



COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE

of

PUBLIC ACCOUNTS AND AUDIT

Reference: Asset management by Commonwealth agencies

CANBERRA

Monday, 20 April 1998

OFFICIAL HANSARD REPORT

CANBERRA

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

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Mr Georgiou
Mr Griffin
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Mrs Stone

The terms of reference for this inquiry are:

Asset management by Commonwealth agencies.

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DARCY, Mr Mike, Manager, Accounting and Reporting, Accrual Budgeting Project, Department of Finance and Administration, Newlands Street, Parkes, Australian Capital Territory	63
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PEIRCE, Mr David Michael, Acting Assistant Secretary, Financial Management Branch, Department of Foreign Affairs and Trade, R.G. Casey Building, John McEwen Crescent, Barton, Australian Capital Territory 0221	56
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Monday, 20 April 1998

Present

Mr Charles (Chair)

Mr Beddall

Mr Griffin

Committee met at 9.18 a.m.

Mr Charles took the chair.

CHAIR—I declare open this public hearing of the Joint Committee of Public Accounts and Audit inquiry into asset management by Commonwealth agencies. The Joint Committee of Public Accounts and Audit will now take evidence as provided for by the Public Accounts and Audit Committee Act 1951.

In 1996, the Australian National Audit Office examined how Commonwealth agencies manage their assets. The audit found that scope existed for significant improvement in asset management practices. In 1997, a follow-up survey of selected agencies showed that not all aspects of asset management recommended by the 1996 audit had been addressed. The JCPAA will inquire into the effectiveness and efficiency with which Commonwealth agencies manage their non-financial assets.

The inquiry will examine three key areas: first, the impact of the government's proposed accrual based management framework on Commonwealth asset management policies and practices. This will also include an examination of what is needed to facilitate change to the new accrual accounting framework to be put in place from the financial year 1999-2000. Second, the effectiveness with which the individual agencies currently manage the assets for which they are responsible and their capacity to meet the demands of accrual accounting. And, third, the potential for the introduction of greater efficiencies in the new environment in the way that Commonwealth agencies manage assets.

As of 30 June 1997, the gross value of the Commonwealth non-financial assets—primarily land, buildings, infrastructure, plant and equipment—was approximately \$114 billion. The JCPAA is concerned that, despite the substantial sums of public monies invested in Commonwealth assets, chief executive officers do not appear to have direct involvement in the management of assets under their control.

Today, the committee will take evidence from the Auditor-General, the Australian Society of Certified Practising Accountants, Coopers and Lybrand, Domain Consulting, the Department of Defence, Centrelink, the Department of Foreign Affairs and Trade and the Department of Finance and Administration.

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 contempt of parliament. The evidence given today will be recorded by *Hansard* and will attract parliamentary privilege.

Before swearing in the witnesses, I refer members of the media who may be 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 statement are available from secretariat staff present at the meeting. I now welcome the Acting Auditor-General and representatives of the Australian National Audit Office to today's hearing.

[9.19 a.m.]

GREAVES, Mr Andrew Mark, Acting Executive Director, Business Assurance Services Group, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

HAY, Mr Edward, Group Director, Business Assurance Services Group, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

NELSON, Mr William George, Acting Auditor-General, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

CHAIR—Because we have not received a submission from you, would you like to make an opening statement about the issues that we discussed earlier off the record?

Mr Nelson—As you are aware, I am currently Acting Auditor-General as the Auditor-General is overseas. Indeed, he does send his apologies to you today. We have prepared for *Hansard* a broad summary of the two Auditor-General's reports arising out of our program of financial control and administration audits. Both these reports were entitled *Asset management*. One was tabled in parliament in June 1996 and the one was tabled out of session to the President of the Senate last Friday, 17 April. I will hand that report over at the end of my brief statement.

The significant issues referred to in these reports are the recent government asset management initiatives and the need to improve the strategic management of the Commonwealth's assets. Better asset management performance will no doubt result from the many government initiatives implemented, or proposed to be implemented in the near future, as part of the public sector reform that has been taking place in recent years. It is disappointing, however, that none of these reforms has been aimed specifically at improving strategic asset management, despite the huge investment of over \$72 billion in gross value in Commonwealth physical and intangible assets at organisations in the general government sector. The ANAO hopes that the issue of specific policy and guidance might be an outcome of your inquiry. A number of state governments has taken this course.

We also note with interest that the proposed accrual framework being developed by the Department of Finance and Administration includes a proposal for a capital use charge upon net assets. The purpose of such a charge would be to ensure organisations price their outputs in full regard to the cost of holding assets. Accordingly, it should provide a direct incentive for organisations to manage their assets more effectively and efficiently. The ANAO fully supports the notion of a capital use charge. A similar charge has been operated by the Victorian government since 1994. It was established to raise the awareness of organisations of the assets that they control and the costs associated with the retention of those assets.

Victoria has also been operating a managed insurance fund since 1995 to, among other things, improve asset management. The Commonwealth, I believe, is introducing a similar fund from July 1998. We would be happy to answer any of your questions. In particular, Mr Hay and Mr Greaves have been closely involved in both of these audits. Thank you.

CHAIR—Did you want to make a statement, Mr Hay?

Mr Hay—Not at this stage, no.

CHAIR—Is it your view that the Commonwealth, in terms of asset valuation and asset management, is ahead or behind its state colleagues in terms of modern thinking?

Mr Nelson—First, in regard to asset valuation, I understand that the deprival method of valuing assets is soon to be implemented in the Commonwealth. I will look to my colleagues, but I think that similar methodology has already been implemented in state jurisdictions, particularly in Victoria and possibly in New South Wales. In that sense, the Commonwealth is moving in the right direction in establishing an overall methodology for valuation of Commonwealth assets. In terms of management, it would seem that the Victorian jurisdiction would be considered to be ahead of the Commonwealth at this stage.

Mr Hay—What we have seen is that the state governments have spent a good deal of time and resources over the recent past in putting together manuals and documentation dealing with what we call strategic asset management issues. One of the issues that has specifically come out of both of our reports is that the Commonwealth, while moving to deal with some of the incentives within an asset management framework, does not have an integrated strategic asset management plan at this stage.

CHAIR—Is that Victorian procedure that you talked about centrally based, and is it simply guidelines or is it in fact active management—in other words, is it controlled?

Mr Hay—It is guidelines, policy and practices at the highest level. It sets the framework and the parameters in which you would then manage assets within an organisation. It is not prescriptive; it talks about asset principles and practices.

CHAIR—Do those principles vary between various Victorian state government departments?

Mr Hay—Again, I am not sure I can comment on that. We have not been into Victorian agencies.

CHAIR—In *Audit report No. 27* you said that approximately 30 per cent of the agencies did not appear to actively respond. Would you like to tell us about that?

Mr Hay—You mentioned *Audit report No. 27*?

CHAIR—Yes, *Audit report No. 27* ‘. . . had an impact on approximately 30 per cent of the agencies . . .’.

Mr Hay—I believe that comment comes from the survey that we undertook at the end of last year in terms of progress that agencies had made in responding to *Audit report No. 27*. We found that a large number of agencies had looked at their asset management during the previous two years and that a number of them had used our report as an impetus for that but that a number of agencies had other reasons to look at their asset management practices. So it was really trying to bring together the reasons why agencies had looked at their asset management. Our report had had some impact on some, but others were already looking at their asset management practices.

Mr GRIFFIN—Percentage wise, do you have a ballpark figure of how many were actually looking at the question of their assets?

Mr Greaves—Almost all agencies indicated to us that they had reviewed asset management over the time since the asset management report was issued. The point of the 30 per cent figure was that seven of the agencies indicated that the audit report that we produced was a driver in reviewing asset management. Of those seven agencies, six indicated that it was also a part of the normal management cycle to review assets. The balance of agencies, of the 25 that we surveyed, indicated that they had reviewed asset management over that two years, not necessarily because of the audit report, but for other reasons.

Mr GRIFFIN—Had the other agencies utilised the audit report?

Mr Greaves—Yes, all the agencies that we surveyed indicated that they had taken notice of the report and the recommendations and had accepted the recommendations. We also surveyed the agencies against the principles in the *Asset Management Handbook* and most responded that they had looked at those principles and had tried to implement them.

Mr GRIFFIN—One of the things that interests me sometimes is the question of when the Auditor-General’s office does broad ranging reports that go across agencies, so that, rather than saying, ‘You’ve got a problem here, in these general sorts of issues,’ it is a matter of just how well agencies pick up those recommendations. Have you got any comment to make on that?

Mr Nelson—Again, through the procedures put in place by the Department of Finance and Administration for follow-up, we then note what is happening there. You will be aware, with our performance audit program, that we do a series of follow-up audits. Indeed, our second report on asset management was a follow-up in that sense. As you will appreciate, we do not have any authority to impose our recommendations on any of the

agencies. So, in that sense, we look to committees such as yours to add a great deal of support to the recommendations that we might be putting out. Nonetheless, in this case, as Mr Greaves has indicated, I think there has been a reasonable number of agencies taking note of what we had said in that report.

Mr Greaves—Yes, I would support that. As we noted in our latest audit report, there was general acceptance of the findings of the earlier audit report. I suppose what we are concerned about is the progress in implementing those recommendations.

Mr GRIFFIN—Yes, it is one thing to accept a recommendation, it is another to implement them.

Mr Nelson—I think the important issue for us is that the principle of asset management has to be recognised and must make good business sense to all people in agencies for it to be implemented well and properly. While we recognise some of the initiatives of the government reform agenda—we mentioned the capital user charge and insurance—and they will no doubt be mechanisms that will help push it along, at the end of the day, you really need program managers fully understanding and recognising the benefits of asset management and they need to be doing it because it makes good business sense. That is where, in terms of the higher level policy direction and guidelines, we think it would be particularly beneficial.

Mr GRIFFIN—At what stage in that process do you think we are now? Given the culture of the Australian Public Service, do you think that we are halfway down the track or most of the way, on the question of line managers understanding these sorts of issues?

Mr Nelson—I think we have made significant improvements. I have been in the APS for 15-odd years. If you compare the position today with where we were a number of years ago, I think we have made significant progress. In particular, the move to accrual reporting has been a significant drive in focusing people's attention on the need to have a proper framework for reporting information in the annual reports of all agencies. We find now when we go to some agencies that program managers are certainly well versed in aspects of, for example, their accountability under accrual reporting. So I think we have made significant improvement and we will continue to do so.

Some of the external sanctions, if you could call them that, that could be imposed—for example, the capital user charge—will add a bit of bite to get managers more alert to proper asset management. But I think we have made significant progress and are continuing down that track. That is certainly what our indicators are telling us.

Mr Hay—I think the issue that we are really talking about in these two reports is to try to take the next leap. It is fine to have reasonably effective accounting systems that record the valuation of assets, record the assets that you have and physically control them, but the real value will come when agencies, program managers and CEOs are asking

themselves these questions: why do we have these assets? What are these assets contributing to our program outcomes? Are they contributing? If not, why do we have them? In a sense, we are talking about that cultural change that is required to make the next leap.

CHAIR—Considering that Commonwealth agencies have traditionally only considered the number of bickies in each jam tin and now are required to look at their physical assets, and intellectual property as well, do you think that they have a good basis for valuing assets?

Mr Nelson—Certainly, in terms of a good basis for valuing assets, as I indicated earlier, the introduction of the deprival valuation methodology will certainly put a consistency across all Commonwealth agencies in terms of valuing assets. Already, in the balance sheets of all Commonwealth agencies under accrual reporting, we do have assets, we do have them appropriately and fairly disclosed and, therefore, valued. Under our financial statement audit program each year, we are required, as part of our opining on the fairness of those financial statements, to determine the valuation and whether the valuations of assets are fair. It is my understanding—and I would need to be corrected here—that there has not been any particular audit qualification relative to the valuation of assets.

CHAIR—Can you tell me why, in 1996-97, the Commonwealth disposed, at written down values, of some \$93 million worth of assets and received \$52 million? That implies to me that we do not have it very close to right.

Mr Greaves—I suppose I would draw the distinction between fairly valued for financial reporting purposes, within that financial reporting framework that has been set up through accounting standards, which provide for valuations at historic cost, or at any one of the deprival valuation methodologies and, perhaps, valuation for effective asset management. That particular issue was raised in the 25 agencies that we surveyed. We noted—you are correct there—that the actual proceeds on disposal were significantly below the written down value of the assets. That indicates to us that, while the gross book valuations may be correct, agencies are not necessarily closely monitoring the useful life of the asset and the value of the asset over time.

I suppose our concern—to bring it back to the strategic issue again—is that in both reports we have said that agencies really need to raise these issues to a strategic level and incorporate their asset management thinking into their strategic planning processes, so that they understand the impact of future decisions on their asset values and, therefore, at the beginning of the asset life cycle, set a residual value and a useful life which accords with where they are going to be taking their organisation in the next 10 years, or whatever. It seems to me that, in a number of the agencies we looked at, when they went to dispose of their assets, the assumptions that they had made when they bought the asset had changed, and they had not necessarily updated those assumptions, in a number of cases.

CHAIR—How do we get to both the carrot and the stick? If the three of us were a

board of directors of a private sector company—

Mr GRIFFIN—You would be in big trouble!

CHAIR—Not necessarily. If we reported to the shareholders that we had sold \$93 million worth of assets for \$52 million, I would have thought that some, if not all, of our heads would have rolled. Is that not true?

Mr Greaves—It is true. With regard to most of the general government agencies, the assets that they hold are not wealth creating assets or revenue generating assets, and they are certainly not held as investments. With regard to the performance of the assets on disposal, you are really talking about the residual values of assets that have been used for their useful life, they are no longer required by the entity and they are selling them.

Certainly, both times we have looked at asset management, we have looked at the disposal process. We believe agencies need to pay a lot more attention to how they go about planning for disposal. We have found that it is generally an ad hoc approach to planning for disposal and that planning normally commences very close to the time that disposal is required. Once again the need for a strategic approach to asset management suggests that you should really be planning for the disposal of your asset when you are planning to buy the asset.

We are suggesting that agencies should be adopting whole of life cycle costing methodologies when they go to acquire assets and that they should use the information that they put together in that planning process as a benchmark then to test performance of the asset, including its disposal value at the time that they sell it, and then feed that information back into the planning loop. We noted one agency that actually did a review of their asset disposal performance. They noted that, while they had the assets depreciating over 10 years, they consistently sold them after about six years. Just through a simple review like that they were able to then change the rate at which they had depreciated assets and therefore much more closely aligned the disposal value with the actual proceeds.

The other issue there is not necessarily that the disposal proceeds were a long way away from the residual value in the books; the other issue there is that the depreciation charges over time have been wrong. So anyone making a decision about the cost of services has actually been using information that was wrong. It may not have been materially incorrect—it depends on what the assets contribute to the program—but the bottom line is that, if the depreciation charge is wrong, then they will be making decisions based on that information.

Mr Hay—Just to round up that question if I may, the initiatives that are currently being taken in terms of accrual budgeting, the accrual accounting, financial statements, the capital charge and the like will all encourage agencies to do better at a mechanistic level,

at the process level. We are really saying that that is fine as far as it goes, but let us try to set our sights on the managers of the programs and get them to understand the implications of better managing their assets.

Mr BEDDALL—I will give you an example. What about better utilisation of a current asset rather than what tends to happen in the IT field, which is update for the sake of update? For example, electorate offices are now getting an updated computer package. Nobody bloody needs it. What is currently there is more than adequate for the job that is to be done. Private enterprise would not go through this thing on such a regular basis, spending huge amounts of money, just for the sake of having state-of-the-art equipment. What about that sort of management of those assets—not that there is disposal, but the waste of resources in purchasing bells and whistles? How much of that culture is just a fact that these people seem to think that all you need to have is the latest and best at all stages?

People who use the system are never consulted. Both of my staff are long time electorate staff. I have lost one for a bloody week and then another for three weeks because they have got to go to training. They do not want the new system, but there are no options. How much in asset management is the fact that purchasing the asset is often a waste of money taken into account?

Mr Greaves—I think you have hit on two very key areas there, Mr Beddall, and they really are the first two principles that we came to form a view on when we reviewed asset management two years ago. The first one is that an asset is just another cost of program delivery—you have purchased it and you allocate the cost over time. It is just like any other expenditure and, therefore, you would want to apply the same management disciplines to working out whether you need to spend that money in the first place. So it is this concept of incorporating your asset management decisions into your strategic planning processes.

Certainly one of the key areas there is you try to align the assets that you hold and the new asset you are going to buy with your program delivery objectives and with your service delivery standards. We would certainly strongly push that there should be some central guidance which says that, if you are making major capital acquisition decisions, the first thing you have to establish is the business case which says that this is a functional requirement to either meet a certain service delivery standard or to achieve a program delivery objective and that below that, therefore, we need to actually look at buying assets.

The second point which you raised—and it is another area we pushed hard in our report and our asset management handbook—was this consideration of what we call non-asset solutions or alternatives. Certainly the alternative you raised, which is to upgrade existing equipment, should be something that is considered in addition to not using assets at all. Is there another solution? Is there another way around this, including, for example, outsourcing the delivery of the service to the private sector or finding assets from another

part of the organisation that are underutilised? We found that, because organisations have not adopted this strategic asset management approach, therefore, they do not have the management information on which to base these decisions, so they cannot really make informed decisions at that strategic level.

