



**COMMONWEALTH OF AUSTRALIA**

# **JOINT COMMITTEE**

of

**PUBLIC ACCOUNTS**

**Reference: Review of the Auditor-General's Report 1996-97**

**CANBERRA**

**Wednesday, 23 October 1996**

**OFFICIAL HANSARD REPORT**

**CANBERRA**

## JOINT COMMITTEE OF PUBLIC ACCOUNTS

### Members

Mr Somlyay (Chair)

Senator Crowley	Mr Anthony
Senator Macdonald	Mr Beddall
Senator Mackay	Mr Broadbent
Senator Watson	Mr Laurie Ferguson
Senator Woods	Mr Fitzgibbon
	Mr Georgiou
	Mr Griffin
	Mrs Stone
	Mr Vaile

The matter referred -

Review of reports of the Auditor-General.

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JOINT COMMITTEE OF PUBLIC ACCOUNTS

*Review of Auditor-General's reports 1996-97*

CANBERRA

Wednesday, 23 October 1996

Present

Mr Somlyay (Chair)

Mr Beddall

Mrs Stone

Mr Vaile

The committee met at 9.12 a.m.

Mr Somlyay took the chair.

**DARCY, Mr Michael Edward, Director, Accounting Development Branch,  
Department of Finance, Newlands Street, Parkes, Australian Capital Territory 2600**

**KENNEDY, Mr Maurice John, Assistant Secretary, Financial Administration  
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**RICHARDSON, Mr Arthur Philip, Assistant Secretary, Government Business  
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**TUCKER, Mr Ian, Assistant Director, Department of Finance, Newlands Street,  
Parkes, Australian Capital Territory 2600**

**WALLACE, Mr Dean Kingsley, Assistant Secretary, Accounting Development  
Branch, Department of Finance, Newlands Street, Parkes, Australian Capital  
Territory 2600**

**BOURNE, Mr Denzil, Senior Director, Performance Audit, Australian National Audit  
Office, Centenary House, 19 National Circuit, Barton, Australian Capital Territory  
2600**

**CRONIN, Mr Colin, Executive Director, Economic Coordination Branch, Australian  
National Audit Office, Centenary House, 19 National Circuit, Barton, Australian  
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**GREENSLADE, Mr Alan, Acting Group Director, Performance Audit Business Unit,  
Australian National Audit Office, Centenary House, 19 National Circuit, Barton,  
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**HOLBERT, Ms Frances, Director, Performance Audit, Australian National Audit  
Office, Centenary House, 19 National Circuit, Barton, Australian Capital Territory  
2600**

**McPHEE, Mr Ian, National Business Director, Performance Audit, Australian  
National Audit Office, Centenary House, 19 National Circuit, Barton, Australian  
Capital Territory 2600**

**CHAIR**—Welcome. Today's public hearing is the first in a series of quarterly hearings to examine reports of the Auditor-General tabled in the financial year 1996-97. Today we will be taking evidence on two audit reports, namely *Audit report No. 5 1996-97: Accounting for aid—the management of funding to non-government organisations, Australian Agency for International Development*, and *Audit Report No. 6 1996-97: Commonwealth guarantees, indemnities and letters of comfort*.

I remind you that today's hearings 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 the parliament. The evidence given today will be recorded by *Hansard* and will attract parliamentary privilege. I refer any members of the press who are present to a committee statement about broadcasting proceedings. In particular, I draw the media's attention to the need to report fairly and accurately the proceedings of the committee. Copies of the committee statement are available from secretariat staff present at this hearing.

In the first and second sessions of this public hearing, the committee will examine the main issues raised in *Audit report No. 6 1996-97: Commonwealth guarantees, indemnities and letters of comfort*. I now invite the Department of Finance to make a brief opening statement to the committee before we proceed to questions.

**Mr Wallace**—The Department of Finance welcomes this efficiency audit of Commonwealth guarantees, indemnities and letters of comfort and the opportunity to speak to the committee. As you will be aware from the report, the department has agreed, in principle, to all the recommendations, seven of which were directed specifically to Finance. We are in the process of examining the follow-up necessary and have already taken action to raise agencies' awareness of their responsibilities under the legislative framework.

The department is aware of the need to manage all risks, having regard to the costs and benefits of doing so. The extent and nature of the risk management task is largely a function of the extent of financial exposure and the likelihood, in the case of guarantees and indemnities, of their materialising. The focus of the government's risk management in this area has been primarily to manage the activities, processes, outputs or outcomes to which a guarantee or indemnity attaches to ensure that, to the extent possible, they do not materialise.

**CHAIR**—Thank you. I now invite Mr McPhee to give us a brief opening statement.

**Mr McPhee**—Overall, the audit office is of the view that in most agencies there needs to be a marked improvement in the management and administrative practices associated with Commonwealth guarantees, indemnities and letters of comfort. As well, there needs to be greater public accountability at both the agency and whole of

government level through better reporting.

It is important to point out that the audit of Commonwealth guarantees, indemnities and letters of comfort focused on explicit undertakings provided by the Commonwealth. It did not consider such instruments issued directly by statutory authorities and GBEs. So we are just looking in this report at those issued in the name of the Commonwealth.

The Commonwealth's gross exposure to these instruments amounts to at least \$222 billion, as at 30 June 1995. There is also a large number of indemnities and some letters of comfort which have no specified financial commitment. The report presents a framework for better administrative practice, which is premised on the current government's framework, and drew on examples from a number of government agencies including the Department of Finance and the Department of Communications and the Arts.

In addition, the report has outlined a range of possible approaches for dealing with the risk exposures from these instruments within a more commercially oriented framework of risk management and control. These options range from risk prevention measures to outsourcing risk to the private sector. The ANAO is not necessarily advocating outsourcing risk in the form of commercial insurance, rather we are promoting the effect of management of risk by encouraging sound risk assessment and effective treatment of the risk determined in this process.

The audit office made 16 recommendations which were accepted by the 15 portfolio departments involved directly in this audit. Agencies either agreed, agreed in principle or made no comment with the recommendation on record management, document security, reporting arrangements, improved public accountability, risk management planning, risk pricing, risk transference and proposals for better administrative practice.

Notwithstanding this overall response, the Department of the Treasury and the Department of Finance did have some reservations that the audit report did not adequately reflect the control arrangements that exist in relation to the instruments in terms of risk management and prudential supervision. Also, the Department of Finance did have some reservations with regard to the options presented for the pricing and transfer of risk. Again, the point is made that the ANAO is not advocating a particular preference regarding these options but we are attempting to encourage the application of a more rigorous approach to risk management overall.

