



COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE OF PUBLIC ACCOUNTS

**Reference: Auditor-General's reports sectional committee review of first quarter
1997-98 audit reports**

CANBERRA

Tuesday, 16 December 1997

OFFICIAL HANSARD REPORT

CANBERRA

JOINT COMMITTEE OF PUBLIC ACCOUNTS

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Mr Griffin (Vice-Chair)

Senator Coonan
Senator Faulkner
Senator Gibson
Senator Hogg
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Present

Mr Charles (Chair)

Senator Gibson

Mr Griffin

Mrs Stone

Observer

Department of Finance :

Mr J. Clout

The committee met at 2.52 p.m.

Mr Charles took the chair.

BARRETT, Mr Patrick Joseph, Auditor-General, Australian National Audit Office, Centenary House, 19 National Circuit, Barton, Australian Capital Territory, 2600

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MUELLER, Major General Desmond Maurice, Command Support Australia, Department of Defence, Victoria Barracks, St Kilda Road, Southbank, Victoria 3006

CHAIR—I now open today's public hearing, which is the first in a series of quarterly hearings to examine reports tabled by the Auditor-General in the financial year 1997-98. This afternoon we will take evidence on two audit reports, namely, Audit Report No. 5 1997-98: *Performance management of Defence inventory—Department of Defence*, and Audit Report No. 10 1997-98: *Aspects of corporate governance—the Australian Tourism Commission*. The committee has received one submission from the Department of Defence in relation to report No. 5. We will be running the sessions in a round table format, which means that all relevant participants will be present to hear what others are saying about the Auditor-General's reports.

I ask participants to strictly observe a number of procedural rules. Firstly, only members of the committee can put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I ask them to direct their comments to me

and the committee will decide if it wishes to pursue the matter. It will not be possible for participants to directly respond to each other. Secondly, witnesses should, to assist *Hansard*, identify themselves whenever they wish to make a comment. Thirdly, given the length of the program, statements and comments by witnesses should be kept as brief and as succinct as possible.

I also remind you that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will be recorded by *Hansard* and will attract parliamentary privilege. I refer any members of the press who are present to a committee statement about the broadcasting of proceedings. In particular, I draw the media's attention to the need to fairly and accurately report the proceedings of the committee. Copies of the committee's statement are available from secretariat staff present at this hearing. The audit report being considered in this first session is Audit Report No. 5 1997-98: *Performance management of Defence inventory—Department of Defence*. I welcome the Auditor-General, representatives from the Australian National Audit Office and representatives from Defence to the first session of today's hearing.

We have commenced this public hearing to examine the main issues raised in the Auditor-General Audit Report No. 5, *Performance management of Defence inventory*. The JCPA will take evidence today on a number of issues including: best practice in inventory management, management of the performance and costs of the supply chain and logistics information systems. The Auditor-General's views have been set out and the report has had the initial responses from the audited agency. However, the committee would be interested to learn if any action has already been taken or is planned to address the issues raised in the Auditor-General's report. Major General Mueller, do you wish to make a brief opening statement to the committee before we proceed to questions?

Mr Lewincamp—If I may, I would like to make an opening statement about the broader context of management within the Defence organisation and then Major General Mueller will address more directly some of the matters relating to inventory and logistics management.

In terms of the broader climate within Defence, it is a time of significant change and reform, as I am sure you are aware. That is due both to the broader government reform agenda for the public sector in general and to specific Defence initiatives. We see those changes as being mutually reinforcing and complementary. Some of those have been mentioned in the ANAO report. I will briefly talk about progress in one or two of them because they go to the question you asked at the start about some of the action we have planned or have already taken.

The first initiative under the government reform agenda is the introduction of accrual based output management. We are participating very closely with the Department

of Finance and Administration in the accrual budgeting project. As you are aware, the time frame for the introduction of full accrual budgeting is a very challenging one—by 1 July 1999—and there is very much work to be done on the policies, the business rules, the systems and education and training of our staff in order for us to meet that time frame. I would say that Defence, as with all other government departments, is very much dependent upon the whole of government developments and time frames that are occurring there.

The question of output management for Defence is a particularly challenging one. As you might imagine, in the defence arena there is great difficulty in trying to define precisely the outcomes that the government expects of the Defence Force, particularly the outputs that you define in terms of the level of required capability. These are matters of fine judgment that are proving difficult for us.

The second broad initiative is the revised performance management and reporting regime, including concepts of corporate governance. You are probably aware that Defence participated in the second tranche of the performance information review, with a report going to the ministers for finance and defence in July 1997. We are putting in place a new performance framework that will be considered by our senior defence committee early in the new year, and we have just had endorsed by our audit committee our revised evaluation strategy, which has a rolling two-year program of evaluations within the organisation.

A number of measures have already been put in place to clarify the responsibilities of officers throughout the organisation to cascade our outputs, objectives and performance measures down through the organisation and also to put in place customer supplier arrangements between those parts of the organisation that are delivering services and products to other parts of the organisation. You would also be aware of the revised legislative framework being put in place by the Financial Management Accountability Act, the Workplace Relations Act and the Public Service Act.

In relation to some of the internal defence reforms, the pre-eminent one of those, as you are all aware, is the defence reform program. This is increasing our focus on outputs. We have a revised corporate approach. We have put in place better longer term planning arrangements or are in the process of doing so. We have fully implemented the new program structure and the higher management structure in Defence as of 1 July 1997. The revised management planning and decision making processes are progressively being implemented. We have overhauled the senior committee structure.

We have also put in place specific program initiatives where there is a whole series of rationalisations, reviews of functions and processes, service level agreements between programs and revised regional support arrangements to the Defence organisation throughout the country. We have also got our programs of ongoing market testing under the commercial support program and civilianisation. I think I will leave the broad

overview there and ask Major General Mueller to talk about how some of these things impact upon the inventory and logistics management process.

Major Gen. Mueller—Mr Chairman, by way of some opening remarks, I think it is probably worth while if I highlight that the ANAO report, which certainly from my point of view is a welcome report, equates the function of inventory management with the total logistic process or the notion of a supply chain which extends from commercial suppliers to end customers. In the context of our business, the end customer can be a ship at sea, a tactical fighter squadron deployed in an area of operations or one of many of Army's combat units deployed in an area of operations. In that sense, inventory management, possibly in the way that it is being used by ANAO, extends beyond what we would generally consider to be inventory management. We normally view it as consisting of requirements, determination and inventory control.

Having said that, in the contemporary world and especially in the private sector, best practice logistic organisations usually view the end to end supply chain in the context of an integrated logistic or integrated distribution system. I have included a simple diagram reflecting that as an annex to the Defence submission. I think it is important to recognise that in such a system no particular function can be viewed in isolation from the others. Indeed, an impact on warehousing has an impact on transport. Especially within my organisation, equipment maintenance activities are a major consideration and they can have a very significant downstream and long-term impact on our distribution chain.

As the committee would be aware, one of the principal planks of the defence reform program was the establishment of Command Support Australia on 1 July of this year. The establishment of that organisation brought together the chosen logistic elements from Navy, Army and Air Force. The task of this newly raised organisation is to optimise material support arrangements for the Australian Defence Force by removing the duplication of activities to the maximum extent practicable, integrating and standardising processes and introducing valid performance measures.

In a nutshell, what we are being asked to do is to undergo a very significant cultural transformation—indeed, from a traditional public sector organisation to a modern knowledge based defence business. I would not in any way underestimate how formidable that task is going to be. The key to it, I think, lies in three things: culture, process and information technology, with all three being overlaid by performance management arrangements. In undergoing this transformation we have initiated about 70 significant projects. We are undergoing a major restructuring. We will be required over the next three years to market test at least half the jobs which are in the organisation, if not more. As a consequence, a significant part of the work force were somewhat anxious about their long-term job security and about their career prospects.

We have inherited a legacy of non-standard and often fragmented processes and a proliferation of logistic and other information systems, many of which are not integrated. I

think the ANAO report makes the observation that, in order to move towards best practice in managing an integrated distribution system, there is a requirement, firstly, for standardised processes and, secondly, for integrated information systems. At the moment I do not have either.