Mr BEDDALL—My point was that you have an asset that you are not getting the full life out of. For example, going to the electorate office, we are getting these computer upgrades but there is no access to the Internet. I would have thought in a cost benefit analysis people would have preferred access to the Internet rather than the latest Windows 97.

CHAIR—There is access to the Internet.

Mr BEDDALL—In Parliament House there is.

CHAIR—And in your electorate.

Mr BEDDALL—We have not been told.

Mr GRIFFIN—Possibly not for Queensland, that is all.

Mr Hay—Mr Beddall, one of the things that our reports are talking about is precisely the issue about the interface between the people who use the service delivery program and the people who provide the service. Part of strategic asset management is asking the people who are using the service what they need and what they want and then making decisions about what you deliver based on that, as distinct from upgrading just for the sake of it, if that is the case.

CHAIR—How about comparing with some private sector practice as an example? I was a contractor to both Victorian and Commonwealth governments and I saw what I thought was absolutely huge waste of public funds in both the specification and management of projects to provide physical assets for both governments. How do we go about encouraging those people who are going to make those kinds of asset acquisition purchasing decisions test their hypotheses with the private sector?

Just because it is for government does not mean it has to be gold plated, as an example. If you have got to build a building rather than lease one, must it be so special purpose that, when it has finished its useful life with you, the chances of marketing it for a reasonable value in the continuing commercial market has no chance of success? How do we go about encouraging them to do that?

Mr Hay—That is an extremely difficult question to answer.

CHAIR—Should we not ask them?

Mr Hay—Probably we should. What we have tried to do in these two reports is to say there are a number of principles. If you work with those principles and take each individual agency's case specifically, there is a better chance for the right decisions to be taken in relation to program outcomes and future utilisation. So in a sense we have tried to encourage the approach that you are talking about, but at the end of the day it is up to each individual manager.

The carrots and the sticks, the incentives and the penalties, that are being introduced and have been introduced over the recent past are likely to provide a greater impetus for some of those principles to be adopted. There is the capital charge, for instance. Agencies are going to have to have a better handle on their assets and what they are using them for because all of a sudden there is going to be a cash outflow.

CHAIR—Would you tell us about that capital use charge? What is it and how does it operate?

Mr Greaves—Certainly. It is interpreted in a number of ways in a number of jurisdictions. Effectively, you are saying—if you want to take the private sector, for example—when you want to purchase an asset there is a certain cost of funds associated with that, whether it is the return you need to pay to your shareholders or whether it is the interest on your borrowings. We are saying that, in the general government sector where there has been no return on investment required back to the government, that interest cost on borrowings has not been transparent to the people and the agencies that are buying the assets. Effectively, the government has been wearing that cost of borrowing.

Really, all the capital charge is is a device to make that cost more transparent to the people who own and consume those assets. I think there is a proposal that it will now be levied on general government agencies on the basis of their net assets, but I am sure the Department of Finance and Administration will be able to give you much more detail in that regard.

Mr Nelson—So, in that sense, it becomes part of the costs of services of each individual agency. When they are looking at their own costs of services and, indeed, comparing against market testing, included now in costs of services or in the future will be a cost of that capital for the acquisition of assets.

CHAIR—I assume then that their operating budget takes that into account. If I had \$10 billion worth of assets, regardless of what the operating budget had traditionally been and is in the forward estimates, and all of a sudden I introduce a 10 per cent capital charge on \$100 million worth of assets and I do not have a corresponding budget increase to take account of that, I am going to have some significant difficulty in delivering whatever it is I am supposed to deliver, I would have thought.

Mr Nelson—I understand that is correct. No doubt our colleagues from the

Department of Finance and Administration will give you full details on that one.

CHAIR—We will take that up with them.

Mr GRIFFIN—The current approach as to how this whole question of asset management is handled is basically agency by agency. Do you believe that there is any merit in developing a more centralised approach or do you think the current approach is the best way to go forward?

Mr Nelson—A major theme within our first report was that there needs to be a central role played to bring together the policy, the guidelines and the general leadership and push behind better asset management within the Commonwealth. That is what we largely are endorsing here today. Again I go back to some of the comments we made previously that, unless you can get CEOs and program managers to see asset management as making good business sense, it is hard then to get the best outcome. To get that notion across to them, it would seem to be more appropriate to deliver those messages and the guidelines with it from a central coordinating area. Possibly there is an avenue there for pursuing better practice as well from a central area.

Mr Hay—But making it very clear that, in our view, it is not a question of central control.

Mr Nelson—No.

Mr Hay—It is a question of central guidance, leadership and the like.

CHAIR—I understand you tabled this report No. 41 of 1997-98 entitled *Asset Management* at our session on Friday. In your statement of audit findings, you said:

In particular, many organisations have yet to:

- . adopt a strategic approach to the management of assets by effectively integrating their asset planning decisions into their corporate and resource planning frameworks . . .

What percentage of ‘many organisations’?

Mr Greaves—I do not have the precise percentage with me. That is based on the survey of agencies. We did the 25 and then the detailed follow-up that we did in six agencies. I would suggest that it is a high proportion, above 50 per cent, from what we found in the six agencies.

CHAIR—You went on and said:

In particular, many organisations have yet to:

-
- . formalise, and systematically analyse, ‘whole of life’ cost concepts in major asset acquisition, operational use or divestment decisions.

Including:

- . integrate disposal decisions into an overall planning framework which monitors the outcome of disposal processes.

Would you like to talk to us about that?

Mr Greaves—It comes back to the point I was making earlier about the proceeds on disposal versus the book value of disposal. We are basically saying that we did not see a consistent use or even a consistent understanding of whole of life cycle cost concepts being applied in the general government sector. What we see as part of whole of life cycle costs includes obviously some revenues from when you dispose of the asset and also the cost of disposing of that asset.

The point I made earlier was that agencies, when they were considering buying assets, were not applying whole of life cycle costing and therefore were not necessarily setting some benchmarks that they could use to monitor performance over the life of the asset—not simply the disposal performance but also the operating costs, maintenance costs and so on—such that when they came to actually dispose of the asset it was not done in the context of any kind of strategic or corporate planning. It may have looped back into their acquisition decision for their next asset acquisition in terms of how they were going to apply the proceeds, but we did not see any systematic analysis of disposal performance against any kind of original benchmarks that may or may not have been set.

CHAIR—You also stated:

The audit also confirmed the limited nature of central policy advice and guidance which is in contrast to the experience in a number of State jurisdictions.

Yet, as I read your recommendations, I do not see the recommendation with respect to that statement.

Mr Hay—We have thought about that issue continually. The report keeps talking about and affirms that need for strategic management. We went to the Department of Finance and Administration and they advised us:

. . . that it considered the *Asset Management Handbook* to represent a key source of general guidance to organisations on asset management principles and practice. The Department also advised that as the major proportion of physical assets have been assigned to specialist organisations, it would not be appropriate for the Department to promulgate guidelines which attempt to be specific in relation to matters which come within the responsibilities of specialist asset managers . . .

In response to that, we have said that we think that it is not the appropriate way to go. The experience of the states gives us sufficient comfort to think that you can provide strategic management guidance at a central level without interfering with the specialist

managers' asset management role. We have some difficulty in making a recommendation that may be going into the area of the policy of the government's approach to asset management, but we have tried to provide support for an alternative point of view.

CHAIR—Are you asking the committee to make a recommendation in that regard where you are unwilling to?

Mr Hay—We are asking the committee to confirm and reaffirm the view that it expressed in its review of our previous asset management report. You suggested that the government should use that response, which is the response to a previous report of yours, No. 349, as an opportunity to:

. . . make a clear and comprehensive statement of its intentions in relation to financial management reform in the Commonwealth, including the steps that will be taken to promote better asset management in Commonwealth agencies.

That came out of our previous report and I think that recommendation continues to stand. In terms of that central guidance, progress is still some way off.

CHAIR—Gentlemen, thank you very much. Is there anything else you wish to add?

Mr Nelson—No.

CHAIR—Thank you for coming to talk to us once again.

[10.00 a.m.]

HOPE, Mr David, Member, Public Sector Accounting Centre of Excellence, Australian Society of Certified Practising Accountants, Level 8, Colonial Building, 161 London Circuit, Canberra, Australian Capital Territory

WALLER, Ms Rhonda, Manager, Australian Society of Certified Practising Accountants, Level 8, Colonial Building, 161 London Circuit, Canberra, Australian Capital Territory

CHAIR—I now welcome representatives from the Australian Society of Certified Practising Accountants. I thank you for coming to talk with us again today. Because we have not received a submission from you, would you like to make a brief opening statement to the committee on the record?

Mr Hope—We are here today on behalf of the Australian Society of CPAs, which is one of the two major accounting bodies in Australia. The society obviously has an interest in topics such as asset management and it has a role to play. In particular, the Public Sector Accounting Centre of Excellence does research into topics of immediate importance and perhaps future importance for managers in the public sector. It has actually published some readings and papers on asset management. I would like to tender a recent publication entitled *Asset valuation by government trading enterprises: an evaluation of pricing issues*. That is an example of the work that the centre of excellence does. We are continuing to do research into topics like this and provide papers to our members and also to the broad community who look at things that the Australian Society of CPAs does. We have previously appeared before you to make an in-camera submission and would be only too happy today to discuss the contents of that, answer any further questions or amplify any points in that submission.

CHAIR—Thank you for that. One of the big issues, it seems to me, is culture. The public sector have a culture of not needing to value assets because they lived with bits of cash in jam tins, so it was a matter of managing the jam tins so you did not run out at the end of the year, and sometimes you did not have any left in the jam tin, too. That is entirely different from a private sector company, particularly operating in the public spheres. Could you tell us your opinion of how that culture is impeding, or will continue to impede, the proper evaluation of assets and the management of those assets in order to provide a proper return to the Commonwealth for the investment?

Mr Hope—I think it is fair to say that, in general, in the public sector, the culture in the past was one of asset creation and not a lot of thought was put into issues of managing those assets. That is perhaps too sweeping a statement, because obviously the assets did have to be managed to a large extent, but the reality is that they were spent in the year or years in which they were built and, in terms of the capital cost, it was just no longer referred to, except when it came time to renew that particular asset. So the

emphasis was always on building the asset and getting it into service. Then there was a sort of sigh of relief once that was done and there was just the ongoing maintenance of the assets.

There was not really a holistic approach to asset management and the Auditor-General's staff have made some allusion to that this morning—that is, when you purchase an asset that is the time when you should be thinking about everything to do with that asset. In fact, it is not even when you purchase it. When you plan to purchase it, you should be thinking, 'How should we purchase it?' or even, 'Should we purchase it?' You should look at state jurisdictions. We now see state jurisdictions actually encouraging the private sector to build assets and they are making particular arrangements with them to finance those assets. Those arrangements in themselves provide a culture that now focuses on how they are going to fund those assets in the future, because some of the assets that have been provided in state jurisdictions currently have to be paid for sometime in the future by those state governments when they become the ultimate owners. So there is a changing culture there.

To return to the point I was making, the reality is that it is at the time you plan to purchase the asset that you should look at how it will be purchased—whether it will be purchased or leased or whether you get the private sector to do it—what sort of maintenance regimes you want to have and, in the end, ultimately how you will dispose of it. In the case of many governments, even local governments, disposal becomes a serious problem if you are looking at an asset like a waste disposal site. When you come to dispose of something like that, you generally have a very long time after it where there has to be some attention paid to the assets so it does not damage the environment in which it exists. Asset management is a very complex matter. That does not mean that the complexity of it cannot be solved by good management. I think ultimately that is the point you are trying to get at today—how can we manage the assets that the Commonwealth and the public sector in general have?

CHAIR—Mr Hope, do you have any experience with local government and/or state governments and how they manage and value their assets? Could you also tell us about those experiences with respect to where you see the Commonwealth?

Mr Hope—I think it is fair to say, just as a general comment to start with, that the Commonwealth is a bit behind what the states are doing. I think the Auditor-General has also made that comment. From the statements the Auditor-General made this morning, which I tend to agree with, they are looking very closely at what the states and local governments are doing—particularly the states, though—to see what has worked and what has not worked.

I do have experience at working in local government, in state government and also in the Commonwealth, but my Commonwealth experience is rather old now. I have recently been doing some work as an independent consultant along with some colleagues

in Victoria. The Victorian government is conducting a research project into the long-term viability of councils to fund their infrastructure needs in the future. Some of that work has shown some very interesting things, and I am sure the same opportunities and challenges will be found in the Commonwealth. Perhaps the first challenge that has been seen in Victoria is that the local governments did not have a very good record about the assets they had. They did not have records on what their assets were.

I have also experienced that by actually working in a local government. When we adopted AAS27, we found quite a few parcels of land that we owned that we did not know we owned. We actually thought we had that pretty right before AAS27 came in. So it was quite interesting. Governments do not know what assets they own. They do not know what the lives of those assets are, they do not know what the maintenance regimes are, they do not know what the conditions of the assets are and they do not know whether they need to hold those assets, now or into the future.

I know that is a fairly broad statement, but in general that would be the case. There are many assets like that which governments do not know that they own, what condition they are in or how useful they might be, because they have not done any asset management work. They have not done any strategic asset management work. They have not been looking at the assets and at the services they deliver and saying, 'Are the assets we have meeting the service objectives that we have as an organisation, and will they continue to do that into the future?' That is not how things have been done because of the, as you rightly put it, jam tin mentality that 'We'll spend what we've got this year and we'll worry about next year when next year comes up.' That, unfortunately, has pervaded the public sector for a long time. But that attitude is definitely changing.

Mr GRIFFIN—When you say it is changing, in your view, by how much? How far down the track are we?

Mr Hope—I do not know whether I could give you a percentage of how far down the track we are. I think it varies. With regard to the states and local governments in general, local governments, because they are creatures of the states, are being pulled along on the states' coat-tails to some extent. They are probably well past the 50 per cent mark in improving their asset management, but I would say that the Commonwealth has not got to the 50 per cent mark. But that is a very broad generalisation.

Mr BEDDALL—In another part of this building, probably at this very moment, budget cabinet is sitting down to discuss the May budget. One of the parameters it will work on is the forward estimates. The culture in the Department of Finance and Administration is still—unless it has changed dramatically in two years, which I do not think it has—that it is much better to have something on a lease. For example, I think they still lease the AGSO seismic ship rather than buying it, because that costs money in one budget rather than spreading it over a number. When you have got that sort of regime in the Department of Finance and Administration and in the Treasury, how can you really

come to an asset management regime that is realistic?

Mr Hope—The reality is that if you are thinking of acquiring an asset it is important to think whether you want to spend all the money now, whether you want to lease it, how you will actually fund the acquisition of the asset. In the Commonwealth, the department that has the asset does not have the responsibility for finding the money, effectively. It does not have to raise the borrowings; that is done centrally. It may not have to have a lease arrangement, but I believe that some of the old DAS arrangements were arrangements like that.

It is a strategic decision to make, when you plan to acquire the asset, as to how you will acquire it; whether you will borrow the money to buy it—and, as I say, that is not a decision taken at departmental level—whether it should be leased or whether there is some other arrangement like the BOO or the BOOT arrangements that currently exist with the private sector. All of them may be quite valid at the time the decision is made, depending on what the circumstances are. If you lease something, every year you have got to look at your budget again, see that you are going to make those lease payments and at least it makes you think about whether that asset is still providing you with the outputs you are looking for, and whether you are still getting the outcomes from using that asset.

Mr BEDDALL—Conversely, in a climate where a budget surplus is seen as the persona, the temptation, therefore, to spread the purchase of an asset over a number of years to give you the illusion of budget surplus is a factor the private sector does not normally have. That is a cultural thing within the Public Service, as well as the political process. Doesn't that have some impact on skewing the asset management process?

Mr Hope—I can only say yes. I do not really want to offer comment now on what the government might do as its policy.

Mr BEDDALL—No, it is not policy. It drives asset purchase and however you lease, purchase, BOO or BOOT—whatever you want. All of those things are driven not only by the parameter of acquiring the asset but by the budgeting process that takes place at a government level.

Mr Hope—The political process obviously has to be taken into account when you are looking at asset management and that obviously changes from time to time with different governments in power. I am not so sure it should drive asset management, but it may well drive some of the decisions that are made about asset management.

CHAIR—The Auditor-General tabled on Friday a report entitled *Asset Management*—Auditor-General Audit Report No. 41. Amongst the findings, they found that there is still some significant gap between what is desirable and what has been achieved. The report states:

1.30. In particular, many organisations have yet to:

- . adopt a strategic approach to the management of assets by effectively integrating their asset planning decisions into their corporate and resource planning frameworks;

Does that sound right to you?

Mr Hope—It sounds like what is happening. I would say that it is not what should be happening, though. Quite clearly, asset management should be part of the strategic and corporate planning of any organisation.

CHAIR—The report also states:

1.31. The audit also confirmed the limited nature of central policy advice and guidance which is in contrast to the experience in a number of State jurisdictions.

Would you like to comment on that?