The value of this audit, as I see it, has been in raising the awareness of agencies about managing the exposures associated with these instruments. This awareness raising, combined with the audit recommendations and the developments we have seen with respect to accrual accounting and reporting should see a significant improvement in administration in this area.



**Mr BEDDALL**—My first question is to the ANAO. I note that at the completion of the audit you were not confident that all of the exposures to guarantees, indemnities and letters of comfort were known. Why was this? On page 7 of the report you note that the figures some agencies provided on the number and value of the instruments they had on issue were inconsistent with figures available to other published material. You also state that attempts were made to resolve these inconsistencies with agencies when they arose. How significant was the effect of the potential inaccuracies on the assessment of total exposure? How many of the 20 agencies surveyed in your audit had up-to-date and detailed registers or their portfolio exposures to guarantees, indemnities and letters of comfort?

**Mr McPhee**—Mr Beddall, perhaps I can make a few comments and I will ask the team to fill in some of the details. It reflects a bit of history, really. In the past, and going back a number of years, the handling of particular guarantees and indemnities et cetera was done as a one-off exercise related to a particular subject matter. Agencies generally did not have the risk management framework and the record keeping framework to properly manage the risks associated with these instruments.

We have seen some important developments in recent years with the heavy emphasis on risk management by MAB/MIAC, the move to accrual accounting and reporting, and that has really required a discipline now on agencies to make sure that supporting records are in better shape than they have been before. So while we have come across a situation which we think is less than satisfactory, we are certainly moving in the right direction in terms of the framework to improve the management of these instruments.

In terms of the differences between the financial reports and the survey results, I will get Colin Cronin to comment on that.

**Mr Cronin**—In terms of the reason why we did not capture them all, guarantees, indemnities and letters of comfort arise out of legislation, deeds, contracts and, indeed, correspondence. We do not believe that we have captured all of those things. We note in the report that, in terms of contracts and deeds, there is no guarantee that all those have come out. In fact, we think only a few departments actually went through their contracts in a very systematic manner to pull out the indemnities and guarantees that may have been within those.

The Department of Finance in terms of their asset sales was one such department which went systemically through and pulled them out. For a lot of the other departments, we are uncertain whether they have actually undertaken that process. So often these guarantees and indemnities can be embedded in contracts and, on that basis alone, we do not believe that we have them.

In terms of the other aspects, we did not feel confident that all departments fully understood what these instruments were. It was not up till virtually the eve of the report

that we got in our last response from the Department of Foreign Affairs and Trade on the Austrade guarantee. That was actually a legislative guarantee, but it took an extreme period of time for that to come out. On that basis, we are uncertain that we have actually captured the full cohort of these instruments. For that reason we have also printed in the report, attachment 2, the list as far as we know it, because we think it is important to get on the record what is out there.

In terms of the other question that you asked, Mr Beddall, on the inconsistency, I will pass over to Fran Holbert who will explain some of the problems that we had with some of the numbers which we tried to track down. As a general caveat, we have reported in the report those numbers provided to us by the departments. There are major variations on some numbers between what the departments have told us and what other sources have, but for consistency we have gone with the numbers reported to us by the departments.

**Ms Holbert**—Some of the problems we had were that we were dealing with the portfolio departments and we were not going into the GBEs where a lot of the guarantees are. So some of the numbers coming back were at variance to other published numbers that we had seen, such as in table 13 or annual reports by departments.

We had some variations, for example with EFIC, but we were able to resolve that in the end because EFIC gave us final numbers on that. AIDC had four different numbers, and we were not able to resolve which was the correct number, so we simply gave in the report the number that AIDC reported to us in response to our survey. HLIC was a large statutory guarantee which was unreported. It is missed in the financial statements, but it has now been picked up. DOCA have a Telstra superannuation guarantee, where there has been some variation in how it has been reported. In terms of table 13, the possible liability at the outset of that guarantee was reported at the time. In our report now, DOF provided to us the actual remaining liability to run on that superannuation guarantee, as it stands at the moment.

Those account for some of the major variations. There were lots of small variations in terms of individual instruments on loans in portfolio departments that were remote from the agency or GBE or, in the case of territories, Northern Territory loans. In terms of the figures we are talking about here, there were minor variations which were difficult for the department because they were remote from the authority which actually had the loan balances in their custody.

**Mr Cronin**—We actually went back and, where we had inconsistencies, attempted to test these with the departments. This saw quite extensive revisions to the initial numbers that were reported to us. I will pass to Mr Denzil Bourne to answer the third question.

**Mr Bourne**—In fact, we went back on three occasions to confirm those numbers. At one stage, regarding the central registers, we sent out a separate survey, as I guess you

would call it, to ask a number of questions in regard to record keeping and things like that. The direct question was asked: do you have a central register? At that stage, of some 20 departments canvassed, five responded positively, saying that they did have one. We did not check every one of those but one thing that was clear is that the central register was, to a degree, in the eye of the beholder. For the ones that we did check, there was some variation in the quality of them. For example, DPIE had a very good central register. For the others who claimed to have a central register I would say that that was probably a little of an overstatement.

**Mr VAILE**—This is a question to Finance. To go on from there, with the information that has come to light out of this report, has Finance ever had a fully compiled central register of these instruments that exist in different departments?

**Mr Kennedy**—No, we have not. Reference has been made to table 13, which is a table in aggregate financial statements of the Minister for Finance. Table 13 sets down a number of loan guarantees, but as far as the whole spectrum of guarantees, indemnities, letters of comfort is concerned, the answer is no.

**Mr VAILE**—Does it concern the Department of Finance that when the ANAO went to different agencies to try and get the information there seemed to be some difficulty, and there is still not a lot of certainty that a lot of the instruments have come to the surface? They do not know what exists. Surely there needs to be a mechanism put in place across all agencies such that, when they are entering into contracts where some of these instruments might form a part, there would be a responsibility to put them on a central register somewhere.

**Mr Kennedy**—Putting them on central register is probably less important than putting them on their own registers.

**Mr VAILE**—That is what I mean—a register in their own departments so that if the ANAO turns up every 12 months or two years a book can be produced to say, ‘That is exactly what the exposure of the Commonwealth is with this department.’

**Mr Kennedy**—While accrual reporting will not be the panacea for all ills, it certainly will be an enormous benefit to agencies in recording and knowing what their assets and their liabilities are. Flowing from that knowledge one would expect, and certainly Finance will be pushing, that that knowledge will flow over into proper management decision making. But yes, we agree that it is important for agencies to know what they are exposing the Commonwealth to and, in fact, on 20 December 1995, Finance put out a Finance circular on the very point of recording loans, guarantees and other contingent liabilities to remind people that it has been a longstanding requirement under Finance Direction 23 that they should do this.

