section 39(9) of the Act.
- 10.35 Each investment made under Section 39 of the FMA Act involves a separate use of the sub-section 39(9) special appropriation. This was confirmed in legal advice provided to Finance in July 2003. The ANAO found that there had been widespread non-disclosure of the use, and non-use, of the Section 39 special appropriation. In total, over the period examined by this performance audit, eleven entities did not report their use of the Section 39 special appropriation, involving drawings of more than \$36.8 billion.¹⁸
- 10.36 During the public hearing Finance admitted that an error had occurred in terms of not disclosing investments under section 39 of the FMA Act. The ANAO reported that Finance had failed to disclose \$95 098 million during the period 2001-02 to 2002-03.¹⁹
- 10.37 Finance informed the Committee that:

Regarding those special appropriations that were drawn on which were not reported in the financial statements at the time, the department no longer draws on section 39 of the FMA Act. If you like, it is analogous in one sense to ATSI's experience where the practice of drawing on that special appropriation to make investments is no longer undertaken by the department. So, going forward, there is nothing to

16 ATO, *Transcript of Evidence*, 5 April 2005, p. 30.

17 AGD, *Transcript of Evidence*, 5 April 2005, p. 30.

18 ANAO Audit Report no. 15, 2004-05. pp. 34-35

19 ANAO Audit Report no. 15, 2004-05. pp. 34-35

report against the appropriations. The issue has been drawn.²⁰

- 10.38 The ANAO reported that ATSIC had failed to disclose \$4 888 million during the period 1998-99 to 2002-03. ATSI confirmed at the public hearing that the full sum of money owed, including interest had been repaid.

The amounts have been determined as to how much was overdrawn. Those have been repaid. In addition, a calculation was made as to how much interest was earned on those overcreditings and that has also been repaid.²¹

- 10.39 The DVA informed the Committee that in relation to:

the nondisclosure of the use of section 39(9) in relation to Defence Service Homes Insurance, there was reporting disclosure in our financial statements under special accounts. But they were not disclosed in the manner required and this has since been rectified in the 2003-04 financial statements.²²

Debit balance

- 10.40 The FMA Act envisaged agencies entering into overdrafts for short periods. That is, agencies were prohibited from entering into overdraft arrangements unless the arrangements provided for each drawing to be repaid within 30 days. Under changes to the financial framework effective from October 2003, agencies are required to estimate all their funding requirements in accordance with the Finance Minister's delegation to Chief Executives. Overdrafts remain available where, despite agencies' best endeavours, estimates prove to be incorrect or cheques are dishonoured. However, data supplied to the ANAO by Finance showed FMA Act agencies with overdrafts on 448 occasions in the six months from October 2003 to February 2004 inclusive.
- 10.41 The DVA administers special appropriations that provide services to entitled members of the veteran and defence force communities, including Section 199 of the *Veterans' Entitlement Act 1986* and Section 41 of the *Defence Services Homes Act 1918*. The Department operates a number of bank accounts to support its activities. In the course of this audit, the ANAO identified that the DVA's official administered

20 Finance, *Transcript of Evidence*, 5 April 2005, p. 16.

21 DIMIA, *Transcript of Evidence*, 5 April 2005, p. 16.

22 DVA, *Transcript of Evidence*, 5 April 2005, p. 3.

payments 'head account', as well as various other official administered payments accounts, entered into debit balance inter-day during the 2002–03 financial year. The DVA's contract with its transactional banker, the Reserve Bank, does not provide DVA with overdraft facilities.

10.42 The DVA advised Finance in August 2004 that the overdrafts arose from automated payment processes established in July 1999 and that, if Finance had agreed suitable arrangements prior to October 2003, breaches of Section 8(3) of the FMA Act could have been avoided. Finance advised the ANAO in November 2004 that the requirements on agencies to estimate payments from special appropriations have existed since July 1999. The adherence to this requirement should have minimised the frequency of debit balances on agencies' bank accounts.

10.43 The DVA informed the Committee:

Our head account inadvertently went into debit balance between 27 and 29 December 2002 as a result of a request for a draw-down on 24 December not being processed until 30 December by DOFA. There was no cost to the Commonwealth because of that inadvertent breach and no breach of our transactional banking arrangements. We now have measures in place to address any future occurrences of that.²³

Committee comment

10.44 The Committee was disappointed to learn that the majority of Commonwealth entities were not managing and reporting correctly their special appropriations. Given that special appropriations are part of the legislation for financial management, the Committee was alarmed to discover that it took an ANAO performance audit to bring to light these discrepancies.

10.45 On a more positive note, the Committee was pleased to learn that most agencies have resolved the errors that had occurred and now have processes in place to better manage and report on special appropriations.

23 DVA, *Transcript of Evidence*, 5 April 2005, pp. 2-3.

Special appropriations stocktake

- 10.46 Special appropriations are usually distinguished by the form of words used in their parent Act to create them. The appropriating clause signals Parliament's clear intention that the Act authorises money to be drawn from the CRF for the purpose described in the Act.
- 10.47 The ANAO audit focussed on agencies' financial management of provisions in Acts that directly provided funding from the CRF (except where the law is an annual appropriation). The ANAO found that in 2002-2003 there was a total of 414 special appropriations in existence.²⁴
- 10.48 The ANAO's audit identified instances of multiple appropriations existing for the same purpose. For example, the ANAO found that in a number of instances, a special appropriation for the payment of the salary and allowances of a statutory office holder existed in two Acts. Advice from the AGS shed light on this issue:

Where there is a standing appropriation in respect of particular expenditure and Parliament later provides a further appropriation in respect of the same expenditure, for example, on an annual basis, there is an issue whether the standing appropriation has been impliedly repealed or at least suspended by the later appropriation. In such a case, it may not be correct to say that [AGD] remain 'responsible' for the standing appropriation within the meaning of the [*Finance Minister's Orders*], at least while the later appropriation is in place. Ultimately, however, this question can only be resolved on a case by case basis, having regard to whether Parliament intended to repeal or suspend the earlier standing appropriation or to provide two appropriations, either of which could be used.²⁵

Inconsistent management of special appropriations

- 10.49 The ANAO found significant inconsistencies between agencies' disclosure of special appropriations. For example, some agencies did not disclose the use of their special appropriations at all whilst other agencies incorrectly reported the special appropriation as being unlimited in nature.

24 ANAO Audit Report no. 15, 2004-2005, pp. 46-47.

25 ANAO Audit Report no. 15, 2004-2005, p. 48.

10.50 The ANAO also found that significant differences of view emerged in terms of whether the special appropriations 'in respect of' each year actually lapse at the end of the relevant financial year. Some agencies received legal advice which was not consistent with the advice being received from Finance.

10.51 During the public hearing the ANAO explained to the Committee how the AGO had doubled up on appropriations due to incorrect advice.

...take the example of the Australian Greenhouse Office, which was told that its share of the special appropriations does lapse, in the sense that if it is not used in this financial year it is not available next year. The Australian Greenhouse Office then went and obtained additional annual appropriations so that it could continue to pay the programs. As it now transpires, the most recent advice is that the special appropriations do not lapse. Effectively, what has happened is that the parliament has, through no fault of its own, appropriated the same money for the same programs on two different occasions.²⁶

10.52 The Committee agrees with the following statement made by the ANAO.

The ANAO considers that there would have been benefit, and reduced overall administrative costs to the Commonwealth, had an effective coordination arrangement been established for the management of these special appropriations within the context of the overarching financial management framework.²⁷

Committee comment

10.53 The Committee notes that Finance is responsible for developing and maintaining the financial framework for the Commonwealth public sector. This includes ensuring that agencies are aware of the correct management of each relevant special appropriation.

10.54 The Committee urges Finance to continue to update circulars that refer to special appropriations and ensure that the advice being

26 ANAO, *Transcript of Evidence*, 5 April 2005, p. 15.

27 ANAO Audit Report no. 15, 2004-2005, p. 74.

provided to agencies on special appropriations is accurate and consistent.

Recommendation 32

- 10.55 **The Committee recommends that the Department of Finance and Administration continues to provide ongoing advice to all Commonwealth agencies in relation to the accurate management and reporting of special appropriations.**

Mirror taxes

10.56 The majority of revenue or money raised, or received, by the Commonwealth is reflected in the Official Public Account (a group of bank accounts maintained by Finance) and individual entities' official bank accounts. However, there are some amounts that form part of the CRF that are not dealt with through official bank accounts. This is the case in relation to three Acts that validate certain State and Territory taxes, fees and charges that would otherwise be constitutionally invalid. These are:

- the *Commonwealth Places (Mirror Taxes) Act 1998* (Mirror Taxes Act), allocated to Treasury. In relation to this Act, Finance was advised as follows by Australian Government Solicitor (AGS) in May 2003:

Under the Mirror Taxes Act, State authorities collect various taxes that have been levied by the Commonwealth in relation to Commonwealth places. This legislation merely picks up and applies as Commonwealth law State taxes that had been declared invalid by the High Court in 1997 because they impermissibly intruded into the Commonwealth's exclusive Constitutional power with respect to places owned by the Commonwealth.
- the *Commonwealth Places (Application of Laws) Act 1970* (Application of Laws Act), allocated to the Attorney-General's Department (AGD). Similar in its provisions to the Mirror Taxes Act, since 17 April 1998, this Act has applied only to those State laws not scheduled under the Mirror Taxes Act; and

- the *Gas Pipelines Access (Commonwealth) Act 1998* (Gas Pipelines Act), allocated to the Department of Industry, Tourism and Resources (DITR). This is the lead legislation for the national scheme for third party access to natural gas pipelines. In certain circumstances, the Act provides for payments to be collected by the States and Territories on behalf of the Commonwealth, which are then returned to the relevant State or Territory by the Commonwealth.
- 10.57 The revenue collected by the States and Territories in each case automatically forms part of the CRF, reflecting its self-executing nature. Each Act provides, therefore, a Special Appropriation permitting this revenue to then be paid from the CRF back to the collecting State or Territory. However, the ANAO found that none of the relevant departments disclosed the use, if any, made of these Special appropriations in the audit period of 1998–99 to 2002–03.
- 10.58 In August 2004, the Attorney General’s Department (AGD) advised the ANAO that it did not, and is not ever likely to, receive monies or make drawings against the Special Appropriation provided by the Application of Laws Act. The AGD further advised that there are likely to be a number of agencies that apply this Act in a wide range of locations in Australia and that AGD had no information, and has never collected information, on which agencies may receive monies into the CRF and/or make drawings against the Special Appropriation.
- 10.59 The AGD raised concerns with the ANAO about the potential inefficiencies and duplication of administrative effort that would arise, together with the need for additional resources, should the AGD be held responsible for reporting revenues and expenditures against this Act. The Department suggested that it might be more appropriate for the Act to be made the responsibility of a central agency, such as Finance. On this point, matters dealt with by a Department of State, including the legislation it administers, are set out in the Administrative Arrangements Order (AAO).
- 10.60 At the public hearing the Committee asked AGD to update them on this piece of legislation. The AGD commented:
- the department does not draw down on itself. We really are not in any position at all to know how widely spread that particular special appropriation is. It was a suggestion I had made at the time that it could be better managed perhaps on a centralised basis where agencies might feed into a central

point and where there may be more capacity than there is in the Attorney-General's Department to actually administer that across what could be a wide number of agencies.²⁸

10.61 In response to the AGD's above comments, Finance told the Committee that:

we might need to enter into some further discussions with our colleagues in the Attorney-General's Department. The bottom line is that the administrative arrangements orders allocate responsibility for legislation to portfolios. That is where the responsibility lies and that is the way the system runs.²⁹

10.62 In relation to this point the ANAO commented that:

I think we are very much in Finance's camp at the moment. It is clear through the AAOs that the departments and agencies have responsibility. I will say that mirror taxes legislation is hard to administer unless you are actually thinking about it and planning it. It is not an easy piece of legislation. But we have to recognise that underlying it is that the CRF is actually self-executing – we are using a Commonwealth power in place of a state power to raise money and, in effect, it is an automatic in and out of CRF.³⁰

10.63 The AGD added:

It is the case that the department administers that piece of legislation, but any moneys drawn down against that special appropriation would be made by other agencies. The department had not included that special appropriation in its financial statements but it is not in a position to actually know – or it had not been in a position to know – what had been drawn down by other agencies against that special appropriation.³¹

Committee comment

10.64 The Committee agrees that the AGD and Finance should discuss this issue further, as suggested by Finance at the public hearing, to resolve

28 AGD, *Transcript of Evidence*, 5 April 2005, p. 24.

29 Finance, *Transcript of Evidence*, 5 April 2005, p. 24.

30 ANAO, *Transcript of Evidence*, 5 April 2005, p. 25.

31 AGD, *Transcript of Evidence*, 5 April 2005, p. 4.

this issue of responsibility for the Special Appropriation to ensure that correct administrative reporting is carried out by the responsible agency.

Recommendation 33

- 10.65 **The Committee recommends that the Attorney-General's Department and the Department of Finance and Administration resolve which agency is best equipped to administer the Special Appropriation in relation to Mirror Taxes.**

Responsibility for special appropriations

- 10.66 As stated at the beginning of the chapter, each entity is responsible for correctly managing and reporting on its relevant special appropriations.
- 10.67 Finance reinforced this responsibility at the public hearing with the following comment:

The primary responsibility for the financial management of an agency rests with the chief executive. That is pretty clearly set out in the FMA Act, which provides that the chief executive is to provide for the proper control of Commonwealth resources.³²

- 10.68 During the public hearing, the Committee asked Finance who has the ultimate responsibility for ensuring that the special appropriations are dealt with correctly. Finance commented:

I suggest that it is the role of the chief executive of each agency to make an assessment as to whether their chief financial officer has the capacity to do the job expected of them.³³

32 Finance, *Transcript of Evidence*, 5 April 2005, p. 11. *Note:* The FMA Act 1997, s. 48 (1) states that a Chief Executive must ensure that accounts and records of the Agency are kept as required by the Finance Minister's Orders.