To remedy these problems, obviously we will have to migrate progressively to common processes and systems where it is technically feasible and cost effective to do so. Information systems are subordinate to the business processes they support; so the first thing we have to do is align business processes, and therefore business process modelling, re-engineering and performance measurement will have to precede any rationalisation of supporting information systems. This is going to be a formidable task technically and a formidable task intellectually and the resources required to achieve it will be substantial.

One of the measures that we have put in place is the establishment of a Joint Logistics Systems Agency within Support Command Australia and its charter is to facilitate progressive migration to common processes and systems. We are seeking external support through a consultancy to assist with developing a strategy for both short-term—so that we can get some runs on the board quickly—and long-term improvement of logistic processes and systems and also to identify a suitable methodology to allocate priorities for logistic business processes and systems improvement.

The defence efficiency review recommended, amongst other things, that Defence develop with the assistance of industry a more efficient storage and distribution system which can accommodate its operational requirements and allow savings to be made by further reducing warehousing and transport expenditure, in particular through a much greater use of inventory for these purposes. We are pursuing that recommendation, but in addition the ambit will be widened to indeed look at inventory management itself and even procurement with a view to determining the practicality or otherwise of outsourcing some of those activities partially or wholly, and in the corporate sector it is not unusual to do that.

The final point I make is that these changes will be very dependent on raising levels of competency in a range of key logistic and management skills, especially financial management skills. While I have got pockets of expertise in most of these skills, the spread of competencies is uneven and in many cases it is too shallow. We have already embarked on both a long-term and a short-term strategy to raise levels of competency in a number of areas which are enunciated in the Defence submission.

I would like to conclude by saying that what we have embarked on is a journey and not a destination. There will be no end point to this. I believe that we can make significant progress in three years, I believe that we can make very substantial progress in five years or more, but I would perhaps end by just emphasising that the resource implications of doing this will be quite substantial in terms of time, people and funding.

CHAIR—Thank you, Major General Mueller. Does the Auditor-General wish to make an opening statement in response?

Mr Barrett—My colleague does, Mr Chairman.

Mr McPhee—A critical element in the preparedness of the ADF is the availability of various items at the time and place required to support operations or training. Management of these items throughout their lives is an integral part of logistics support to the ADF. The Defence inventory of items consisting of spares, consumables and repairable items, but excluding ordinance, is valued at approximately \$3.9 billion, with \$1 billion spent annually on further procurement and the maintenance of repairable items by external contractors. This represents a very significant investment of Commonwealth funds and as such it is imperative that Defence employ best practice in its management.

In the course of this audit, the defence efficiency review found that there were significant opportunities to improve the management of Defence inventory. The DER recommended that Defence establish a joint support command, review the value of the Defence inventory and develop a more efficient storage and distribution system, as mentioned by General Mueller. It analysed the usage rates of items and concluded that current levels of operating stock were far too high and that Defence should reduce its holdings of low usage stock and further implement commercial management practices such as vendor held stock.

The DER team had difficulty obtaining reliable data to support its analysis of the efficiency and effectiveness of Defence's logistic support activities. Its experience highlighted the need for improved information to support reliable analysis of the inventory, particularly in identifying the effectiveness with which the supply chain operates in support of the ADF.

This issue was identified in the preliminary study of the management of Defence inventory conducted by this office in August 1996. The study concluded that an audit could best add value by focusing on the overarching issue of performance management of the Defence inventory. Overall we found that, despite the increased focus in this area by Defence in recent years, performance management of Defence inventory does not reflect best practice. As a result, Defence managers are not provided with adequate information or incentives to ensure their decisions are based on consideration of the efficiency and effectiveness of the total supply chain.

With assistance throughout the audit from a specialist consultant on the audit team—Bob Easton, who is on my left—and recognising that Defence is quite different from a commercial organisation, we identified a number of issues that would help Defence develop a more effective logistics performance management framework. Fundamental among these is the need for Defence to take a more strategic, coordinated approach to developing and implementing credible and useful performance measures for its supply

chain. Although there have been efforts to improve the performance management practices applied to the Defence supply chain, these have occurred in isolation within each of the three services. This may be seen to be counter to the unified approach on Defence strategy that has been increasingly recognised in recent years as desirable. There has been little attention to the overall management of supply chain performance.

In our view, Defence would benefit from developing a clear, uniform strategy for logistics performance management and coordinating it from a central point within Defence. This would help ensure that the set of performance measures used is balanced, integrated and covers all aspects of supply chain management.

The ANAO identified three key techniques to assist Defence to develop a better understanding of the characteristics of its inventory and the management of it—for example, mapping the processes that occur in the supply chain to identify the best ways of managing and measuring influences on these processes. The application of segmentation techniques to the inventory would provide a basis from which Defence could develop appropriate stockholding strategies and identify items on which to focus the greatest management attention. Although some efforts have been made, these techniques have not been comprehensively applied. Total cost analysis would also enhance Defence's ability to make informed trade-off decisions within the supply chain.

In our analysis of Defence's inventory related performance measures, we could identify no measures relating to total supply chain costs. There was only limited analysis of the costs associated with various elements of the supply chain. In addition, the resource management framework does not provide inventory managers with the information needed to relate their decisions adequately to Defence preparedness and operational capabilities.

Performance management can play an important role in changing Defence's inventory management culture and in the successful transition to a joint integrated logistics organisation. However, there has been no coordinated strategy for addressing the training and educational issues involved in successfully introducing a strong performance management culture.

The recommendations in the audit report will assist Defence develop a well-constructed logistics performance measurement system. Potential benefits for inventory management in Defence include better planning and control, better buying decisions, more accurate and timely recognition of obsolescent material, more focused accountability and, generally, a much more cost-effective operation. The audit office estimated that even a five per cent reduction in the current stock levels could yield annual savings and inventory carrying costs of at least \$23 million and a potential one-off capital release of \$197 million. In our view, this is the minimum possible outcome that could be delivered.

Implementation of the audit recommendations will help to create an environment and culture in which supply chain managers are better equipped to achieve such savings

while maximising the timeliness, relevance and quality of the support provided for military capability and other Defence outputs. The issue of culture was referred to earlier by General Mueller.

Defence was very supportive of the audit and agreed with all of the recommendations. I would like to say that we very much appreciated the positive attitude and cooperation that the audit team received. Defence has already begun to implement recommendations from the audit report. Tony Minchin and Tina Long were the senior audit staff involved in the audit. We would be happy to answer any questions.

CHAIR—Thank you, gentlemen. General Mueller, in your opening statement you told us about the major difference between Defence and private sector organisations. Could you explain to the committee, excluding the issue of armaments, how Defence would differ substantially in terms of inventory and purchasing from a large transport corporation which operated a fleet of trucks, operated on our rail lines, operated a fleet of ships and operated as air carriers?

Major Gen. Mueller—First of all, the Defence inventory varies significantly—and this is recognised in the ANAO report—from one that you would find in a normal commercial enterprise. Some of the items that we have in our inventory are low cost, high volume consumption, readily available commercial items, and they should be managed accordingly. Items such as that, I would suggest, on balance, we probably should not store ourselves. We should resort to a technique known as ‘vendor managed stock’, and there are other modern inventory management practices that are appropriate for such items.

Other items that we carry, for example, we refer to as insurance stocks. They invariably are very high value. An example of those would be the propellers and propeller shafts that you would find on surface combatants. If, as a result of misadventure or hostile action, we need a new propeller shaft or a new propeller, they must be available within a short time frame because they are not readily available from the commercial sector. For example, the additional F111Gs which we have recently purchased from the United States, because that aircraft is being withdrawn from United States service, we have pursued the life of type purchase of consumable repair parts and repairable items for them. Many of those items will remain in storage and will not be used for some time.

We also have to bear in mind that we are quintessentially a contingency organisation in that our peace-time rates of effort, in many respects, are markedly less than what they would be in war. If we are faced with the prospect of an operation, when rates of effort will accelerate quite significantly, then clearly consumption will accelerate and the issue of having enough depth in our stocks, or in terms of what we would describe as ‘reserve stocks’, is fundamental if we are to be able to sustain those rates of effort until the procurement pipeline actually comes on stream.