**CHAIR**—What happens if these requirements are not adhered to? I ask that in the

context of Mr Cronin's statement that information came in from DFAT at the very last moment that conflicting information on four occasions was received from an agency. That seems pretty serious in view of the Finance Direction that was given last December.

**Mr Kennedy**—I have a sense of *deja vu* here, Mr Chairman. We have made the point many times over many years that Finance's role is to establish the legal framework, the administrative framework, within which good practice is supposed to occur. We do not have power to go out and make it occur. Simply as a matter of law, the responsibility for making good practice happen does not rest with the Department of Finance, it rests with each individual chief executive of an agency.

At times it is frustrating, even heartbreaking, that the work that goes into trying to establish quality framework for better public sector management is adhered to patchily by agencies. What we can do about it is to use the occurrences like this audit report to pull the whip out and crack it a few times to try to get departments to lift their game. I have no doubt that that will happen as part of the impetus of this and perhaps even of these proceedings. It is also inevitable that at some future time there will be another public accounts committee and another team of ANAO and Finance officials sitting at this table and will be discussing the same sort of thing. Hopefully, it will be a long time before that happens.

**Mr VAILE**—Would you suggest that if we were able to hurry up the process of the implementation of accrual accounting and accrual reporting it would help improve the situation?

**Mr Kennedy**—I do not think speed is necessarily synonymous with good practice.

**Mr VAILE**—It certainly is not synonymous with government departments implementing accrual accounting!

**Mr Wallace**—As Maurie said, accrual accounting is not a panacea for this. The accounting guidelines which were issued by the Minister for Finance reflect best practice as reflected in the Australian accounting standards and concepts. The Finance Directions which, in a sense, preceded the guidelines that we have now adopted for accrual reporting purposes have, as Maurie pointed out, required for some time that each departmental secretary arrange a record to be maintained in respect of his or her department of all contingent liabilities of the Commonwealth. But to help to close the loop and to assist in the compliance process, each secretary is also required to report annually to the Department of Finance on those contingent liabilities and that is the basis for the reporting in the Minister for Finance's aggregate financial statement, table 13, which has previously been referred to.

So that closing of the loop, in a sense, reinforces the compliance requirement. In addition, in preparing the aggregate financial statements for audit purposes, we do

reconcile, together with the auditors concerned, what is reported to Finance with what will appear in the financial statement of each individual agency. So there is a fair degree of oversight of that process at the moment. I think one of the things that this efficiency audit brings about is a recognition of the need every now and again to bring the hammer down on particular areas of risk management to ensure that the risk management processes are being carried out fully and appropriately.

**CHAIR**—Mr Kennedy, will the FMA bill and the CAC bill which will come before the parliament soon provide the financial disciplines on heads of departments to perform with regard to financial stringency and contingent liabilities?

**Mr Kennedy**—There is a provision in the FMA bill, in the bill that lapsed before the election—that was clause 45—that required chief executives of agencies to manage the resources of their agency in a way that promoted efficient, effective and ethical use of those resources. That provision, and what will hang from it in terms of subsidiary legislation to translate into good practice frameworks the object of that high level principal exhortation of efficient, effective and ethical use of resources, what that will do is provide a framework within which people can work with some confidence.

One of the main—dare I use the term—cultural changes of the new legislation to replace the Audit Act is to move the emphasis away from compliance to actually some results. One thing that efficiency audits should produce—and under the Auditor-General bill a performance audit should produce—is a change in behaviour of the people who are affected by or who can relate to the outcome of the audit.

Changes in behaviour are the things that cause, if they are the right changes, improvements to public sector administration. I believe that this sort of audit, and particularly on the recording of liabilities and the managing of liabilities, will help to change behaviour of the people that are out there in departments. The FMA bill and the package of legislation that goes with it will push that along.

**Mr BEDDALL**—My concern is in relation to the total size of this continuing liability, which will be at least 1½ times the Commonwealth's annual budget at about \$220 billion. The problem I see here is that, whilst you were talking about a cultural change taking place, this is an audit report of 1996-97, you are a long way from cultural change. And then we find that in fact it is up to heads of individual agencies to be accountable. My concern is that evidence that we have received so far indicates that some of these undertakings of either indemnities, letters of credit or guarantees can be undertaken at quite a junior level within the public sector. Do you think that if the Department of Finance does not have the power to enforce the framework, perhaps it is time that somebody in government had the power to enforce framework rather than leaving it to the heads of individual agencies? From this report, the heads of individual agencies to date have not taken their responsibilities seriously; particularly where you find that at the last minute people are bringing forward more contingent liabilities.

We heard lots about a \$9 billion black hole, and we have something like a \$200 billion potential black hole because, in any set of real accounting figures, a contingent liability is a liability, not something that you ignore. It seems to me that inside the public sector there has been a great number of people deciding to ignore the contingent liabilities. The thing that concerns me particularly is passing down responsibilities to quite junior officers.

**Mr Wallace**—I will take that question, initially. When we refer to the gross exposure identified in this efficiency audit, we must put it into some perspective. If we segment it further—according to guarantees, indemnities and letters of comfort—something over 99 per cent of the total exposure is in respect of guarantees. Less than one per cent is in respect of indemnities, and letters of comfort do not reach the first decimal point. Nevertheless, the amounts in respect of each are still significant; hence the need for risk management. But, in terms of the risk management strategy, it is clear that it needs to focus primarily in the areas of guarantees, where over 99 per cent of the exposure lies. The bulk of that exposure is in relation to the liabilities of Commonwealth financial institutions, one of which has now been sold to the private sector. But there is still, under the Commonwealth Bank Sale Act, a provision for the winding down of that extensive guarantee.

To put this in further perspective, the management of the risk in those areas is quite explicit. The previous government, and other governments before it, and the current government have all adopted a GBE monitoring framework. This framework is administered by the Department of Finance. It gives extensive coverage to monitoring the underlying performance of all GBEs, including the financial institutions, to ensure that the Commonwealth's exposure to risk is adequately managed. It is quite an extensive framework, and I think it is true to say that certainly in the major cases the guarantees are not the exercise of delegations by officers, but they are indeed included in legislation passed by the parliament.

In relation to indemnities, in aggregate they still come to a bit over \$1 billion, so they are not insignificant, even though they are less than one per cent of the total exposure. I think it is true to say that delegations of the powers to enter into indemnities would rarely be given to junior officers. They are given to senior officers, yes; but most senior officers—and I would like to think it was 'all' senior officers—who exercise delegations or authorisations of ministers would exercise those with considerable care and diligence. As I mentioned in the opening statement, with the major focus of risk management in relation to these contingent liabilities - I should add that a contingent liability is one which one enters into with the expectation that it will never materialise, so the full gross exposure is not necessarily what would be faced, even if part of it did materialise, is to manage the underlying viability of the entity subject to a guarantee, etc.