33 Finance, *Transcript of Evidence*, 5 April 2005, p. 22.

Performance bonuses

- 10.69 The Committee was interested to hear at the public hearing how many of the Chief Financial Officers (CFOs) and their counterparts were paid performance bonuses in the last five financial years. All of the agencies present at the public hearing commented that it was most probable that each of their respective CFOs were paid performance bonuses in the last five years.
- 10.70 The Committee raised the issue of performance bonuses as it wanted to highlight the point that whilst many highly paid public servants were being paid performance bonuses for their financial management skills they were also breaching Section 83 of the constitution, or were not appropriately reporting on and/or disclosing significant financial management issues.
- 10.71 The ATO defended the fact that performance bonuses were given to CFOs for carrying out a broad range of tasks. The ATO commented that performance bonuses 'for any executive relates to a range of activities that are undertaken in an agency. Particularly, for most of the CFOs, that also involves budget management and other administrative stuff.'³⁴

Committee comment

- 10.72 The Committee understands that the ultimate responsibility rests with each department, namely the CEO and the CFO for correct management and reporting of special appropriations. Therefore, the Committee urges all CFOs to acquire a more comprehensive understanding of all relevant special appropriations that exist within their specific legislation.
- 10.73 The Committee recommends that CFO performance bonuses should be linked to a proven knowledge of and understanding of correct procedures for the management and reporting of all relevant special appropriations.

34 ATO, *Transcript of Evidence*, 5 April 2005, 05-04-05, p. 13.

Recommendation 34

- 10.74 **The Committee recommends that all Chief Financial Officers' performance bonuses should be linked to a proven understanding and application of correct procedures for the management and reporting of all relevant special appropriations.**

Finance guidance and training

- 10.75 The Committee was interested in finding out what action Finance had taken to assist agencies to achieve a sound understanding of the management and reporting of special appropriations. Finance commented that 'We have a publication entitled "The role of the chief finance officer" for departments, which indicates the sorts of things that agencies might take into account.'³⁵
- 10.76 In respect of this publication the Committee asked Finance when it was developed and whether Finance had consulted with other agencies. Finance responded:
- ...a CFO guidelines reference group was established in November 2002. The group was chaired by Finance, and included representatives from the Departments of Agriculture, Fisheries and Forestry (AFFA), Employment and Workplace Relations (DEWR) and Foreign Affairs and Trade (DFAT). Between November 2002 and February 2003 the group developed a set of guidelines detailing the role of the CFO in Commonwealth agencies. The ANAO was consulted and provided comments on the draft guidelines.³⁶
- 10.77 In addition, Finance informed the Committee:
- In regard to raising the profile of the chief financial officer in departments and raising, if you like, the professional qualifications of those people, there is not only the best practice guidance issued by the department of finance but also for a number of years we have every so often issued a

35 ANAO, *Transcript of Evidence*, 5 April 2005, p. 21.

36 Finance, Submission 2.1, p.2.

survey of the departments to see whether the general standard has been improving.³⁷

- 10.78 Finance told the Committee it has produced quite a lot of guidance in the last few years to assist agencies in meeting their obligations under the compliance framework.³⁸

First of all we have a series of finance circulars, many of which are listed in our submission. More broadly than that, we have now produced 15 booklets in our financial management guidance series to advise agencies about how they should conduct themselves on various matters concerning the financial framework. We also have estimates memorandums and there are additional ones in preparation on a variety of issues that will come out in due course.³⁹

- 10.79 The Committee asked whether there were any opportunities for the CFOs to group together to share information. Finance commented:

We do have a CFO forum which meets once a month and addresses issues of current interest in the financial management of the Commonwealth, which goes beyond special appropriations to budget issues and various other matters that emerge.⁴⁰

Processes in place for a better understanding on the drawings of special appropriations

- 10.80 The Committee was interested in hearing from each of the appearing agencies about what processes they had implemented to give them a clear understanding of the full amount drawn under each appropriation.
- 10.81 The Committee appreciated the ATO's honesty in admitting that mistakes had been made in the past in relation to special appropriations. During the public hearing the ATO commented that the audit report:

37 Finance, *Transcript of Evidence*, 5 April 2005, p. 21.

38 Finance, *Transcript of Evidence*, 5 April 2005, p. 10.

39 A list of Finance guidance to agencies to assist them with the management of appropriations was attached to the Finance submission to the inquiry (submission no. 2). Finance, *Transcript of Evidence*, 5 April 2005, p. 11.

40 Finance, *Transcript of Evidence*, 5 April 2005, p. 23.

...has shown us a couple of things that perhaps we were not as conscious of before. You could argue that we should have been – and we certainly are now – particularly around the interaction of the tax acts and the FMA Act. We are much more conscious and we explore that more actively now, whereas before we tended to think more in terms of what the powers under the tax act were. But there are interactions between those acts, and some of those issues where we did not do so well are actually about that interaction and understanding that.⁴¹

10.82 The ATO also commented:

The tax office accept that we have not paid enough attention to some of the details, particularly around the reporting of how that money is spent. I suspect that, again, some of that is buried in history. Some of the newer ones deal with the complexity of making one payment to a taxpayer that will contain money that comes from a number of special appropriations. We have not necessarily focused to the extent that we should – and I might say that we have now, and those things have been fixed – on making sure that the reporting of that payment appears in the appropriate places.⁴²

10.83 In terms of changes that had been made the ATO informed the Committee:

As I mentioned previously, we sorted out most of our reporting issues in the 2003-04 financial statements, with a flow-on into how we disclosed some estimates in the 2004-05 budget. We are also putting in place special appropriation ledgers, which will be in place by the end of April, but we already have processes in place that allow us to report against those different special appropriations. As part of that, we have developed allocation rules so that, when we make a single cash payment and we then need to split that in cash terms back to the different appropriations, we have agreement with the ANAO about how we will go about that.

We are also putting in place processes around new policies so that, as new policy comes up, we are actively exploring both the appropriation and the drawing rights issues at the time

41 ATO, *Transcript of Evidence*, 5 April 2005, p. 12.

42 ATO, *Transcript of Evidence*, 5 April 2005, p. 4.

that the new policy is being developed, to ensure that we understand both the accounting reporting and payment responsibilities that occur as that is being developed rather than when payments are suddenly being made at the end of the process.⁴³

- 10.84 The AGD explained to the Committee the changes that had been implemented since the ANAO audit:

We currently draw down against three special appropriations. We have separate ledger codes for those appropriations. We have a procedure with our HR area, which makes some of those payments, to advise us if there are any new payees or any changes to the current payment arrangements. The hand gun buyback program is administered by a separate area in the department. Again, there is a full set of separate ledger codes set up for that area to use. Those expenditures are reviewed both by the area itself against the requirements of the legislation and by people in my branch.⁴⁴

- 10.85 The DVA informed the Committee of procedures in place to allow for a clear understanding of its special appropriations:

We have a number of special appropriations to pay pensions and provide health care and other benefits to eligible veterans and their dependants. We have separate ledger codes for these appropriations. Expenditure against those appropriations is reported on a monthly basis to the executive of the department. We have full reporting of expenditure against those special appropriations in all of our financial statements. We have a drawing rights register which records the officers who have the authority to draw down money. Our expenditure against special appropriations is very closely monitored by the Department of Finance and Administration.⁴⁵

- 10.86 The Committee was pleased to note the following comment from one of the DVA's officers present at the hearing – 'I can assure the

43 ATO, *Transcript of Evidence*, 5 April 2005, pp. 19-20.

44 AGD, *Transcript of Evidence*, 5 April 2005, p. 16.

45 DVA, *Transcript of Evidence*, 5 April 2005, p. 17.

chairman that we have learnt some lessons from this particular audit report.’⁴⁶

- 10.87 Finance informed the Committee on the changes that had been implemented since the audit report:

Our areas for the department were primarily reporting, and those areas have now been corrected – which was the story that you heard before. More generally, now we have a complete list of the special appropriations, we have got to the point where we have been able to allocate almost all of them to a particular department. We expect to complete that work of allocating the special appropriations by the end of this year, so that agencies are able to accurately report on their special appropriation.⁴⁷

- 10.88 In a supplementary submission, Finance advised the Committee that extensive work had been carried out in terms of compiling a list of all special appropriations and allocating responsibility of these appropriations with the relevant agencies. Finance stated:

Extensive work has been done by Finance and it is expected that the list will be completed before the end of July 2005. Discussions with agencies will then occur over the next quarter to ensure allocations are correct and agreed. We will advise the Committee once this work has been completed.⁴⁸

- 10.89 Finance also outlined to the Committee the system which is used to allow agencies to draw funds against special appropriations.

Finance has a thing we call the CAMM system, which is basically our cash management system for handing out cash to agencies. Under that system there are estimates provided against each of the authorities. But when it comes down to the question of drawing against those authorities, whether or not that is the correct drawing against the authority is really a matter for the department concerned.⁴⁹

- 10.90 Finance continued to explain to the Committee that :

When agencies draw down funds through system finance, if it is an annual appropriation, we check to make sure there is

46 DVA, *Transcript of Evidence*, 5 April 2005, p. 18.

47 Finance, *Transcript of Evidence*, 5 April 2005, p. 19.

48 Finance, Submission no. 2.1, p. 1.

49 Finance, *Transcript of Evidence*, 5 April 2005, p. 18.

still appropriation available. Where it is a special appropriation, if the agency has made an estimate and the draw down would exceed that estimate, we then refer it back to them to talk to the relevant area in Finance to agree a new estimate, and we are notified of that before we proceed with the draw-down. However, it is the agency's responsibility to choose the right special appropriation for the payment they are about to make.⁵⁰

- 10.91 In a submission to the Committee, Finance commented that agencies are more aware of their responsibilities and are responding to both the enhanced guidance available and the recommendations of the audit report. Finance believed that:

The additional guidance already made available by Finance and the work still underway should further assist agencies to implement internal controls that will allow proper management of special appropriations.⁵¹

Committee comment

- 10.92 The Committee's review of this Audit Report on the financial management of special appropriations is one of a series of reviews the Committee is undertaking into aspects of financial management within the public sector. In the previous Parliament the Committee looked at the management of special accounts, and in September 2005 we have begun a review into the investment of public funds.
- 10.93 A theme emerging from each of these reviews is that managers at quite senior levels within the public sector are either not fully aware of their responsibilities under the FMA Act, or are not discharging them appropriately. The Committee is most concerned to note this pattern across a number of Audit Reports. The Committee wishes to place all public agencies on notice that this is a matter we will continue to investigate throughout the 41st Parliament.

50 Finance, *Transcript of Evidence*, 5 April 2005, p. 19.

51 Finance, Submission no. 2, p. 3.

Audit Report No. 16, 2004-2005

Container Examination Facilities

Introduction

Background

- 11.1 The current international security environment requires a heightened awareness of border security in Australia. Australia's isolation means that we are particularly reliant on imports and exports arriving by sea. Furthermore, movement in sea cargo is expected to grow substantially by 2010. This important trade mechanism means that Australia's maritime industry will be propelled to the forefront of border security.
- 11.2 The maritime transport industry contributes over \$180 billion to Australia's economy each year. Four major ports handle over 94 percent of the cargo arriving by sea in Australia: Brisbane, Sydney, Melbourne and Fremantle. To this end, they are considered primary targets for those wishing to import or export prohibited goods or drugs through Australian borders.
- 11.3 The Australian Customs Service (Customs) is the agency charged with oversight of border protection. As part of the Federal Government's *Tough on Drugs, Protecting our Borders* and *A Safer*

Australia initiatives, funding was provided to enable Customs to carry out its border protection function, particularly on the waterfront.¹ Part of the funding programme included a significant increase in the number of containers inspected by Customs.

Container Examination Facilities (CEFs)

11.4 The Container Examination Facilities (CEFs) combine advanced x-ray technology and physical inspections to allow Customs to examine containers entering Australia by sea. The specific aims of the facilities are to:

- prohibit the flow of contraband such as illicit drugs and weapons;
- minimise revenue losses through revenue evasion and smuggling;
- protect industry through detection of non-compliant importers and exporters; and
- improve the security of sea cargo.²

11.5 Prior to the introduction of the CEFs, Customs examined 11 000 containers annually.³ The CEFs were introduced progressively across the ports (beginning with Melbourne) from November 2002 to enable an increased inspection capacity. Recent increases in funding have allowed Customs to increase the hours of operation of the CEFs which has greatly increased throughput levels of containers. Current Customs inspection capacity has increased to over 100 800 containers annually.⁴ The Committee notes that this still represents a small percentage of total loaded sea cargo importations – around seven per cent of a total of over 1.4 million imports per year.

The audit

11.6 The ANAO conducted an audit of the administrative effectiveness of the CEFs in 2004. The main areas examined by the ANAO were target selection processes, target development strategies, intervention processes and the operation of facilities.

1 Australian Customs Service, *Overview of the Customs Container Examination Facilities*, Exhibit No. 9, p. 3.

2 ANAO Audit Report No. 16, 2004-2005, *Container Examination Facilities (Australian Customs Service)*, Commonwealth of Australia, December 2004, p. 29.

3 Customs, *Transcript of Evidence*, 28 April 2005, p. 2.

4 ANAO Audit Report No. 16, 2004-2005, p. 29.

- 11.7 During the audit, the ANAO considered that Customs' new Integrated Cargo System (ICS) would be functional by 2005. This project, as part of a larger strategy, will replace existing transaction processing systems.

Audit findings

- 11.8 In the area of target selection, the audit found that Customs has effective systems in relation to risk assessment and targeting cargo for assessment. The ANAO also found that the interpretation of responsibilities of the Target Selection Officers varied between regions, while no specific training was provided for this position. Customs also did not fully understand the complexity and time required for the logistical management of the CEF screening process.
- 11.9 Developing targets for screening is an essential aspect requiring quality intelligence. The ANAO found that while Customs had sound information sharing strategies with other law enforcement agencies, the communication between Customs regions could be improved. The ANAO called for further assessment of cargo environments, given that each region faces unique issues. The ANAO also recommended the implementation of an expert panel to review 'country of origin' profiles as previously recommended in Customs' *National Cargo Targeting Strategy*.
- 11.10 The ANAO found that Customs had well defined procedures for the examination of containers. The ANAO was concerned that none of the regions met inspection targets, especially of those containers given the highest priority rating (of which all should be examined). The audit found data integrity issues in the Examination Data Management System (EXAMS) and that interpretation of events (such as the discovery of contraband) varied between regions.
- 11.11 A final aspect analysed by the ANAO was the operation of the CEFs. As stated previously, none of the regions had selected enough containers to meet their targets, and the ANAO was advised that this may have been due to CEF staff requesting that TSOs reduce the numbers of containers being selected as CEFs were having difficulty managing their targets. Customs undertook regular liaison with industry to improve processes, and the ANAO noted that this consultation resulted in the introduction of additional shifts at the CEFs to alleviate industry concerns relating to storage charges. The audit found that Customs could improve performance measures against logistics and maintenance contracts which are entered into

with service providers. Logistics plans have yet to be developed and formalised as part of these contracts.