Mr Hope—Yes, that is the case—that there has not been much essential guidance from the Commonwealth to its agencies about asset management. If I put my mind to it, I could probably say that all of the states have produced some sort of manual and policy guideline with differing levels of prescription and, depending on which state it is, how the policy and the manuals are to be implemented.

The Auditor-General mentioned Victoria; they have put out a reasonably good asset management manual. It is at the policy level, and I think that is where the central direction ought to be. It ought to be at the policy level and ensuring that there are proper processes in place for the management of assets.

I do not think it should be too prescriptive. I was going to say that asset management is not a linear function. What I really mean is that the same rules may apply in general, but there are certainly cases involving things like the economic lives of assets. The same asset can have different economic lives, genuinely different economic lives, in different geographic, topographic or use circumstances.

While I agree that, to get a degree of consistency across the Commonwealth, there should be clear policies and processes outlined, it has to be careful not to be too prescriptive in what is put into those particular manuals. It should not say what the economic life of a particular class of asset is. It should not do that sort of thing because that is not correct.

The Auditor-General also alluded to a similar thing in regard to depreciation, which you actually alluded to as well. When you come to sell off an asset, often the depreciated value and the market value are very different. I think that will always be the case while we continue to have straight-line depreciation as basically the only way you can depreciate

an asset, because assets do not depreciate in a straight line. Infrastructure assets, in particular, do not depreciate in a straight line, and the value of those assets is very much changed by the amount of maintenance that is or is not done to a particular asset. There are a lot of elements that go into determining what the value of assets are. But there is no doubt that some central direction will help Commonwealth agencies to put in place appropriate practices.

I think there is one more thing that is needed to put in place appropriate practices in Commonwealth organisations. We talked at the beginning about culture. The reality is that, if we have not got a culture where asset management is part and parcel of what the organisation does, if the culture is not that the only reason we have assets is to provide services and outputs to the community, and if we do not have the culture where the performance of the chief executive is measured on whether those services and outputs are produced effectively and efficiently, we can write all the manuals we like and nothing will change.

We have to require that the performance of the organisation is judged not solely on how it manages its assets but certainly on how it manages its assets. I had two interesting figures quoted this morning—one of \$114 billion and another of \$72 billion. That is a lot of assets. As a simple taxpayer, I would like to feel that we are using those assets wisely to produce outputs for the Australian community.

CHAIR—The 72 was not billion but million.

Mr Hope—Sorry.

CHAIR—Are you familiar with the ANAO *Asset Management Handbook*?

Mr Hope—Yes, I am.

CHAIR—We were talking about central advice to agencies or central control or however we want to put it. Tell us your view of that handbook, its recommendations and whether or not acceptance of that handbook across all of the government departments would or would not meet your criteria.

Mr Hope—I think it is a very good document, but I do not think it is a policy or process-type document. It is more a primer or an overview about what asset management is. I think it is very useful in that it helps managers within the public sector understand what asset management is about, but it is not what would drive the process. It is helpful but not a driver in the process. It is an educative tool more than a driver.

Mr GRIFFIN—What other drivers are required then?

Mr Hope—I think we need to do something similar to what has happened in the

States—that is, to put out some sort of policy manual which says that this is what is expected of asset management processes and advice on taking that holistic approach to asset management. As the Auditor-General's manual talks about the different steps in the process, we need to talk about them, fit them together and make sure that organisations have in place processes which will allow them to take the information which they need to know about managing the assets and bring it up into the corporate or strategic plan and push information from that area down to the people who have to manage the assets.

Mr GRIFFIN—So you are supportive of a more centralised approach as outlined by the Auditor-General before on the question of policy?

Mr Hope—On the question of policy, yes. I would feel difficulty if the actual people who had to manage the assets had to do it too prescriptively without having the flexibility to take into account local conditions.

Mr GRIFFIN—Do you think there is scope for outsourcing of asset management?

Mr Hope—Yes, definitely. There is scope for outsourcing anything that the government does. So there is definitely scope for outsourcing asset management.

CHAIR—Thank you very much for coming to talk to us once again. We really appreciate your input and your advice. We will certainly send you a copy of our report as soon as we table it.

Mr Hope—Thank you.

[10.24 a.m.]

O'LOGHLIN, Mr James Graham, Director, Property Group, Coopers and Lybrand, 53 Blackall Street, Barton, Australian Capital Territory

CHAIR—Mr O'Loghlin, we have received your submission. Would you care to make a brief opening statement about the issues we are here to discuss?

Mr O'Loghlin—Yes.

CHAIR—I have a heap of questions to ask you about your submission, I can tell you.

Mr O'Loghlin—I want to make a couple of small preliminaries, if I may. The committee documents indicate that this is from Coopers and Lybrand ACT. It is in fact from Coopers and Lybrand Australia. It was prepared in the ACT but we are organised on a national basis and not on a state basis. The comments that we have made in the submission and make today will be the product of experience around Australia with both state governments and the private sector, as well as the Commonwealth.

The only points I would like to make by way of introduction are to say, firstly, we completely support and agree with the principles of asset management as expressed by the Australian National Audit Office. Secondly, our observation is that those principles are generally not well applied in Commonwealth agencies. In particular, the principles that relate to integrated planning, to asset planning and accountability are not well followed in Commonwealth agencies on the whole. We believe that the reasons for that relate to two things, the first being that there is not a strong incentive and reward system in the Commonwealth. There are no prizes for managing assets well in the Commonwealth. Secondly, whether it is the Commonwealth or not, for governments to manage assets well is very hard work.

Most of the institutional machinery and financial structures of government do not lend themselves to good asset management. Assets, generally speaking, have a long life. Decisions about them can take up to 10 years to have an effect. Almost by definition, that does not lend itself to good decision making by governments. That simply means that governments have to work even harder at it than the private sector does. The last point I would make is one that we have, without appearing overdramatic, tried to make in the submission, and that is that I think the pay-off for the Commonwealth in managing assets better is quite high.

CHAIR—You made nine recommendations. The first of those was to establish a small asset management policy unit in a central agency, presumably, but not necessarily, the Department of Finance and Administration. Would you like to expand on that?

Mr O’Loughlin—Yes. The necessity for a central guidance unit is pretty clear. Most of the states have them. Most of the states have got good results from them. The philosophy of providing general guidance is not inconsistent with the directions of the Department of Finance and Administration. There are, after all, in that department central guidance units for competitive tendering and contracting and a number of other initiatives the government is undertaking. I would see that asset management should rank equally as highly as those in terms of the necessity to provide guidance.

Professional asset management is a highly sophisticated and technical matter. Expert knowledge about it is not easily diffused throughout a large organisation down to the working level. That says two things: you need to be careful about where you delegate that responsibility to and it also means that some degree of authoritative central guidance is quite critical if good asset management practices are to take hold.

CHAIR—Would it surprise you that, in 1996-97, the Commonwealth disposed of \$93 million worth of assets and received \$52 million in recompense?

Mr O’Loughlin—It does not surprise me because I heard you say it earlier. It was not a number that I was familiar with. My observation on that would be that the quality of the valuations in the first place is probably suspect. I saw a document giving guidance on valuation of assets in the Commonwealth for the first time only last week. I think a variety of approaches have been used which, while technically correct and not easily shown to be at fault in an audit sense, often do not fully reflect the physical reality of the asset on the ground.

The other point made by the audit office representatives is also true. I think the Commonwealth’s approach to the disposing of assets has not always been consistent with getting best value for the Commonwealth. I was reminded when I heard that discussion going on about some discussions I was recently having with one of Australia’s largest property owners in the private sector. We were discussing what they call an exit strategy. An exit strategy is something they have for every asset and review every year—‘How much longer do we need to hold this and how do we get out of it?’ It is a common fact of life for a professional asset manager and a professional investor.

CHAIR—Does it not go back to the original decision in the first place when you make a decision to purchase or acquire an asset? If you could use a general purpose asset and make some adaptation of that asset to suit your purpose, wouldn’t that be a management decision that generally corporate Australia would make, but not one which would necessarily be made by a government department?

Mr O’Loughlin—I think that is quite true, Mr Chairman. I think there is a tendency to go about the acquisition of an asset with the object of procuring the best possible solution that can be found. I think the committee has seen some of the consequences of how high-tech assets when purchased can turn around and bite you. I think that tendency

is probably still present. I think it flows from a culture of genuinely believing that the Commonwealth should have the best. I think it also flows from the notion that capital is a free good and, if it costs a bit more, why not? I think that the culture in the Commonwealth generally does not encourage the full evaluation of life cycle costs that those decisions incur.

Mr BEDDALL—I would be interested to see the exit strategy for a Leopard tank.

Mr O’Loughlin—Yes, but I am sure there can be one.

Mr BEDDALL—I am sure there can.

Mr GRIFFIN—That would suggest the asset was worth something.

CHAIR—In your submission, you state:

The "Whole of Government" financial statements for 1996/97 reveal that the value of non-financial assets held at 30 June 1997 was \$82.7 billion. If inventories are excluded this figure falls to \$75.1 billion. (It should be noted in passing that the \$6 billion "inventory" is itself a significant Commonwealth investment, and that much of it is likely to be spare parts for other assets).

Can you expand on that?

Mr O’Loughlin—I do not have detailed information about that, which is why it is in passing and why it is still to a degree speculative, but I am conscious of the fact that a number of the assets that the Commonwealth has purchased—and it should have adequate stocks of these—have spare parts which are required at the same time and are kept in inventory. I suppose it is fairly obvious that that comment is probably stimulated by a knowledge of the types and character of assets held by the Department of Defence, which has very substantial stores holdings and needs to. I am not questioning the necessity for it; I am just saying that the real investment when an asset is acquired quite often goes beyond the actual apparent capital cost of that asset.

CHAIR—You went on to talk about acquisitions in that year and stated:

. . . the asset stock is growing at the rate of some 9% p.a. The increase is well in excess of reported depreciation of \$5.1 billion (i.e, the capital expenditure is adding capacity, not just replacing consumption)

Are you able to make any analysis of where that is happening?

Mr O’Loughlin—I do not know where that is. We should remember that there were a number of disposals in that year, some of which were not disposed of as a profit, as you have already pointed out. I do not want to duck the question, but I do want to point out that I think those numbers are still approaching the level of accuracy that government will

actually be seeking from them. In other words, the approaches to valuations have not been very precise up until quite recently and I think those numbers are quite rubbery. Nevertheless, the gap was sufficient enough to make me believe that the acquisitions are in excess of consumption. I am just curious why in today's climate governments should be investing that much, particularly when it seems to have a philosophy of trying to get rid of them. I cannot be more specific about where they are or what they might be.

CHAIR—In talking about the value of assets reported, you said:

The Commonwealth expends funds each year on assets that it does not own. Examples are the Road Program, the contribution of some \$200 million every year towards the construction of TAFE facilities . . .

You actually talked about it going towards the construction of primary and secondary schools owned by the state governments. What was the point you were trying to make?

Mr O'Loghlin—I guess that is technically outside your terms of reference in this inquiry, Mr Chairman. I am just saying that the Commonwealth does expend some substantial sums of money on public assets in Australia and it basically leaves the accountability for them with the beneficiary. I was reminded of that recently because, as I mentioned there, there is a significant investment every year in the national education and training system, the TAFE system. That was a program which I think was originally initiated to improve access to those sorts of services and resulted in the construction of TAFE colleges in country areas and outer parts of capital cities. That is a very good thing to be doing, I would have thought.

That expenditure has tended to keep on as a matter of course. In today's world we are now thinking of delivering a lot of education services with virtual campuses and information technology. Maybe the investment ought to be going there. I have a feeling that this continuing investment in buildings is not something that has been subject to very systematic scrutiny and it is Commonwealth money.

CHAIR—Isn't that just simply a policy question rather than a asset valuation question? Surely you do not propose that some proportion of the Commonwealth's contributions to TAFEs be on the Commonwealth books?

Mr O'Loghlin—I am sorry, I am not making that comment from an accounting point of view, I am making that comment from an asset management point of view, and I am just observing that there is Commonwealth investment in assets going out in that direction and wondering whether it is attracting the same sort of scrutiny as the main core of your inquiry is.

CHAIR—Fair enough. I suppose if we got rid of the states then we would not have the problem.

Mr O’Loughlin—You would take over a lot of assets if you did that.

Mr BEDDALL—In the broader assets, under two governments there has been the sale of very large assets—the Commonwealth Bank and a third of Telstra. Seeing as there has been a huge capital gain for all the people buying the shares, do you think the process we have gone through for either or both of those were rigorous enough or do you think we are not getting value for money? I think Telstra has doubled in price and God knows what the multiplier is for the Commonwealth Bank. But it was an asset sold by the Commonwealth, which is an asset of the Australian people, to a smaller number of Australian people and the Commonwealth does not seem to have got a share of revenue.

Mr O’Loughlin—I think that is outside my expertise. I am perfectly happy to comment on physical assets and non-financial assets; I do not think I am well equipped to comment on the value of organisations.

CHAIR—When you talk about the nature of Commonwealth assets, you listed a number of significant specialised assets, including things like purpose designed buildings from museums and all that stuff. In the next to last item you put:

. substantial investments in IT and communications systems

Have you got any proposals on how we value software and communication systems that might be outdated tomorrow?

Mr O’Loughlin—I was actually very pleased that in the document—the orange covered one—that the Department of Finance and Administration produced recently on the valuation of assets it devoted some attention to the valuation of software assets. I had no quarrel with the approach that it was taking to it. I was pleased to see it because not many people have actually tackled that issue and it is a difficult issue. I think that is all I can say about it.

CHAIR—Thank you very much for coming. We thank you for your submission. You certainly have helped to answer some questions that we had about it. We appreciate your time.

Proceedings suspended from 10.41 a.m. to 11.04 a.m.

EDGTTON, Mr Wayne Steven, Director, Domain Consulting Pty Ltd, GPO Box 4598, Sydney, New South Wales 1044

CHAIR—Welcome. We have received your submission. Would you like to make a brief opening statement to the committee?

Mr Edgton—It was quite pleasing to hear, earlier in the day, the emphasis being put on the culture of asset management and the idea that it requires a cultural change, because I think that really is the key. Unfortunately, our experience at all levels of government and in the private sector—but in particular with the Commonwealth government at the moment—is that, for the most part, this cultural change is yet to happen.

There are a couple of key points for having this cultural change happen. We see asset management very much as a process, a way of thinking, a culture that has to be brought into an organisation. It is not a thing that happens, is there and then everyone runs with it thereafter. A key part of that is the integration of asset management thinking between the accountants within an organisation and other parts of the organisation—such as senior management, engineers if they are looking after buildings, IT managers, et cetera. It requires full integration of asset management thinking amongst all the various aspects of management and all the various sections within an organisation. That does not happen overnight. It does not happen in six months or a year. It actually takes many years. That has been our experience.

Often, when asset management starts to be brought in, as has happened in the Commonwealth sphere, organisations have implemented it within their realm of comfort, which means getting in an asset register so that the accountants are happy that the evaluations are there and things are depreciated. However, that is not integrated with other sections in trying to identify the purpose of the assets with respect to service delivery. That process has to happen and the integration has to break down a lot of walls within organisations. That is a difficult thing to do in terms of culture.

CHAIR—Thank you for that. I have to say, in opening, that when I first saw your name on your letterhead I wondered what on earth an Internet service provider was doing coming to talk to the committee about asset management, but I came to the conclusion that Domain Consulting is not about the Internet. Considering what you have just said, can you give us a model for making that happen? How would you go about it?

Mr Edgton—The *Asset Management Handbook* produced by the Australian National Audit Office is a very good document. It is very concise in the way that it explains to agencies in general what asset management is. A key part is to hold the hands of a couple of agencies in order to get that implemented in a pragmatic way in those organisations. Other agencies within the Commonwealth can then see what asset management is and how it works, and they can copy that model.

CHAIR—Who holds their hands?

Mr Edgton—As a suggestion, I think it would best be done by, if you like, sponsoring from the Commonwealth via a central agency, via other advisers, in order to work with a small agency to implement asset management in a simple framework, but not in all the details. We think that it should be implemented in layers, in a rolling period over a couple of years, but getting the key principles integrated into the organisation within, say, a 12-month period.

CHAIR—Who does that? Does it need central control or central guidance? Or is it enough that those principles be issued as a de facto directive in departments and they then decide on their own procedures for implementing the principles, and so each of them goes their own way?

Mr Edgton—Initially, in implementing it into the first couple of agencies, it would be a key for central agencies to have a role in the steering committee involvement for the implementation so that they can see what is happening with that agency. To that extent, it could benefit the agencies and it would benefit those central agencies as well.

Mr BEDDALL—Like the chair, I noticed that in your submission the letterhead says that you are asset management specialists. There is not a lot more detail. Could you give us some idea of what Domain Consulting does, what its client base is and that sort of thing, just so it puts the submission in context?

Mr Edgton—Domain Consulting is a team of consultants in asset management that consults to organisations. That is why we specialise in it. We specialise in it from a strategic level. We have worked at the government level advising on government policy and on how to implement that policy, right through to helping agencies and private sector organisations in its implementation and then going back regularly and doing reviews. That involves practices, policies, procedures, the systems involved in having it happen, and even helping agencies with their submissions back to Treasury each year for funding. That is why we have a hands-on role in seeing the pragmatic implementation of asset management, from the strategic right through to the information gathering.