There are other considerations. For example, if you are talking about commercial

motor vehicles and you want to purchase repair parts, generally speaking, you can always get ready access to those in the commercial market. But, if you are looking at something like a ground based air defence system, for which there has only been one production run in an offshore country and the original equipment manufacturer will not do a run on spares until it is economical for that organisation to do so, then we have to carry sufficient to cover that gap. So it is a very heterogeneous inventory that we manage but, where it is possible to manage those segments of the inventory which should be managed in a way that is consistent with best practice in the commercial sector, we should do so. Let there be no doubt about that.

There is one other difference that I would like to emphasise and it is with regard to what our colleagues in ANAO refer to as the supply chain. In the context of a defence contingency, you do reach a point where certain influences start to intrude, unlike those you would find, for example, in your commercial organisation. These are the questions of the vagaries of weather, the vagary of rates of effort on combat operations and, unfortunately, from time to time, the enemy will intrude into the supply chain. At that end of the supply chain it will be necessary to build in some redundancies because the consequences of logistic failure within the operational environment, as you would well appreciate, are quite severe. But, certainly, at the front end of the distribution chain, at the so-called strategic level, and to a degree at the operational level, we can pursue best business practice in the commercial sense.

CHAIR—I accept the differences that you quote. Is there any reason, though, why those differences would preclude you setting individual performance targets for each of those kinds of inventory and reporting outcomes against the original target?

Major Gen. Mueller—There is no reason for not doing that at all. The trick is to determine what the appropriate performance measures are and then to ensure that you can collect the data to measure the performance. I think, as the ANAO audit observed, and quite correctly, there are some significant shortcomings in our current information systems with regard to being able to collect that information.

The other issue I think is important is that, for performance measures to be worth while, they must be derived from an analysis of your core and key processes. That again falls back to one of the principal ANAO recommendations with regard to the need to do an audit of where Defence is overall with its process mapping. If you select performance measures that are not consistent with process, you will find that you are not measuring the right things.

Mr GRIFFIN—From what you say, the changes that are occurring and the movement that is taking place sound quite encouraging. I have to express a little bit of cynicism—not with respect to your bona fides on this issue—but we regularly have Defence before us on a range of different issues. I have been on this committee for nearly five years, and on practically every occasion some serious concerns have been raised about

the operation of the particular component of Defence that we are looking at. The representatives who come before the committee basically say, 'Yes, we've made some mistakes and we're going to fix them,' and they agree with the report and off it goes from there. With some of the reports, we are still waiting to hear as to whether that change is actually occurring. Why wasn't something done about this 10 years ago?

Major Gen. Mueller—The reason something was not done about it 10 years ago, I would suggest to you, is quite simply that before 1 July this year—and this is consistent with the observations in the defence efficiency review—each service ran its logistics system as best it could to meet its particular needs. The DER made the observation that there were overlaps and shortfalls between the three systems, and it recommended that the three systems be integrated. Further to that—if my memory serves me correctly—it also observed that there was no single point of authority prior to the implementation of the defence reform program that could actually impose that integration on the Defence organisation. The opportunity to do that now exists.

Mr GRIFFIN—You mentioned earlier the question of cultural change—and I agree with you that that is a major issue, probably in Defence more so than most. How do you see that cultural change occurring?

Major Gen. Mueller—Firstly, we have done some work on this with an organisation in Melbourne which specialises in cultural imprint. The first thing that has to be recognised is that it would appear to a degree that the expression 'cultural change' is apparently a little bit of a misnomer in the sense that once people are imprinted with a culture they tend always to keep it. I have in fact four cultures in my organisation—if you like, really, five. I have the Australian Public Service, Navy, Army, Air Force and what you might call the traditional public sector culture in the way that business is done. We have to build a complementary culture which is joint in nature and more business oriented than the one that we have entertained in the past.

The experience in the private sector would appear to be unequivocally that, if you are to successfully implement a major change program, you have to initiate in parallel a comprehensive and sustained culture change program which is driven from the top. We have sought assistance by way of a consultancy to do this and, as of 2 February next year, we will be instituting a sustained culture change program which will involve managers and leaders at all levels. It will be driven from my level, and the first culture change workshop that will be conducted will involve the 14 senior managers and leaders of the organisation, one of which will be myself.

Mr GRIFFIN—The impression that I have of Defence over the last few years is that, in the drive to ensure that people have expertise in different areas, there is an awful lot of trying to push square pegs into round holes within the organisations. This leads to a situation where often you may have very good personnel under your command in a particular area but, frankly, they should not be in that area because that is not really what

they do.

Major Gen. Mueller—It would be interesting to reflect on whether I am a square peg in a round hole or a round peg in a round hole.

Mr GRIFFIN—Some pegs are more flexible than others of course.

Major Gen. Mueller—I think the point you raise is a legitimate one. It is one on which I have already had a dialogue with the new head of the personnel executive in the sense that I would aspire to have, in particular, service personnel managed in a way such that their progression through the organisation that I am responsible for reflects a better planned progression and that at appropriate stages in that progression they are given the education and training that they need.

Mr GRIFFIN—I think it goes beyond that as well. It is like what you said before about culture—you get a culture and it is ingrained. Like the old saying, ‘You can teach an old dog new tricks,’ but sometimes the old dog isn’t going to be too good at those tricks.

Major Gen. Mueller—True.

Mr GRIFFIN—That issue is also about the nature of the personnel. As an observation, one thing that has concerned me about Defence in general is that sometimes people are being put into areas where in fact that is not what they do. Some of them have adjusted very well, but some of them just have not got a clue, and that has created real problems for the operation of the organisation.

Major Gen. Mueller—I think that is true. Without trying to avoid the issue, where uniform personnel are concerned, by and large under current arrangements, that responsibility rests with the personnel executive.

Mr GRIFFIN—You mentioned that you expected that it would be three years before there will be obvious—

Major Gen. Mueller—Significant.

Mr GRIFFIN—Significant changes, and five years or more before dramatic change, I gather. What about the question of monitoring that progression over the next year or two? I would draw back to another earlier comment that I made where I alluded to the concern which I have about Defence that, with all the best will in the world with respect to aspects of other reviews and audits that we have done, we seem to see the same sorts of mistakes happening over and over again.

Mr Lewincamp—I can help out with that in part. In relation to the initiatives that

we are going through at the moment, there will be two mechanisms by which we will oversee and monitor the changes. Firstly, under the defence reform program, we have an obligation to report to the minister and to parliament on a regular basis on our progress in that, and a large part of the initiatives that we are talking about here under this ANAO report will be swept under that umbrella. You will see that, in our regular reporting into parliament, our portfolio budget statements and our annual report will include progress reports. We will have a six-monthly report to cabinet on progress in those areas. That will be monitored by parliament.

Mr GRIFFIN—Is it going to cabinet or parliament?

Mr Lewincamp—The six-monthly report will go to cabinet.

Mr GRIFFIN—The parliament will not see it.

Mr Lewincamp—It is a matter for the minister as to whether he makes statements in the House about those progress reports. But, in our formal documentation, you will certainly see reports on how we are going in the area of the defence reform program. Inside our organisation, the Senior Defence Audit, Policy and Evaluation Committee has responsibility for overseeing progress and implementing the reports of the National Audit Office, and that committee monitors that progress regularly, and the Audit Office is represented on that.

Mrs STONE—You have told us that from July you have had your joint logistics agency. The ANAO report recommended a centre of excellence type of approach. Is that your response to that centre of excellence suggestion?

Major Gen. Mueller—The Joint Logistics Systems Agency, as such, will come into being early next year. To date, we have been working with the people who are going to be aggregated into that, because it is essential first to define what the problem is. I have, as I said, inherited a very large legacy of processes and systems. The decision to establish that agency was made before I ever saw the ANAO report, *Performance management of Defence inventory*. I would suggest that it is entirely appropriate that it be a so-called centre of excellence—which is not a term that I am necessarily attracted to. Centre of expertise is, to my mind, more appropriate.

Mrs STONE—Have you looked at benchmarking Australian Defence Force logistics development against other defence forces in developed countries?