ANAO recommendations

11.12 The ANAO made eight recommendations aimed at improving the administrative effectiveness of the CEFs. Customs agreed with all the recommendations.

Table 11.1 ANAO recommendations, Audit Report no. 16, 2004-05

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|----|--|
| 1. | To more effectively manage logistical coordination, the ANAO recommends that Customs consider adopting a consistent national approach by: <ul style="list-style-type: none">(a) assessing the feasibility of using the EXAMS system to monitor and track selected containers, including the reporting capability of the Corporate Research Environment;(b) clearly defining the roles and responsibilities associated with the target selection coordinator's position; and(c) providing appropriate training and developing procedural guidelines for this specialist position. |
| 2. | To strengthen target development and target selection processes and to provide a better understanding of the sea cargo environment in which regions are operating, the ANAO recommends that the New South Wales, Victorian and Queensland regions: <ul style="list-style-type: none">(a) complete an assessment of the sea cargo imports and exports discharging into their respective ports; and(b) regularly review and update this data so that it may be used as a reference source for developing risk profiles. |
| 3. | To strengthen high-risk country identification and target selection practices, the ANAO recommends that Customs review the risk profiles of cargo origin countries and, as part of this review: <ul style="list-style-type: none">(a) re-evaluate the risk ratings for all major countries;(b) revise the weighting applied to country risks; and(c) develop a process to regularly review this risk rating set. |
| 4. | To enable accurate reporting of the inspections and examinations carried out by the Container Examination Facilities (CEFs) using EXAMS system data, the ANAO recommends that Customs develop: <ul style="list-style-type: none">(a) common system business rules and reporting parameters for the EXAMS system; and(b) standardised report templates in the Corporate Research Environment that are specific to the CEFs. |
| 5. | To capture inspection and examination data accurately and consistently, the ANAO recommends that Customs develop and implement guidelines that clearly articulate: <ul style="list-style-type: none">○ what constitutes a positive find at the Container Examination Facility (CEF), including when the cargo is referred to another area;○ how the find is to be recorded by the CEF in the EXAMS system; |

- how this information will be treated by the EXAMS system; and
 - who is responsible for completing the EXAMS record.
6. To enable the operational effectiveness of the Container Examination Facilities (CEFs) to be assessed and reported on, the ANAO recommends that Customs:
- (a) develop performance measures and targets specific to the CEFs; and
 - (b) include these measures in Customs' Outcome/Outputs framework performance information.
7. To identify and address problems associated with segregating, prioritising and transporting selected containers to and from the Container Examination Facilities (CEFs), the ANAO recommends that Customs, in consultation with the container terminal operators and transport service providers, develop a logistics plan for each CEF port.
8. Prior to renegotiating its container handling, transport services and unpack and repack services contracts, the ANAO recommends that Customs undertake a comprehensive review of these contracts including:
- an assessment of the risks associated with the contracted service delivery;
 - benchmarking performance across ports;
 - an evaluation of existing service level agreements, service specifications and key performance indicators;
 - reviewing the existing performance management framework; and
 - developing a standardised performance reporting regime.
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The Committee's review

- 11.13 On 28 April 2005, the Committee held a public hearing to review the progress made against the ANAO Audit Report recommendations. The public hearing was attended by representatives of the ANAO and Customs.
- 11.14 The Committee took evidence on the following issues: progress on the recommendations made by the ANAO, ports without CEF facilities, reporting of incoming cargo, target selection staff and processes, CEFs not meeting selection targets, export containers, priority profiles, staff training and interpretation of procedures, contraband or prohibited items; and customs contracts and performance.
- 11.15 In processing containers through Australian ports with the CEF facilities, the main steps are:
- target development – the policies underpinning Customs' criteria for prioritising containers for examination;
 - target selection – procedures for selection of individual containers for further inspection; and

- intervention – screening containers through the CEF, and further intervention such as an unpack where deemed necessary.

11.16 The Audit Report's findings, and the Committee's review, of each of these steps are outlined below.

Target development

11.17 Customs relies on intelligence and other information gathered from various agencies in its assessment of targets. A target refers to any entity (including people, organisations or occurrences) which Customs or another agency chooses to place a focus on for further scrutiny.⁵ Customs uses a variety of methods in their efforts to detect prohibited items and dishonest operators. These include the development of profiles relating to country of origin using intelligence available from local and international sources.

Profiling

11.18 Customs develops 'country of origin' profiles relating to countries which export to Australia.⁶ These profiles are used as a major tool when Target Selection Officers are making judgements about priority ratings in relation to containers.

11.19 Customs advised the Committee that it has implemented a review team to examine current 'country of origin' profiles. The review team has found that many profiles have not been updated since 1999 and that some countries for which profiles have not been created have emerged as potential 'high-risk' countries. Consideration is also given to countries where containers may have been in transit.

11.20 The ANAO noted that while 'country of origin' was the most quoted reason for the examination of a container, it was also the criterion which yielded the least amount of success in terms of detection of prohibited items.⁷ Customs advised the Committee that:

Country of origin is one of the broad parameters used to capture a group of consignments for further consideration, but consignments are not finally selected for examination for

5 ANAO Audit Report No. 16, 2004-2005, p. 48.

6 ANAO Audit Report No. 16, 2004-2005, p. 55.

7 ANAO Audit Report No. 16, 2004-2005, p. 55.

this reason alone. As the indicators used are various, and change as risks and patterns of legal and illegal trade change, Customs does not see value in using resources to record in detail all the reasons for each selection...The relationship between country of origin as a reason and success is therefore somewhat misleading.⁸

- 11.21 Customs also provided the Committee with information relating to their intelligence gathering and analysis capabilities. The information provided is confidential and may pertain to current and future operations and therefore was taken as 'in-camera' evidence. The Committee is satisfied that Customs' activities in this regard are sound.

Target selection

- 11.22 The process of selecting containers to be further examined by the CEFs is multi-staged. It requires selection staff to use their judgement combined with risk analysis and intelligence from sources such as law enforcement agencies in Australia and around the world.

Containers

- 11.23 The Committee heard that in addition to the five ports with CEF facilities, there are another 14 ports around Australia which receive containers imported by sea. Another 54 ports have the capacity to receive containers but do not do so on a regular basis.⁹ Where ports do not have CEF facilities, Customs can 'take the container to a facility where we can unpack it and do an old-fashioned physical examination'.¹⁰
- 11.24 The Committee was also told that some facilities which do not have full CEF facilities are equipped with limited x-ray facilities. For example, Darwin only receives a small volume of containers in comparison to the larger facilities. Customs commented:

We will have the large static X-rays where you can put the box level stuff through rather than pallet level. So you can see that as the volumes go down the technology is matched to the

8 Customs, Submission no. 9, p. 11.

9 Customs, Submission no. 9, p. 8.

10 Customs, *Transcript of Evidence*, 28 April 2005, p. 4.

volumes we face. Then of course in the very small ports the volumes are such that physical examination is sufficient.¹¹

11.25 The Committee also heard that empty containers and those being exported are also subject to examination by Customs. Customs deems empty containers to be of low risk and in the past five years no empty containers have been found to contain prohibited or contraband items.¹²

11.26 To date, only a small number of containers destined for export have been checked by the CEFs. The items which are prohibited to be brought into Australia are also the same ones which are prohibited to be exported from Australia.¹³ Customs advised the Committee that:

Since the CEFs have commenced operation, they have inspected around 2,300 export containers. In the next financial year we want to increase the number of export containers that the CEFs are looking at. So we have a program where we are gradually increasing the number of export containers we inspect.¹⁴

11.27 Each container to be examined by the CEF is given a priority rating by the Target Selection Officer from 1 (as the highest priority, which is to be x-rayed and physically examined) to 4 (as the lowest priority, and which is used to adjust CEF workflow).¹⁵

Information systems

11.28 Customs uses several electronic information systems in its work relating to the import and export of sea cargo. A major initiative is the Cargo Management Re-Engineering project, which aims to change and improve the way 'industry reports the movement of cargo and involves a major review of Custom's practices'.¹⁶ CEF-specific data is entered into EXAMS.

11 Customs, *Transcript of Evidence*, 28 April 2005, p. 5.

12 Customs, *Transcript of Evidence*, 28 April 2005, p. 13.

13 Customs, *Transcript of Evidence*, 28 April 2005, p. 8 and Submission no. 9, p. 13. Customs provided the Committee with a breakdown of prohibited items intercepted from 1 July 2004 to 30 April 2005. The list includes firearms, wildlife, weapons and drugs.

14 Customs, *Transcript of Evidence*, 28 April 2005, p. 8.

15 ANAO Audit Report No. 16, 2004-2005, p. 41.

16 ANAO Audit Report No. 16, 2004-2005, p. 34.

Integrated Cargo System (ICS)

- 11.29 The information technology component of the Cargo Management Re-engineering project is called the Integrated Cargo System. The ICS aims to replace four existing transaction processing systems.
- 11.30 Of these four systems, the Sea Cargo Automation system is the most pertinent to the CEFs. The Sea Cargo Automation system contains sea cargo reports of all cargo being imported into Australia. Importers are required to lodge sea cargo reports 48 hours prior to the vessels arrival. These reports contain general information about the cargo including origin, supplier, receiver and a description of the goods.¹⁷ It is these reports combined with intelligence that TSOs use to make judgements about which containers are to be inspected by CEFs.
- 11.31 The Integrated Cargo System will be a single system for the electronic reporting of cargo. Risk profiles will be incorporated into the system via the Cargo Risk Assessment system and will contain all current risk assessment profiles and provide alerts to staff when cargo profiles are matched with risk indicators.

Examination Data Management System (EXAMS)

- 11.32 In the event of a container being selected for inspection, the cargo is held through the SCA system and a record is created in EXAMS. The EXAMS record includes information such as the container and priority number, reasons for the container's selection, and other information which may help the CEF image analyst decide whether to proceed with unpacking the container.
- 11.33 During the course of the audit, the ANAO sought to determine the accuracy of the data in the EXAMS system. The analysis aimed to determine rates of physical inspection, both overall and by priority rating. Aspects of EXAMS data were also compared with that kept within the centralised Corporate Research Environment, which provides an analytical tool integrating a wide variety of data sources. It was found that data in the EXAMS system contained numerous discrepancies. For example, in all regions, the Corporate Research Environment record of numbers of containers selected was higher than that recorded by EXAMS. Other data related discrepancies included the numbers of CEF and physical inspection data as well as data relating to 'positive finds'.¹⁸

17 ANAO Audit Report No. 16, 2004-2005, p .31.

18 ANAO Audit Report No. 16, 2004-2005, p. 64.

- 11.34 In terms of rectifying these data integrity issues, Customs advised the Committee that several measures are being undertaken to improve data quality. These include that the EXAMS helpdesk is monitoring the examination data for inconsistencies including deviations from normal practices and potential data duplication.
- 11.35 A project being conducted by Customs in relation to EXAMS data (and being monitored by the EXAMS helpdesk) is the EXAMS data quality assurance strategy. The project aims to check records entered via EXAMS for quality. The ANAO described the two-step process as:
- Step 1: Customs officer completes the relevant EXAMS records then checks to ensure that all details are in accordance with what was actually observed and amends the relevant record where necessary.
 - Step 2: Officers conduct ongoing compliance checks and provide reports periodically to the Client Data Management System User Support Group. These reports will be distributed to all regions for action and reporting within two weeks.¹⁹
- 11.36 All regions advised the ANAO that entering data into the EXAMS system was time consuming. Some regions also advised the ANAO that local databases had been developed to overcome weaknesses in the EXAMS system.²⁰ Customs advised the ANAO that the next version of the system, EXAMS 2, will reduce the time needed for data entry²¹ and will also include enhanced ‘...recording, searching and reporting capabilities’.²² New business rules are also being developed to ensure consistency of data recording across all regions, ensuring that localised databases will not have to be used.²³

Selection of containers

- 11.37 The process from the initial selection of containers for examination to their release moves through defined stages. Initially, importers are required to provide sea cargo reports electronically (through the Sea Cargo Automation system) to Customs 48 hours prior to a vessel arriving in Australia. These reports are assessed by Target Selection

19 ANAO Audit Report No. 16, 2004-2005, p. 67.

20 ANAO Audit Report No. 16, 2004-2005, p. 62.

21 ANAO Audit Report No. 16, 2004-2005, p. 44.

22 ANAO Audit Report No. 16, 2004-2005, p. 67.

23 Customs, Submission no. 9, p. 11.

Officers to determine whether further examination of cargo by the CEF is required or whether the cargo will be released immediately.