**Mr Kennedy**—I might provide an example of where it is eminently practical to have the power of issuing an indemnity given to people at a relatively low level. In

relation to, say, the conduct of defence manoeuvres, an officer on the spot might be at captain level and may say to the local land-holders, 'We are conducting some exercises, and I am authorised to indemnify you against any damage to your fences or roads or whatever.' It would be a nonsense to have those sorts of indemnities going up the stovepipe to the Minister for Defence.

The power to give indemnities is vested in each minister. It is part of the inherent constitutional powers, under section 64 of the constitution, for a minister in administering that minister's department; but that means that they can commit the Commonwealth in contracts, and that includes, of course, indemnities. It is ultimately up to each minister as to how they want to authorise people within their department to exercise the particular inherent powers that they have.

**Mr BEDDALL**—Can I take an example, seeing that we have used examples? We referred at the last hearing to CSL, where we were told there was a \$1 billion indemnity on blood supply. We were told by the Department of Health officers, who are coming back to talk to us today, that they had verbally briefed the minister on the indemnity. I still find it extraordinary that it was a verbal briefing of the minister.

You say it is just under \$1 billion for indemnities. I understand that the indemnity to CSL on the blood supply is \$1 billion. Therefore, there must be virtually nothing left. I keep reading what a great privatisation CSL was, and what a great success it was in the stock market; but nobody has yet brought \$1 billion to counter CSL, and we do not know how long the indemnity is going to last. It is indemnified because they said it was too hard to get insurance. Hopefully, the Department of Health will be able to say that they have been talking to CSL since the last hearing. But perhaps you could say how that example was in the best interests of the Commonwealth.

**Mr Richardson**—Mr Beddall, I was not personally involved in that; and I think that undertaking was given as part of the sale process. I have recently worked in the asset sales area, but not on the CSL sale. It is often the case with asset sales that the owner of the asset is in a position where, unless it gives sufficient comfort to potential buyers that the risks that are perceived by the buyers would be such that, if they discounted that in the price they paid—in other words, if no comfort were given—the asset value would be very substantially reduced.

It is also often the case that the owners of the asset have a much higher degree of confidence—because they have been owning it and managing it and they are familiar with it—that the risks are modest, whereas somebody coming in from outside might say, 'I have not been involved; there is clearly a risk there.' They typically take the worst case and they say, 'There is potentially a very large risk. The risk may be very low, but I do not know: it may be quite high.' Their position to judge is often not as good as the position of the owner of the assets.

**Mr BEDDALL**—Can I just take that up again? You might address this as you are going along. What is the normal ratio, then? I understand that the indemnity given to CSL is three times the sales price. Is there a rule of thumb? That really is a case where the Commonwealth has kept the risk and has sold at what I think would be a very cheap price, in terms of the exposure that we still carry. Where do you strike the balance between the level of indemnity and what is considered an appropriate sale price? At some stage, shouldn't the Commonwealth say, 'It really is not appropriate to sell an asset unless you can minimise the contingent liability that goes with it'?

**Mr Richardson**—Yes, I understand the question. Again, I was not at all involved with the sale. I think the key thing is to have regard to the real level of risk. If the risk were high, or reasonably high, that the obligation would have to be met, then I think you are right, just in terms of commonsense and economics. If you were standing a reasonably good chance of having to pay out all of that money when the proceeds you are getting are very much less, it just would not stand up to reason. I think the principle is where the risks are relatively low. In the sort of case you are talking about, that would have been based on scientific evidence and technical advice—

**Mr BEDDALL**—Twenty years ago you would have thought the blood supply was fairly safe, but I would not have thought so now.

**Mr Richardson**—I am confident that scientific and other evidence was provided and it was on that basis that the judgments were made. I am not sure about that case. I suspect the liability or the comfort related to operations up until the time the asset was sold. But, if there were something wrong and it came back to bite the Commonwealth, presumably the Commonwealth would be out of pocket in any event. So, if the asset had not have been sold and there were some serious flaw in the blood supply and it led to great damages, then that would have to have come back and would have to have been met by the Commonwealth in any event, I assume.

So, I guess it is a question of the alternative. If there was a liability there, perhaps the Commonwealth was facing it in any event and was just saying to the buyers, 'We will meet what we would have to have met anyway, and will continue to meet in relation to anything that went on prior to the sale date.' Again, I have had no involvement whatsoever in the sale, but I imagine that those sorts of considerations would have been taken into account.

**Mr Kennedy**—I am sure the officers from Health and Family Services will be able to give you an excellent answer to this.

**Mr BEDDALL**—They have had plenty of time to get it ready.

**Mr Kennedy**—Bear in mind that in the case of CSL it is probably swapping a contingent liability for an ongoing liability. There was a provision in the Commonwealth



Serum Laboratories Commission Act that required the Commonwealth to actually put money into national interest stuff like blood fractionation. Perhaps that was part of the equation that went into the government's thinking as to whether or not the sale of CSL was going to be a good idea anyway.

**Mrs STONE**—It seems to me you are saying that there are comprehensive frameworks in place now to guide and direct the different departments as to how they should report annually their aggregated liabilities. We have got this situation where a lot of the listings of liabilities are unspecified. We do not seem to have the exact number of dollars involved in the government's liability. You said earlier that there were problems in getting information out of the different departments and that, right down to the wire, you were still getting data, and so on.

It seems to me, though, you are placing a great deal of faith in this particular inquiry to bring about the cultural change that we seem to be agreeing needs to happen. Do you think that is adequate? Are you able to actually pinpoint what is the problem? Why is it that we have got this situation where departments have failed over a period of time to give us the information? Is it a training issue; is it to do with resources; is it a failure to understand the needs of the government in terms of understanding its liabilities? Can you actually pinpoint where it has gone off the rails?

**Mr Kennedy**—I could probably speculate. It would be an impression rather than a statement based on precise knowledge, but I am prepared to speculate. There is quite a difference between the process of sending off once a year to the Department of Finance or the Treasury big ticket items that can appear in an obscure publication—obscure as far as the agency is concerned—called the Minister for Finance's aggregate financial statements and one where you have to put it in to your own financial statements—statements that are going to be signed off by your own chief executive; statements that are going to accompany the annual report that is going to be tabled in parliament by your own minister. There is a vast difference in mind focusing between that latter situation and the one where you just send off the stuff to Finance once a year.