Major Gen. Mueller—I have in a sense. I have not had the opportunity to visit any, but I have had access to a range of United States government accounting office reports on the United States defence organisation logistics. I have also had access to some reports on the management of logistics in the Royal Air Force.

On the issue of logistics in the United States Department of Defense, the examination by the government accounting office, if anything, revealed problems that are more severe than what have been found in the Australian Defence Force, and are on a scale which makes ours pale in comparison. On the one hand, I was dismayed; on the other hand, I was greatly encouraged to read that.

The Royal Air Force has something of the order of 200 separate logistics information systems. According to the advice that I have, they have embarked upon a 10-year program to rationalise those information systems, with a projected investment of £400 million. Those are the sorts of problems that exist in defence organisations elsewhere in the developed world.

CHAIR—During the audit, did the ANAO compare performance of our defence department with other defence departments?

Ms Long—It is important to remember that the focus of this particular audit was performance management practices rather than performance per se—in other words, how they were generating the information rather than necessarily trying to draw direct comparisons of actual levels of performance. In a similar route to the General's, we looked at a lot of the published reports of the general accounting office of the United States department, and also a report on similar problems in the New Zealand defence force.

CHAIR—Would you care to comment on the General's comments?

Ms Long—Certainly there are very great similarities in the types of problems that are evident in defence organisations around the world. Management of inventory is a difficult area. Management of logistics generally is a difficult area, particularly as you become more complex in your organisation. Performance measurement of that complex organisation is something that is very difficult for a lot of organisations to come to grips with.

We might say there is a role for looking at the other defence forces in particular in that, given that they have got the same problems and those same problems have been identified by other accounting and auditing organisations—and they have made various recommendations about how to address those problems—it may be very useful for ADF or the Australian Department of Defence to look at what the US, the UK or New Zealand is doing to try to address those problems. There could be some cost benefit in trying to tap into what is happening in a much larger organisation such as US Defense where they have similar problems.

Mrs STONE— In the lead-up to the establishment of the Joint Logistics Systems Agency have you already set up a single supply agency?

Major Gen. Mueller—Brought together more than supply. What we brought

together were the materiel support elements of the previous single service logistics systems. That embraces inventory management, purchasing, warehousing, transport, materiel maintenance and engineering.

Mrs STONE—Is this going to feed into your new joint logistics agency, or are you creating two separate entities?

Major Gen. Mueller—No, the agency will be part of our organisation. Perhaps it might help to outline in global terms how we are organised. We have a headquarters with a joint staff. We have three components—a Navy component, an Army component and an Air Force component. The Air Force component, for example, is responsible for all aerial Systems Agency as a part of the organisation, and it is about how to do things. The components Navy, Army and Air Force are the doers.

CHAIR—Does that replace purchasing in the three services?

Major Gen. Mueller—No, it does not. Purchasing is an integral part. If I can put it this way, integrated logistic management—

CHAIR—We would really like to know how you do purchasing, quite frankly.

Major Gen. Mueller—In what way?

CHAIR—To put it in context, about four years ago the industry, science and technology committee of the House of Representatives did an inquiry into government purchasing. Defence did not get a bad rap compared with the rest of the departments, but what we found was that purchasing was spread diversely across departments. I think there were something like 30,000 separate authorisations for government purchasing and 12,000 to 13,000 government credit cards floating around the joint. I guess what I am interested is that, in a management sense, how do you manage purchasing? What, if any, careers paths are there in purchasing? How does that tie into infantry control and management?

Mr McNamara—I think you are referring to the Bevis committee report of some years ago.

CHAIR—Yes.

Mr McNamara—Our belief is that the Bevis committee recommendations paid particular and appropriate attention to Defence, and I think we came out fairly well from that exercise. From the management vantage point, though, the committee rightly referred to the need to ensure we had skilled purchasing officers in the procurement game, and as a consequence we embarked on a series of fairly major training programs in the devolved defence environment. In other words, we do not all purchase from one central agency, be it in Canberra or what have you. So we set up a group to train people in the skills of

procurement—be it simple procurement, at the advanced level or strategic level procurement. I do not have the statistics with me, but we have embarked on a very onerous program in that regard to ensure that we do have skilled people engaged in that activity. It is not something you acquire by simply on-the-job training. Our people now have qualifications as a consequence of implementing those processes.

CHAIR—Are there systems in place to go from what generates the need in the first place, whether it is having enough shells for rifles to undertake an exercise in North Queensland or having retreads for a tank or a turbine for an F111? Are there systems in place that generate the requirement through the chain of authorisation to purchasing whereby we do not have privates purchasing fan jets—without any logistical inventory control coming into play to decide whether that is a go or a no go? Is purchasing spread so far?

Major Gen. Mueller—Purchasing must be preceded by inventory management actions. As I mentioned initially, there are two components to that. The first is requirements determination: what to buy, when to buy, and how much to buy. Allied to that is inventory control, which is a matter of either where to store it after you buy it or, conceivably, on some occasions, you solve the problem not by purchasing but by redistributing items within the existing warehousing network.

The inventory management decisions have to be made before they are passed to the purchasing staff. The job of the purchasing staff is to buy what they are told to buy, how much, and where it is to be delivered by the inventory managers. So you do not, for example, have someone who is of a relatively low skill level making decisions of that order.

Senator GIBSON—My questions go to the availability of expertise in inventory management within the service. My first question is to ANAO on some comments from the consultant with regard to the current market for inventory managers with genuine expertise in the commercial world. My impression is that there is a shortage of well qualified people in this arena in the commercial world. Would you care to comment on that, for a start?

Mr Easton—Yes, I will. There is a significant shortage in the market at the moment of not only inventory management professionals but also supply chain professionals. Today the market does not look for purely functional specialists; it sees inventory management, purchasing management and transportation management in the context of the supply chain. At the junior level, there is a shortage of functional specialists, and people will be hired for functional specialist skills. But at the middle level, senior management and executive levels today, companies are looking for supply chain people—people who know how to integrate and where they fit into the organisation. There is a significant shortage in the market, and they are commanding higher salaries because of that.

Senator GIBSON—Major General Mueller, what are you doing within Defence to meet the competition to train your existing people up to those skills? Then how are you going to retain them? Alternatively, how are you going to recruit from outside to carry out the aims which you have outlined to us today?

Major Gen. Mueller—I mentioned in my opening remarks that we have embarked on a training strategy that has two prongs. In the short term, I want to remedy some significant shortfalls in a range of competencies. We are going to do that over the next calendar year. Very briefly, that includes competencies in areas like business process modelling and re-engineering; performance measurement, including simple statistical control analysis; benchmarking; accrual accounting and accrual budgeting, which will soon be upon us; total logistic cost analysis, which I understand from people in the private sector is a very difficult process; life cycle costing; activity based costing; and distribution chain management with significant emphasis on the inventory management dimensions, which is principally requirements determination and inventory control.

There are other areas where, because of the emphasis we have on complex platforms and systems, there also has to be other emphasis. That is in areas like integrated logistic support, including reliability and so on, availability, maintainability and configuration management.

In recognition of what I would call the institutional shortfalls that we currently have, we have commenced a joint project with the head of joint education and training on measures to overcome or meet Defence's longer term needs for people trained, in particular, in integrated logistic management. That would include, amongst other things, I would assume, the option of looking at putting greater emphasis on this at places like the Australian Defence Force Academy.

Senator GIBSON—Will you have the flexibility, though, within Defence to pay sufficient remuneration to hold people when they do acquire these skills and keep them in these jobs?

Major Gen. Mueller—I think the ineluctable facts of life are that people with these sorts of skills—and particularly if they are able people—are, from time to time, going to be seduced into the private sector.

Senator GIBSON—Obviously.

Major Gen. Mueller—I suppose the only way that we can, if you like, keep that brain drain to what I would call a tolerable level is simply to ensure that remaining within the Defence Force gives them the sense of purpose which doubtless they seek, and in many cases they have to trade that off against the prospects of a more attractive salary in the private sector.

Senator GIBSON—Should I imply from that comment that, in fact, the current remuneration rates will not be adjusted to try to meet the market?