- 11.38 Upon arrival at the wharf, a container is stored free of charge for 72 hours by the container terminal operator, after which time storage charges (imposed by the operator) apply. It is the importer's responsibility to contract transport providers to collect containers from the wharf. Customs endeavours to have containers that are selected for inspection returned to the wharf with at least 24 hours storage remaining on it. Customs advised the Committee that less than two per cent of containers are returned with no storage time remaining.²⁴
- 11.39 Once a container is selected, the terminal operator is notified and it is held upon arrival. Priority ratings are assigned to held containers (through the Sea Cargo Automation system), while a record is created in the EXAMS system. Customs has arrangements with transport providers to transport the containers to and from the CEF. Once cargo is put through the x-ray facility, an image analyst uses the x-ray, priority rating and other available information to determine whether any further action is to be taken. If the container has not been assigned a 'priority 1' rating and the x-ray image does not contain any anomalies, it is returned to the cargo terminal and released. All 'priority 1' and other containers as determined by the image analyst are to be physically examined.²⁵

Non-selection of containers

- 11.40 A required number of containers must be selected for examination by the CEFs, inclusive of 'priority 1' and other target priority levels. The ANAO analysis examined whether each CEF met its selection targets from the opening of the facility to 1 September 2004, giving consideration to the 'ramp up' period required for each facility to be fully operational and the increase in targets for when extended operating hours were introduced. It was found that none of the CEFs met specified targets, with both the Sydney (90 per cent) and Fremantle (86.9 per cent) facilities being substantially behind targets.²⁶
- 11.41 Customs responded by informing the Committee that since the Audit:

24 Customs, Submission no. 9, p. 18.

25 ANAO Audit Report No. 16, 2004-2005, p. 31.

26 ANAO Audit Report No. 16, 2004-2005, p. 39.

All regions are now meeting or exceeding agreed targets. From 1 July 2004 to April 2005 the CEFs have inspected 101.8% of their inspection targets.²⁷

- 11.42 The ANAO also found that not all containers marked as 'priority 1' were being examined, contrary to Customs guidelines.²⁸ In particular, Brisbane (60 per cent) and Melbourne (72 per cent) had low rates of physical examination of 'priority 1' containers. Customs advised the Committee that since the audit, 'Across the board nationally, we are now physically examining 92 percent of the priority 1s'.²⁹
- 11.43 Customs also advised the Committee that there are factors which may cause the cancellation of inspection targets. These include the duplication of records, containers being discharged in other ports and requests being cancelled by other regions. There are also instances where Customs may cancel the physical inspection of a 'priority 1' container but only in situations where the x-ray image of the cargo is very clear.³⁰

Staff training

- 11.44 An issue raised by the ANAO was that of the training received by Target Selection Officers to enable them to select quality targets.³¹ Several training courses exist including the general Target Selection Officer training course and a one-day Container x-ray training package. The ANAO found that many current Target Selection Officers had not completed training, and required further training in container selection techniques.
- 11.45 Customs informed the Committee that the current training focus for Target Selection Officers is primarily based on the changes in the new ICS. Components of this training include a refresher on general selection techniques and spending time working in the CEFs to increase familiarity with image analysis and examination methodology.³² Weekly meetings between targeting and examination staff had also been implemented to provide feedback and exchange of information.³³

27 Customs, Submission no. 9, p. 4.

28 ANAO Audit Report No. 16, 2004-2005, p. 61.

29 Customs, *Transcript of Evidence*, 28 April 2005, p. 7.

30 Customs, Submission no. 9, p. 16.

31 ANAO Audit Report No. 16, 2004-2005, p. 42.

32 Customs, Submission no. 9, pp. 2 and 6.

33 Customs, Submission no. 9, p. 8.

- 11.46 Customs also advised the Committee that staff were being trained in the use of the new EXAMS 2 system, which replaces EXAMS. EXAMS 2:

...has a separate training environment which is a replica of the production environment. Each region has some experienced users who have participated in Train the Trainer courses in EXAMS 2 and have also been involved with the development and testing of the EXAMS 2 application. Each new user is required to be trained in EXAMS 2 using the Training environment under the guidance of an experienced trainer. The supervisor of the new user then has to confirm that the user has been appropriately trained in the use of the system, before the new user is given access to enter data into the EXAMS (Production) system...It is also planned to setup an E-Learning environment for EXAMS 2, where users would be able to get training at their own pace. The environment will have capabilities to monitor the progress of the trainees and their level of knowledge.³⁴

- 11.47 One of the tools that staff receive training about is a central image library.³⁵ Customs maintains an x-ray image database of detections made by CEFs which are compared to typical cargo. Cargo and EXAMS reports are attached to each image. The Committee agrees with the ANAO that this will greatly benefit staff.

Committee comment

- 11.48 The Committee is pleased to note that the rate of inspections of 'priority 1' containers has increased substantially since the audit.

34 Customs, Submission no. 9, p. 8.

35 ANAO Audit Report No. 16, 2004-2005 p. 71; and Submission no. 9, p. 15.

Recommendation 35

11.49 The Committee recommends that the Australian Customs Service:

- continues to rectify data integrity issues within EXAMS;
- creates clearly defined business rules for data entered in EXAMS 2 for consistency across regions; and
- ensures that the one-day TSO x-ray training course is implemented across all regions.

Intervention processes

11.50 Customs outlined the CEF process from beginning to end for the Committee. The Committee was also given insight into the course of action taken in the event that prohibited or contraband items are found.

Examination of containers

11.51 Cargo which has been given a 'priority 1' rating during the selection phase must undergo an x-ray and physical inspection at the CEF. Containers that have not been given a 'priority 1' rating but that have been selected for CEF inspection must at least be x-rayed. Customs has agreements with transport service providers to transport containers from the wharf to the CEF. Once a container arrives at the CEF it is checked into a 'scanning hall' and the container is put through the x-ray system, with the process lasting approximately six minutes.³⁶ The image is analysed by an image analyst using the x-ray image and EXAMS record. Amendments to the EXAMS record are made if necessary, especially in the case of an anomaly being discovered.

11.52 A container selected for physical inspection is first tested for fumigants. Once tested, the contents of the container are removed by 'unpack/repack service providers'³⁷ using one of four levels of examination. These are:

36 Customs, *Exhibit no. 9*, p. 7.

37 Customs, *Exhibit no. 9*, p. 9.

- full unpack, where all cargo is removed from the container for further examination;
 - partial unpack, where some but not all cargo is removed from the container for further examination;
 - tailgate, where the container is opened and inspected without unpacking; or
 - tunnel unpack, where the container is unpacked to the point identified by the x-ray image as being inconsistent.³⁸
- 11.53 Customs informed the Committee that a 'full unpack' takes approximately 54 minutes while a 'full repack' takes approximately 64 minutes. A 'partial unpack' takes 22 minutes while a 'partial repack' takes 24 minutes.³⁹
- 11.54 A 'positive find' during an examination refers to the discovery of prohibited goods or substances. As previously mentioned, data integrity issues within EXAMS meant the ANAO did not get a true picture of the number of 'positive finds'. However, Customs provided the Committee with updated data in relation to 'positive finds'.⁴⁰ The total number of 'positive finds' from 1 July 2004 to 30 April 2005 was 275, which includes compliance and quarantine issues, to finds of prohibited items (such as firearms and wildlife) and drugs.⁴¹ Information on positive finds is passed to police for further enforcement action.

Facilities operation

- 11.55 The operation of the CEFs presents a major logistical challenge not only for Customs, but also for the CTO and associated service providers. In terms of contact management and monitoring, the ANAO found that some improvement could be made in the areas of CEF performance and against some key performance indicators (KPIs).⁴²

38 ANAO Audit Report No. 16, 2004-2005, p. 71.

39 Customs, Submission no. 9, p. 12.

40 Customs, Submission no. 9, p. 1; and Exhibit no. 9, p. 11.

41 Customs, Submission no. 9, p. 1.

42 ANAO Audit Report No. 16, 2004-2005, p. 82.

- 11.56 Customs has entered into contracts with service providers to streamline logistical processes such as container handling, container transport and unpack/repack services. Contracts for the maintenance of x-ray facilities have also been negotiated.
- 11.57 As part of their contracts, service providers are required to develop logistics plans in consultation with Customs. The ANAO found that although there are agreed processes in relation to the movement of containers to and from wharves, these have not been formalised. There is also the added expectation that containers which have been selected for inspection are physically segregated for security reasons (although this is not specified in contracts with service providers).⁴³
- 11.58 Customs advised the Committee that since the audit, formalised logistical plans have been implemented in all regions. Physical segregation will be incorporated into the review of contracts currently underway.
- 11.59 Contracts relating to CEFs contain key monitoring components including monthly reports, comparison against internal records, yearly and quarterly costs periodic audits. The ANAO found that Customs did not require standard reports from its logistics partners, KPIs were not reviewed when scheduled, no comparisons or analysis against costs or periods have been undertaken. In addition, due to ambiguous definitions in service level agreements, reconciliation of performance against monthly reports is difficult.
- 11.60 Customs told the Committee that some KPIs have been negotiated, especially in relation to stevedores and transport turn around times which has significantly improved timeliness. However, the Committee agrees with the ANAO's recommendation relating to a review of service providers contracts prior to their renegotiation.

43 ANAO Audit Report No. 16, 2004-2005, p. 82.

Recommendation 36

11.61 The Committee recommends that the Australian Customs Service:

- report to the Committee by June 2006 of the progress and findings of the current review of contracts with service providers; and
- strengthen its reporting requirements within service providers contracts for ease of reconciliation and comparison.

Audit Report No. 18, 2004-2005

Regulation of Non-prescription Medicinal Products - Department of Health and Ageing and Therapeutic Goods Administration

Introduction

- 12.1 The Therapeutic Goods Administration (TGA) is responsible for the regulation of the manufacture and supply of medicines, including complementary and over-the-counter medicines, in Australia, to protect public health and safety. The *Therapeutic Goods Act 1989* gives effect to the regulatory powers required to fulfil this role. The TGA is a division of the Commonwealth Department of Health and Ageing (Health).
- 12.2 Manufacturers of non-prescription medicinal products must be licensed or certified to manufacture. Approval by the TGA is only granted if the proposed manufacturing premises are compliant with the Australian Code of Good Manufacturing Practice for Medicinal

Products (Code of GMP). Products supplied to the public must also be approved by the TGA. Compliance with regulatory requirements is monitored by the TGA. Where a manufacturer or a product is not compliant with regulatory requirements, the TGA has a range of actions available to reduce possible risks to public health and safety.

Audit objectives

- 12.3 The audit's objective was to assess the TGA's regulation of non prescription medicines, particularly the systems, procedures and resource management processes used to:
- confirm new manufacturers comply with requirements for the manufacture of non-prescription medicines;
 - monitor manufacturers and medicines to ensure requirements continue to be met; and
 - manage non-compliance.
- 12.4 The ANAO tabled its report in December 2004. The report contained 26 recommendations, a high number by ANAO standards.

Overall conclusion

- 12.5 The ANAO concluded that the TGA has a structured framework for the regulation of risk presented by non-prescription medicinal products. This has regard to the risk presented by the type of product, and by the adequacy of manufacturing operations. However, the ANAO found that more rigour around systems, procedures and resource management was required to provide assurance that non-prescription medicines are appropriately and cost-effectively regulated.
- 12.6 The ANAO found that aspects of risk management for non-prescription medicines required better articulation and structure, to support targeting and monitoring of risk treatments. This was the case both for manufacturers audited by the TGA, and for the almost 60 per cent of manufacturers audited by overseas regulators. Risk management would also be better informed by greater utilisation of information available.
- 12.7 The TGA's regulatory framework is supported by a substantial number of standard operating procedures. However, the ANAO reported that greater clarity and guidance was required for some key

aspects of the TGA's regulatory functions. There were also some gaps in documented procedures.

- 12.8 The ANAO found that maintaining the quality, consistency and reliability of manufacturer audits, and of any enforcement actions, continues to be an area that requires management attention, as is recognised by the TGA and industry stakeholders. The ANAO found that recent initiatives had the potential to improve the integrity of these processes, but required management focus, better information support, and monitoring of effectiveness for the assurance of all stakeholders.
- 12.9 The ANAO reported that decision-making, including reasons for particular action and enforcement, required more structured documentation, especially when discretionary judgments were being made. Key information obtained through the TGA's regulatory functions was often not captured, or not utilised for the purposes of monitoring and analysis of trends. Information was often unreliable, limiting its value for management purposes. The ANAO also found that better management of information was required to inform the TGA in its regulation of non-prescription medicines.
- 12.10 The ANAO reported that performance management arrangements were insufficient to support sound management of regulation, and accountability to stakeholders. Performance indicators provided limited insight into the effectiveness of the regulation of non-prescription medicines, and of manufacturer compliance.
- 12.11 The ANAO found that transparency to manufacturers and sponsors can be enhanced, both to facilitate manufacturers' ability to comply with regulatory requirements, and to improve the TGA's accountability for its actions.

ANAO recommendations

- 12.12 The ANAO made 26 recommendations aimed at strengthening the regulation of non-prescription medicinal products. The Committee notes that this is an exceptionally large number of recommendations compared to most ANAO reports. The Committee also notes that the Department agreed with all 26 recommendations, and argued that many of the issues raised during the audit were already addressed by the time the Audit Report was tabled in Parliament.

Table 12.1 ANAO recommendations, Audit Report no. 18, 2004-05

1. The ANAO recommends that the Department of Health and Ageing develop, and publish, suitable performance indicators and targets for the processes associated with the licensing and certification of non-prescription medicine manufacturers. The targets should be reflected in the TGA's customer service charter, and in decision-making and audit processes.
2. The ANAO recommends that the Department of Health and Ageing, taking into account any international agreements, develop a strategic management plan to monitor the regulatory equivalence of countries with which it has GMP agreements, including:
 - standards and procedures to be monitored;
 - performance measures and targets to be monitored;
 - the currency of the agreements;
 - resources required to monitor equivalence, including management arrangements; and
 - reporting arrangements.
3. The ANAO recommends that the Department of Health and Ageing strengthen the management of, and accountability for, the process for assigning GMP audit frequency by:
 - articulating the rationale for audit frequencies, based upon systematic risk analysis, and undertaking regular evaluation of their appropriateness;
 - ensuring that reasons for use of discretion in setting audit frequency are documented;
 - maintaining reliable records of risk ratings, and supporting information; and
 - recording the degree of acceptable compliance.
4. The ANAO recommends that the Department of Health and Ageing:
 - establish systems for the collection of management and performance information to enable it to assess performance in the execution of the GMP audit program; and
 - assess the impact on TGA's regulation of manufacturers, including the risk of undetected non-compliance, from failure to achieve a GMP audit program consistent with risk profiling.
5. The ANAO recommends that the Department of Health and Ageing establish contingency plans, consistent with the TGA's regulatory responsibilities, to address the risk of delays in the execution of the overseas GMP audit program.
6. The ANAO recommends that the Department of Health and Ageing assess the cost-benefit of unannounced GMP audits, and their role and contribution in the regulatory oversight strategy. The assessment could also address the broader lessons for the future from the targeting of non-prescription medicine manufacturers in 2003.
7. The ANAO recommends that the Department of Health and Ageing establish greater structure around administrative procedures, and develop support tools around planning of GMP audits and collection of evidence to facilitate consistency and adequacy of coverage in the conduct and reporting of audits of non-prescription medicine manufacturers.
8. The ANAO recommends that the Department of Health and Ageing provide guidance to auditors and manufacturers on the deficiencies considered critical for OTC medicine manufacturers and for complementary medicine manufacturers. The department should also monitor the consistent application of such guidance by GMP auditors and Review

Panels.