**Mr McPhee**—I do not disagree with Maurie in what he said. To me the issue is the link between the program areas in departments, which deal with these indemnities and issues relating to their programs and traditionally have dealt with the minister on those matters, and then the relationship between those people and their own finance areas. I think in the past the indemnities have been seen as a vehicle to pursue program objectives in one way or the other and that is quite sensible and reasonable in most cases. The issue is then conveying that information across to the finance people who record it properly, rather than just in the file relating to the particular issue and then getting disclosure. It is through the disclosure that you get the attention of the senior executives and ministers in parliament on these key instruments. I think the area to work on, as in many of the reforms—this is not particularly special—is the link between the program managers and getting them a bit more across some of the consequences from a financial perspective of

some of the decisions that they take or they recommend to their minister. It is getting it all together and I think we are still working at that.

**Mrs STONE**—Could I follow up and just ask Mr Kennedy: are you agreeing with Mr McPhee on that analysis of what the problem is?

**Mr Kennedy**—Yes, I do. I was going to go on to say that it is not that we are pinning our hopes on the JCPA's outcome of today. We are saying that it is very much a help—a catalyst—to get this change in behaviour. The sort of thing that Mr McPhee was talking about, where you are going to get more cohesiveness in terms of financial information flowing within agencies between the program areas and the bean counters of the agency, is starting to emerge. Accrual reporting, accrual budgeting and inquiries like this and audits like this are the sorts of things that will help push that along.

**Mr Wallace**—I should add here also that the advent of audit committees within departments, which will become a legislative requirement under the FMA act is also an important catalyst in this process. The audit committees do, of necessity, bring together people from program areas as well as the bean counters and sheet home responsibility far more than has been the case in the past.

**Mrs STONE**—Are you satisfied those measures—these new audit committees, the getting together of the program managers and the accountants, finance areas—will be sufficient? You do not think we need to have another totally different management structure, perhaps a one-stop shop in the Department of Finance which specifically addresses these problems and the annual reporting process?

**Mr Wallace**—What I was saying was that the accountability framework itself is becoming far more robust. One cannot get an accountability framework which guarantees in any absolute sense that everything will be covered, and covered correctly, in a financial environment. This is, in a sense, harking back to the notion of risk management: one must manage risk rather than try to eliminate every element. But the accountability framework entails both the legislation and the requirements under that legislation, including audit committees, the audit process itself, which is being strengthened, and the JCPA inquiry process. They are all part of that accountability framework, which I think helps to make the process far more robust.

**Mr BEDDALL**—How do we actually enforce it, though? The problem I think we have is that there is nobody in control of it. It is all right to have the standards and the framework and the policy, but if it is not happening then whose responsibility is that?

**Mr Darcy**—I think the central issue here is that the recording of guarantees and exposures of this nature really has to be fairly close to where the guarantee and indemnity is given. The point was mentioned earlier about whether or not a central system would work. I think that, under the old arrangements for table 13, Finance has to rely on

information that is provided to it by the areas that are close to where these guarantees and indemnities are given. Certainly, the discrepancy shown up in this efficiency audit would indicate that a centralised system such as that is really not going to work.

The real issue comes down to a systematic approach to the recording of these exposures. We have mentioned the annual reporting requirements. They are only three years old. Certainly, the evidence that I am aware of, in relation to other items that are in the financial statements, would indicate that there has been a significant improvement in the quality of the information being provided. I would expect that guarantees and indemnities would also fall into that category.

The requirements to disclose those in the finance minister's guidelines, which are signed off by the secretary and the person responsible for the preparation of financial statements, are also subject to audit. Again once you start to achieve this systematic approach to looking at a particular thing, whether it be—certainly at the moment—on a yearly basis or, as it is more likely to be, on a more regular basis, then the disciplines in terms of recording the correct details on registers will come to be. The question as to whether or not the risks are managed is a different question altogether. That really comes to the state of responsibility of each CEO.

**Mr BEDDALL**—Does the ANAO agree that it is just the responsibility of the CEO, or does it think there is somebody out there in the corporate public sector who should take the responsibility?

**Mr McPhee**—I do tend to agree that it is the CEO. I think you have to sheet the responsibility home directly. I think indirect mechanisms like table 13 in the Minister for Finance statements have traditionally not worked that well. I think you have to sheet it home to the CEO. We have indicated in the report that perhaps the reporting requirements can be enhanced, and Finance has suggested that we work together to look at the reporting requirements. We would review it now during our financial statement audit with a stronger focus, so for me that direct way of dealing with the issue is probably the best.

Having said that, we do recommend that Finance take a role in increasing the awareness of agencies of the importance of managing these instruments. Agencies have to be alerted to what is required here and how to better manage the instruments, but then it should be placed on the CEO to record and report. I think that through disclosure and reporting you do tend to get a focus on the management side as well.

**CHAIR**—Mr McPhee, it has been at the back of my mind to ask this question: what triggered this audit report? What was the catalyst? In 1994-95 all agencies adopted accrual reporting. One would imagine that you cannot report on an accrual basis without identifying clearly and being able to quantify your contingent liabilities. Yet your officers, in conducting this audit, had to draw teeth to obtain this information.

**Mr McPhee**—I will ask Colin Cronin to speak, but the primary impetus for this audit report was our previous audits of asset sales, where we noticed that indemnities were being given in relation to specific sales—some significant indemnities. We were aware that over the years indemnities and guarantees had been given, and while, as Mr Wallace indicated earlier, they have been subject to other frameworks, I think they have been very much in the shadows of the other frameworks. We were aware of some very significant potential exposures but it flowed from the asset sales work.

**Mr Cronin**—At the time we launched this we had two asset sales under way, the sale of the Moomba-Sydney gas pipeline and the CSL audit, in both of which indemnities and guarantees featured significantly. During the audit of the sale of the CSL we could not actually find, when we looked at the indemnities issues, any actual quantification of the liabilities that were potentially involved. We report on that, in the report, at some length. There was insufficient information available to the ANAO to determine whether the issue of indemnities to CSL outweighed the financial and supply risks that the Commonwealth would have been exposed to. The theory was that, if we found this in two audits, there was a much wider problem. The question had been previously reported on in the ANAO, in the report *Who will pay the Piper*, so it had been an ongoing theme that had been coming up right across the board. Against that background we undertook this audit.

We are continuing, with our further work on asset sales, to concentrate on ongoing Commonwealth exposures, whether in guarantees, which we expect to pick up further in our audit of the sale of the third tranche of the CBA, or in indemnities, whether they are to directors, to products or however they arise. So it is generally a feature of asset sales, as Mr Richardson referred to, and we will continue to do work in this field over the next 12 months.

**CHAIR**—On page 12 of the report, Treasury identified \$214 billion in liabilities and said, ‘Don’t you worry about that. We have got it under control.’ You identified \$222 billion. Can you reconcile these statements?