Major Gen. Mueller—That question is well outside my ambit of responsibility or insight, I am afraid. That is really a matter for—

Senator GIBSON—It is a fundamental problem though, isn't it?

Major Gen. Mueller—It is a fundamental problem, and I would suggest that in areas like information technology it is a problem. I think that is well known to everybody.

Mr GRIFFIN—Perhaps we could pay them more instead of their having to get second jobs to get by.

Mrs STONE—One of the issues is the regular transfer of individuals in the defence forces, and often that transfer is to a different geographic locality. Do you have sufficient flexibility in your new agencies, to not have that transfer occur when you have developed up your specialists in logistics, or are you going to be subject to the same constraints and losses due to that transfer process?

Major Gen. Mueller—The difficulty caused to an organisation like mine due to transfers of individuals is recognised. But what I perhaps would emphasise is that I am a joint commander, I am not a single service commander, and the issue of managing personnel postings rests with the head of the personnel executive. He has a wide range of stakeholders whom obviously he has to satisfy. But, as I said earlier, I have already had discussions with the head of personnel executive to see whether we can explore options to reduce the disadvantages that my organisation suffers when people are moved perhaps with a frequency that is certainly not the optimum one from our point of view.

Mrs STONE—So you anticipate an improvement in that area to cure your particular problem?

Major Gen. Mueller—I anticipate an improvement, yes.

CHAIR—But you are not confident of it.

Major Gen. Mueller—I would have to say that it is not an easy problem to solve. That is based on advice that I have received over many years from people who are in the HRM business.

CHAIR—This committee has received evidence from Defence and others relating to the JORN inquiry, which also grew out of an audit report. It is my understanding that project engineers are hard to find and float in and out of the JORN project office. This perhaps has left Defence without the proper project management capacity they might

otherwise have had.

Here we are talking about individuals moving in and out of the whole supply chain or inventory management system, including purchasing, warehousing, transport, and all of that, where it takes time to build up expertise—and you have acknowledged that there is a shortfall in personnel with advanced IT capability. How does Defence intend to cope with these problems? We would not be happy, I think, to sit here five years from now and ask the same questions again.

Major Gen. Mueller—I go back to the point that I am not in the personnel management business. That rests with the personnel executive. Other than to re-emphasise that there is a recognition of the problem, it is really outside my ambit of responsibility.

Mr GRIFFIN—I return to a question I asked earlier and the response that you gave, General Mueller, on why something was not done about this earlier. I note that there were three separate inventory approaches being taken with the services. I can see that that has to have some major implications. I refer you to paragraph 34 of chapter 6 at page 72 of the audit report:

Defence has been aware of the poor state of its data relating to inventory for some years. For example, a 1989 report on Defence supply services by consultants Arthur Young noted that:

The pricing of inventory evaluation has been identified as a matter of major concern by the services. This impacts negatively on the reliability of the inventory investment cost. Discussions with department personnel have generally revealed that an estimate of the rate of degree of error in the service databases cannot be established.

So even 10 years ago it was a problem within the services. Although I concede that uniting the services under the one banner has to assist with that process, what, if anything, was done in each of the services over that 10-year period? It appears from the audit report that there was not an awful lot.

Mr McNamara—That report by the Arthur Young consulting firm led to a project known as the defence logistics redevelopment project. It rationalised our warehousing and sought to rationalise our holding of inventory. I would say that we did rather better on the rationalisation of warehousing than we did on the inventory holdings. The audit report refers to that. As General Mueller has said, at that time we were negotiating with each of the three services, which had not just different cultures but a different way of managing the inventory. They were pulling that together in what we called a project price clean-up. Even cleaning up the valuation of the inventory was itself a time-consuming and, I regret to say, not terribly productive task. It helped us for some other managerial purposes, but it was not as though we sat still on it and said that it was all too hard.

Mr GRIFFIN—It may not sound as though you put it aside and said that it was all too hard, but it appears to have been too hard until now.

Mr McNamara—I am really saying that simultaneously we were implementing our standard defence supply system. I guess that the two went hand in hand. We were seeking to get the information in relation to our inventory at the same time as we were seeking to rationalise the inventory. That process was an elongated one; it was arguably too elongated. We lacked the information systems that would enable us to take the strategic decision as to where we should change our inventory management practices. We are now in the process of the final implementation of the standard defence supply system that empowers us to do the things that the audit office has suggested we ought to do. However, I would be remiss if I claimed that that was going to happen tomorrow. The general has put that time frame to us.

Mr GRIFFIN—The concern I am raising is that it appears that this issue was largely identified 10 years ago. A number of things were done, but in real results not a lot was achieved. Part of that appears to be the fact that it was a complex, difficult process, no doubt with all the cultural change and other issues which the general mentioned earlier. That is what worries me about it. I wish you all the very best with what you have to do in this area, because I think you have a hell of a job.

Major Gen. Mueller—You should see it from where I sit.

Mr GRIFFIN—Having said that, I approach the question of change and results coming out of Defence with an element of extremely unhealthy cynicism at this stage. I do not wish to sound like an absolute mongrel, but I am starting to feel like it every time I see Defence witnesses in front of me. I am sorry; no offence. I should have been rude to the people who appeared before you, not to you. It just really worries me whether this can and will be achieved. As I said earlier, we have had Defence people come before us a number of times and say, ‘We recognise that there is a problem. We are looking to fix it. We agree with the recommendations. However, the dog ate my homework, the weather has not been that good at the moment and I have a sore tummy.’ It has come almost to that stage in some respects.

I really worry about the question of results in this respect. I am also worried about the question of the monitoring process which Mr Lewincamp outlined earlier as to how effective it will be. Going back 10 years—so it is not your responsibility—this sort of stuff was identified. Some changes were made, but if there had been a proper monitoring process or a process to determine whether the proper monitoring processes were in place then this would have been identified as a real problem five years ago. That worries me. I hope I am not here in five years time, but I certainly do not want to be here in five years time having the same conversation. That is more of a statement than a question.

Mrs STONE—The ANAO made some estimations of the savings that could occur if there were a more efficient integrated system. Do you agree with those savings that have been identified?

Major Gen. Mueller—No. I do not know on what those savings are based.

Mrs STONE—So you have no estimation of how your new structure might affect your bottom line? There is a suggestion here that a 75 per cent reduction in Air Force breakdown spares could be achieved with a different system, resulting in \$3 million to \$4 million a year.

Major Gen. Mueller—I have some confidence in that figure in the sense that, prior to the implementation of the defence reform program, the Air Force, of its own volition, pursued the implementation of a software package which was ideally suited to the management of its breakdown spares. My understanding of it would give me confidence that that is probably a reasonable estimate.

Mrs STONE—Seventy-five per cent.

Major Gen. Mueller—Yes. I might add that one of the issues that we are currently examining is the applicability or otherwise of translating that software package across the entire Defence Force.

Mr Lewincamp—The savings that the audit office talks about here in this particular report are going to be dwarfed by the savings required of General Mueller's program under the defence reform program. There are massive savings to come out of that whole area. The minister has committed us publicly to making those savings. We will make \$900 million per annum in ongoing savings as a result of the defence reform program, and we will do so within five years.

CHAIR—I hope you are not telling this committee that you consider this audit report or these recommendations unimportant because of the scope of change in other areas.

Mr Lewincamp—No. I did not say so. I said that the savings that they talk about will be dwarfed by the savings that we will make through the reform program. I did not say that the report was unimportant.

CHAIR—ANAO commented that performance targets have not been set for over 80 per cent of the measures analysed by ANAO. Could you tell us why so few performance targets have been set for the supply chain?

Major Gen. Mueller—When we say targets, they have to be related to performance measures. I am not aware, for example, of what performance measures were used prior to DRP within either Navy or Air Force. Within Army we used a number of performance measures that related to the distribution chain. We viewed those as being appropriate. ANAO has offered a view that there should be additional performance measures, as I recall, extrapolated from some work done by the Michigan State University.

I accept their observations, although at this stage, until we have actually modelled our own business processes, I would not necessarily agree with what they propose.