9. The ANAO recommends that, to improve transparency and to assist its clients in their compliance, the Department of Health and Ageing:
 - improve the information available to non-prescription medicine manufacturers and sponsors on the GMP audit process; and
 - develop, and make transparent to its clients, procedures for the handling and resolution of complaints, appeals and disputes regarding audit findings.
10. The ANAO recommends that, to improve transparency and to assist its clients in their compliance, the Department of Health and Ageing:
 - improve the information available to non-prescription medicine manufacturers and sponsors on the GMP audit process; and
 - develop, and make transparent to its clients, procedures for the handling and resolution of complaints, appeals and disputes regarding audit findings.
11. The ANAO recommends that the Department of Health and Ageing:
 - establish a suitable range of expertise on TGA Review Panels to address regulatory issues, consistent with procedural requirements; and
 - ensure that Review Panels are constituted in accordance with SOPs.
12. The ANAO recommends that the Department of Health and Ageing establish, and promulgate, TGA procedures for the:
 - imposition and management of short term reporting enforcement action;
 - consistent application of licence restrictions; and
 - imposition of restrictions on overseas manufacturers audited and certified by the TGA. Relevant matters include the roles and responsibilities of officials, key steps, complaints mechanism and time-lines.
13. The ANAO recommends that the Department of Health and Ageing arrange independent assessment of recent key enforcement actions, to draw lessons for the future when making decisions potentially affecting public health and safety.
14. The ANAO recommends that the Department of Health and Ageing establish procedures to guide and prepare staff and management should there be difficulty in gaining access to premises to conduct a GMP audit.
15. The ANAO recommends that the Department of Health and Ageing strengthen the TGA's management and monitoring of enforcement action by establishing:
 - timeliness standards for key decision steps in the enforcement process, and monitoring performance against the standards; and
 - monitoring and reporting procedures for the implementation of Review Panel recommendations and other enforcement action.
16. The ANAO recommends that the Department of Health and Ageing enhance management procedures for GMP compliance ratings to enable review and analysis over time, and to identify issues needing correction, by:
 - assessing and recording initial compliance ratings; and
 - documenting reasons for ratings and subjecting them to appropriate review.

17. The ANAO recommends that the Department of Health and Ageing inform manufacturers of their compliance rating, to assist manufacturers in improving quality management, and to reinforce findings presented in Deficiency Reports.
 18. The ANAO recommends that the Department of Health and Ageing increase testing when there is increased risk exposure arising from limitations in the manufacturer audit program and where there is a reasonable expectation it will assist in monitoring compliance. The overall strategy for priority testing should reflect this increased use, as well as the requirement for the Manufacturer Regulator to advise the laboratory when limitations arise.
 19. The ANAO recommends that the Department of Health and Ageing develop performance indicators and targets for the timeliness of TGA laboratory testing.
 20. The ANAO recommends that reports be provided to the TGA's Product Regulator on the effectiveness of recall-related corrective actions implemented by manufacturers.
 21. The ANAO recommends that the Department of Health and Ageing conduct, and disseminate to relevant stakeholders, regular trend analysis of recalls information, in order to assist in identifying systematic issues.
 22. The ANAO recommends that the Department of Health and Ageing review and enhance the TGA's risk management framework for non-prescription medicinal products. The revised framework should, *inter alia*,:
 - be systematic, structured and integrated with the TGA's overall risk management strategies;
 - allocate resources to various risk treatments;
 - identify any necessary differences in risk treatments between Australian and overseas manufacturers, and their impact;
 - provide information necessary to support effective management of risk and monitoring of treatments;
 - ensure new or targeted strategies are based upon structured risk assessments, and evaluate their outcomes for lessons learned for future management of compliance; and
 - identify the impact of slippage on planned risk treatments.
 23. The ANAO recommends that the Department of Health and Ageing strengthen the capture, recording, management and use of information to support regulation of non-prescription medicines by:
 - holding key information collected from its regulatory processes on management information systems;
 - maintaining the reliability and completeness of data holdings; and
 - enabling better integration and sharing of information between the different areas of the TGA involved in regulatory functions.
 24. The ANAO recommends that the Department of Health and Ageing strengthen its documentation procedures to ensure key regulatory decisions taken by the TGA are fully documented, and that files are appropriately maintained.
 25. The ANAO recommends that the Department of Health and Ageing review and improve the TGA's quality assurance program to improve the quality, consistency and reliability of its GMP audits.
 26. The ANAO recommends that the Department of Health and Ageing implement a
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performance management system that defines key outcomes, key performance indicators and targets for the regulation of non-prescription medicinal products.

The Committee's review

- 12.13 The Committee held a public hearing on 5 April 2005, taking evidence from the ANAO and the Department of Health and Ageing (including representatives from the TGA, a division of the Department).
- 12.14 The Committee received one submission relating to the inquiry. The main issues canvassed at the public hearing included:
- licencing and certification processes;
 - manufacturer audits;
 - deficiency findings in manufacturer audits; and
 - TGA management issues.

Department's response

- 12.15 The Department of Health and Ageing and TGA advised the Committee of progress against the ANAO's 26 recommendations.
- 12.16 Health's audit committee has established a small sub-committee to oversee the department's response to the ANAO's audit report (comprising three officers: TGA's National Manager; a First Assistant Secretary and the Chief Operating Officer, Business Group). The main task of the audit sub-committee is to manage a short-term consultancy aimed at outlining the actions needed by Health and TGA to implement the ANAO recommendations. At the time of the Committee's hearing, Health was in the process of calling for tenders for the consultant's work. The terms of reference for the consultancy required the consultant to:
- assist the TGA in implementing the ANAO recommendations including development of an implementation strategy;
 - undertake a review of recent key enforcement actions to draw lessons for the future; and

- review broader aspects of the TGA's administration, management and governance structure and make recommendations where appropriate.¹
- 12.17 Health subsequently advised the Committee that Deloitte had been appointed to the consultancy and work was scheduled to run from April 2005 and complete the assignment by June 2005.² In August 2005 Health informed the Committee that the consultancy had found that TGA was planning activities to address all 26 ANAO recommendations. Around half of all recommendations would be addressed by the implementation of new TGA standard operating procedures, planned for August 2005.³
- 12.18 The consultant also concluded that 'many of the planned activities could be further enhanced to give effect the broader intent of the recommendations.' To this end, the consultant has developed further recommendations for the TGA to build into its implementation plans. Health reported that a second phase of the consultancy is now underway to assist the TGA in finalising the implementation of all recommendations.
- 12.19 The Department's response to the ANAO report was welcomed in a submission from industry groups. However, the submission noted that 'the recommended improvements must not only be agreed, but must also be seen to have been put into effect.'⁴

Licensing and certification

- 12.20 Australian manufacturers of non-prescription medicinal products are required to hold a manufacturing licence, issued by the TGA, covering one or more sites where manufacture takes place.
- 12.21 Overseas manufacturers are required to be sponsored by an Australian importer, exporter, and/or supplier of the product. Sponsors must provide evidence that the products are manufactured to a standard equivalent to the Australian Code of Good Manufacturing Practice (GMP). This may be achieved by providing a

1 Department of Health and Ageing (Health), *Request for Quotation: Consultancy*; Exhibit No. 7..

2 Email correspondence with secretariat, 10 May 2005.

3 Health, submission no. 12, p. 2.

4 Australian Self-Medication Industry et. al; submission no. 1, p. 1.

certificate of GMP compliance issued by an overseas regulator with which Australia has a GMP agreement. If documentary evidence cannot be produced, the TGA will itself undertake an on-site audit.

- 12.22 Most non-prescription medicine manufacturers are overseas manufacturers who have been certified as GMP compliant by overseas regulators (see Figure 2.1, p. 41 of Audit Report).
- 12.23 The ANAO found that the TGA did not have a standard or target for time to conduct licensing audits. The ANAO recommended that the TGA develop and publish suitable performance indicators and targets for the processes associated with the licensing and certification of non-prescription medicine manufacturers. The targets should be reflected in the TGA's customer service charter, and in decision-making and audit processes.

Manufacturer audits

Scheduled audits

- 12.24 Once manufacturers of non-prescription medicines are licensed, they are subject to ongoing regulation to ensure that their products meet the Code of GMP. This is primarily through a program of audits known as GMP audits. Ongoing conduct of GMP audits mitigates the need for an extensive post-market testing program.⁵
- 12.25 The ANAO found that some 80 per cent of audits were conducted later than their due dates. The TGA advised the ANAO that it aims to complete audits within a window of three months prior to the audit due date to six months after the due date. The TGA's performance target is to complete all audits within six months of their due date. However, the ANAO found that the TGA did not meet this target, with 26 per cent of all non-prescription medicine manufacturers due for audits, but not audited by six months after the due date. Of more concern is that compliance ratings are not held on the TGA's electronic systems, meaning that management does not have ready access to information about the risk of rescheduling audits. TGA

5 ANAO Audit Report no. 18, 2004-05, *Regulation of Non-prescription Medicinal Products – Department of Health and Ageing, Therapeutic Goods Administration, Commonwealth of Australia*, December 2004, p. 40.

advised the ANAO that it was developing a new information system to allow this to happen. The information system was due to be introduced by the end of 2004.

- 12.26 The ANAO found that audits of overseas manufacturers were more overdue than Australian audits. Furthermore, the ANAO found that where the TGA decides to accept an overseas manufacturer's compliance on grounds other than a TGA audit, this is not supported by a systematic risk-based process – nor are these decisions documented.⁶
- 12.27 At the Committee's hearing in April 2005, Health advised that it had cleared the backlog of audits. While there were some that fell into the category of 'zero to six months' past their scheduled due date, there were no domestic or overseas audits overdue beyond six months.⁷
- 12.28 The Committee questioned the rationale used by TGA to determine the frequency of manufacturer audits. TGA responded that audits are conducted on a one-to-three year cycle, depending on a number of risk factors for each manufacturer. These risk factors include:
- audit history;
 - adverse drug reactions;
 - intelligence – tip-offs or problem reports relating to product quality; and
 - the risk of the product – for example a prescription medicine which requires a high level of sterility requires more frequent auditing than a herbal product.
- 12.29 Based on the above information, TGA may target aspects of the manufacturer, that it wishes to focus on for that particular audit.⁸
- 12.30 The Committee noted the ANAO's concern that 'the rationale for assigning the specific audit frequencies for given risk parameters has not been documented'.⁹ The ANAO report also stated that the audit frequency matrix used by TGA to determine when manufacturer audits are to be conducted, had not been reviewed since its introduction.

6 ANAO Audit Report no. 18, 2004-05, p. 62.

7 Health, *Transcript of Evidence*, 5 April 2005, p. 39.

8 Health, *Transcript of Evidence*, 5 April 2005, p. 33.

9 ANAO Audit Report no. 18, 2004-05, p. 14.

- 12.31 The TGA responded that a review of the audit frequency matrix is one of the tasks to be undertaken by the consultant employed to respond to the ANAO audit report. TGA also reported that its standard operating procedures had been amended to reflect the ANAO's concerns.¹⁰

Recommendation 37

- 12.32 The Committee recommends that the TGA provide this Committee with a copy of the audit frequency matrix, and any other documentation linked to determination of audits (such as procedures for undertaking an unannounced audit), when it is completed.**

Unannounced audits

- 12.33 The TGA does not favour the routine use of unannounced audits. However, because of the suspension of Pan Pharmaceuticals' licence in 2003, there was a sharp increase in unannounced audits in order for the TGA to assess quality risks of other manufacturers' increased production to fill the market gap. The ANAO noted some advantages in conducting unannounced audits, and that some other regulatory bodies conduct unannounced audits as part of their oversight strategy.¹¹ The Committee was told that TGA undertook 13 unannounced audits in 2004.¹²
- 12.34 The Committee questioned Health about the planning for unannounced audits. The Committee was interested in whether the manufacturers targeted for unannounced audits are chosen at random, as the result of tip-offs, deficiency reports, or other criteria. Health responded that it conducted a large number of unannounced audits in 2003 following the Pan Pharmaceuticals licence suspension. TGA's National Manager commented:

I think it is important that the regulator pays attention to any intelligence it gets. Otherwise, you get a situation where

10 Health, *Transcript of Evidence*, 5 April 2005, p. 36.

11 ANAO Audit Report no. 18, 2004-05, p. 67.

12 Health, submission no. 12.

complainants stop complaining and the intelligence that is important to underscore the quality of the system falls off.¹³

- 12.35 Health also outlined a number of other situations which would trigger an unannounced audit, such as:
- tip-offs from manufacturer employees, for example about broken machinery or contamination from foreign material;
 - reports of adverse drug reactions; and
 - questions of quality arising out of TGA's random product testing.
- 12.36 Health advised that one of the areas it is asking its consultant to look at is to assess the balance of announced and unannounced manufacturer audits and to advise on the indicators, separate to those listed above, that would trigger an unannounced audit on a manufacturer. The Secretary of Health told the Committee:
- ...the expectation is that in targeting unannounced audits they are not just spread on an equal chance basis across the manufacturers in the sector. A limited resource needs to be targeted at the areas of potentially greatest risk, and we need the indicators of potential greatest risk.¹⁴
- 12.37 The Committee is concerned that TGA seems to have a mainly reactive approach to unannounced audits. While acknowledging TGA's concerns that over-use of unannounced audits could result in industry distrust of TGA, the Committee feels that there needs to be a systematic approach to unannounced audits, in addition to those conducted in reaction to specific complaints (as outlined above). It appears that Health and TGA are taking positive moves towards developing a framework for planning unannounced audits. The Committee encourages this move and looks forward to Health reporting on these measures.

Audit planning and collection of evidence

- 12.38 The ANAO found that the TGA did not have a structured audit planning process. Rather, individual auditors wrote their own audit plans, with detail varying according to the individual. The ANAO also found variations in the collection of evidence as part of audits. Auditors are encouraged by the TGA to make handwritten notes on

13 Health, *Transcript of Evidence*, 5 April 2005, p. 49.

14 Health, *Transcript of Evidence*, 5 April 2005, p. 51.

their observations. When the ANAO suggested the use of checklists to ensure all required evidence is gathered, the TGA responded that the use of checklists is not considered international best practice.

12.39 The ANAO recommended that TGA improve its administrative procedures and develop support tools for audit planning and evidence gathering.¹⁵

12.40 At the hearing, the TGA advised that its standard operating procedures have now been modified to include the ANAO suggestions for improving data collection.¹⁶

Deficiency findings

12.41 A deficiency is recorded if the auditor considers that the manufacturer's practice does not produce an outcome stipulated by the GMP code. Deficiencies may be classed as:

- Critical – it has produced, or may result in a significant risk of producing, a product that is harmful to the user. For example, lack of sterilisation, gross pest infestation;
- Major – non-critical, but of sufficient seriousness to be listed in a Deficiency report. For example, damage to walls/ceilings where a product is exposed; or
- Other – neither critical or major, but a departure from good manufacturing practice.