**Mr Cronin**—The numbers will move around. The thing that we would say is that we still have not identified the full extent of the exposure. An example of this is in the Commonwealth Bank of Australia. What we report on there is only the on-balance sheet exposure. At the bottom of page 24, in 3.5, there is a dot point. This is taken from the Commonwealth Bank’s public share offer that reports on the guarantee. It says that the Commonwealth will guarantee:

. . . all other liabilities and off-balance sheet obligations, until maturity . . .

The size of that we expect to be fairly significant. We have not got that number, for example. That is an example where you can say that we have not got the first plank, which is the identification of what we have got guaranteed. That is just symptomatic, I think, of a number of others. What is exactly our exposure—

**CHAIR**—So the Commonwealth has indemnified—

**Mr Cronin**—Guaranteed.

**CHAIR**—Guaranteed and they do not know what the exposure is?

**Mr Cronin**—We have yet to determine that in terms of the Commonwealth Bank sale audit we are doing, but this is in terms of the straight reading from the prospectus. What we have done in this report is that we have essentially put a disclaimer on our Commonwealth Bank number. It is related only to the on-balance sheet number. Once you take into account what is stated in the public share offer, the guarantee is expected to be much wider than we have reported in this report. The Department of Finance may be able to provide further details on this.

**Mr VAILE**—Has the Department of Finance got any figure or any handle on that exposure, from the last tranche of the CBA sale?

**Mr Richardson**—No, we certainly do not have any better information than the audit office has got. Treasury was the department which had the day-to-day supervision of the bank. It was part of the Treasury portfolio and it was a GBE before it was sold. I know there have been discussions. When these arrangements were put in place, when this guarantee was given, there were quite extensive discussions between Treasury and the bank, but Finance was not directly involved in those.

**Mr VAILE**—But was it not a sale that was put together by the asset sales task force, which was a function of Finance?

**Mr Richardson**—Yes, that is right, the selling of the asset was, but the arrangements for this guarantee were handled by the Treasury. It was included in the enabling legislation, which was Treasury's responsibility. They handled the drafting instructions and the carriage of that. Once the asset was ready for sale and the enabling legislation had gone through, Finance was involved, we had some comments, we talked to Treasury, but they had the prime carriage of it. Once the asset was available for sale, the Commonwealth Task Force on Asset Sales, as it was then, did conduct the sale, but by that stage certainly the broad framework for the guarantee was in place and was in the legislation by the time the sale process got fully under way.

**Mr BEDDALL**—That is the same problem we had when we had evidence last time. If the Department of Health says it is not their responsibility and Finance says it is not their responsibility in terms of the contingent liability, whose responsibility is it? Obviously, we should be asking Treasury, but I would have thought when the asset sales task force is selling an asset it does take some account of the contingent liabilities to make sure it is getting the right price.

**Mr Wallace**—I do not want to be putting words in Treasury's mouth, but my understanding of the general point that Treasury is making in this in its response to the

audit report was much along the lines of one of my earlier comments that the management of total exposures, whether they be on or off balance sheet, are primarily achieved through monitoring the viability of the entity in respect of which the guarantee or indemnity is being given.

In the case of the Commonwealth Bank, apart from while it was in Commonwealth hands having people specifically on the board, there was a GBE monitoring process which involved regular reporting to the Commonwealth through the Department of Finance, assessments going up to cabinet at least once a year, assessing the risks and recommending, if appropriate, any remedial action.

In addition to that, in the Commonwealth Bank's case, it is also subject to the Reserve Bank's own prudential arrangements, so the risk management framework is quite extensive in relation to these in ensuring the underlying viability of the total asset, if you like. I think that is the general point that Treasury is making here—the processes are in place to ensure that the total exposure is managed.

**Mr BEDDALL**—When the Commonwealth Bank used to report to Finance and Finance assisted, would it not have taken account of other liabilities, off balance sheet obligations, and all those things that then became an issue? Is there not a corporate memory of that?

**Mr Wallace**—This is in relation to the sale process?

**Mr BEDDALL**—No. You said you monitored the Commonwealth bank for all these things while it was in Commonwealth hands.

**Mr Wallace**—Yes.

**Mr BEDDALL**—When it is in private hands you obviously do not do that.

**Mr Wallace**—The data would have been collected through the Treasury all the same, but under the monitoring process of the Commonwealth Bank and any other GBE, the information is passed through to Finance for assessment in the normal way and presented to Cabinet on a regular basis.

**Mr BEDDALL**—So you should have known what all the liabilities were, should you?

**Mr Wallace**—Certainly with this monitoring process, the primary focus is on the balance sheet and other financial statements, the operating statement. In other words, the viability of the enterprise is what is being assessed. The off balance sheet exposures would have a lesser focus than the exposures that are real and on the balance sheet of the organisation. But certainly during the sale process one had a market in the shares which

would have taken into account the public's assessment of what the value of the organisation was, including the exposures to which it was subject.

**Mr BEDDALL**—Concerning the Commonwealth Bank, who would hold the liability for staff superannuation up until the date of sale, the Commonwealth or the Commonwealth Bank shareholders?

**Mr Richardson**—Guaranteeing those superannuation payments in the future, my recollection is that that is the Commonwealth's responsibility. We have guaranteed that as part of the sale. In the enabling legislation that guarantee has been given by the Commonwealth.

**CHAIR**—The shareholders would be happy. No wonder the price is good.

**Mr Darcy**—I think that is a fairly important issue, to what extent do you give guarantees. From past experience, when you are selling an asset to one entity you will warrant that there is nothing undisclosed that has happened that would influence the purchaser's decision to buy at a certain price.

If you take the situation with the Commonwealth Bank and look at the extent of the guarantees that were given; if you were selling the Commonwealth Bank to another bank, you may make a business decision at that point that you are not going to guarantee past a certain point. But the Commonwealth Bank was sold basically on the Australian share market. You are not warranting an exposure to an individual, it is a whole range of individuals. That may be the reason why they appear to be more generous than what would otherwise be the case if you were selling it to a single entity.

**Mr BEDDALL**—In terms of when you are floating on the stock exchange, your prospectus would surely make all people aware of all risks.

**Mr Darcy**—Yes.

**Mr BEDDALL**—Therefore, if they did, the success of the float is dependent on the information in the prospectus. I do not understand that point. I does not matter who you sell it to, people take account of the risk before they buy whether they buy one share or all the shares.

**Mr Darcy**—Yes, I do accept that. What I am saying is that it is a business decision that you would make at the time and who it is being sold to may be relevant to that final decision.