CHAIR—I do not know how long you have been here this morning, but one of the things we learned from an audit report is that in 1996-97 the Commonwealth disposed of some \$93 million worth of assets at written down value, for which it received \$52 million. From your experience, can you talk to us about how that can happen and what you think needs to be done in a strategic or a management sense in order to try to preclude that becoming a general sort of practice?

Mr Edgton—As Graham O’Loughlin alluded to, I think one of the key points with that discrepancy is likely to be in the valuation of the asset, particularly assets held by the Commonwealth which are quite difficult to value. Often there are a lot of arguments, such

as the value of land under roads, et cetera, and that emphasis on asset management takes people off the track of the purpose of asset management. I do think the valuations are probably a key part.

The other key part is that, when we have gone to review asset management within organisations, in almost every circumstance we have seen huge discrepancies between the valuations, and even the assets, that are on the books and the assets that they physically hold. A key point to that is usually that the accountant or financial controller within an organisation keeps an asset register for their purposes; where you have an IT manager, they keep an asset register for their purposes; and your property manager has an asset register for their purposes. When you go into organisations, it is quite common to see 20 separate asset registers and, often, when assets come into the organisation they go into one of those operational registers but not into the financial one, and vice versa. So discrepancies are usually quite large.

A key thing to integrating asset management is integrating it so that they work off the one register and they use the one management tool. That way, the people that are operating the assets keep the information more up to date and that benefits the people from the financial and accounting side.

CHAIR—Are you suggesting a common chart of accounts across all agencies?

Mr Edgton—At the moment, I am talking more of an agency having one asset register—one list of assets that is used for management purposes, for financial reporting purposes, for maintenance purposes, for operational purposes, and for audit and control purposes; that they use the one register.

CHAIR—And one chart of accounts?

Mr Edgton—Yes.

CHAIR—Not separate ones depending on what part of an agency might be involved? For instance, Defence might keep one asset register and chart of accounts for strategic military hardware and a different register and chart of accounts for disposables, for instance ammunition. Are you suggesting that Defence have a huge chart of accounts that manages these things across the entirety of the Defence portfolio?

Mr Edgton—What we are suggesting is that one asset register is held for each type of asset, not separate asset registers for the one asset, split up according to the function. Such that, if an agency is very large, as Defence is, it could have separate registers for the different classes of assets, but they should at least be able to be integrated for higher management reporting.

CHAIR—But how do they do that if they have varying charts of accounts for each

group? How do you integrate? How do you do that when you have separate definitions of what happens with that asset, how it is treated in the books? One lot puts the numbers in one place and one lot puts them against a different title. I have lived with that in the private sector; it is enough to drive you nuts.

Mr Edgton—Yes, I know. One of the key things in the policies and procedures document, when you come to putting in the systems and moving information from legacy systems across to the newer systems, is providing links back to the older registers and older systems. You might need that because drawings or manuals were set up according to those old numbers. There should at least be provision of a framework such that the information can be integrated together to roll up all classes up above. I think that definitely can happen even independent of the chart of accounts as the actual register, because the chart of accounts is where some of the financial reporting on that asset rolls up into.

CHAIR—Turning back to the culture issue again, one of the management things that this committee has heard as we have proceeded with this inquiry is a statement by some, at least, that in order to make asset management work, both valuation and management, there needs to be the strategic involvement of the CEO—if you will, the secretary to the department. Would you like to comment on that view?

Mr Edgton—Yes. This is another issue with that culture change. I believe that asset management is one of the key two or three parts of management within all organisations. It is not just a subrole of the financial controller or a subrole of the chief engineer; it is a key management function, particularly tying it back into the strategic parts within the organisation. Because of that, that is where decisions can be made, such as in an example used before about computers being purchased when the actual users would probably prefer to spend the money elsewhere. That is where things like capital charging—capital charging is very functional because it affects the purse strings of integrating assets with the strategic planning of the organisation. That way, capital money is not free money and, if a section within an organisation wants an asset, that then has a recurrent implication for them. So they can make that whole-of-life cycle decision at the time.

Another key part of that is when you do use your asset registers and when organisations do manage their assets on a day-to-day basis it integrates thinking on each asset, such as the level of utilisation of the asset, the criticality of that asset to that organisation's key business and the functionality and financial performance of the asset. It is only by integrating those types of factors that you do get proper performance indicators and proper thinking on your assets. That has to then aggregate through into the strategic plans of the organisation. That is signed off by the CEO. So they have to understand the information that is coming back through.

CHAIR—But can't we get carried away with this a bit? If you think about a department like Social Security or, let us say, Immigration, both of whom have a very

focused social objective program—that is, they have to administer programs to spend money and to achieve outcomes—in terms of priorities, where do you place asset management in the responsibility of the CEO of each group to achieve the outcomes that government, indeed the community, expects?

Mr Edgton—Asset management is a key business tool to release resources for the organisation to spend on more core activities. As I have said in my submission, no Commonwealth agency exists purely to own assets; its business is to do other things. It needs assets in order to deliver those services. So a key part of it is to release funding from those assets. To avoid organisations being bogged down in asset management, a key part of it is working through asset class by asset class to identify the higher value assets—the assets that do have a greater impact on the service delivery and also a cost impact—and that is where effort should be targeted to improve management.

CHAIR—The CEO of a private company—and indeed the board of directors in answering to the shareholders—has to achieve return on investment and if they do not then they get displaced. Where is the carrot or the stick for a Commonwealth agency like Social Security or Immigration? What benefit do you offer them? What do you say to the secretary of the department, ‘This is the gold star you get’—the bonus or whatever—‘for doing a good asset management job’? What is the stick side or the downside of it? If you do a poor job, what are the consequences? It is pretty strategic stuff. It is good to say light and wonderful things such as, ‘This is terrific, everybody should do it and there will be great benefits,’ but that does not necessarily make it happen in the real world, does it?

Mr Edgton—I know that private sector organisations such as construction companies or something like that are very diligent in the way that they cost all the plant and equipment that is going to be used on construction projects. At the end of that project, costed into that project is how they are going to dispose of it or, if it is going to be used on another project, often that equipment is put back into a pool and there is somebody, which is like the plant manager who runs a separate identity, that hires out from one project to another project. So the true cost of the ownership of those assets becomes transparent to each of the services that they deliver—in the case of a construction company it is each project. In that way, the true cost of those assets do hit home to the board or senior management, because it directly affects the profitability of that organisation with respect to each of those projects.

When you transfer that into the government sphere, the case should not be altogether that different. If you take higher education, for example, I see that there is a lot of potential to better utilise current facilities and to reduce the need for capital expenditure on new facilities. By having a transparent process where those costs savings are then able to be reused or used more effectively by those organisations, they are able to apply that to the teaching programs, their core business. That is the real carrot and stick. But it is only by agencies seeing the effect and the benefit of that—piloting quick wins within the organisation—that asset management can be adopted and then rolled on to other aspects of

the organisation. That is what we have seen happen quite extensively within the government sphere in New South Wales and other states, and in local government.

CHAIR—Do you have a view of the use of the capital charge?

Mr Edgton—I think the capital charge is a great idea and has many benefits, providing it is implemented in a simple way. Some of the states have attempted to become very sophisticated with the financial reporting and the financial implementation of capital charging. I think a lot of the benefit gets lost because of all the detail that is being worked through. But if it is applied in a simple form so that an approximate cost—maybe not the absolute cost of capital of capital is apportioned back to the organisation then they can make better informed decisions about whether to spend money on capital, staffing or on organisational change, and they can see the direct benefit back from that.

CHAIR—You said in your submission:

The potential life cycle savings to agencies of adopting and implementing full asset management correctly are usually in the order of 10-20% of the annual holding cost of the assets. This represents a relative untapped resource . . .

Could you expand on that and tell us how you came up with those numbers and exactly what you mean by that?

Mr Edgton—When you go through and review many agencies, as we have done over the years, it is amazing how much money they do have tied up in assets that they find a great deal of difficulty relating directly back to the service that those assets provide. Indeed, it often becomes a big catalyst for them to document what services they provide and to provide those links through to assets.

In local government, for example, by working through, say, a property portfolio, I have not seen a case where it has not been very easy to identify a significant number of assets which are being under utilised and are not there for a particular purpose; they have just always had those assets. By identifying those assets and releasing those funds, the benefits come back through. So those figures are based on our experience.

CHAIR—In your experience, would it be reasonably usual, particularly with buildings—when governments purchase assets or construct assets—that the cost to the Commonwealth is probably greater in consideration of the function to be produced than it would have been in the private sector?

Mr Edgton—Yes. That is often due to the process that it has gone through, and then often some of the assets have tried to be too specific for the purpose. Again, I was very pleased to see in the asset valuation guidelines by the Department of Finance and Administration the emphasis on software and IT type assets, because increasingly a

percentage of an organisation's asset portfolio is being taken up in those assets, and to date not many organisations have paid much attention to that aspect of things.

That is where we have seen a lot of money not being wisely expended: either in keeping some dinosaur type software that has been around for quite a while, or in overcapitalising in some new software that has a lot of bells and whistles and moves the organisation, if you like, slightly away from the core functions that they need.

Often the core functions that they need out of software are relatively simple. A lot of software has a lot of other bells and whistles that they go and buy or spend a lot of effort developing in house. Usually the true cost of developing that software and then administering that software is not reported anywhere. Those sunk costs are often hidden or not given full consideration, and they can give significant benefit to actually moving either towards new software or to simplifying their software—at least identifying the true cost of the service being provided by the software.

As was mentioned before, that is where it might be possible to outsource asset management. I think that very much is the case. It is particularly true in relation to the software component, where the agencies could subscribe to a bureau service and have the system implemented for them and receive the reports back through. It could be managed by experts, if you like, rather than each agency having to set up a duplicate type of service within themselves. It depends on the size of the organisation, but that is an example of where the total cost of asset management within an organisation may be less.

Mr GRIFFIN—You mentioned the asset valuation guidelines exposure draft document. Do you have any other comments on it?

Mr Edgton—I thought it was quite a good and reasonably simple explanation of asset valuation guidelines. The point I would like to make is that with asset management right through all the states—and I was involved with the initial committee in New South Wales over 10 years ago defining what asset management was and how it should be rolled through—I have seen an over-emphasis on valuation of assets. The organisations ask themselves, 'How should we implement asset management?' They say, 'Well, we are not sure. Let's go and collect information.' They then ask, 'What information do we need?' and they say, 'We are not sure. Let's go collect a lot of information.' So a lot of resources tends to be spent on that side of things rather than bringing that cultural change into the organisation.

That cultural change is where the benefit comes from, and that is where this has a lot of value. But it should be emphasised that this really only has value when it is implemented reasonably simply and when it is integrated with that cultural change. That is where the thinking on the overall performance of assets comes in. So it is not just valuation of assets. If you are valuing an asset and you put that valuation into your register and you have not identified the criticalness of that asset to the organisational level,

the utilisation and the functionality to the organisation, you have not collected the key information. That, in some respects, is even more important than the valuation.

CHAIR—Thank you for your submission and thank you for coming to talk with the committee today. We appreciate it very much.

Mr Edgton—Thank you for the opportunity.

CHAIR—We will, of course, send you a copy of our report when we bring it down.

[11.32 a.m.]

LEWINCAMP, Mr Walter Frank, First Assistant Secretary, Resources and Financial Programs, Department of Defence, A-6-40, Canberra, Australian Capital Territory 2600

TONKIN, Mr Robert Henry, Deputy Secretary Corporate, Department of Defence, F-2-10A, Canberra, Australian Capital Territory 2600

CHAIR—I now welcome representatives from the Department of Defence to today's hearing. We have received your submission and we thank you for that. Would you like to make a brief opening statement before we ask you our deeply penetrating questions?

Mr Tonkin—Yes, thank you, Mr Chairman. The Department of Defence supports the asset management principles which were set out in the appendix to the ANAO report No. 27 entitled *Asset management*. Accounting, management, reporting and systems changes are being progressed and the department plans to implement these principles across the defence organisation.

Given the size and the complexity of the defence organisation and the scale of its asset base, substantial improvement in asset management would represent a sufficient challenge on its own. However, the challenge is compounded by the conjunction of the historic whole of government reforms associated with the introduction of accrual budgeting and accounting, and the implementation and evolution of the defence reform program. Taken together, this represents a truly turbulent environment for both defence management and staff.

While we are very confident of achieving substantial and enduring improvements, the only certainty is that our achievement will fall short of theoretical best practice for the first couple of years. Defence management is content with this risk strategy. We are prepared to seek to overachieve and to learn from our initial errors and shortcomings. Our aim is focused on the longer term, where we expect to realise a number of enduring benefits from an accrual based outcome budgeting and accounting framework.

In summary, the benefits are, firstly, planning and management on the basis of government endorsed outputs and agreed performance levels, especially Defence's key output of developing and maintaining capable combat forces and the assets which underpin that capability. Secondly, the availability to managers of more timely and accurate information to support strategic decision making which will be provided by enhanced information systems. This will include measures of performance and reliable costing of outputs and the activities and services which contribute to them, and a better understanding of our asset base through the provision of consolidated information about assets, inventory consumption and stock levels. Thirdly, the identification of responsibilities and

accountabilities of managers at all levels for their contribution to the Defence outputs. This includes recognition of clients' supplier relationships, inherent in the effective delivery of capability and asset management responsibilities. Finally, the revision of business processes and rules and an awareness, education and training strategy and a changed management strategy. All these changes will be coordinated through a new Defence resource management framework, a brief summary of which was provided in the Defence submission.

Refinements and enhancements of resource management processes and systems are already being implemented. The new framework brings with it many changes. All financial processes, planning, budgetary allocations, in-year management, accounting and statutory reporting practices will need to change. The framework will be introduced progressively through 1998-99, with an initial target of sufficient implementation by 1 July 1999 to allow Defence to meet the demands of the new accrual based output management. While the challenges in progressing the extensive change and reform agenda are only too evident, the key strategic issue for Defence is how to maximise the opportunity which these challenges represent. Thank you, Mr Chairman.

CHAIR—Thank you for that. Am I right that asset valuation and management would not, however, have told you that the Leopard tanks needed airconditioning before you sent them to the Northern Territory?

Mr Tonkin—I think that is correct, Mr Chairman. Asset management by itself is not the whole answer to anything, nor is any one of these initiatives.

CHAIR—Can you explain the statement that you made in your submission that the agency probably most affected by the new accrual environment is Defence?

Mr Tonkin—I think the basis of our statement was because of the size of our asset base. If we have \$38 billion worth of assets, which is something like 70 per cent of the budget funded, that is I think readily apparent. Then you add to that the fact that a substantial proportion of our asset base is of a nature where valuation of it is somewhat different than the normal run of business, where most people are concerned with computing systems, office administrative systems, land and buildings. For those, we are on a par with everyone else. For other objects, it is somewhat more interesting.

Mr BEDDALL—In your asset management, you compare yourself to the private sector. Defence has a large amount of property around the country. Any legitimate business will assess property they own and see if it is suitable for their purposes, as well as make an assessment of the value of that asset as to whether it is too valuable for the purpose for which it is being used. To store ammunition in Sydney Harbour, you would not go out and buy the land today because of the land value. How much of that thinking is about looking at the assets you own, the value of them and the purpose for which they are used and then making an assessment about the disposal, if the assets are too valuable for

the purpose for which they are being used?

Mr Tonkin—We certainly have done that and are doing that. There are two aspects. As part of the Defence efficiency review and now the Defence reform program, we have identified a range of Defence facilities around the country which we wish to close and relocate the functions. Our estimate is that that will yield around \$400 million of one-off gains. On top of that, by taking these bases and looking at areas, we look at accommodation costs, for example. In Sydney, as an example, it costs three times as much to accommodate a service family on the North Shore of Sydney as it does to accommodate them at Holsworthy. That is just in terms of the rental and the capital costs you pay for housing in that sector. We look at those sorts of costs and rationalise facilities along those lines, always remembering that the first priority is the actual operational effectiveness of the force.

So we have identified some 33 bases to close as a result of the Defence reform program. That will be addressed progressively over the next few years. Those base closures also bring with them an efficiency gain of about \$140 million per annum in terms of reduced overheads. The more you can consolidate activities to get efficiencies of scale, the more you will get that benefit.

We have been rationalising our land and buildings for quite a significant period. We have a standing arrangement with government which says that Defence can retain within its budget base, assets or net income from the sale of land and buildings to the tune of one per cent of our guidance, one per cent of our budget, so it is about \$100 million now per annum. We have been managing our process and selling off land going back for a long time.

The next step is that we are embarking on a recurrent review of Defence's strategic locations, so we will go perhaps further than the Defence efficiency review went to consider these things, in all cases looking to say, 'Where is the most efficient place to put our resources? How can we maximise the value of those assets we have got?' So we will consolidate the management of all Defence assets into a Defence estate organisation and then run probably a notional rental system so commanders will be aware that, if you do not occupy the space available, you are going to pay for it in some way. That will focus people on what they actually require, so that we can again force more efficient decisions in this regard. We are doing all of that.