Probably one of the most important performance measures where a distribution chain is concerned is a door-to-door performance measure—in other words, the time from when the customer raises a requisition until he or she gets the item that he or she wants in the form that he or she wants and of an appropriate quality. Within the Defence distribution chain, in many cases, that is very, very difficult to measure, particularly if you are talking about an Army combat unit in the field, because we do not have an information system that runs end to end across the distribution chain. At the end of the day, from the customers' point of view, that is the most important performance measure in a distribution chain.

CHAIR—Thank you for both your response to the audit report and coming to talk to us today. We will deliberate at some date in the near future and report to parliament on our observations.

[4.10 p.m.]

HOPWOOD, Mr John, General Manager, Business Services, Australian Tourist Commission, Level 4, 80 William Street, Sydney, New South Wales

HUDSON, Ms Margaret, Manager, Corporate Strategy, Australian Tourist Commission, Level 4, 80 William Street, Sydney, New South Wales

MORSE, Mr John, Managing Director, Australian Tourist Commission, Level 4, 80 William Street, Sydney, New South Wales

BARRETT, Mr Patrick Joseph, Auditor-General, Australian National Audit Office, Centenary House, 19 National Circuit, Barton, Australian Capital Territory

GREENSLADE, Mr Alan Jeffrey, Executive Director, Australian National Audit Office, Centenary House, 19 National Circuit, Barton, Australian Capital Territory

McPHEE, Mr Ian, National Business Director, Performance Audit, Australian National Audit Office, Centenary House, 19 National Circuit, Barton, Australian Capital Territory

MORTON, Ms Susan, Senior Director, Performance Audit Business Unit, Australian National Audit Office, Centenary House, 19 National Circuit, Barton, Australian Capital Territory

CHAIR—We now come to the second and final session of today's public hearing. I must ask participants to strictly observe a number of procedural rules. Firstly, only members of the committee can put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I ask them to direct their comments to me and the committee will decide if it wishes to pursue the matter. It will not be possible for participants to directly respond to each other. Secondly, to assist *Hansard*, witnesses should identify themselves whenever they wish to make a comment. Thirdly, given the length of the program, statements and comments by witnesses should please be kept as brief and succinct as possible.

I also remind you that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will be recorded by *Hansard* and will attract parliamentary privilege.

From the committee's perspective, the main purpose of this session is to examine the key issues identified in Audit Report No. 10, *Aspects of corporate governance—the*

Australian Tourist Commission and whether any action has been taken or is planned to address the issues raised. The issues the committee will pursue include the extent to which the ATC's strategies and performance information address its statutory objectives, performance information on the effectiveness of ATC programs, reporting on performance and the role of the ATC board.

With that background, I welcome representatives from the Australian National Audit Office and representatives from the Australian Tourist Commission to the second session of today's hearing. I would like to provide an opportunity for a brief opening address from the Australian Tourist Commission and the ANAO. Does Mr Morse wish to make a brief opening statement to the committee?

Mr Morse—Yes, Chairman.

CHAIR—Please proceed.

Mr Morse—Thank you for the opportunity to appear today. Firstly, could I pass on a sincere apology from my chairman and my deputy chairman, who could not attend this hearing because of prior commitments, but I am here as the managing director and also as a board member of the Australian Tourist Commission.

I have a couple of brief comments that I would like to make. Firstly, we believe that this audit has in fact been of great benefit to the Australian Tourist Commission, particularly because of the introduction of the CAC Act. We have learnt a lot through it and we have gained great benefit. I would like to make the comment specifically that the board of the ATC, senior management and, indeed, our audit subcommittee were closely involved with all aspects of the audit. The next point is that we agreed with all of the recommendations of the ANAO and that we have already taken action to implement a number of the recommendations. The remaining recommendations will have been implemented by June 1998, and at that time we will prepare a full report to the board on the enactment of all the recommendations within the report.

I would like to make a couple of comments on individual aspects of the report itself. One of the issues raised was the relationship between our statutory and corporate objectives and the follow-through of those objectives into our corporate plan and into our operations plan. At our December board meeting—and I will table this for the committee's reference if you so desire—we introduced a paper which was approved by our board which demonstrates quite clearly the relationship between the corporate objectives, our strategic plan and the objectives as defined in the act. So we have already taken action to do that.

The other issue that is important is that of key performance indicators and the relationship of those indicators to our corporate objectives and to our corporate plan. We have again taken action on that already. Again, I will table for the committee's

information a series of key performance indicators which have been developed and approved by our board and, in fact, will be presented at each board meeting over the year—we have six more meetings.

There were also a number of issues raised in the audit which have already been addressed regarding board processes. These include the reformatting of the delegations of the commission—and that has been completed; the introduction of a new focus on legal compliance, including such areas as risk management—we have a major risk management review in train at the moment; and other areas such as industrial relations. Minute taking for our board meetings has been upgraded and made more extensive and more complete, as has reporting of external correspondence—as was recommended in the audit report. This also applies to the reporting of board members' activities in support of the commission's objectives outside the formal aspects of the board meeting.

The other issue which has also been addressed, and was a recommendation from the audit office, is the confidentiality and the acknowledgment of observers attending board meetings. That is now officially documented at each board meeting, as is more detailed information such as the opening and closing times of board meetings.

I would like to make a brief comment on the third objective of the commission, that is, in relationship to the environment. The act states that the ATC requires us to ensure—and I underline the word 'ensure'—that Australia is protected from adverse social and environmental impacts in international tourism. The reality is that we do not have the regulatory power to ensure that. What we do have is a recognition of the importance of the environment to Australia generally and to our tourism industry. The Australian environment is one of our greatest assets, if not the greatest asset, and it is one of the key reasons people choose to come to Australia.

We have undertaken a number of initiatives which will contribute to the achievement of this objective, including a research study we have just done into social attitudes on the environmental impacts of tourism; development of environmental messages, which appear in all our publications and on airlines flying to Australia, in conjunction with the Office of National Tourism; partnership with other organisations in undertaking environmental best practice issues; production of an annual portfolio of ecotourism; and development of an environmental strategy. I wanted to make this point quite specifically because, as I said, one of our concerns is that under the act we cannot adequately fulfil that objective because we have no legislative power to do so.

I am confident that this organisation has benefited from this audit. We are a good corporate citizen. We are a well-run organisation. We are held in very high regard by our peers around the world, by foreign governments, by the industry and, I think, by the Australian government as well. I sincerely believe that the Australian Tourist Commission is making a major contribution to the development of this economy through foreign exchange earnings and employment. Thank you.

CHAIR—Does the Auditor-General wish to make a formal statement in response?

Mr Barrett—My colleague would like to make a comment, Mr Chairman. Can I just say, from the audit office's point of view, that we welcome the selection of this particular audit for inquiry because of the focus that it does give to corporate governance at a time when the Public Service is moving more to a private sector orientation. Also, as Mr Morse said, with the introduction of the replacement of the Audit Act on 1 January and the expectations that that legislation has of the Public Service and the way it governs itself, I think it is very timely that we focus, and that this committee focuses, on what are the essential elements of corporate governance and how well organisations in the public sector are conducting their corporate governance. I would now invite my colleague to make a comment.

Mr McPhee—Thank you. John Morse has done a pretty good job of summarising not only what the commission has done but what the audit findings were as well, so I can be very brief. I will just explain why we chose the audit in the first place and what the recommendations were directed to.

The reason we chose the ATC for an audit was that it is a key national body which plays an important role in the overseas promotion and marketing of Australia as a tourist destination. The ATC has operated for 10 years under its current legislation. Although there have been some reviews of its impact as a marketing body and there has also been a consultant's review of its administrative efficiency and effectiveness, conducted by Bain International, there have been no Commonwealth reviews or evaluations of the performance of the commission against its statutory objectives.

Given the focus on corporate governance these days, we thought we could usefully undertake a review of the corporate governance of the commission. We made 10 recommendations in the report, aimed at enhancing the corporate governance through an effective corporate governance framework. We were very pleased with the cooperation and response of the commission to our recommendations. As we have heard from Mr Morse, action is very much in hand to address these matters. I would like to mention that Alan Greenslade and Sue Morton were the senior audit staff involved in the audit and they would be happy to answer any questions.