**CHAIR**—If we need to we can revisit this later.

**Mr VAILE**—On page 46 the ANAO stated that management of exposures would

be improved if the Department of Finance played a more active role in encouraging higher standards and recommended that the Department of Finance prepare an explicit strategy to manage the Commonwealth's overall risk associated with these instruments. The ANAO also developed a set of better administrative practice principles to assist agencies to more effectively manage Commonwealth exposure. I am interested in a comment from Department of Finance. Would you endorse agencies' use of this document of better administrative practice principles?

**Mr Kennedy**—I think so. As I said earlier, the ultimate test of the benefit of all of this process is in changing behaviour and best practice documents, guidelines, provide a path down which people who want to change their behaviour for the better can go. So, yes.

**Mr VAILE**—Thank you.

**CHAIR**—Thank you very much.



[10.27 a.m.]

**SANTAMARIA, Ms Cathy, Deputy Secretary, Department of Communications and the Arts, GPO Box 2154, Canberra, Australian Capital Territory 2601**

**WISHART LINDSAY, Ms Lois, Acting Director, Collecting Institutions Section, Department of Communications and the Arts, GPO Box 2154, Canberra, Australian Capital Territory 2601**

**JOHNSON, Mr Mark, Assistant Secretary, Financial Management Branch, Corporate Services Division, Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory 2601**

**LOY, Dr John Gerard, First Assistant Secretary, Health Services Development Division, Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory 2600**

**ROBERTS, Mr Michael Roy, Acting Director, Export Credit Group, Department of Industry, Science and Tourism, 51 Allara Street, Civic, Australian Capital Territory 2600**

**RYAN, Mr John, Acting Deputy Secretary, Department of Industry, Science and Tourism, 51 Allara Street, Canberra, Australian Capital Territory 2600**

**CHAIR**—I now welcome representatives from the Department of Communications and the Arts, the Department of Health and Family Services and the Department of Industry, Science and Tourism to the second session of today's hearing. I would like to offer the departments the opportunity to make opening statements. Do the representatives of the Department of Communications and the Arts wish to make a brief statement to the committee?

**Ms Santamaria**—Our understanding is that we are here because of the Commonwealth indemnification scheme, and my comments relate to that. The scheme has been in operation since 1979. Since then it has indemnified 76 exhibits valued at over \$5 billion which have been seen around the country by 16 million people. The Minister for Communications and the Arts approves the indemnity for each exhibition within a total indemnity limit of \$500 million on any one day. The approval of the Prime Minister and the Minister for Finance must be sought if exhibitions with a total value in excess of this limit are indemnified. On occasion, top-up indemnity has been provided by a state government.

The minister gives effect to the indemnity by signing a legal instrument which includes a schedule listing each lender to the exhibition and detailing their artworks and values. The standard deed was drafted by the Attorney-General's Department. There is an extensive set of guidelines with very detailed policies and procedural and security

guidelines. These are actually currently under review; we want to make it even better.

Currently the two principal organisations managing indemnified exhibitions are the National Gallery of Australia and Art Exhibitions Australia Limited. Art Exhibitions Australia was established in 1980 by the Commonwealth as a non-profit private company to manage indemnified exhibitions. While exhibitions are sometimes curated by a state art gallery, the tour is usually managed by Art Exhibitions Australia.

Organisations managing exhibitions periodically provide the department with a forward schedule of exhibitions proposed for the next three to five years. A consolidated forward schedule is usually provided to the minister annually. I will not go into the detail of the process, but simply say that since 1979 two claims only have been paid out totalling \$381,000—that is in the whole 17 years of its operation. Currently the scheme is being evaluated.

**CHAIR**—Thank you. I understand the audit office had some kind words to say about your department. Can I invite the Department of Health and Family Services to make a brief statement?

**Dr Loy**—Yes. Thank you, Mr Chairman. The extent of Commonwealth guarantees, indemnities and letters of comfort administered by the Department of Health and Family Services is relatively limited compared with some other agencies covered by the audit, but we are notorious in having the indemnity to CSL in line with agreements established during the sale process. That has obviously been the subject of discussion with the committee at the hearings on the audit report on the sale of CSL. We have subsequently written to the committee expanding on the information from that hearing. In addition, there are indemnities for certain Queensland employers associated with work training placements by clients of the Commonwealth Rehabilitation Service.

In terms of the audit report, the department has taken action to implement the report's recommendations with a central register having been developed to record indemnities and facilitate monitoring and reporting and a practice of a six-monthly review of the register to ensure that the records are up to date. We will be reporting the indemnities in the 1995-96 financial statements. Implementation strategies for other recommendations as they affect us are under consideration.

**CHAIR**—Thank you. I now ask the representative of the Department of Industry, Science and Tourism to make a brief statement.

**Mr Ryan**—Thank you, Mr Chairman. There are two major issues which are of interest to this committee: the guarantees associated with the AIDC and the guarantees associated with EFIC. In addition, there are two indemnities provided through the department. One is to the Australian Technology Group Ltd which was an indemnity provided in response to a legal action against the Commonwealth and the ATG group and several departmental officers. That litigation has been resolved and the department is not

aware of any further action pending.

The second related to a contract which involves a US company, Bloomberg, which coordinates an electronic information service. The contract to use this service has a provision to absolve Bloomberg from any liability whatsoever, including any loss which may result from negligence on its part. The department has provided an indemnity for Bloomberg. However, the use of Bloomberg information will be limited to in-house use, and this will limit the potential liability for the department.

**CHAIR**—Do any of your agencies use letters of comfort?

**Dr Loy**—Not for us.

**Mr Ryan**—No.

**CHAIR**—Do you know what they are? The first time I heard about letters of comfort was when that audit report was tabled, and I wondered whether, within the agencies, it was a common phrase or term. Of the three agencies here, it is not known.

**Dr Loy**—No.

**Mr BEDDALL**—I will start with my good friends from the Department of Health and Family Services. I haven't actually seen that correspondence so perhaps you could run me through some of the additional information that was provided. Probably the most important issue after the discussions we had at the last hearing and following on from the report is whether any approaches have been made to CSL to see what they are doing in terms of insurance. I understand that the indemnity was given because it was thought difficult to find insurance at the time, and we wanted to know if that was going to be forever or for a reasonable period of time. Also, what is the contingency in other areas of the world—what do other organisations like CSL do to get an insurance policy?

**Dr Loy**—The letter that Mr Lindenmayer wrote to the secretary on 28 August does set out in quite some detail the efforts that CSL has made over the years to obtain insurance, and describes the efforts that were made in relation to HIV-AIDS and for hepatitis. The circumstance as of present is that they have obtained some limited insurance cover for hepatitis claims and that is being done within its existing product liability insurance for no additional premium. So it is a matter of the insurer having made a judgment that it can now remove some of the exclusion clauses about hepatitis claims without adjusting the premium.