Mr GRIFFIN—We have spoken a bit today about the cultural issues with respect to the Public Service in general. In my experience of dealing with defence forces in a range of different inquiries conducted by this committee, I would probably say that the cultural issues in Defence are several times, if not many times, worse than the Public Service in general because of the whole nature of what Defence does. Could you comment on that?

Mr Tonkin—I would not agree, unless you can suggest to me specifics.

Mr GRIFFIN—Yes, I can suggest a whole range of things. There is the general management issue around the question of project management as with JORN and the submarines and the question of the valuation of the assets, what they are endeavouring to try and do with those assets and how they operate those assets in the interim. What comes through very clearly is the view that you have Defence's priorities as against general government priorities. How long do you want me to go on for?

Mr Tonkin—It is difficult to deal with what essentially are generalisations. I will just pick up the last point that Mr Griffin made, where he said that Defence pursues objectives which are not consistent with the government's objectives. I would flatly deny that is the case. To suggest that is to suggest that the leadership of the Defence force and the leadership of the department are not responsive to their minister or that their minister is not responsive to the government. I do not think you can say that.

Mr GRIFFIN—I think I can make a point that there has been a range of inquiries conducted by this committee and a range of other inquiries conducted by the ANAO which have shown a range of different recommendations required for action by Defence. They have suggested that Defence has got off the rails when it comes to the question of implementation of what has been government policy.

Mr Tonkin—Mr Chairman, I do not know whether you wish to spend a long period of time reviewing matters of previous discussions, but Defence has proceeded with quite a wide range of the recommendations which have flowed out of other inquiries and it is continuing to do so.

The general point I would make in response to Mr Griffin's observations is that one of the findings of the Defence efficiency review was the observation that Defence can do better, and we acknowledge that they can do better, in ensuring that all our activities point towards the achievement of the Defence mission—the defence of Australia, to put it simply—rather than perhaps looking at program specific objectives or single service specific objectives. We do have, within our Defence community and Defence organisation, lots of competing objectives and a hierarchy of interests. One of our challenges is to direct that towards the achievement of the Defence mission. That is not the same, I believe, as saying that Defence, either on a single service base or collectively, actively or deliberately proceeds down a pathway which is not consistent with the direction and requirements of the government of the day.

Mr GRIFFIN—My point—and I think you slightly misunderstood me at the start, although I still stand by what I said—is that the priorities of Defence are different to the operation of government in general because of the fact of what Defence does. For example, on inventory—

Mr Tonkin—Yes, I accept that.

Mr GRIFFIN—That is my point. And that, I think, is a cultural difference which, it can be argued, is necessary given what Defence does. But I would argue on from that, even if you allow for that fact, or put it as a fact, you have then got additional issues around the question of how you handle the issue of asset management.

Mr Lewincamp—I think there is merit in part of your comment. The Defence force historically—in fact, still, at the present—has a very great emphasis on effectiveness, on getting the job done. I think one of the cultural issues that we are addressing progressively within the Defence organisation, and have done over the last 10 years or so, is how to balance that with efficiency. Very clearly, we need to make sure that we are operating our assets and acquiring our assets in order for the efficient and effective delivery of the outputs to government. Increasingly, we are putting in place systems which provide us with the information to be able to make assessments about efficiency as well as effectiveness.

I think that is a cultural dimension that we have been addressing, and it would be quite valid to make a distinction between the way Defence approaches that business and perhaps the way other organisations do. There is a very strong emphasis on being effective in the delivery of capability and in getting the job done.

Mr GRIFFIN—What about the fact that within the actual services themselves there is a whole issue of management, which again people are approaching from a different perspective in that they are qualified, experienced, professional military personnel who are often in a situation where they are put into management roles where the emphasis is in itself quite different?

Mr Tonkin—To some extent, that is true and, to some extent, there is a reluctance by some to focus on their managerial responsibilities. One of the challenges for us is to ensure that the management systems and processes we put in place and the requirements we place upon them are based on commonsense—in other words, that we are not laying layers of theoretical overhead. What we certainly want to avoid is an environment such as in the introduction of accrual budgeting and accounting where a military commander of a support organisation, for example, simply defaults that responsibility to a civilian financial adviser.

One of the arts is to try and make the process transparent, sensible and manageable. When you break it down, there is nothing really different in the process of what you do between running an infantry battalion and running a stores depot, or something else. There are issues which go to leadership in operations which are self-evidently different but, in terms of the basic fundamentals, there is not a lot that matters. In fact, if you read a lot of the management textbooks and find out where they came from, they come out of military experience. So the trick is not to mystify the process so much that the warriors

decide this is all too much, too boring, or too irrelevant.

Mr GRIFFIN—How do you think that is going?

Mr Tonkin—That is an interesting question.

Mr GRIFFIN—I want to stress that I think it is a very difficult job.

Mr Tonkin—The warrior will always say that more is better. One of the things that we have done in the Defence reform program is to refocus the activities of the chiefs of service so that they have a more strategic role in the organisation—in other words, they have will not have to worry about running large parts of the personnel empire and so on; that is done by other providers. They can focus their attention on the strategic issues. While their basic inclination would certainly be that more is always better, and that more for them is always better, individually—which is quite natural—they are then confronted collectively with the issue that, if you add up all the mores, there is not that much. So they have to make those choices. I think there is coming to be a clear acceptance of this.

One of the pleasing things to come out of the Defence efficiency review—when you read through the piles of material—is that those initiatives that are sitting in the detailed stuff came from the people of our organisation, service and civilian. So there is a strong desire to do a lot of this stuff better, and a strong recognition to say, ‘Here’s a great chance to break away from what we used to do—custom and practice and stuff—and start again in different ways.’ So I am pretty confident that we are getting there, but you will find pockets of resistance, or reluctance, or just natural scepticism.

Mr BEDDALL—Never surrender. This is very much about asset management. I have got a filing cabinet on one thing which, thank God, is no longer in my electorate, the Canungra jungle warfare centre, where the department compulsorily acquired land during the Vietnam War and never used it. The family never acknowledged the fact that it was theirs. There was a dispute and, even though the land has never been used by Defence, as far as I know Defence has still kept the land. It was just this attitude that it was ours and you cannot have it, no matter what, even though it was surplus to requirements. Maybe that attitude has changed.

Mr Tonkin—Taking note of the Chair’s caution that we are drifting into areas which are well outside the inquiry, in relation to that particular asset, that particular case, the land was compulsorily acquired because we felt there was an increased requirement for jungle training during the Vietnam War. As we have continued to use the Canungra jungle training facility quite extensively, the area of the land in question came within the safety arcs of ranges. In other words, you can have a requirement to have land that you walk over. You can have a requirement that, if other people walk over bits of land, they run the risk of being shot by a stray bullet. Now, in the interests of our care and concern for the citizens, it seems prudent to encourage them not to do that.

Mr BEDDALL—A lot of training went on before that land was acquired. Maybe the rifles shoot further these days.

CHAIR—I want to redirect the question. In talking about the magnitude of change, you said:

While expecting to be ready by 1 July 1999 to meet necessary whole-of-government and Defence requirements, the size of the task and the time required to put replacement and upgraded corporate systems in place will result unavoidably in a stepped approach to the new framework.

Then you go on and suggest that:

. . . full requirements of the new accrual based management framework will not be introduced until 2000-2001 or later.

How are we going?

Mr Lewincamp—Perhaps I could respond to that, and also to the earlier question about how it is going. As Mr Tonkin indicated, we have already achieved a significant cultural change. There is also a sense of frustration in the organisation at the moment because we are unable to manage that as we would like to because we simply do not have access to the right management information. We are not able to give our managers at all levels of the organisation exactly the sorts of information they will need in an accrual output based environment.

CHAIR—Such as the value of a Leopard or the value of a tread for the Leopard?

Mr Lewincamp—The full accrual cost that goes in keeping a tank capability, for example, yes: what is the opportunity cost of the investment in the tanks compared to what we might be able to get if we invest that money in some other capability.

In terms of the strategy, we are putting in place a range of new corporate systems. The new personnel corporate system is going through final source selection at the moment, and that should be implemented by the end of next year. There is a new financial management system which will provide much of this information that we want, and that is currently out as a request for proposal. We hope to have source selection for that by October this year with partial implementation for next year. We will put in place a budget module and a Treasury module and a general ledger. It will be about 18 months away before we have the full implementation of that system.

So it is those types of systems—and I am talking about them cascading right down through our organisation. We are confident by 1 July 1999 we will have in place portfolio level processes that will enable us to meet our external requirements for whole of government accrual output and management reporting. I cannot tell you that by that date we will be managing on an accrual basis right through the organisation. That will take

about a further two years.

CHAIR—We have heard from other respondents to this inquiry, and indeed ANAO tell us, that too few of the departments in their view have taken this whole issue of both valuation of assets and their management seriously at a CEO or senior executive level. Can you tell us what you are doing in Defence and how you view this?

Mr Lewincamp—Certainly, we take that very seriously. At the moment, for example, we are going through a complete revaluation of our assets. We do that every three years, as you will appreciate, anyway. But we are going through a complete review of our asset valuation and recognition so that by the time we get to July this year we have our opening balance right, if you like, in terms of asset valuation and asset recognition. We are reasonably confident that we will be in a good position at that stage.

As Mr Tonkin indicated earlier, though, it is a more difficult problem in Defence, given the nature of our specialist military equipment. In fact, valuations that we use on that are basically those of our own officers, and ANAO has accepted that that is the most appropriate valuation methodology.

Every time that we put a new sonar, a new radar or a new weapon on a piece of equipment, we have to revalue it and it is a very difficult process for us. I do not want to underestimate the complexity of this, but we are reasonably confident that we will have our asset valuations in good shape by July this year.

Mr Tonkin—One of the other things that we have done with the general encouragement of ANAO is that this year we will require our senior program managers, chiefs of service and others, to actually sign off or formally certify that the information they are providing in our financial statement processes—including the assets under their control and the valuations—is materially correct, as it builds up to the portfolio process. The reason for doing that is to increase the consciousness because once they have to sign on the dotted line that, yes, the material that they are feeding into the systems is correct, instead of having Mr Lewincamp being personally liable for the accuracy of the totality, they will share that liability.

CHAIR—Are you also reasonably confident that your asset valuation does not include some substantial number of spare parts, for instance, for obsolete equipment? I can recall taking over a company in the private sector. We did a stocktake, I looked at the store and I found that the value made some reasonable sense, except that there was nobody left using that equipment and no-one was ever going to buy that spare part. So instead of being at a value in the store, it should have been there at a negative value because it cost me money to take it to the tip.

Mr Lewincamp—I understand that came up earlier.

CHAIR—I have been around a few defence establishments. I worked for the United States Navy for a couple of summers in an overhaul and repair station. I know what kind of stuff was lying around that somehow was on the books for something. Are you confident, though, that you have got all that stuff reasonably valued?

Mr Tonkin—You would certainly be able to go and find some stuff lying around. I found some years ago a Daring class destroyer propeller shaft. It was about 10 years after they went out of service, and it was there just in case something came up—it was useful. I think the point is not whether it is lying around but what value has been placed on it.

Mr Lewincamp—I am confident that our current asset cleansing process will get rid of any remaining items of that nature.

Mr BEDDALL—When will that be finished?

Mr Lewincamp—By July this year.

CHAIR—I do not envy you the stocktake, or the valuation process after the stocktake. Your submission states:

Most Defence assets are specialised military equipment and supporting inventories and infrastructure required to deliver combat capability. Through a comprehensive force development process, current and future capability needs are assessed, and investment in the maintenance and enhancement of capabilities is planned. This includes assessment of the adequacy of current assets and their economic life-of-type, and a systematic examination of proposals to replace these assets and to acquire additional assets.

That seems to me to be a huge undertaking for Defence.

Mr Tonkin—It certainly is. Again, one of the themes of the defence reform program is to provide a more total approach to strategic planning, strategic management and capability development. You do that in a number of ways. One of the processes that Mr Lewincamp and his colleagues are contributing to is to re-express our organisation in terms of outputs rather than in terms of input costs. That will give us visibility as to the costs of the various force element groups, the cost of the submarine force, cash and accrual, right across, who contributes to that, and what the slices are. If we look at that by every output of our organisation, we start to then form these judgments: why does this particular output, which does not seem to be contributing a heck of a lot to the totality of our business, consume this big slice of money? In other words, you put it up on a matrix and you start targeting the big lumps. That helps us to drive our decisions process to think about bringing objects, bringing capabilities, out of service before they may be obsolescent because they are not cost effective.

We are also running through the defence capability committee a more total cradle-

to-grave process for capability, so that you take a decision based on the full life, the through-life cost of the equipment, rather than making a decision based on the capital cost and three years' spares, taking into account factors like the personnel operating costs of a new capability because, despite the protestations of the proponents often of a lot of this stuff, it costs you more to run the new stuff than it did the old. Where does the delta of funds come from? We are driving down a process to be much more disciplined in dealing with all of those aspects so that we get the right sort of choices made.

Mr Lewincamp—We are also putting in place an enhanced performance management framework within the organisation and, particularly in this capability area, we are refining and enhancing our performance measures of capability, in terms of what these force element groups actually deliver. We will then be able to make a better assessment of what we want them to deliver and how much we are prepared to pay for that. That will flow through into decisions on the assets that underpin the capability.

CHAIR—What do you think about an asset use charge?

Mr Lewincamp—It is a discipline. I think the previous speaker was saying that it is okay provided it is applied simply. We would support that. The quantum of the charge is a matter for some debate. We think 12 per cent is a little high but it is a matter for government to make that decision. It does provide a useful discipline in the organisation. We are, of course, prepared to go along with it.

CHAIR—Wouldn't that help you with respect to the example you were just talking about where you have, for instance, a high value, under-utilised asset that is of questionable value? Wouldn't having to sustain the charge for that asset make you re-think very quickly and very strongly whether it was worth keeping?

Mr Tonkin—We would support that because that is the process whereby the capital use charge works in your interest. We would expect that when the capital use charge is introduced our budget would be supplemented for the initial cost of it—\$4.6 billion was the figure I heard. If we can then manage our assets so that we can realise 'profit' from the managers of the capital use charge and reallocate that to some other productive purpose, that is good. If there are mechanical or technical difficulties in terms of bringing assets to valuation, especially when they come out of the production pipeline into service or something like that, which causes a technical glitch which could run the other way, we are naturally less attracted to that. Essentially, as Mr Lewincamp said, what we would like is a pretty simple and straightforward system, not another large and complex overhead that we have got to worry about in great detail.

Mr BEDDALL—What about a broader use of your assets as a community asset rather than just a Defence asset? For example, I saw recently that the new airfield near Weipa has just been completed. It is very much a northern Defence asset, worth \$130 million. We have also got an airport at Weipa. There are two caretakers at the air base

when there is nobody there. Why couldn't that be utilised as a community asset and the other one could be closed down?

Mr Tonkin—I am not sure why it could not be utilised. The only concerns we would have—we get a lot of questions about public use of playing fields and things like that—are insurance charges and costs and those sorts of things, but they are things that can be managed.

Mr BEDDALL—The US Air Force does this in many airports.

Mr Tonkin—Another example would be the one at Learmonth. Learmonth is the airport for Exmouth. There is a civil terminal there. I think the same applies at Curtin. I think the airfield at Scherger, which is the Weipa one, is a bit out of town.

Mr BEDDALL—Thirty kilometres, isn't it?

Mr Tonkin—Maybe the bauxite miners do not like driving 30 kilometres.

Mr BEDDALL—The current airport is quite a distance away, anyway.

Mr Tonkin—In principle, so long as we can protect the taxpayer from the downside risks of liabilities—

Mr BEDDALL—You could use Richmond at Penrith for the second Sydney airport.

Mr Tonkin—I have no comment on that.

CHAIR—Could you elaborate on this statement in your submission:

As asset management issues have been identified, Defence has initiated corrective action.

Can you tell us what it is you are talking about?

Mr Lewincamp—We are responding progressively to the recent ANAO findings on a number of asset issues. You might recall that the issues they raised really related to things like ownership of the systems by particular elements of the programs. For example, they commented on our financial management information system, the capital projects model and the asset management model about ownership. They talked about control of data and access to the system. We are progressively responding to each of those findings—I think, to the satisfaction of the National Audit Office. Perhaps we are doing it a little more slowly than they would wish, but we are responding to them.

Mr Tonkin—In some of those instances it was simply a case of saying, 'You are

responsible for the management of this modular system,' and that solves the ownership issue.

CHAIR—If, as a hypothetical, I told you that there was to be a central agency with a common policy for mechanics of value, without being absolutely prescriptive, but with a consistent application across all agencies to both value assets and some procedures regarding their management, would that upset Defence?

Mr Lewincamp—They would probably get their skilled expertise in specialist military equipment from us and poach our staff. That would be about the only source of it within Australia.

Mr Tonkin—As with many of these sorts of notions, we find it somewhat amusing that, while the philosophy all speaks of devolution to heads of departments and managers in general, we find a constant litany of suggestions that certain functions should be centralised across a whole of government perspective. When we then inquire about what that means, we find that it is a 'one size fits all' system. As Mr Lewincamp says, a lot of what we do in this area of asset management would not compute, but we are the experts in respect of this area. My general response is usually that there is merit in establishing central agencies to undertake such functions as a service to small agencies which otherwise would bear a disproportionate overhead for doing it. For those agencies which have a sufficient size to undertake their own activities, there is little merit in being drawn into that net.