12.42 Most audits reveal a number of manufacturing practices that do not meet standards. Deficiencies are recorded in a Deficiency Report issued to the manufacturer. If deficiencies are critical, manufacturing may be suspended. In less serious cases, manufacturing may continue provided the manufacturer advises the TGA of steps to address the deficiencies.

12.43 Health told the Committee that in the period from 1 January 2001 to 31 December 2004, there were 13 'unacceptable' compliance ratings for Australian manufacturers of non-prescription pharmaceuticals; and nine for overseas manufacturers. An 'unacceptable' compliance

15 Recommendation 7, ANAO Audit Report No. 18, 2004-05, p. 70.

16 Health, *Transcript of Evidence*, 5 April 2005, p. 50.

rating occurs if there is one or more Critical deficiencies found; or if there are a number of Major Deficiencies.¹⁷

- 12.44 The ANAO found that there was a risk that auditors identify deficiencies inconsistently. In its consultations with industry, the ANAO found concerns about consistency in auditing. For example, manufacturers cited instances where an auditor assessed a practice as deficient that had previously been accepted by another auditor.
- 12.45 The ANAO found that manufacturers generally respond to Deficiency Reports within the required four weeks, and that TGA is also prompt in reviewing these manufacturer submissions. However, the ANAO found that on-site follow up inspections are relatively uncommon. The TGA argued that in general, its standard operating procedures allow for sufficient follow-up action, and that it considered this to be in the interests of maintaining a good working relationship with industry.¹⁸

Enforcement action

- 12.46 The TGA has a range of enforcement actions available to control the risk of a non-compliant manufacturer. A lower-level response is utilised where risk to public health and safety is not considered serious or immediate. This action includes:
- issuing a warning letter to the manufacturer, which is likely to require regular reporting on corrective action; and
 - increasing audit frequency, or conducting special audits.
- 12.47 Where risks are considered more serious, formal restrictions may be placed on the manufacturer.
- 12.48 For lower-level enforcement actions, the ANAO found that there were no documented procedures to manage short-term reporting. Roles and responsibilities were not defined, and there were no procedures for on-going assessment and response to reports. ANAO also found that recommendations to increase audit frequency were not always implemented.
- 12.49 For more serious matters requiring licence restrictions, the ANAO found that there were inconsistent approaches in administering licence restrictions. In some cases, manufacturers were offered the

17 Health, submission no. 12, Attachment A and Attachment B.

18 ANAO Audit Report no. 18, 2004-05, p. 77.

opportunity to make a submission regarding a decision to condition their licence, while others were not given this opportunity. The ANAO found there were no operational procedures for placing restrictions on overseas manufacturers.

- 12.50 The ANAO recommended the establishment of procedures for management of short-term reporting action; consistent license restriction; and restrictions on overseas manufacturers audited and certified by the TGA.¹⁹

Pan Pharmaceuticals enforcement action

- 12.51 The ANAO briefly overviewed the enforcement action for Pan Pharmaceuticals in 2003. The TGA provided the following overview of enforcement action:

The TGA conducted an unannounced audit of a large non-prescription medicine manufacturer, following serious adverse reactions to particular products. The audit found manipulation of records, but its scope was not extended to address other products. The audit resulted in the conditioning of the manufacturer's licence for the products concerned.

As the problems were seen to be widespread, a Review Panel recommended that a further audit be conducted within a week. The audit was actually conducted after three weeks. The reason for the delay was not documented. The TGA advised that it considers this a reasonable period, with considerable effort expended on preparation.

When the audit team arrived on site, the manufacturer objected to the audit, as the Quality Assurance Manager was on leave. The TGA negotiated two days access to documentation only, with agreement that they would audit the factory and operations at a later date. There is no formal record of this decision making process.

Five critical deficiencies were identified as a result of the audit. The TGA decided to complete the outstanding part of the audit. This was not conducted until six weeks after the first phase. The TGA advised that this was a period of intense

19 ANAO Audit Report no. 18, 2004-05, p. 83.

activity related to the audit findings and preparation for the next phase.

Approximately 12 weeks after the first audit, the TGA suspended the manufacturer's licence, with immediate effect.²⁰

- 12.52 The TGA advised the ANAO that it considered the 12-week gap between initial audit action and enforcement action to be appropriate, given the vast amount of work required to identify and assess the problems, collect information, identify appropriate enforcement action, and prepare for the product recall.
- 12.53 The ANAO noted that the TGA had not undertaken any independent assessment about whether the above actions were appropriate, and whether there were any lessons to be learnt from the experience. The ANAO noted that an expert advisory group advised that there were imminent risks of death, serious illness or injury. These would have been present during the 12-week gap between audit and enforcement action.

Committee comment

- 12.54 The Committee is concerned about the lack of documentation for TGA enforcement actions. Even if the majority of enforcement actions are of a minor nature – such as letters to manufacturers – these procedures should be consistent and well-documented. It is also of concern that the ANAO found that follow-up audits for manufacturers subject to enforcement action were not always undertaken in a suitable timeframe. In one instance, a follow-up audit was not undertaken until 12 months after the enforcement action. The Committee believes the TGA must strengthen its oversight of enforcement actions and review processes once enforcement has been taken. From a manufacturer's point of view, it is also unacceptable that the ANAO found different procedures undertaken by the TGA for different companies.

20 ANAO Audit Report no. 18, 2004-05, p. 85.

Recommendation 38

- 12.55 **The Committee recommends that the Therapeutic Goods Administration document its procedures for implementation of enforcement action against manufacturers. This should include:**
- **a clear definition of different enforcement actions, the circumstances in which they are applied, and manufacturers' rights of submission or appeal;**
 - **stipulation of management authorisation for enforcement actions;**
 - **a definition of timelines for short-term reporting and TGA assessment of manufacturer reports; and**
 - **a requirement that all manufacturers subject to an enforcement action will undergo a follow-up audit within three to six months of the initial action.**

Post market monitoring

- 12.56 A third step in regulation of non-prescription medicinal products (after licensing and ongoing auditing), is post-market monitoring. The TGA spends \$6.6 million per year on its post-market monitoring program. The nature of post-market monitoring depends on the categorisation of products according to their level of therapeutic promise and claim. These categories are high-level (for example, products for the treatment of depression); medium-level (eg, products to help relieve stress) or general-level (eg, products which aid digestion).
- 12.57 Post-market monitoring may include:
- reviews of recently listed products to identify potential inaccuracies in information provided by sponsor;
 - laboratory testing of products and ingredients;
 - reporting of consumers' adverse reactions to products; and
 - safety and efficacy reviews to re-assess the approval of products.

- 12.58 The ANAO recommended that the TGA increase its laboratory testing of products where there is an increased risk arising out of limitations in the manufacture audit program. It also recommended performance indicators for the timeliness of TGA laboratory testing.²¹
- 12.59 The Committee questioned TGA as to whether it should be conducting more post-market testing, noting that the ANAO found that only about one per cent of non-prescription medicinal products are tested annually.
- 12.60 The TGA responded that it spends around 20 per cent of its total budget on laboratory testing for all therapeutic goods. For testing of non-prescription therapeutic products, targeting is important. The TGA targets the products for laboratory testing based on adverse drug reaction reports, intelligence and other objective evidence.²²
- 12.61 The ANAO stated that the audit had not found major problems with the post-market testing program. However, the ANAO believed that the TGA should conduct more post-market testing on products from overseas manufacturers who had not been audited for a considerable period of time.
- 12.62 The TGA also advised that it had developed performance indicators for the timeliness of TGA laboratory testing, as recommended by the ANAO. The consultant will elaborate further on these indicators.²³

Committee comment

- 12.63 The Committee agrees with the ANAO that the TGA should undertake more laboratory testing on products from overseas manufacturers who have not been audited for some length of time. While the TGA assured the Committee in April 2005 that there were no overdue audits for overseas manufacturers, the Committee notes that the ANAO audit found that in previous years, overseas audits in particular have been long overdue. Given Australian consumers' reliance on the TGA to oversee the provision of safe non-prescription medicinal products, it seems reasonable to undertake post-market testing on a percentage of these imports.

21 ANAO Audit Report No. 18, 2004-05, p. 99.

22 Health, *Transcript of Evidence*, 5 April 2005, p. 59.

23 Health, *Transcript of Evidence*, 5 April 2005, p. 58.

Recommendation 39

- 12.64 **The Committee recommends that the Therapeutic Goods Administration increase its post-market laboratory testing for non-prescription medicinal products from overseas manufacturers, particularly with an emphasis on products from manufacturers who have not been subject to certification or audit in the past 18 months.**

Communication with industry

- 12.65 The Committee asked what kind of information sharing the TGA undertook to ensure that industry is aware of the standards they must meet to ensure GMP compliance. The TGA responded that it has held a number of workshops, training sessions and seminars, particularly following the Pan Pharmaceuticals audit, to communicate with industry. Mr Slater told the Committee that the key steps manufacturers must take to ensure GMP quality are:
- to ensure that inputs that go into a product are of the required quantity and quality;
 - that processes need to be documented, and manufacturers need skilled staff and equipment necessary to ensure that products are compliant with the code of GMP – including staff training; and
 - that products must be end tested to ensure that the quantities of active ingredients are there, that they are in the quantities required and that the product complies with end product standards.
- 12.66 The focus of TGA audits is to ensure that those three critical steps are undertaken by the manufacturer.²⁴
- 12.67 The ANAO raised the issue of manufacturers not being told of their compliance rating. TGA responded that it agrees with the recommendation, but has not yet implemented it. The consultant employed by Health to plan TGA's response to the ANAO's audit will advise on the best method of communicating compliance ratings to manufacturers.²⁵

24 Health, *Transcript of Evidence*, 5 April 2005, p. 52.

25 Health, *Transcript of Evidence*, 5 April 2005, p. 58.

TGA management framework

- 12.68 The ANAO reviewed the over-arching aspects of TGA's regulation of non-prescription medicines, including:
- cost recovery;
 - risk management;
 - information management;
 - record management and documentation;
 - quality management; and
 - performance measurement, monitoring and reporting.
- 12.69 Throughout its report, the ANAO found that the TGA could improve its risk management strategies. The ANAO recommended that TGA review and enhance its risk management framework for non-prescription medicinal products.²⁶
- 12.70 The ANAO also found that some key TGA decisions were not supported by formal documentation of the decisions, including reasons and supporting documentation. Files relating to manufacturer audits were often poorly compiled. Important documents such as letters of intention to suspend a manufacturer's licence, were filed without signature or a date. The ANAO had to resort to accessing archived email records and personal notebooks in order to find key information required for the audit. The ANAO also found that TGA needed to improve its quality assurance program.²⁷
- 12.71 The Committee considers this poor practice from an industry regulator. Important documents relating to manufacturer audits and other actions which may affect the operations of commercial companies must be properly maintained and filed.

26 ANAO Audit Report no. 18, 2004-05, p. 118.

27 ANAO Audit Report no. 18, 2004-05, p. 120.

Recommendation 40

- 12.72 **The Committee recommends that the Therapeutic Goods Administration urgently review its information management systems, including documentation of key decisions and correct electronic and hard copy filing of relevant documents. The importance of maintaining accurate and up-to-date records should also be communicated to all TGA staff.**

External accreditation

- 12.73 The ANAO noted that the TGA's GMP audit unit had ceased its ISO 9000 accreditation and National Association of Testing Authorities (NATA) accreditation in 2003.²⁸
- 12.74 The Committee asked Health and TGA why it had ceased all external certification. TGA replied that following recommendations from previous reviews and internal audits, a consultant reviewed the GMP area. The consultant concluded that the external accreditation was of little value, and that TGA's own internal procedures were robust and that the quality system in place at TGA was providing better value, in the consultant's opinion, than the external accreditation. As a result, TGA ceased its external accreditation regime and employed a quality systems manager to oversee the TGA quality system.²⁹
- 12.75 The TGA noted that when its ISO and NATA accreditation ceased, it still belonged to the European Pharmaceutical Inspection Convention (PIC/S). PIC/S is a group of countries which recognise each other's skills in the area of GMP. The TGA reported that the PIC/S had audited the TGA in July 2003, and the World Health Organisation (WHO) had also audited TGA's GMP processes, and that 'both regard the TGA as a world leader in GMP quality'.³⁰
- 12.76 Despite TGA's belief that its own internal quality systems were as good as the international accreditation standards, TGA is now re-seeking both ISO and NATA accreditation as a result of the ANAO audit and some industry concerns.

28 ISO 9000 is an International Standards Organisation protocol on quality management. ANAO Audit Report No. 18, 2004-05, p. 121.

29 Health, *Transcript of Evidence*, 5 April 2005, p. 38.

30 Health, *Transcript of Evidence*, 5 April 2005, p. 38.

- 12.77 The Committee asked the ANAO to report on whether it was unusual for a regulatory authority not to follow ISO or some similar international quality standards. The ANAO replied that current audits of two other health regulators, the Private Health Insurance Administrative Council (PHIAC) and the Office of the Gene Technology Regulator (OGTR) indicated that these two organisations had regard to such standards.
- 12.78 The PHIAC has its own risk management standards which are consistent with the Australian Standard for Risk Management, AS/NZS 4360:1999. The Australian standard, in turn, is consistent with the relevant ISO standard. The OGTR has ISO accreditation for compliance and investigation activities, and has adopted ISO standards for its monitoring activities, although it has not yet received certification for these systems.³¹
- 12.79 The ANAO also noted that another regulator agency, the Australian Pesticides and Veterinary Medicines Authority uses the ISO 9000 standards as the framework of its quality system.