CHAIR—Mr McPhee, have you examined the documents that Mr Morse has talked about that the board has approved?

Mr McPhee—No, we have not seen them; they are obviously quite recent and in response to some of the issues raised in the audit report.

CHAIR—May I say on behalf of the committee that we would like to receive the documents as formal evidence.

Mr McPhee—Yes.

CHAIR—The first object of your statutory objective is to increase the number of visitors to Australia from overseas. I think ANAO is asking: with the dollars which you receive from the federal government and then spend on behalf of the Australian people to advertise Australia in a generic sense, have you now set in place some performance measures to measure outcomes from each of the kinds of programs that you put in place by location, regardless of extraneous factors such as airline promotions, hotel promotions, the weather and—

Mr Morse—Economic crises in Asia.

CHAIR—We will talk about that in a minute.

Mr Morse—Yes, we have, and for many years we have had performance measures in place to measure each of our activities. I will just refer to one that you referred to, Chairman, and that is advertising. We undertake tracking research where we conduct consumer advertising on television. That research is designed to measure the effectiveness of our advertising, the effectiveness of our campaigns, whether or not people intend to travel to Australia, what they think about Australia and, if they are not going to come here, why they are not going to come here.

On specific advertising programs that we run with the travel industry internationally, we do quite strict evaluation of the number of people who book because of those promotions. So, at all times, we are measuring the performance of our individual marketing activities. I think one of the issues that came out within the audit and something that we have agreed with and we have addressed is the relationship between our statutory objectives, our corporate objectives, our strategic planning objectives, our operational objectives and how they all link and relate to our key performance indicators. That is something that we have taken on board and will be doing. Does that answer your question?

CHAIR—I think so.

Senator GIBSON—Figure 2 on page 7 of the ANAO report shows your marketing expenditure and international visitor arrivals. How come from 1995 to 1996 the expenditure was severely pruned from 90 back to 72 or so and yet the numbers went up significantly; what is going on?

Mr Morse—I would have to say—and this relates to our first objective to increase arrival numbers—that our own marketing activity is not the only influence on arrival traffic to Australia. We have always acknowledged that. Exchange rate variations play a major part in that, both from a good side and from a negative side. So I would say that, in those two years, the numbers would have gone up because of exchange rates. The other

factor is that marketing activities such as advertising often have quite a long timelag. If you are advertising generically on television, it may be two or three years, or even four years, before that actually impacts on arrival figures.

Senator GIBSON—Why did you cut back substantially from 1995 to 1996?

Mr Morse—That would have been because of government appropriations, and government appropriations have a direct correlation with industry contributions and industry investment in our activities as well. If government funding increases, so too does our potential to increase industry funding, and the opposite is also true.

Mrs STONE—The ANAO report highlighted the fact that objective C of the statutory objectives is to ensure that Australia is protected from adverse environmental and social impacts of international tourism. That is obviously a key statutory objective for Australia. We have all seen other nations which have had their national parks or fragile places destroyed because of an oversupply of visitors, either domestic or international.

You made the point that you do not have regulatory power to ensure anything, so how are you tackling that issue? Are you looking to recommend that that particular statutory objective is rewritten so that it becomes something that you can actually deliver? Where do you see that 'ensuring' being more effectively placed? Is it with departments of natural resources or our federal Department of the Environment? Can you comment on how you are tackling that?

Mr Morse—Yes, certainly. The issue of whether or not that clause in the act should be rewritten to reflect our ability would be more a matter for our board to discuss with our minister, and that has not happened as yet. At the moment the way we interpret it is that we have a strong advisory role and we have a strong role in monitoring any adverse effects of international tourism. I will just give you an example to put it into perspective. Under the second objective, to maximise benefits to the Australian community, that is in fact to do with what we call dispersal of visitors. That objective means encouraging people to travel beyond the gateways, to disperse widely throughout regional Australia, which brings benefit and also minimises any impact on particular pressure point areas. There are a couple of pressure point areas within Australia: Uluru would be one and certainly another one would be in the Blue Mountains at Echo Point.

Mrs STONE—The Great Barrier Reef?

Mr Morse—I do not feel expert enough to comment on the Great Barrier Reef, but my own intuition says no. If you look at this from a national perspective, we are receiving four million international visitors a year. When we look at countries like, for example, Spain, France or Turkey, they are receiving over 50 million international visitors. Relative to global terms, the impact on Australia is much less than many of the major tourist destinations.

I really do see our role as one of monitoring, one of consultation with other government departments and one of being aware, and in our promotion we continually focus on the fact that the greatest asset this country has is its own natural environment. Indeed, one of the exhibits I have is a series of advertisements that is being placed in all our publications on airlines coming to Australia, which has been developed with the Office of International Tourism, which encourages people to look after the environment while they are here on holidays. The headline is 'Worth looking at, worth looking after'. So we are driving that environmental message through our own marketing activities.

Mrs STONE—You referred to research that you are doing in this environmental area. Can you tell us what that research is?

Mr Morse—The research was into community attitudes to tourism in this country, and in fact the first stage has been completed. One of our objectives is to monitor the social impacts of tourism. We have a responsibility, I believe, to be aware of what the Australian public and the Australian community are thinking of the tourism industry. There is no point in us going out and doing the job we are doing if the people of this country are really not interested.

The results from the first part of the study are available. Eight group studies were done right throughout Australia in both tourism, that is, the Gold Coast, and non-tourism, that is, the Orange area. Overall, I have to say that the community at a macro level have a very good understanding and a very great appreciation of the tourism industry. They understand that it creates employment, it brings foreign exchange earnings into the country and it is good for the way Australia is imaged around the world. In fact, there is an enormous amount of pride within the Australian community in showing off their country to visitors from other countries.

When you get down to a more personal individual level, there is not a great understanding in the community of how tourism benefits them on an individual basis. There are also concerns at an individual level that tourists may come in and overcrowd or change the social fabric of their particular area. But this is the first stage of a study which we will continue over the next 12 months or so. We have a responsibility to do that and then report back, firstly, to the government, and of course back to the industry and to the community generally.

CHAIR—Mr Morse, I want to take you back to something you said in an initial response to Mrs Stone and, if you do not mind, correct you. You said it was up to your board to decide whether or not to recommend to the minister that your statutory responsibility be changed. With respect, this committee also has a statutory responsibility, and it is entirely within this committee's ability—and within our competence and our authority—in producing this report to make such a recommendation. If your board believes, legitimately or otherwise, that the statutory requirement cannot be met, may I suggest to you the committee would love to receive those comments, and we will consider

those in terms of producing our report on this hearing.

Mr Morse—Thank you, Chairman. I apologise if I gave you the wrong impression with that. My comment and statement were more in relation to me feeling that I do not have the responsibility or the authority here to make a comment on changing an act of parliament without consultation with my board. That was the only reference.

CHAIR—I understand that. I simply wanted to tell you that there is a path other than your board going to direct to the minister and that is through the authority and competence of this committee, which does represent the parliament at these hearings.

Mr Morse—I understand that.

CHAIR—I have a question for the auditors. In paragraph 1.9 you quote the Bain review as describing the ATC as a model for other national tourist offices. You also note that both local and international industry believe the ATC is doing an excellent job. I would like to know if your findings supported that view.

Mr Greenslade—I think in that part of the report we are acknowledging the reviews that have been undertaken about their effect on this and so on. It was not the purpose of this audit to look at their effectiveness but rather how they have been addressing their statutory objectives and reporting against them. We were reflecting the general high regard that the ATC is held in internationally and we were reporting here on the others' comments, basically in this audit focusing on the statutory objectives.

CHAIR—So your audit found nothing adverse from the Bain review?

Mr Greenslade—No, nothing that contradicted that.

CHAIR—So, in your view, the major shortcomings of the ATC relate to its objectives and performance in respect of its statutory responsibilities lining up with its corporate governance responsibilities?

Mr Greenslade—Yes.

CHAIR—With regard to the ATC, the graph on page 7 of the report shows that since 1993 visitor numbers have risen despite the cut in ATC's marketing expenditure. Would you like to comment on that?