CHAIR—If we had 10 government departments—again, this is hypothetical—and 10 separate procedures for valuing buildings, do you think that is in the Commonwealth's best interest?

Mr Tonkin—No, that is not what I am saying. There is nothing wrong with central organisations, in consultation with major users, developing common principles to be applied. That is a reasonable thing to do. That is not a particularly great overhead. To suggest, however, that one agency would do it on behalf of everybody else, or by extension then start to direct how those assets are used or managed, then you start to cross the pain threshold.

Mr BEDDALL—There is this argument that, because Defence does it, Defence knows best. There was one instance recently with the JORN project. Defence's project management skills were not good enough to run the program. So it does not necessarily follow that, because you actually have the project, you can do it.

Mr Tonkin—Mr Beddall, I just draw the distinction that what I am saying in respect of assets, and particularly staying on asset management, is that there is a class of assets which are Defence assets which are, by their nature, unique in terms of asset valuation. In relation to the issue of project management in general, you can run a counter

line to say that there is an approach to project management which is relatively common across wider rays of activities in the private sector as well as the public sector.

Mr BEDDALL—But you have two classes of assets, don't you? You have the assets that are Defence specific and then a whole range of other assets.

Mr Tonkin—I am not running this argument in respect of the non-Defence specific assets.

Mr Lewincamp—I might be able to short-circuit the debate because we actually used the Australian Valuation Office for land building and infrastructure that is not Defence specific military equipment. We follow a whole of government process in the way that we do that evaluation. So I do not think it is an issue.

Mr GRIFFIN—We can get your asset base as outlined in the submission. I guess what you are talking about in terms of Defence specific is most of the infrastructure, plant, equipment and, I gather, inventories as well. Would that be correct?

Mr Tonkin—Yes.

Mr GRIFFIN—So it is the overwhelming majority of what Defence assets are, in the circumstances, less, value wise.

Mr Tonkin—Yes. You would probably find that some element of that is administrative in nature and hence common anyway. But, in dollar terms, it is going to be the big ticket items which drive the total equation.

CHAIR—What is the 'other' item? In your summary you have land, buildings, infrastructure and all that stuff and then you have 'other, \$0.6 billion.' In other words, \$600 million. What is 'other' for \$600 million? With respect, that is a lot of money.

Mr Lewincamp—It is administrative type assets such as computers, desks, IT systems mainly, furniture and fittings and all that sort of thing.

CHAIR—Furniture and fittings? I would not have thought that would have been under infrastructure, plant and equipment.

Mr Lewincamp—No. It is mainly computers and IT systems.

CHAIR—Your submission states:

Defence has a number of asset management systems and a significant challenge has been the acquisition of accrual functionality for these systems, complicated by the sheer size and diversity of the assets involved. For example, the Standard Defence Supply System has approximately 1.7 million line items covering inventory and spare parts for weapon systems. Defence does not intend

to acquire one asset management system for the new framework.

Would you like to talk to us about that?

Mr Lewincamp—It is a judgment that we have made at this stage that acquiring one system in a big bang type approach would simply be too difficult. At the moment, we have a range of systems that provide information to us on assets. What we are trying to do is to simplify the number of systems that provide that information and then make sure that we can pool out of those systems through a data warehouse concept the information we need for corporate management purposes rather than a single system.

CHAIR—Can you work between varying numbers not only on your register but also on your chart of accounts?

Mr Lewincamp—Sorry, I do not understand.

CHAIR—If you have a chart of accounts that discards expenditure or whatever against a particular asset type item, can you ensure that your central computer system can intelligently recognise the fact that a chart of accounts item in one of your systems is the same as a chart of accounts item in another?

Mr Tonkin—We only have one chart of accounts, though.

Mr Lewincamp—Yes, we have one chart of accounts.

CHAIR—One chart of accounts, right.

Mr Tonkin—If this is a question of systems to record assets, it is a matter of getting—

CHAIR—So you get separate registers but one chart of accounts?

Mr Tonkin—Yes.

CHAIR—Okay. That clarifies that. Gentlemen, thank you very much. I can assure you that I do not think there is anybody here that does not recognise the immensity of the task that you are going through. We accept that and we wish you good luck in the challenge.

[12.13 p.m.]

FIELDING, Mrs Diane Mary, National Manager Finance, Centrelink, Tuggeranong Office Park, Australian Capital Territory

CHAIR—Thank you very much for coming to talk to the committee today. We have received your submission, for which we thank you. Would you like to make a brief opening statement to the committee before we ask you searching questions on what you have told us.

Mrs Fielding—Thank you. I will make a very brief statement, just basically to establish the framework in which Centrelink is operating and make a few pertinent comments that we did not actually tease out in the submission. As you probably know, Centrelink was established under the Commonwealth Services Delivery Agency Act and came into being on 1 July 1997. Centrelink is in a purchaser-provider relationship with a number of welfare related policy departments including: Social Security, from whom we actually obtain most of our staff; DEETYA; and Health and Family Services. We are in a relationship with them to provide service delivery. We see ourselves as just the beginning of a one-stop shop concept within the Commonwealth government. We like to say that in the future we will be the face of government. Essentially, that is Centrelink and what we are about.

We have approximately 24,000 staff located in about 400 sites. That varies and, in fact, needless to say, that is one of the issues we have to address in terms of asset management. In terms of demand for our services, we are frequently opening and closing offices and changing staffing numbers. We pay over \$40 billion in welfare payments each year. Having said all that, we are a relatively small holder of assets. Our total asset holdings are \$150.7 million. Of those, IT hardware dominates at \$59.7 million. Leasehold improvements—in other words, the fit-out for our offices—is \$36.5 million, and IT software is \$23.9 million. They are our main asset categories.

One reason that we are not a particularly large asset holder—and, in fact, we have declined over the last few years—is that we have made a number of business decisions, initially as DSS and now as Centrelink, to lease a lot of the resources that we utilise, rather than buy them. We own very little property these days and, where we do own it, it is predominantly in the far west where it is very difficult to acquire leases. We also lease our office machines. We have two very successful click charge contracts with Xerox and Lexmark in relation to those. We do not make a major funding decision within the organisation without a business case. That is a rule that we apply very rigorously within Centrelink. Included in any business case has to be whole-of-life costs for any additional assets that we need to acquire to undertake that project.

In closing, I would like to say that we take asset management seriously, even though we do not have a particularly large number of assets, particularly compared to your

previous interviewee—

CHAIR—Fair enough. You do not have many tanks.

Mrs Fielding—We do not have any tanks! We do think that asset management is important. It impacts very much on the concept of stewardship within the organisation and, of course, it is important for both decision making and our planning.

CHAIR—What do you think about the concept of a capital use charge?

Mrs Fielding—I am on the steering committee in DoFA for the implementation of accrual budgeting. You would be aware that the capital use charge is a very hot issue within that committee. It makes a lot of sense, I believe, in terms of the fact that, as we move into a contestability environment, we have to make some payment for our capital. I have a concern that we need to get it right. You are probably aware that at present DoFA is talking about 12 per cent as that charge.

CHAIR—We heard.

Mrs Fielding—We are having a lot of difficulty obtaining from them exactly where they got that figure from, particularly as we are aware that the UK's cost of capital charge is about six per cent. My concern, if we do not get it right, is that it could lead to some inappropriate decisions in the future, particularly in terms of leasing—decisions may be made to lease assets where, if there were an appropriate charge of capital, the decision may go the other way. So I believe we need one, but we need to get it right.

There is also a tension between the charge of capital and depreciation, which is going to fund our asset replacement in future. If the charge of capital starts to devour the bulk of the depreciation that we are getting returned to us as funding, again it could lead to inappropriate decisions in terms of buy or lease.

Mr BEDDALL—Whilst you do not physically own a large number of Centrelink offices, a large proportion are Commonwealth owned, aren't they?

Mrs Fielding—These days, we lease most of them from the private sector. We have a real estate firm, Knight Frank, which is in a strategic partnership with us. They look after all our leasing. In terms of ownership, when I said before that we owned properties in some rather obscure neighbourhoods, they are predominantly houses for staff in places like—

¥\DB\SPC\QE4\MR BEDDALLP**Mr BEDDALL**—Maybe my electorate is unusual.

CHAIR—Kalgoorlie?

Mrs Fielding—I do not think so. In Kalgoorlie we rent. Where there is a rental market, we will rent, but there are some places, incredibly, where we have offices where we find it very difficult to accommodate staff.

Mr BEDDALL—Maybe my electorate is different because of the three Centrelink centres. Two of them are Commonwealth owned and the one you are closing down is the one that is leased. So maybe that is unusual. The Commonwealth is no longer building those centres in urban areas, is it?

Mrs Fielding—No. I am surprised that there are two of them. I presume they are within Commonwealth buildings.

Mr BEDDALL—That was the point I was making. In essence you say you are opening and closing offices. These buildings are purpose-built buildings and if Centrelink is no longer a tenant—

Mrs Fielding—There are some, obviously, that will always be with us. They are areas where we know we will always have a high level of customers. Within some other areas, we may open offices if, for instance, there is an unfortunate occurrence that leads to increased unemployment in that area or we notice within demographics that there are an increased number of families, but there are a number of offices and it is usually the ones in the big Commonwealth centres that will always be open. It would vary, probably, from about 380 to 420 across the Commonwealth over the years.

CHAIR—On Friday, ANAO tabled a report called *Auditor-General's Audit Report No. 41: Asset Management 1997-98*. One of the things they said was:

The audit also confirmed the limited nature of central policy advice and guidance which is in contrast to the experience in a number of State jurisdictions.

I recognise that it probably goes to policy, but do you have a comment or would you be willing to make a comment about your view of the desirability of some centralised guidelines which are not necessarily 100 per cent procedure based, but would at least produce commonality across all of the Commonwealth departments in respect of procedure for valuing assets—excluding some of Defence's more specialised stuff, which we all understand—and for managing them?

Mrs Fielding—Yes, we would certainly welcome some higher level policy advice. At present, as the audit office has quite rightly stated, we are basically to a large extent on our own. To a large extent, we make our own decisions in terms of asset policy. There would be considerable benefit in an organisation like DoFA, for instance, giving us more policy advice. Having said that, I would hope that that advice would be outcome focused rather than process focused. I would like them to be able to say to us, 'This is what we expect you to achieve,' rather than, 'This is how we expect you to do it.' I felt that that

was a big problem when Purchasing Australia was responsible for procurement policy within the Commonwealth.

When things went horribly wrong, they chose to be very prescriptive in terms of how we went about our business instead of saying to us, 'This is what you have to achieve; how you get there within broad parameters is up to you.' But we would certainly welcome some more information on that basis.

In terms of valuation, yes, we would be quite comfy with being given directions on valuation. We already use the Australian Valuation Office pretty regularly to revalue our assets. In quite a number of circumstances, particularly with property—and this is, again, in very obscure outback areas—we quite often use rate notices and real estate advisings for those areas. We find it is more cost effective for us to do that than to use the AVO in those circumstances. Certainly, the audit office, the people who do our financial statements, seem quite comfy with that. So we would like, certainly, enough flexibility to be able to make those decisions.

CHAIR—The Auditor-General said that, in 1996-97, all Commonwealth agencies disposed of, at written down value, \$93 million worth of assets, for which the Commonwealth received \$52 million. Have you got any idea how Centrelink would go in such an evaluation?

Mr BEDDALL—You would have no assets left.

Mr GRIFFIN—She would not have much left.

CHAIR—No, she has got \$150.7 million worth of them.

Mrs Fielding—I could not tell you what our figures were for last year, but I could certainly get back to the committee if you would like that information.

CHAIR—I like what you are saying, and I like what I saw in your report. An indicator to the committee of whether you are really doing a good job or not would be that set of numbers. Does that make sense?

Mrs Fielding—Yes. I will get them for you.

CHAIR—That would be good.

Mrs Fielding—I was interested in the comments before about giving away assets. I must say, particularly with some of our old IT equipment, that we do give it away, usually at the time when its written down value is pretty close to zero. We find that it helps us and it helps a lot of the community service organisations if we give them computer equipment.

CHAIR—I think the committee's concern is not an issue like that. That has certainly got to be of good value. It is where so little attention is paid either to the original valuation of the asset or the depreciation process, or no attention is paid to going back and periodically testing the book value of that asset against what is potentially realisable if the asset could or might be disposed of in the foreseeable future so you do not wind up with a situation where you have got very high book values and very low realisable values, or indeed, the other way around. It would be absolutely ludicrous to have everything written off and find that the real value on the street was twice what it is in the books.

Mrs Fielding—We revalue our long-term assets, as I said before. I think we make a comment about deprival value and whether that is a great deal of use to us. A lot of our assets are short-term—three years, four years. They are computer equipment that we turn over very rapidly. With them, we have actually made a conscious decision not to revalue them. We feel that that short period of time does not warrant a serious revaluation, whereas with land, buildings and fit-out for the buildings we lease, they are revalued on a regular basis.

CHAIR—You said that one of the methods of monitoring is stocktakes in which all asset registers Australia-wide are subject to a rigorous check. Have you got many of those, and how often do you do that?

Mrs Fielding—Yes. While we say many asset registers, essentially we only have one asset register, but each location in which we exist we could see as a separate register within the overall register. We stocktake twice a year. It is a big job. We find by the time we have finished and resolved the queries that arise, quite often it is getting quite close to the next stocktake commencing.

CHAIR—Is that overkill?

Mrs Fielding—No. I do not think so at present because we still identify a lot of problems. Once we have got it right I might feel it is overkill, but not at present.

CHAIR—What kind of problems are you finding, and why?

Mrs Fielding—There are two problems. One of them is the very basic fact of recognising that an item is an asset, and that is education as much as anything else. I know a couple of years ago when we first started getting serious about assets, we found to our horror that we had quite a few people who were supposed to be looking after assets who saw fixed assets as assets that were actually chained down. They did not really understand the accrual accounting concepts. We have done a lot of work educating people since. But that is a problem. The stocktake will pick up things that are in that situation.

We also run a report each month that we look at within our central asset group within my branch, which basically says, 'Tell us all the over-\$2,000 procurement activities

that occurred this month,' and, with the description there, it is very easy to quickly go through that report and identify where we have had assets that have been missed. So that is a problem we just have to keep hammering away at.

Our other problem, which again is probably quite specific to us, is in transferring assets. With opening and closing offices, we move assets pretty regularly from one office to another, and people are slack—they forget to record that transfer in the register. We find they tend to be quite meticulous about disposals—I think there is probably again a stewardship concern—but they are a bit blase when they move the assets around, and of course that comes out in the stocktake.

We also involve our assets in our risk management strategy for the organisation. About 18 months ago, we decided to move from a very prescriptive process policy to one where our chief executive instructions focused on outcomes. So as a framework for that sort of approach—which basically says, 'Let the managers manage. We will tell you what you have got to deliver, then you work out how to deliver it'—we have embedded a risk management strategy for all key financial areas, including assets, and that is underpinned by a quality assurance process which basically checks to make sure that we have got it right in terms of identifying risks and how we are going to manage them.

It has been very successful. We actually won the CPA award last year for outstanding contribution to public sector accounting with that revised process, so we are quite proud of it, and it does augment the stocktakes. In fact, I believe that progressively it will become a more important element than the stocktakes in how we manage assets and a number of other financial elements.

CHAIR—You were talking about cost control and that you will report, and you said an example is the depreciation forecast report, that asset managers will use this report to simulate depreciation for selected assets for individual asset values and for future fiscal years. Have you become sophisticated enough yet to use a variation analysis for reporting on that?

Mrs Fielding—No, not yet. We are implementing a new financial system on 1 July. In fact we went into pilot today. We have acquired SAP, which we believe is quite a superior product when it comes to financial systems and, once we have moved into full production there, we believe that we have got the tools to do a lot of simulation, not only in terms of asset projections but also in terms of our budgetary projections in general to a far more sophisticated level than we can at present.

CHAIR—So you think you then could get down to the point, instead of reporting all this massive volume of data, where you can get down to variation analysis, which really tends to focus on those issues or those areas where there are in fact problems?

Mrs Fielding—Exactly, exception reporting—and that comes in with the risk

management as well where we are only focusing on issues where things are not going right.

CHAIR—Have you got anything else?

Senator GIBSON—No.

CHAIR—Thank you very much. We appreciate your report, and your frankness and forthrightness in answering the committee's questions.

Mrs Fielding—Thank you. I will get that information.

CHAIR—It sounds like you are doing pretty well. If you can give us a good number, then we will give you a red tick or a blue star or whatever.

Mrs Fielding—We try hard. Thank you.

Proceedings suspended from 12.35 p.m. to 2.04 p.m.

PEIRCE, Mr David Michael, Acting Assistant Secretary, Financial Management Branch, Department of Foreign Affairs and Trade, R.G. Casey Building, John McEwen Crescent, Barton, Australian Capital Territory 0221

CHAIR—I now welcome the representative from the Department of Foreign Affairs and Trade to today's hearing. Thank you for your submission to the inquiry. Would you like to make an opening statement to the committee before we ask you penetrating questions about your submission?