Recommendation 41

- 12.80 The Committee recommends that the Therapeutic Goods Administration continue with its re-accreditation process for ISO 9000 and National Association of Testing Authorities (NATA) standards. When the TGA achieves these standards this information should be promulgated to manufacturers and other industry bodies.**

Trans-Tasman agency

- 12.81 The Committee notes that from 1 July 2006 a new regulatory scheme will be established for therapeutic products in Australia and New Zealand. The Trans-Tasman Therapeutic Products Agency will replace the current Australian Therapeutic Goods Administration (TGA) and New Zealand's Medicines and Medical Devices Safety Authority (Medsafe).
- 12.82 The Trans-Tasman Agency will report to a joint Ministerial council comprising the Australian and New Zealand health ministers. The
-

31 ANAO, Submission no. 5.1; p. 1.

agency will be governed by a five-member board. While the ministerial council will determine the regulatory requirements of the scheme, the Agency's Managing Director will make orders for more technical requirements.³²

- 12.83 The new regulatory arrangements will mean that sponsors of therapeutic goods will now only need to seek one licence for manufacturing therapeutic goods for the Australian and New Zealand markets. Similarly, auditing, testing and disciplinary actions will be administered by the single agency.
- 12.84 The Committee notes that the establishment of the Trans-Tasman agency was reviewed in August 2004 by the Parliament's Joint Standing Committee on Treaties, which approved the treaty which gives effect to the Trans-Tasman agreement.
- 12.85 The Treaties Committee found that the new Trans-Tasman Agency would not result in a diminution in standards for regulation of therapeutic products in Australia or New Zealand. The Treaties Committee reported:

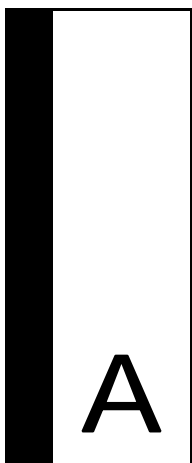
Harmonisation under the Agreement is expected to reduce costs for firms wishing to export to the other country through the reduction or elimination of differences in regulatory standards...Additionally, the creation of a single regulatory agency for both countries will ensure that Australia remains a regional centre of excellence for therapeutics regulation by maintaining regulatory capacity in the face of emerging technologies, and enabling Australia and New Zealand to better influence global and regional standard setting.³³

32 *National Interest Analysis for the Agreement with New Zealand Concerning the Establishment of a Joint Scheme for the Regulation of Therapeutic Products*; Joint Standing Committee on Treaties Report No. 62: Treaties Tabled on 30 March 2004; August 2004; Canberra, Australia.

33 Joint Standing Committee on Treaties Report No. 62: *Treaties Tabled on 30 March 2004*; August 2004; Canberra, Australia.

Recommendation 42

- 12.86 **The Committee recommends that the Therapeutic Goods Administration report to the Committee on the establishment and operation of the Trans-Tasman Therapeutic Products Agency, with regard to how the new agency will continue to regulate non-prescription medicinal products in accordance with the 26 ANAO recommendations. The TGA should also report on any changes to its governance and reporting arrangements. These reports should be forwarded to the Committee in February and July 2006.**



Appendix A — Conduct of the Committee's review

Selection of Audit Reports: 3rd and 4th Quarter 2003-04

In May 2004 the Committee considered fourteen audit reports tabled in the third quarter of 2003-2004 and four audit reports tabled in the fourth quarter of 2003-2004. These were:

- No. 25 Performance Audit
Intellectual Property Policies and Practices in Commonwealth Agencies
Across Agency
- No. 26 Performance Audit
Supporting Managers - Financial Management in the Health Insurance Commission
Health Insurance Commission
- No. 27 Performance Audit
Management of Internet Portals at the Department of Family and Community Services
Department of Family and Community Services
- No. 28 Audit Activity Report
Audit Activity Report: July to December 2003
Audit Activity Report
- No. 29 Performance Audit
Governance of the National Health and Medical Research Council
National Health and Medical Research Council
Department of Health and Ageing
- No. 30 Performance Audit

Quality Internet Services for Government Clients - Monitoring and Evaluation by Government Agencies
Across Agency

- No. 31 Business Support Process Audit
The Senate Order for Departmental and Agency Contracts (Financial Year 2002-2003 Compliance)
Across Agency
- No. 32 Performance Audit
Wedgetail Airborne Early Warning and Control Aircraft: Project Management
Department of Defence
- No. 33 Performance Audit
The Australian Taxation Office's Collection and Management of Activity Statement Information
Australian Taxation Office
- No. 34 Performance Audit
The Administration of Major Programs
Australian Greenhouse Office
- No. 35 Business Support Process Audit
Compensation Payment and Debt Relief in Special Circumstances
Across Agency
- No. 36 Performance Audit
The Commonwealth's Administration of the Dairy Industry Adjustment Package
Department of Agriculture, Fisheries and Forestry, Dairy Adjustment Authority
- No. 37 Performance Audit
National Marine Unit
Australian Customs Service
- No. 38 Performance Audit
Corporate Governance in the Australian Broadcasting Corporation - Follow-up Audit
Australian Broadcasting Corporation
- No. 39 Performance Audit
Integrity of the Electoral Roll - Follow-up Audit
Australian Electoral Commission
- No. 40 Performance Audit
Department of Health and Ageing's Management of the Multipurpose Services Program and the Regional Health Services Program

Department of Health and Ageing

- No. 41 Performance Audit
Management of Repatriation Health Cards
Department of Veterans' Affairs
- No. 42 Business Support Process Audit
Financial Delegations for the Expenditure of Public Monies in FMA Agencies
Across Agency

The Committee decided to take evidence at public hearings on the following audit reports:

- No. 25 Performance Audit
Intellectual Property Policies and Practices in Commonwealth Agencies
Across Agency
- No. 34 Performance Audit
The Administration of Major Programs
Australian Greenhouse Office
- No. 36 Performance Audit
The Commonwealth's Administration of the Dairy Industry Adjustment Package
Department of Agriculture, Fisheries and Forestry, Dairy Adjustment Authority

At the dissolution of the 40th Parliament on 31 August 2004, the inquiries into the above reports lapsed. However, in December 2004 the JCPAA of the 41st Parliament resolved to continue the above inquiries, and to accept the evidence received in the previous Parliament.

Selection of Audit Reports: 4th Quarter 2003-04

In February 2005 the Committee considered the following Audit Reports, which were tabled in the 4th Quarter of 2003-04:

- No. 43 Performance Audit
Defence Force Preparedness Management Systems
Department of Defence
- No. 44 Performance Audit
National Aboriginal Health Strategy Delivery of Housing and Infrastructure to Aboriginal and Torres Strait Islander Communities Follow-up Audit
Aboriginal and Torres Strait Islander Services

- No. 45 Performance Audit
Army Individual Readiness Notice Follow-up Audit
Department of Defence

- No. 46 Performance Audit
Client Service in the Family Court of Australia and the Federal Magistrates Court
Family Court of Australia, Federal Magistrates Court

- No. 47 Performance Audit
Developing Air Force's Combat Aircrew
Department of Defence

- No. 48 Performance Audit
The Australian Taxation Office~ Management and Use of Annual Investment Income Reports
Australian Taxation Office

- No. 49 Business Support Process Audit
The Use and Management of HRJS in the Australian Public Service Across Agency

- No. 50 Performance Audit
Management of Federal Airport Leases
Department of Transport and Regional Services

- No. 51 Performance Audit
HIH Claims Support Scheme - Governance Arrangements
Department of the Treasury

- No. 52 Performance Audit
Information Technology in the Department of Veterans' Affairs-Follow-up Audit
Department of Veteran's Affairs

- No. 53 Performance Audit
The Implementation of CrimTrac
CrimTrac

- No. 54 Performance Audit

Management of the Detention Centre Contracts--Part A
Department of Immigration and Multicultural and Indigenous Affairs

- No. 55 Protective Security Audit
Management of Protective Security
Across Agency
- No. 56 Performance Audit
Management of the Processing of Asylum Seekers
Department of Immigration and Multicultural and Indigenous Affairs
- No. 57 Business Support Process Audit
Administration of Freedom of Information Requests
Across Agency
- No. 58 Financial Statement Audit
Control Structures as part of the Audit of Financial Statements of Major Australian Government Entities for the Year Ending 30 June 2004
Across Agency
- No. 59 Performance Audit
Defence's Project Bushranger: Acquisition of Infantry Mobility Vehicles
Department of Defence

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Selection of Audit Reports: 1st and 2nd Quarter 2004-05

In February 2005 the Committee considered the following Audit Reports, which were tabled in the 1st and Second Quarters of 2004-05:

- No. 1 Performance Audit
Sale and Leaseback of the Australian Defence College Weston Creek
Department of Defence
- No. 2 Performance Audit
Onshore Compliance – Visa Overstayers and Non-Citizens Working Illegally
Department of Immigration and Multicultural and Indigenous Affairs
- No. 3 Business Support Process Audit

*Management of Internal Audit in Commonwealth Organisations
Across Agency*

- No. 4 Performance Audit
*Management of Customer Debt
Centrelink*

- No. 5 Performance Audit
*Management of Standard Defence Supply System Upgrade
Department of Defence*

- No. 6 Performance Audit
*Performance Management in the Australian Public Service
Across Agency*

- No. 7 Performance Audit
*Administration of Taxation Rulings Follow-up Audit
Australian Taxation Office*

- No. 8 Performance Audit
*Management of Bilateral Relations with Selected Countries
Department of Foreign Affairs and Trade*

- No. 9 Performance Audit
*Assistance Provided to Personnel Leaving the ADF
Department of Defence; Department of Veteran's Affairs*

- No. 10 Business Support Process Audit
*The Senate Order for Departmental and Agency Contracts (Calendar Year
2003 Compliance)
Across Agency*

- No. 11 Performance Audit
*Commonwealth Entities' Foreign Exchange Risk Management
Department of Finance and Administration*

- No. 12 Performance Audit
Research Project Management Follow-up Audit
Commonwealth Scientific and Industrial Research Organisation

- No. 13 Business Support Process Audit
Superannuation Payments for Independent Contractors working for the Australian Government
Across Agency

- No. 14 Performance Audit
Management and Promotion of Citizenship Services
Department of Immigration and Multicultural and Indigenous Affairs

- No. 15 Performance Audit
Financial Management of Special Appropriations
Across Agency

- No. 16 Performance Audit
Container Examination Facilities
Australian Customs Service

- No. 17 Performance Audit
The Administration of the National Action Plan for Salinity and Water Quality
Department of Agriculture, Fisheries and Forestry; Department of the Environment and Heritage

- No. 18 Performance Audit
Regulation of Non-prescription Medicinal Products
Department of Health and Ageing - Therapeutic Goods Administration

- No. 19 Performance Audit
Taxpayers' Charter
Australian Taxation Office

- No. 20 Performance Audit

Management of the Energy Grants (Credit) Scheme
The Australian Taxation Office

- No. 21 Performance Audit

Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004
Across agency

The JCPAA discussed the above audit reports and considered whether the issues and findings in the reports warranted further examination at a public hearing. In making this assessment the Committee considered, in relation to each audit report:

- the significance of the program or issues canvassed in the audit report;
- the significance of the audit findings;
- the response of the audited agencies, as detailed in each audit report; and
- the extent of any public interest in the audit report.

The Committee selected the following reports for review:

2003-04, 4th Quarter:

- No. 46 Performance Audit

Client Service in the Family Court of Australia and the Federal Magistrates Court
Family Court of Australia, Federal Magistrates Court

- No. 50 Performance Audit

Management of Federal Airport Leases
Department of Transport and Regional Services

2004-05, First and Second Quarters:

- No. 4 Performance Audit

Management of Customer Debt
Centrelink

- No. 5 Performance Audit

Management of Standard Defence Supply System Upgrade

Department of Defence

■ No. 21 Performance Audit

Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2004

Across agency

■ No. 15 Performance Audit

Financial Management of Special Appropriations

Across Agency

■ No. 16 Performance Audit

Container Examination Facilities

Australian Customs Service

■ No. 18 Performance Audit

Regulation of Non-prescription Medicinal Products

Department of Health and Ageing - Therapeutic Goods Administration



Appendix B — Submissions

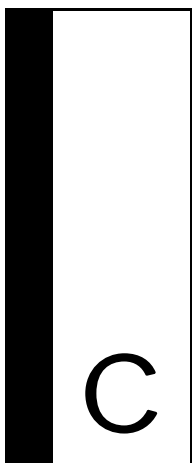
Review of Auditor-General's Reports, Third Quarter 2003-2004

- | | |
|-----|--|
| 1 | Australian Centre for Intellectual Property in Agriculture |
| 2 | Dairy Adjustment Authority |
| 2.1 | Dairy Adjustment Authority |
| 3 | Dairy Australia |
| 4 | Department of Agriculture, Fisheries and Forestry |
| 5 | Department of Environment and Heritage |
| 5.1 | Department of Environment and Heritage |

Review of Auditor-General's Reports, First and second Quarters 2004-2005

- | | |
|-----|--|
| 1 | Australian Self-Medication Industry |
| 2 | Department of Finance and Administration |
| 2.1 | Department of Finance and Administration |
| 3 | Centrelink |
| 3.1 | Centrelink |
| 4 | Australian Customs Service |
| 5 | Australian National Audit Office |
| 5.1 | Australian National Audit Office |
| 5.2 | CONFIDENTIAL |
| 6 | Family Court of Australia |

7	Department of Transport & Regional Services
7.1	Department of Transport & Regional Services
8	Department of Family and Community Services
9	Australian Customs Service
10	Department of Transport & Regional Services
11	Department of Defence
11.1	Department of Defence
11.2	Department of Defence
12	Department of Health & Ageing



Appendix C — Exhibits

Review of Auditor-General's Reports, Third Quarter 2003-2004

- 1 Mr Bob Baldwin MP
Dairy farm Grants used as income

Review of Auditor-General's Reports, First and second Quarters 2004-2005

- 1 CONFIDENTIAL
- 2 Department of Transport & Regional Services
Airport Annual Lease Review Schedule as at 1 March 2005
- 3 Department of Transport & Regional Services
Airport Development Commitment Expenditure as required under Airport Sale Agreements
- 4 Department of Transport & Regional Services
Letter from Assistant Secretary Airport Planning Regulation to company Secretary LEX Property Management Ltd dated 10 Feb 05
- 5 Family Court of Australia
CEO's Report on the Court's recent activities to 30 June 2004
- 6 Family Court of Australia
National Cultural Diversity Plan 2004-2006
- 7 Department of Health & Ageing
Statement of Requirement for Audit Consultant
- 8 Australian Customs Service
Sydney Container Examination (Video)
(Related to Submission No. 30)