Mr Morse—I thought I had already made a comment on that when I said that there are other influences at work which do impact on arrivals. But I also say that, with the reduction in funds, as an organisation we have become smarter in the way we operate. We have pursued a very aggressive strategy in the last couple of years of developing corporate alliances with commercial companies who can assist us in promoting Australia. I

will give you one example: the global sponsors of the Olympics—companies such as Visa. Their contributions do not actually come through the books but they are spending a lot of money helping us to promote Australia. So we have to get smarter in the way we operate internationally, which is not always evident in our financial accounting.

CHAIR—Some newspaper reports have recently predicted a downturn in inbound tourism from South-East and north Asia over the next whatever time period. Are you already receiving information regarding that, factoring that into your overall promotional program and setting performance targets which are realistic in light of those expectations?

Mr Morse—Yes, and I would like to make a number of brief comments on that. Obviously the downturn or the crises in the Asian economies have been of great concern to us and to the tourism industry generally. Three weeks ago I did a trip right through South-East Asia where I investigated the crisis first-hand. I came back from that trip somewhat concerned about our performance next year in relation to tourism from South-East Asia—Indonesia, Malaysia and Thailand in particular. However, those three countries constitute less than 10 per cent of our international arrivals. Of far greater concern to me are the Japanese and Korean economies, which contribute around 25 per cent of our total business.

We have put a number of things in place. Firstly, we have said to the Asian travel interest that the Australian Tourist Commission is maintaining its commitment to Asia. For us or for any other Australian organisation, whether it be government or industry, to suddenly walk away from Asia at this time would be foolhardy. We will maintain our commitment to those countries.

The Tourism Forecasting Council, which is the body responsible for doing tourism forecasts, last week released a set of three different scenarios of what might happen over the coming five years to inbound tourism from Asia. It is too early yet to say definitively what will happen. We are looking at a whole number of different strategies within South-East Asia to help revitalise the business because there are some good signs as well as some negative signs, particularly the relative weakness of the Australian dollar vis-a-vis the US dollar and the UK pound. So we may, in fact, pick up some market share.

It is a very complex situation. Overall, I still see good prospects for growth in international tourism to Australia from Asia, but at a much lower rate than we have experienced in the past.

Mrs STONE—Mr Morse, you began by telling us that you substantially improved your performance monitoring, your board's reporting and the documentation of your board's activities. Do you agree with the major finding of the ANAO that you are having great difficulty in identifying your performance achievements? Certainly, when you look at your annual report, there is not much citing of information or documentation of actual visitor numbers. What you often do is document your outcomes vis-a-vis certain activities.

For example, if you have real estate agents coming to the country you talk about how many have arrived but there is very little translation of that into actual visitor numbers. How are you going to substantially change your reporting in the future so that you can actually report against your first statutory objective, which is to increase the numbers of visitors to Australia from overseas? You have mentioned the way you are monitoring the effectiveness of some advertising but is that going to substantially help you achieve that first outcome?

Mr Morse—I would like to make a couple of comments on that. As I indicated in my opening statement we did, at our last board meeting three weeks ago, present a paper to the board which was approved. It looked specifically at the key performance indicators, how they relate to the corporate objectives and how they relate to the statutory objectives. I will just give you a couple of examples.

The objective to increase the number of visitors to Australia can be measured, firstly, in pure number terms and percentage increases on the previous year. Secondly, and more importantly, would be by market share; in other words, how much we are picking up from other countries rather than the pure numbers. We are putting in place a system of key performance indicators based on market share increases rather than just increases in pure arrivals, again because of the fact that there are many other impacts which figure in our arrivals numbers either growing or declining.

The second statutory objective is to maximise the benefits to Australia of overseas visitors. We have acknowledged that that is an objective which has not been adequately defined in relation to our own corporate plan in the past. We have put a number of key performance indicators in place, including changes in export earnings—that is, how much people are spending in this country; changes in the proportion of the export earnings to Australia's total export earnings—in other words, market share in export earnings; changes in the number of jobs in tourism, which is a very difficult measure to quantify because tourism in this country is both domestic and international, so how do you separate both; visitor expenditure in Australia and how it is changing—by country, by market and so on; and the change in dispersal of visitors within Australia and how widely we can spread visitors throughout Australia or influence them, because that benefits rural and regional Australia as well as a capital city, and the seasonal dispersal, because if we can influence people to come at different times of the year to even out the peaks and the troughs that is good for our travel industry, good for the airlines, good for the Australian community and of overall benefit to the Australian community.

All of those KPIs are being put in place now. They, I think, adequately reflect the statutory objective and relate through to the corporate objective. Then, of course, there is the environmental objective. The key performance indicators for those are the level of awareness of overseas visitors of the Australian environment, the acceptance of the community in Australia of tourism as an industry, changes again in dispersal and changes in Australians' attitudes towards the tourism industry as a viable and economically

beneficial industry for this country. We do have others there and that report that I have just talked about is one of the reports that we have to table.

Mrs STONE—Are you also monitoring the overseas fee-paying student numbers and associating those with your tourism projections?

Mr Morse—No, we are not.

Mrs STONE—Because that is a key indicator of visitor numbers for every overseas student who comes to Australia. They tend to have about three visits from family and so on over the two to three-year period that they are here.

Mr Morse—If I can make a comment, the area of student education is probably one that sits in a promotional sense between ourselves and Austrade. As we move forward we are developing a much closer relationship with Austrade, so in some cases we undertake joint promotional work with Austrade for educational tourism, with the exception of Japan, where we have a large number of school excursion visits as opposed to long-term or short-term students. We have not done any real monitoring of that area, but it is something that we are certainly happy to look at.

Mrs STONE—It is a multimillion dollar business.

Mr Morse—Absolutely, yes.

Mrs STONE—It has also suffered most with our so-called heightened racism charges and allegations reported in the international media unfortunately.

Mr Morse—Yes. It is the only segment of the market where you can demonstrably say that there has been a negative impact on a particular segment. We have not got any proof that says that the so-called race issue is negatively impacting on tourism arrivals. It certainly has a negative impact on the image of this country—there is no question about that—but whether it is impacting on tourist arrivals, we cannot say.

CHAIR—When you were answering Mrs Stone's question you were talking about the various performance indicators that you set up. Do you intend to report outcomes by jurisdiction and by promotion against those objectives?

Mr Morse—If you are asking whether a specific advertising campaign actually results in increased numbers or dispersion, the answer to the question is yes. I am not quite sure what you mean, Chairman, by jurisdiction.

CHAIR—Location.

Mr Morse—By region?

CHAIR—What are you talking about: North America or South America or South-East Asia?

Mr Morse—Often when people talk about region they refer to regional Australia. Yes, absolutely. But we do evaluation by market and by activity.

CHAIR—But do will you actually report against those statutory objectives? That was the question.

Mr Morse—Yes, absolutely.

Mrs STONE—We look forward to your new paper. I think that will be a great help to us.

CHAIR—Yes, we do look forward to that. I think you said something about meeting your objectives by June, is that correct?

Mr Morse—Absolutely.

CHAIR—You wouldn't mind then that this committee decided to revisit this issue in June?

Mr Morse—We will be preparing a report in June 1998 indicating how far we have gone, but I would say that all the recommendations will have been implemented by that date.

CHAIR—We might decide to ask you to come back and talk to us again.

Mr Morse—I would love to.

Mrs STONE—You did say there were some recommendations still be implemented. Are they substantial?

Mr Morse—They really relate to the planning process and therefore are influenced by that process. What I mean by that is that annual report is due to be handed down to parliament on 17 September or whatever, so a lot of the recommendations will be incorporated into that planning process, which by its very nature does not happen for some months yet. So that is the only reason for the delay.

Mrs STONE—Okay.

CHAIR—Is it the wish of the committee that the submission from the Australian Tourism Commission be accepted as evidence and printed? There being no objection, it is so ordered.

Resolved (on motion by Mrs Stone):

That this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

Thank you participants, thank you auditors, thank you observers, thank you staff, thank you *Hansard*. Thank you, my one remaining colleague.

Committee adjourned at 4.44 p.m.