Mr Peirce—Yes, thank you, Mr Chairman. As background to our management and asset structures in the department, I think it would be useful to let you know what sort of assets we do have. DFAT currently manages its assets in a decentralised environment—many posts are overseas—and only collates accrual information on assets once a year for preparation of annual accrual financial statements.

The full accrual framework for Commonwealth agencies introduces regular financial reporting to government—I think it is in the year 2000-01—firstly quarterly and then monthly. It is this particular requirement that influences the way we have to manage assets in the department. While DFAT has a full accrual system in place—indeed, we are recognised by the Australian National Audit Office as being best practice in accrual reporting—it is decentralised and could not support regular reporting to government in its current operation. Therefore, it is necessary to introduce central recording and reporting of non-current assets. This will require systems, procedures and policy changes and will be expensive to implement and, of course, there is no supplementation for that cost.

The nature of DFAT's non-current, non-financial asset base is largely information technology. We have three sites where we control our assets as a special database: overseas, in the states and in Canberra. We have 32.43 per cent of our assets managed overseas, 0.9 per cent in the states and 66.6 per cent in Canberra. An example from our post profiles of assets indicates that 85.9 per cent of post assets are IT equipment—mainly computers as well as office equipment such as faxes, photocopy machines, et cetera—5.6 per cent are motor vehicles and 8.5 per cent are other assets. From the Canberra database, which is the most important one, 1.28 per cent of our assets are furniture, 91.53 per cent are computers, 3.96 per cent are other office automation equipment—which makes 95.49 per cent in comparison to the posts—0.04 per cent are motor vehicles and 3.1 per cent is plant.

Computer equipment, which makes up the majority of DFAT non-current assets, has an industry standard shelf life. This is dictated as much by software as it is by hardware. DFAT has, or is introducing, depreciation programs that reflect that useful life. It is therefore not a major issue for the department in the move to the deprival method of asset valuation. IT assets are also easy to manage in terms of matching against outputs. Once post outputs, for example, are quantified, it will be a simple planning procedure for a post to forecast the amount of IT replacements to match those outputs. This planning

can be done from a central database, which is what we are now going to introduce.

Posts and Canberra divisions manage their own assets, as do states, but standards for IT equipment are set by our information technology branch. We have two major asset bases in IT: one is the secure network and the other is the non-secure network. The secure network is physically managed by our information technology branch, and the non-secure network, which is now being rolled out to all of our sites, is also increasingly being controlled by our information technology branch. In other words, most of the asset management practices are managed through the IT strategic plan of our IT management branch.

CHAIR—Thank you for that. We were told by the Auditor-General that in 1996-97 at written down value Commonwealth agencies disposed of some \$93 million worth of assets which achieved a selling price of \$52 million. Could you tell me where DFAT would stand in such a comparison?

Mr Peirce—I have last year's figures here for asset disposals: the gross value of assets disposed last year was \$25,220,070, the cash received for those assets was \$1,478,000 and the trade-in value received was \$950,000. Our gross value of assets at the end of the financial period was \$145 million and the accumulated depreciation on the assets was \$80 million approximately.

CHAIR—You lost me in there somewhere. I thought you started out saying that you disposed of \$25 million worth of assets—

Mr Peirce—Yes.

CHAIR—And how much did you receive for that?

Mr Peirce—For that, we received \$1,478,000 in cash and we received a trade-in of \$950,000 on those assets.

CHAIR—So we got something less than \$2 million for \$25 million worth of assets.

Mr Peirce—Yes, Mr Chair.

CHAIR—That is worse than the average of the total. How did you get it so wrong?

Mr Peirce—Basically, most of our assets are IT—office automation equipment, computers, desk-top computers—and after three to five years those assets are virtually valueless.

CHAIR—Then why were they on the books at value, if your system is so good with respect?

Mr Peirce—There was a full depreciation. Of that \$25 million worth of assets disposed, the accumulated depreciation was \$22 million.

CHAIR—What I did ask was the written down value of the assets you sold, not the purchase price.

Mr Peirce—I am sorry.

CHAIR—So you sold \$3 million worth of assets at book value for \$2 million?

Mr Peirce—Yes, that is right.

CHAIR—That is not so bad, thank you. I am glad you clarified that. You really had me concerned.

Mr BEDDALL—With all the change around in departments and the creation of DoFA, who now owns the embassies and residences, et cetera, overseas?

Mr Peirce—Foreign Affairs does not own any real property. To my understanding it is still with OPG which is part of DoFA.

CHAIR—Really?

Mr Peirce—Yes.

CHAIR—So you own none of the overseas assets?

Mr Peirce—No.

Mr BEDDALL—It used to be Administrative Services, didn't it?

Mr Peirce—Yes.

CHAIR—I was going to ask you questions about that but we will wait and ask DoFA about that.

Mr BEDDALL—They want to set policy.

CHAIR—If that is the case, how on earth do you report to the Commonwealth on asset management when, in fact, you are charged with the responsibility of using those

assets to achieve your corporate goals and government directives? How does reporting on asset management work when you have no responsibility for the value of the asset?

Mr Peirce—Under the accounting standards we do not effect control of those assets; OPG still manages them. However, what happens is that, up until last year, OPG charged a notional fee, which was a resource received free of charge and was part of the annual financial statements, a value for our use of those assets overseas so that the department reflects in its operating statement a cost of being in those properties.

CHAIR—Is that in the nature of an asset use charge?

Mr Peirce—Yes, part of it is.

CHAIR—Up to the standard that is being talked around the trap—that is, 12 per cent?

Mr Peirce—I do not think I can give you an answer on that, Mr Chairman. I would have to take that on notice and find out the exact fee arrangement that OPG have charged us. There is a component of the use, the leased value of the properties and what they see as a market lease value of the properties where there is not a marketable comparison. Some part of that fee is also the use of furniture and fittings that they provide and they had owned up until last year. I cannot tell you the percentage of the cost of use of that real property to us, but I can find out.

CHAIR—Have you complained about that management arrangement?

Mr Peirce—No, not really, because largely those resources received free of charge have been controlled by, if you like, standards and guidelines by the Department of Finance and Administration and all agencies who provide those fees to other agencies, and they are of course audited. So OPG's value of the assets' use to us would have had to have been compiled according to guidelines, and they would have been audited. We have accepted the fee and we have bought them. We did not complain because, with resources received free of charge, there is an immediate offset, so there is a debit and credit on the operating statements; so it has nil effect in terms of our statements.

CHAIR—Would you rather control your assets and be responsible for them?

Mr Peirce—I could not answer that. I think that would be a broader policy question.

CHAIR—Okay, fair enough. I recall, in the last government, we sold the Japanese Embassy—

Mr BEDDALL—Sold part of it, sold the gates.

CHAIR—As I recall, the realised value was several times the book value.

Mr BEDDALL—You can say we sold it at the top of the bubble. Before the ink dried on the sale, the bubble burst in Japan. It is now a wired-off enclosure with no building on it.

CHAIR—On Friday, the auditor out of session tabled a document called *Auditor-General Audit Report No. 41: Asset management 1997-98*, and a statement from that was:

The audit confirmed the limited nature of central policy advice and guidance, which is in contrast to the experience in a number of State jurisdictions.

Would you like to comment on that statement?

Mr Peirce—This is in terms of the central agency DoFA?

CHAIR—A central agency, whatever. In other words, we are talking about asset valuation and asset management. They are not totally disassociated but, I suppose, separate topics. Many people have put to this committee that they believe there needs to be more than simply a set of principles; there needs to be at least some degree of regulatory approach to gain consistency across all Commonwealth agencies in terms of how assets are valued and, to an extent, at least, how they are managed.

Mr Peirce—There has been, I suppose, in the introduction of accrual reporting—I guess the beginning of the whole accrual framework—more of a guidance approach taken by the central agency in terms of asset management. Looking at it from a practitioner's point of view, it has probably been an incremental process to get to far more refined management principles of the assets. Getting ourselves just into a situation where we can in fact recognise the assets correctly and have reasonable, for example, depreciation policies and valuation policies in place has been quite an effort. Finance, the central agency, did give us, I thought, clear guidelines on that. They have now also given us clear guidelines on the method that we should use to value assets. From a practitioner's point of view, I would not like to criticise their approach, because I think they have been guidelines that we have had to work to and they have been effective as far as Foreign Affairs and Trade has been concerned.

CHAIR—Do you believe your organisation is effectively trained both in the valuation process—that is, in keeping asset registers up to date—and in managing the use of those assets properly?

Mr Peirce—In terms of valuation methods, no. I think we would have to outsource any re-valuation programs. For example, we are taking advice on self-developed software. The deprival method of valuation does not really concern us basically because of the nature of the profile of our assets. Training people to manage the accrual operations of an

assets database has been a very difficult exercise for us because we have had to introduce accrual systems themselves.

With accrual systems and assets databases, you need complex accounting systems. It is true that over about three or four years we had to have a very comprehensive program of training our staff, particularly those overseas, in the operation of those databases. We are, however, now very confident that the staff effectively and efficiently carry out the instructions and keep those asset databases correctly maintained.

However, because of the regular reporting to parliament that comes with the accrual framework for our organisation there is this move to centralise that assets database. That assets database will, therefore, be managed by a group of professionally trained individuals. The department has made quite a good deal of effort to get qualified accountants into its operation. Most of those accountants are in Canberra where the consolidation database will be. Yes, we will be confident that we could manage that database.

CHAIR—You are putting the accountants in place but, with respect, don't you think the bean counters only provide you with information that management is supposed to drive and use?

Mr Peirce—Yes, indeed.

CHAIR—So can you tell us the involvement or otherwise of your CEO and SES in terms of asset management from the information the bean counters give you? One of the things the committee is concerned with is that the Auditor-General has told us that asset valuation and asset management seem to be at a relatively low level within departments and dramatically non-uniform across departments.

Mr Peirce—I would have to say that, in my experience in the department, with the move to accrual reporting and the accrual framework there has been a great deal of interest and concern from the executive in the management of all parts of the accrual accounting information and financial information of the department. The move to this accrual framework has been oversighted by a number of committees, including the Audit Committee, where there have been quite rigorous controls and audit programs placed on all sites in the department for the management of accrual information and particularly assets. In fact, it has been very closely monitored.

There is certainly a very large concern with the executive. In fact, one of the deputy secretaries is now taking on board the chair of the committee to oversight the introduction of accrual budgeting. I would have to say that through our organisation there has been a great deal of concern with ensuring the department fully complies with the introduction of accrual framework.

CHAIR—For *Hansard* purposes, could you please tell us which Audit Committee you are talking about?

Mr Peirce—The department's internal Audit Committee.

CHAIR—Right, because we are also now the Audit Committee of the parliament. There is a big distinction. Could you tell us how friendly the *Asset Management Handbook* has been to use and the degree and extent to which you use it?

Mr Peirce—It is certainly very comprehensive, as the Australian National Audit Office has let us know. They say that it is easy to use, and that was the ANAO's comments. I have to go back to what I said before about the introduction of complex accounting systems and accrual financial systems into an organisation. One does not have, for example, a spread of posts and locally engaged staff who look after the finances for our posts. It has been a difficult exercise to introduce this change. Therefore, you could imagine that the manual would, while it is comprehensive and probably easy to read, be difficult for a number of staff.

With the FMA Act and requirements for the chief executive instructions that go with the FMA Act that we have to introduce, we have a consultant who is about to be employed to restyle that asset management manual and to put it in as part of a chapter of our chief executive instructions and to make it user friendly. In fact, he is a specialist in writing manuals and making things easier to read.

CHAIR—I think we have about run out of questions, Mr Peirce. You seem to be grabbing hold of the issue, and for that we thank you. We will ask your colleagues, who we are about to talk to, how all those physical assets that we do not understand are valued.

Mr Peirce—Thank you.

[2.28 p.m.]

DARCY, Mr Mike, Manager, Accounting and Reporting, Accrual Budgeting Project, Department of Finance and Administration, Newlands Street, Parkes, Australian Capital Territory

JACKSON, Mr Neville Grant, Director, Accounting and Governance Framework Section, Department of Finance and Administration, Newlands Street, Parkes, Australian Capital Territory

LENNON, Mr Brett Anthony, Branch Manager, Policy, Accrual Budgeting Project, Department of Finance and Administration, Newlands Street, Parkes, Australian Capital Territory

MILLAR, Mr Graham, Branch Manager, Financial Framework Branch, Department of Finance and Administration, Newlands Street, Parkes, Australian Capital Territory

CHAIR—Thank you for your submission and thank you very much for coming to talk to us today. It is appropriate that you are the last cab off the rank we will talk to before writing our report. We have talked to some private sector people, we have talked to the Auditor and we have talked to the representative department.

The Auditor-General tells us that in 1996-97 the Commonwealth, at written down value, disposed of some \$93 million worth of assets for which the Commonwealth received \$52 million. Do you have any comment on those numbers?

Mr Millar—I am not aware of where those numbers have come from. Do we have any further details as to what the position is there?

CHAIR—The follow-up survey to *Audit Report No. 27*, I am advised.

Mr Millar—I guess it is a bit difficult for us to make a comment on general figures such as that. There could be a whole range of reasons why that could have been the case—reasons alluding to the depreciation which agencies placed on the assets, a whole range of factors. Without knowing the details, it is a bit hard for us to comment. Certainly, we will be happy to take it on notice.

CHAIR—The committee would appreciate that. It highlighted to us a concern which we gained from the Auditor's interim report as to whether we are picking up the change in culture quickly enough. I am not being critical, but simply questioning whether agencies are picking up the necessity to move quickly to embrace accurately valuing assets and managing them properly as we move into an accrual accounting framework. We well understand that that is a huge cultural shift for a government agency, so please do not take

this as being highly critical. But it just pointed out to me, at least, that either our depreciation schedules are terrible or we are not going back and revaluing, checking and testing the value of assets at appropriate intervals so that their realisable value is substantially less than what we have them at in the books.

It seems to be a long question, but you could take that two ways. Two things could happen: if agencies overvalue and if there winds up being an asset user charge, then they are going to pay dearly for that. On the other hand, they might react by taking it right down and undervaluing in order to reduce the effect of an asset user charge and all of us are the poorer as a result. In that context, can you understand the committee's concern with that as an issue?

Mr Millar—That is certainly the case. Agencies will be under quite a deal of pressure to make sure that they do value their assets appropriately because in pricing their outputs under accrual budgeting that will be a key factor—making sure their assets are appropriately valued.

We have recently issued some draft asset valuation guidelines to agencies which we are hoping to finalise fairly shortly which should help them do that. I take your point that agencies still have a way to go but the introduction of the accrual budgeting framework will be a further step in the right direction in so far as it will be a real incentive for agencies to appropriately value their assets.

CHAIR—In *Audit Report No.41* tabled out of session on Friday, the Auditor-General says:

1.31. The audit also confirmed the limited nature of central policy advice and guidance which is in contrast to the experience in a number of State jurisdictions.

Would you like to comment on that?

Mr Millar—Basically, in the Commonwealth, we see the role of the central agency, the Department of Finance and Administration, as essentially getting the frameworks right for agencies to manage their assets better. At the moment we have a three-pronged approach. The Commonwealth has assets worth about \$114 billion, according to the whole-of-government financial statements tabled last month. Of the \$114 billion worth of assets, the vast majority of those assets, in excess of \$100 billion, are with either specialist asset managers or commercially driven asset managers. About \$44 billion of those \$114 billion is with commercially managed GBEs; about \$56 billion, or about half, is with Defence, as a specialist asset manager.

Most of the remaining large scale assets are with other specialist managers, including our own department, in managing a fairly large value of real estate. One of the first initiatives is to ensure that the allocation of assets is to managers that have a

specialist role or, indeed, a commercially driven role.

The second arrangement is that we put in place an appropriate financial management framework that involves the chief executive of agencies having the responsibility and the accountability to manage the agency's assets and for them to be able to have the tools to do so effectively. That includes the new Financial Management Accountability Act that came into operation on 1 January this year. Chief executives have got the responsibility to manage the assets under their control under that act.

The third major initiative is the introduction of accrual reporting, which came into place in 1994-95, and from 1999-2000 the first accrual budgeting will be introduced. All those initiatives put in place a framework that basically gives the responsibility, incentive, et cetera, to agency heads to manage their assets much more effectively. We see our role in the Department of Finance and Administration as facilitating the effective implementation of that framework to enable the managers to manage that effectively.

Mr BEDDALL—Can I take that one step further, because there seems to be a conflict in what you are saying and in what has traditionally happened. We are moving now to CEOs of agencies running them on a more commercial basis, yet they do not have commercial control of the asset. For example, Foreign Affairs does not have control of its physical assets; they are in your department. Do you think there would now be some merit in looking at, if managers are managing, whether they should manage the totality rather than have a real estate agent—that is, the Department of Finance and Administration—run the physical thing? Should DoFA's role be setting the frameworks? Hasn't this 'one government agency does all' type approach reached its use-by date?

CHAIR—This is not being asked in any political sense.

Mr BEDDALL—No, it is not—it is asked as a non-politician.

CHAIR—This is a totally practical issue. We are addressing this as if we were practitioners, not political adversaries.

Mr Millar—Brett Lennon is looking after the accrual budgeting project, so he might be in a better position to answer that.