- 9 Australian Customs Service
Overview of the Customs Container Examination Facilities
(Related to Submission No. 30)
- 10 Australian Customs Service
Customs Container Examination Facilities (DVD)
(Related to Submission No. 30)
- 11 Family Court of Australia
Memorandum of Understanding between the Family Court of Australia and the Federal Magistrates Court for the Provision of Services, dated 1 July 2004.
- 12 Family Court of Australia
Combined Registry Project Information Bulletin 25 April 2005
- 13 Family Court of Australia
Combined Registry Project - Information Kit for staff
- 14 Department of Defence
Defence Instructions (General) - Stocking of defence Stores (complete Revision) 8 May 2002
(Related to Submission No. 68)
- 15 Department of Transport & Regional Services
Cost Recovery Impact Statement - Minor Cost Recovery Arrangements 22 March 2005
(Related to Submission No. 70)
- 16 Department of Transport & Regional Services
Legal Advice provided by AGS to Department in March 2005 re CRIS
(Related to Submission No. 70)
- 17 Department of Defence
An overview of Standard defence supply system (SDSS)



Appendix D — Witnesses Appearing at Public Hearings

Monday, 9 August 2004

Australian National Audit Office

Dr Paul Nicholl, Executive Director, Performance Audit Services Group

Mr David Nyskohus, Director and Audit Manager, Performance Audit Services Group

Mr Phillip Hagan, Accountant

Australian Bureau of Statistics

Mr Graeme Hope, First Assistant Statistician

Attorney-General's Department

Ms Helen Daniels, Assistant Secretary, Copyright Law Branch

Ms Gabrielle Mackey, Principle Legal Officer, Copyright Law Branch

Commonwealth Scientific and Industrial Research Organisation

Mr Terence Healy, General Counsel

Department of Communications, Information Technology and the Arts

Mr Peter Ostergaard, Manager, Rights Management Section, Intellectual Property Branch

Ms Cheryl Watson, Manager, Corporate and Business Division

Department of Finance and Administration

Mr Brett Kaufmann, A/g First Assistant Secretary, Financial Reporting Division

IP Australia

Dr Peter Tucker, General Manager, Business Development and Strategy Group

Monday, 14 February 2005 - Canberra**Australian National Audit Office**

Mr Warren Cochrane, Acting Deputy Auditor- General, Performance Audit Services Group

Mr David Crossley, Executive Director, Performance Audit Services Group

Mr Alan Greenslade, Executive Director

Mr Peter McVay, Senior Director, Performance Audit Services Group

Mr John Meert, Group Executive Director

Mr Layton Pike, PerformanceAnalyst, Performance Audit Services Group

Mr Oliver Winder, Deputy Auditor-General

CSIRO

Dr Bryson Bates, Director, Climate Program

Dr John Wright, Director, Energy Transformed Flagship

Dairy Adjustment Authority

Mr Martin Bede, Internal Review Manager

Mr Daryl Gifford

Mr Patrick Musgrave, Chairman

Dairy Australia Limited

Mr Duncan Langdon, Group Manager Corporate Services

Department of Agriculture, Fisheries and Forestry

Mr David Moritmer, Executive Manager, Food & Agriculture Division

Ms Sally Standen, A/g General Manager, Meat, Wool & Dairy Branch

Department of the Environment & Heritage

Mr Ian Carruthers, First Assistant Secretary, International Land & Analysis Division

Ms Jane Harriss, Manager, Greenhouse Communications

Mr Mark McGovern, Manager, Greenhouse Communications

Dr Diana Wright, First Assistant Secretary, Industry Communities & Energy Division

Department of the Environment and Heritage

Mr Howard Bamsey, Deputy Secretary

Monday, 7 March 2005 - Canberra**Australian National Audit Office**

Mr Brian Boyd, Executive Director, Performance Audit Services Group

Mr Warren Cochrane, Acting Deputy Auditor- General, Performance Audit Services Group

Mr Peter White, Acting Group Executive Director, Performance Audit Services Group

Department of Transport & Regional Services

Mr Martin Dolan, Acting Deputy Secretary

Mrs Denise Holmesby, Director, Business Review & Improvement Section

Ms Cristina Mojica, Acting Assistant Secretary, Airport Planning & Regulation Branch

Mr Neil Williams, Acting First Assistant Secretary, Aviation & Airports Policy

Wednesday, 16 March 2005 - Canberra**Australian National Audit Office**

Mr Warren Cochrane, Acting Deputy Auditor- General, Performance Audit Services Group

Mr Colin Cronin, Executive Director

Mr Ian Goodwin, Group Executive Director, Assurance Audit Services Group

Mr Ian McPhee, Auditor-General

Mr Michael Watson, Group Executive Director, Assurance Audit Services Group

Department of Defence

Mr Llyod Bennett, Chief Finance Officer

Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation

Brigadier David McGahey, Director, General Materiel Information Systems

Mr Ric Smith AO, Secretary

Monday, 4 April 2005 - Canberra**Australian National Audit Office**

Mr Warren Cochrane, Acting Deputy Auditor- General, Performance Audit Services Group

Mr Greg Cristofani, Senior Director

Mr David Crossley, Executive Director, Performance Audit Services Group

Mr Andrew Morris, Senior Director, Performance Audit Services Group

Family Court of Australia

Ms Jennifer Cooke, Executive Director, Client Services

Mr Richard Foster, Chief Executive Officer

Ms Dianne Gibson, Principal Mediator

Mr Peter Maynard, Manager, Strategy and Review

Federal Magistrates Court of Australia

Mr Brian Scammell, Acting Chief Executive Officer

Monday, 4 April 2005 - Canberra**Australian National Audit Office**

Mr Warren Cochrane, Acting Deputy Auditor- General, Performance Audit Services Group

Ms Fran Holbert, Executive Director, Performances Audit Services

Mr John Meert, Group Executive Director

Mr Andrew Morris, Senior Director, Performance Audit Services Group

Centrelink

Mr Paul Cowan, Acting General Manager, Business Integrity

Ms Carolyn Hogg, Deputy Chief Executive Officer, Business

Mr Jeff Whalan, Chief Executive Officer

Department of Family and Community Services

Dr Nicholas Hartland, Branch Manager, Social Security Relationships and Compliance

Tuesday, 5 April 2005 - Canberra**Aboriginal and Torres Strait Islander Services**

Mr Michael Fileman, Acting Chief Finance Officer

Mr Patrick Watson, Acting Chief Executive Officer

Attorney-General's Department

Ms Sue-Ellen Bickford, General Manager, Financial services Group

Mr Trevor Kennedy, Assistant Secretary, Financial Management

Australian National Audit Office

Mr Kim Bond, Senior Director, Performance Audit Service Group

Mr Brian Boyd, Executive Director, Performance Audit Services Group

Mr Warren Cochrane, Acting Deputy Auditor- General, Performance Audit Services Group

Mr Alan Greenslade, Executive Director

Mr John Meert, Group Executive Director

Ms Gillian Nicoll, Senior Director

Mr Jim Stevenson, Senior Director, Performance Audit Services Group

Australian Taxation Office

Ms Donna Moody, Chief Finance Officer

Department of Finance and Administration

Mr Michael Culhane, Branch Manager, Finance and Banking Branch

Ms Anne Hazell, Division Manager, Financial Reporting & Cash Management Division

Mr Joanthan Hutson, Division Manager, Financial Framework Division

Mr Patrick O'Neill, Team Leader, DIMIA Agency Advice Unit

Department of Health & Ageing

Ms Jane Halton, Secretary

Mr Alan Law, Chief Operating Officer, Business Group

Mr David Learmonth, First Assistant Secretary, Primary Care Division

Department of Veterans' Affairs

Mr Neil Bayles, Chief Finance Officer

Ms Kerry Blackburn, Division Head

Mr Dermot Walsh, National Manager, Defence Service Homes Insurance Scheme

Therapeutic Goods Administration

Dr John McEwen, Principal Medical adviser

Mr Terry Slater, National Manager

Thursday, 28 April 2005 - Canberra**Australian Customs Service**

Ms Gail Batman, National Director, Border Intelligence and Passengers

Mrs Marion Grant, National Director, Border Compliance and enforcement

Ms Roxanne Kelley, National Manager, Research and Development

Australian National Audit Office

Ms Barbara Cass, Senior Director

Mr Warren Cochrane, Acting Deputy Auditor- General, Performance Audit Services Group

Mr Darren Coonan, Audit Manager

Mr Colin Cronin, Executive Director

Mr Ian Goodwin, Group Executive Director, Assurance Audit Services Group

Mr Ian McPhee, Auditor-General

Ms Dianna Smith, Director

Mr Peter White, Acting Group Executive Director, Performance Audit Services Group

Department of Defence

Brigadier Phillip Edwards, Projector Director, Joint Logistics Command

Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation

Mr Alan Henderson, Deputy Secretary, Corporate Service and Infrastructure Group

Brigadier David McGahey, Director, General Materiel Information Systems

Mr Ken Moore, Acting Chief Finance Officer

Dr Ian Sidney, Chief Finance Officer, Defence Materiel Organisation

Mr Ric Smith AO, Secretary

Air Vice-Marshal Christopher Spence, Commander, Joint Logistics

Thursday, 12 May 2005 - Canberra

Australian National Audit Office

Mr Ian Goodwin, Group Executive Director, Assurance Audit Services Group

Mr Ian McPhee, Auditor-General

Mr Peter White, Acting Group Executive Director, Performance Audit Services Group

Department of Defence

Brigadier Phillip Edwards, Projector Director, Joint Logistics Command

Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation

Mr Ken Moore, Acting Chief Finance Officer

Mr Peter Sharp, Acting Head Defence Personnel

Mr Ric Smith AO, Secretary

Air Vice-Marshal Christopher Spence, Commander, Joint Logistics

Monday, 27 June 2005 - Sydney

Australian National Audit Office

Mr Warren Cochrane, Acting Deputy Auditor- General, Performance Audit Services Group

Mr Ian Goodwin, Group Executive Director, Assurance Audit Services Group

Department of Defence

Brigadier Phillip Edwards, Projector Director, Joint Logistics Command

Dr Stephen Gumley, Chief Executive Officer, Defence Materiel Organisation

Mr Frank Lewincamp, Chief Operating Office, Defence Materiel Organisation

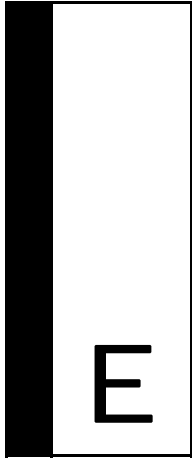
Brigadier David McGahey, Director, General Materiel Information Systems

Mr Ken Moore, Acting Chief Finance Officer

Mr Peter Priddle, DSCCPO

Mr Ric Smith AO, Secretary

Air Vice-Marshal Christopher Spence, Commander, Joint Logistics



Appendix E

Schedule of Airport Insurance Cover – Federal Leased Airports 1997 – 2005 (Department of Transport and Regional Development)

DEPARTMENT OF TRANSPORT AND REGIONAL SERVICES

Schedule of Airport Insurance Cover – Federal Leased Airports 1997-2005

INTRODUCTION

The relevant Schedule to the Sale Agreements sets out insurance requirements in the following terms:

“1. The Transferee will at its expense effect and maintain or cause to be effected and maintained at the Grant Time the following policies of insurance (“Policies”) :

(a) policy or policies of insurance to cover:

- (i) loss and/or damage to or destruction of structures;
- (ii) loss and/or damage to or destruction of plant, machinery and other property on the Airport Site or in transit; and
- (iii) loss of gross revenues and/or additional increase in the cost of working consequent upon loss and/or damage to or destruction of structures, plant, machinery and other property.

Such policy or policies must be effected for the reinstatement or replacement value of structures plus extra costs of reinstatement;

- (b) a policy or policies of insurance in respect of legal liability for, but not limited to, claims made by third parties for bodily injury or death or damage to or destruction of property (including the loss of use of such property) arising out of the Transferee’s use or occupation of the Airport Site or any operations occurring on or in respect of the Airport Site.

Such policy or policies must be effected initially with a minimum cover of \$...” *(The cover stipulated in the Sale Agreements for legal liability varies between airports as follows:*

\$1.5 billion Adelaide, Brisbane, Melbourne, Perth, Sydney

\$1 billion Canberra, Gold Coast, Darwin

\$500 million Alice Springs, Hobart, Launceston, Townsville

\$150 million Archerfield, Bankstown, Camden, Essendon, Hoxton Park, Jandakot, Moorabbin, Parafield

\$25 million Tennant Creek, Mt Isa)

All aviation liability primary policies identified in the table below contain third party legal liability limits consistent with the amounts specified in the Sale Agreements.

In addition to the insurance requirements of the Sale Agreements, all airport leases contain a clause indemnifying the Commonwealth from any actions arising from lessee operation of the airports. The relevant clause states that the lessee:

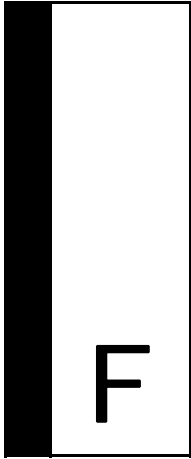
“...hereby indemnifies the Lessor from and against all Claims, Damages or Costs incurred or sustained by the Lessor, or for which the Lessor may become liable, in respect of any Claims, Damages, Costs or Injury to any person by reason of any act or omission on the part of the Lessee or by the performance of the Lease or the use or occupation of the airport Site by the Lessee or any other person...”

Airport ¹	Cover required by Sale Agreement	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
Darwin/ Alice Springs/Tennant Creek	(a)		✓	✓	✓	✓	✓	✓	✓
	(b)		✓	✓	✓	✓	✓	✓	✓
Essendon	(a)					✓	✓	✓	✓
	(b)					✓	✓	✓	✓
Gold Coast	(a)		✓	✓	✓	✓	✓	✓	✓
	(b)		✓	✓	✓	✓	✓	✓	✓

1 Shaded areas in the body of the table indicate that the period was prior to sale. The respective sale dates were:

1 July 1997 - Brisbane, Melbourne, Perth; 28 May 1998 - Adelaide, Canberra, Gold Coast, Launceston, Parafield; 10 June 1998 - Alice Springs, Darwin, Hobart, Mt Isa, Tennant Creek, Townsville; 18 June 1998 - Archerfield, Moorabbin; 30 June 1998 - Jandakot; 10 August 2001 - Essendon; 30 June 2002 - Sydney (KSA); 14 November 2003 - Bankstown, Camden, Hoxton Park.

Sydney	(a)						✓	✓	✓
	(b)						✓	✓	✓
Townsville/Mt Isa	(a)		✓	✓	✓	✓	✓	✓	✓
	(b)		✓	✓	✓	✓	✓	✓	✓



Appendix F

**Airport Development Commitment Expenditure as
required under Airport Sale Agreements (Department of
Transport and Regional Development)**