Mr Lennon—My colleague Mr Darcy is better able to answer that.

Mr Darcy—The point you make is a valid one. It is something that certainly is an option in relation to the accrual budgeting framework that is to be introduced. In essence, the type of situation you are referring to is one where the CEO does not control the particular asset, being an overseas post. The real question is whether or not the public sector can deliver a better output by changing its management arrangements around. I think that the incentives that we intend to try to build into the framework will be such that

it will force CEOs to examine whether or not they are in a better position to manage these assets or have somebody else manage them for them. It is not something you can dictate from the centre, unfortunately, but the point you make is a valid one and it applies to things other than property; it applies to a whole range of assets and activities.

Mr BEDDALL—The reality is that, in the way it is currently administered, that property is just property. For example, some years ago I was in Hong Kong. We were about to knock down the Consul-General's residence and build flats, whereas the Chinese next door were buying flats and building houses because, in terms of that culture, the property was a thing of keeping face where you had a very high diplomatic impact, but on the property market it was just seen as a piece of land. Someone who is running that in a broader sense of managing their portfolio or their agency would not just look at the pure real estate value. But if they had responsibility they would have to take that into account as well.

Mr Darcy—That is right. There is no 'one size fits all'. For example, this House is managed by the Joint House Department. I suspect it would not be a particularly good idea to bring that under the control of the CEO of the Joint House Department.

Mr BEDDALL—Is it an asset?

Mr Darcy—Yes.

CHAIR—It is a tourist venue.

Mr BEDDALL—Not if they had to pay.

CHAIR—Mr Millar, going back to the statement that the Auditor has made about the Commonwealth versus state jurisdictions, to be honest, frank and open, we have heard from most respondents, both outside and some inside, that they believe the Commonwealth is still some way behind most of the states in terms of asset management, and even asset valuation. One of the questions that I have that has bothered me is, if we do not have effective guidance from some central point about how assets are to be valued, how on earth do you get to an integrated set of Commonwealth figures that make any sense? I am frightened that we are going to wind up with even worse stats than \$53 million for \$92 million worth of book value. Does that make sense?

Mr Millar—It does.

Mr Lennon—When you say that the Commonwealth is behind a number of the states—

CHAIR—Yes, that is what we are told.

Mr Lennon—As you would be aware, for reporting purposes—annual reports to the parliament and whole-of-government reporting purposes—the Commonwealth has moved to progressively require departments to value assets by reference to the deprival methodology—current cost valuation techniques—and all departments are required to have moved to that position by 1 July 1999. Similarly, in terms of the move to accrual budgeting, it would be safe to say that we will be looking to replicate that situation where, for budgeting purposes as well, departments are required to move to the deprival methodology, which will mean that, in terms of valuation techniques for the Commonwealth's assets, they will be at best practice, both for budgeting and reporting purposes, by 1 July 1999.

CHAIR—And you do not think it is a little bit overly ambitious to change culture that quickly without a longer lead time? We have had lots of reports that departments still do not even have an accurate asset registry. That is number one. If you do not have an accurate register or you have got several registers and more than one chart of accounts relating to those registers, you have got a pretty difficult task in coming to an accurate valuation. It seems pretty optimistic to me.

Mr Lennon—It has been a staged process. It has been put in place progressively for accrual reporting purposes, for the purposes of the annual reports. The final stage is due to be in place by 1 July 1999. It is not something that has been put in place in haste at all. It is something for which a reasonable lead time has been given for agencies.

Mr BEDDALL—We were told that when we did not have all the statements of assets, we received some hand written notes which were rubbed out and looked like they were less than accurate. Are you aware of those? If not, maybe we should make you aware. Maybe those are the ones you should be targeting to make sure that they are actually looking at the cultural change. It seemed to us that a number of junior officers were given the task of doing an asset register and they went off and did it by hand.

Mr Lennon—We have no doubt that we have got a way to go in terms of making the cultural change side of it. I guess what I was referring to was in terms of the—

CHAIR—I am happy to hear you say that. It makes me feel a bit better if you are up front and admit this.

Mr Lennon—The Commonwealth is only now moving to the introduction of accrual budgeting from 1999-2000. We have had accrual reporting in place for four or five years now. I was referring to the fact that, in terms of the framework, for which the Department of Finance and Administration is responsible, we have now moved to a situation in regard to the asset valuation guidelines for reporting purposes and intend to do so for accrual budgeting purposes, which is best practice.

We acknowledge that, in terms of getting the cultural change in agencies going—

getting them to take more seriously than perhaps has occurred in some cases in the past their duties as good financial managers to properly manage assets—we have a way to go. But the accrual budgeting framework itself will assist us significantly in that area.

CHAIR—But, in terms of the valuation process itself, have you the same degree of control over departments as your Victorian counterpart?

Mr Darcy—I am not aware of how Victoria organises—

CHAIR—We are not either because they will not talk to us.

Mr BEDDALL—Maybe the Prime Minister should ring the Premier, but they are not talking to each other either.

CHAIR—We are advised by private sector individuals who deal across all agencies, including local government, that they do have a centralised system.

Mr Darcy—I think the important point here is that one of the major reasons for the move towards an accrual framework is that managers will always manage the way they budget. If you go to an accrual budget, then it picks up issues such as valuation of assets et cetera. Whilst accrual reporting, I think, led to a fairly significant increase in better asset bookkeeping, I do not think it necessarily assisted too much in relation to asset management because there were no broad incentives in the framework to make sure that people looked at asset management in particular.

One of the things we have also noticed is that, if the financial incentives are in the broad framework and they cover all assets and all resources, it forces CEOs to have a fairly close look at costs and what drives those costs, capital requirements, which is basically purchasing of assets, and how that is to be funded. In an incentives framework such as that, you need to build management flexibility, which basically means that you reduce the options to mandate from the centre. The framework that we are looking at is one that is based on devolution and building those incentives properly.

Just getting to the specific issue of the valuation methodology, it has been mandated in the Minister for Finance and Administration's orders—financial minister's orders these days—which have the force of regulation and require all agencies and CAC bodies to apply that methodology from the 1999-2000 budget year. Again, it is a reporting tool. Provided it survives audit scrutiny, it is really not going to change asset management. The trick is to force managers to look at their depreciation costs, to look at the amounts that they are going to need to replace assets and to look at ways to extend the life of assets so as basically to keep prices down.

CHAIR—Mr Darcy, the Auditor-General in this report tabled on Friday—and I have to say to you that we only saw it today, too, and you may not have seen it at all—

Mr Darcy—I have not seen it.

CHAIR—Under audit findings it says:

The ANAO has found there has been general acceptance of the recommendations made in Audit Report No. 27 1995-96, and hence a recognition by organisations of the need to improve their asset management performance. However, the audit found that a significant number of organisations is yet to implement the recommendations.

That is number one, and that is consistent with his earlier advice to this committee that a substantial number of organisations have not implemented the recommendations. My colleague, Mr Beddall, indicated some handwritten scribbled notes stating what the assets were, which did not look terribly professional to me, I can tell you. He says:

In particular, many organisations have yet to: adopt a strategic approach to the management of assets by effectively integrating their asset planning decisions into their corporate and research planning frameworks; formalise, and systematically analyse, 'whole of life' cost concepts in major asset acquisition, operational use or divestment decisions; establish baseline cost and performance standards for key assets and to monitor outcomes against those standards; implement financial management and asset management systems which facilitate the routine capture and reporting of performance information for management purposes; and integrate disposal decisions into an overall planning framework which monitors the outcome of disposable processes.

That does not read too well to me, quite honestly. That sounds like a pretty big slap on the wrist, I would have thought.

Mr Lennon—I think a key issue here is that what the Commonwealth is seeking to do—progressively, through various tools and through the introduction of accrual reporting, and now, critically, the introduction of accrual budgeting—is to get the incentives framework right for agencies to take asset management seriously. When we move to accrual budgeting from the 1999-2000 year, there will be plenty of incentives in place for agencies to treat asset management seriously, because if they do not then there will be consequences for them in terms of their management which are not particularly pleasant. For example, in terms of funding, departments will be funded on the basis of the price of their outputs.

In determining the price of their outputs, agencies are going to need to take account in the first instance of the costs that go in to make up the outputs they are producing. It will be important for them to value their assets on the basis of deprival current cost valuation if they are going to get the price of their outputs and their funding right. If they do not get it right, and they do not bid for and receive the quantum of funding that they require, then they are going to have a financial shortfall.

The key thing about accrual budgeting which sets it aside from the moves that we have made to date in terms of accrual reporting and other initiatives is that we will

actually require managers to manage, on an accruals basis, their assets and their balance sheet more widely instead of simply managing their cash flows, which is what they do at the moment.

CHAIR—If I have got a culture of putting the beans in each jam tin and taking them out through the year so that, theoretically, I have got each jam tin empty on 30 June—none left, and no negative beans—and I am told, ‘Oh well, I’m going to have to value assets and I am now going to have to produce a statement of assets and liabilities, and I will not be producing a P&L but I will be producing an operating cost statement, and performance indicators against the use of those assets will be tabulated and checked against other agencies,’ if I drag my heels and I do not get my assets valued properly, and I do not have a proper register, and I have not got a chartered accountant that I could make any sense of all this stuff with, all the hyperbole in the world is not going to get it right. Carrots are not going to get it right; sometimes there needs to be a bit of stick as well. So where is the stick?

Mr Millar—Part of that stick, of course, is competitive tendering and contracting. Basically all agencies are being asked to have a look at all aspects of their activities and to effectively compare the price of their outputs with the price of outputs that might be achieved by the private sector. So there is a very real stick there to ensure that agencies make sure that they do get their outputs priced properly, that they do make sure that those outputs are competitive with what might be produced by the private sector. So there is a very real stick there to ensure that they do get it right; otherwise they are looking at having those particular functions done by someone else.

Mr BEDDALL—That is happening without the stick and the carrot.

Mr Millar—It is, but it is a further incentive, I suppose, to ensure this.

Mr Lennon—The difference with the accruals framework is that it actually will require and enable them to cost their outputs properly, not simply on the basis of cash cost but full cost, which is absolutely essential if you are going to be comparing like with like between a service being delivered in the public sector as opposed to one which could be delivered in the private sector.

CHAIR—We are told that consideration should be given to an asset use charge. Could you talk to us about that?

Mr Millar—At this stage, the government has not taken a decision on the capital use charge. But, clearly, the introduction of a capital use charge, if the government were to decide upon that, effectively would ensure that the agencies take into account in the pricing of their outputs the full cost of their net assets. If the government were to go down that particular track, the incentive certainly will be for the managers then to make sure that they do have the right amount of assets and to keep those assets in good working

order.

Mr BEDDALL—But they don't have the assets, do they, in many instances?

CHAIR—Sometimes they don't. Yes, that is right.

Mr BEDDALL—The agency does not have the asset. Someone else is managing the asset.

Mr Lennon—The capital use charge, if introduced, would only apply to net assets which are under the control of agency managers—that is, departmental assets. So-called administered assets which are not under their control would not be included in any charge simply because agency managers, as a practical matter, cannot influence the use of those assets.

Mr BEDDALL—That does not mean they will not be charged for them. If you are sitting in a cabinet room doing the final analysis for the budget and you need to raise some more revenue, you will put a capital charge on it.

Mr Lennon—The design of the capital use charge is being looked at. Consistent with other jurisdictions, it is not intended that the capital use charge apply to anything other than departmental assets—that is, assets under the direct control of agency managers.

CHAIR—There has been some concern expressed to the committee that the number being tossed around is 12 per cent, and some concern is expressed that that varies substantially from some of the states and that it seems on the high side, which would tend to encourage departments to divest themselves of real assets, which decision might not be in the financial interests of the Commonwealth or the department. You would admit, wouldn't you, that if there is to be a capital use charge it would want to try to reflect some market reality?

Mr Lennon—Yes, it would want to try to reflect some market reality. Capital use charges in overseas jurisdictions and the States have varied in terms of the rate applied. Some, such as New Zealand, for example, incorporate significant risk premiums; others do not. The key thing is to get the price of outputs right and to properly take into account the cost of capital in the price of outputs. For the purposes of competitive tendering and contracting, it is going to be important that you are comparing like with like in terms of activities between the public and the private sector and whether or not one or the other delivers a particular output. If a private sector operator is facing a cost of capital with a significant risk premium attached to it, which they would be usually, then in pricing that equivalent output which is currently being produced in the public sector there would be a case for incorporating an analogous risk premium for purposes of competitive neutrality.

Mr BEDDALL—But, in the private sector, David Beddall Pty Limited would have

a higher risk factor than National Mutual. Where these balances are struck is a very fine line.

Mr Lennon—That is right. As I say, no decisions have been taken on the introduction of a capital use charge at this stage. I am speaking purely theoretically. You asked me, theoretically, whether a rate of 12 per cent was being considered. If such a rate is being considered, that will incorporate a significant risk premium. One important factor in applying a significant risk premium of that sort would be to ensure that you have a competitive and neutral situation for competitive tendering and contracting between public and potential private sector providers of outputs currently being delivered by the public sector.

Some jurisdictions—for example, New Zealand—incorporate industry specific rates in their capital use charge. New Zealand has a significant risk premium attached to its capital use charge but incorporates different rates, depending on what particular area of the public sector you are talking about in delivering outputs. That reflects, as you indicated, the differential risk structure of particular markets.

An alternative would be to take the view that the public sector incorporates a wide variety of activities. Some, when you are looking at the equivalent ones being produced in the private sector, have a high risk premium; others have a lower risk premium. You could adopt the attitude of keeping things simple at this stage and apply some sort of average risk premium.

CHAIR—I used to tender against Civil and Civic and A.V. Jennings for Commonwealth contracts. Nobody ever gave me a premium or indeed a charge because of the fact that I was heaps smaller than any of those. Where do you get the commercial neutrality?

Mr Lennon—I get the commercial neutrality in terms of the tender which you might have been putting in against the in-house provider. If that in-house provider had—

CHAIR—No, I am talking about tendering against another commercial entity.

Mr Lennon—What we are trying to do is make sure that, where a public sector manager has a choice of continuing to provide a particular output in-house or via a commercial provider, in terms of the pricing decision, we are comparing oranges with oranges and not oranges with apples. If you do not apply a capital use charge with an appropriate rate attached to it and perhaps a significant risk premium attached to it, the public sector provider could have a significant competitive advantage over his equivalent in the private sector.

CHAIR—I accept that. On the other hand, would you also consider, if you are going to do such a thing, a variance analysis so that at the end of the financial year you accumulate actual costs for that asset charge versus what you have put it on the books at

and adjust the charge appropriately next year?

Mr Millar—We would want to make sure that we kept it fairly simple, though.

CHAIR—That does not make it unsimple. If you are putting stock into store at a standard value, surely you must test constantly whether that standard value is up to date or not, through a variance analysis. Why wouldn't you do the same thing with a capital charge?

Mr Lennon—In terms of pricing the output, we would be looking at the value of the net assets at the start of each year, basically. So what you are saying is that if the value of the net asset changes between years, it needs to be reflected in the price of the output; I agree.

CHAIR—You said everybody was going to be ready by 1999. Defence has told us they have got some rather big problems, which we appreciate. They say:

. . . the size of the task and the time required to put replacement and upgraded corporate systems in place will result unavoidably in a stepped approach to the new framework. This is consistent with the stepped approach being developed by the Department of Finance and Administration whereby the full requirements of the new accrual based management framework will not be introduced until 2000-2001 or later.

That seems to be a bit at variance with what you told us a few minutes ago.

Mr Lennon—The first accrual budget is to occur in 1999-2000 and the full framework has to be put in place by that time. In terms of one particular area—that is, the new outputs and outcomes framework that is an integral part of the introduction of accruals—it was recognised at the time the government took the decision to introduce accrual budgeting that the first attempt at an outputs and outcomes framework which will be made by agencies is not likely to be perfect. They will need at least a year—that is, up to the 2000-2001 budget—to refine their initial outputs and outcomes framework and get it more robust. I think that is what the gentleman who made that quote is referring to.

Mr BEDDALL—We had a lot of very positive feedback on this publication that came out in March. I must say it struck me to see that someone could say all this in 26 pages. I hope that the exposure draft, when it comes back as a second exposure, is not 65 pages. We have had a lot of comments that this is a very good publication. That is from the private sector as well.

Mr Lennon—Thank you. That is much appreciated.

CHAIR—While some of my questions may have been a bit intense, it is not meant to be critical.

Mr BEDDALL—It is just your nature!

CHAIR—It is not even just my nature. It is just a case of trying to get down to the basis of the issues and what we need to report on so that we can help you to encourage everybody to get on board, because I think everybody is after the same objectives. If we have to be critical of some departments, we will not hesitate to be so.

Mr Lennon—We have certainly been very grateful for the support which we have got from some of the parliamentary committees, including the JCPAA, in regard to the introduction of accrual budgeting.

CHAIR—Thank you, gentlemen.

Resolved (on motion by **Mr Griffin**):

That the committee accepts as an exhibit the following document tabled by the ASCPA:
Asset valuation by government trading enterprises: an evaluation of pricing issues.

Resolved (on motion by **Mr Griffin**):

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.

Committee adjourned at 3.06 p.m.