In relation to HIV-AIDS, there has been a development in that underwriters have agreed to provide HIV-AIDS cover of \$49 million, subject to the insuree meeting the first

\$1 million. The premium quoted is of the order of \$50,000. Interestingly, that compares with very similar sorts of cover which were offered in 1994 when the premium quoted was \$250,000. So it reflects the insurance industry beginning to get a better handle on these risks, with more experience and some strong activity on the part of CSL, and briefing them more extensively. That sort of offer of that sort of cover seems to us to probably be something that is in the ballpark of being commercially sensible to take up.

I do not think it is a straightforward issue, given that we are still looking at meeting the first \$1 million of any claim. Most single claims that have been settled to date are certainly less than that. However, if one imagines that there could be a contaminated batch which resulted in the infection of a number of people, then cover up to \$49 million for that price is probably a reasonable judgment.

It is set out in some detail in our last submission to the committee. I think it is a hopeful development that shows that CSL's efforts have paid some dividend and it reflects more experience and knowledge in the insurance industry itself of these kinds of risks.

**Mr BEDDALL**—Just refresh me—I did not quite hear. Who would be responsible for the first \$1 million—CSL or us?

**Dr Loy**—The Commonwealth would be, under the terms of the indemnity.

**Mr VAILE**—How long do those arrangements have to remain in place?

**Dr Loy**—We would seek for them to remain in place for the remainder of the contract—until 2004. Obviously, the insurer will no doubt want a yearly renewal or a review of premium and the like, so there would have to be a judgment made.

**Mr VAILE**—So that is how long the Commonwealth is committed to maintain that indemnity?

**Dr Loy**—That is correct.

**Mr VAILE**—And that was part of the contract in the sale?

**Dr Loy**—That is correct.

**CHAIR**—Sorry, I am not clear. You are carrying a liability for products produced when the Commonwealth owned CSL.

**Dr Loy**—There are two indemnities. One is for AIDS-related and hepatitis claims subsequent to the sale, and the other is for CSL's indemnification in relation to pertussis vaccine and asbestos related claims prior to the sale.

**CHAIR**—Right. So the Commonwealth keeps the liability for product manufactured before the sale and anything after that belongs to CSL?

**Dr Loy**—No. Subsequent to the sale, there is an indemnity for AIDS-related and hepatitis claims that applies if CSL fails to obtain insurance cover at reasonable commercial rates.

**CHAIR**—So five years down the track, if CSL produces blood products that are contaminated, the Commonwealth has got a liability.

**Dr Loy**—That is correct.

**Mrs STONE**—Unless they get insurance under reasonable commercial rates.

**Dr Loy**—That is correct.

**Mrs STONE**—And who determines that they are reasonable?

**Dr Loy**—That would be a matter of discussion between us and CSL and, ultimately, the minister. The minister would have to authorise payment of the premium for the insurance cover, which is the spending of real Commonwealth money, as opposed to the continuation of an indemnity which is a liability but does not require immediate expenditure. So the minister would have to make that judgment.

**CHAIR**—In those areas, does CSL have a competitor?

**Dr Loy**—No. It is for the production of plasma derived products that are not commercially viable. There is no way a commercial producer would go out and manufacture these products, at least for an Australian market. In order to ensure that this market exists, and that the products are derived from Australian plasma—a self-sufficiency policy—there is no choice but to have a single manufacturer. Traditionally, CSL, when it was a government agency, was the manufacturer. In moving to the sale, a long-term contract was negotiated that included these indemnity arrangements.

**Mr BEDDALL**—That is where I am a bit confused because the indemnity arrangement is there unless insurance is available. My impression was that it was unless CSL can get insurance but you are saying that it is unless the Commonwealth can get insurance. Is that right?

**Dr Loy**—CSL must obtain the insurance. It is a matter of the Commonwealth paying the premium.

**Mr BEDDALL**—Why wouldn't CSL pay the premium?

**Dr Loy**—Alternatively, CSL would simply put it into the price of the product for which the Commonwealth pays. So the Commonwealth will pay for it one way or the other, and the arrangement is that we pay directly for the premium.

**Mr BEDDALL**—So we are the only customer for the product.

**Dr Loy**—In essence, yes. It is a product that is supplied to users by the Australian health system so, ultimately, by the Commonwealth in this case.

**CHAIR**—It does not go to private hospitals?

**Dr Loy**—If a person in need of one of these products was being treated by a doctor operating out of a private hospital, yes, it would. It goes to people, however the arrangements are to organise them. Most of the people using these products are treated in the public system but there is no rule saying that they could not be treated in a private situation.

**Mr BEDDALL**—But to say that it is a Commonwealth responsibility—I mean, the Commonwealth government is having some difficulty convincing the states that they should not be charging people on Medicare in public wards because that is just a shift of responsibility. Isn't this a charge to the state hospital systems that is funded from the Commonwealth but not necessarily unlimited funding?

**Dr Loy**—I think you could argue that, yes. You could say that there is no fundamental Commonwealth responsibility here and that the states should purchase this product from CSL. It was not done that way historically so it has evolved in this way. Who knows what may happen in the future.

**Mr VAILE**—I have a question for the Department of Communications and the Arts. In your opening statement, you spoke about indemnities for mainly art displays, as I understood it, visiting collections on display. But in the loan guarantees and non-loan guarantees sections there are a couple of fairly large items. Under loan guarantees, the Department of Communications and the Arts has \$940 million worth of loan guarantees, and \$947 million of non-loan guarantees. How are those risks managed?

**Ms Santamaria**—I did limit my opening remarks to the exhibitions because that was the nature of the letter that we received in respect of evidence that we would give. Those amounts in the guaranteed loans include loans to Telstra, the ABC and SBS. In the case of the Telstra loan, there are explicit government guarantees of existing loans provided under section 72 of the Telecom act, amended in 1986 to section 72B. The guarantees were made by the then Treasurer or his delegate. There have been no guarantees for borrowing since the corporatisation of Telstra on 1 July 1989, when the power to guarantee new borrowings was removed from the legislation.

As borrowings have matured and have been refinanced or paid out in the normal course, the stock of Telstra's explicitly guaranteed debt has fallen sharply, and this trend will continue. So, in 1991-92, there was a balance outstanding of \$2.5 billion. By 1995-96, that had reduced to \$456 million.

**Mr VAILE**—That is on the loan guarantees?

**Ms Santamaria**—Yes.

**Mr VAILE**—So they have been retiring debtors that have been making super profits?

**Ms Santamaria**—That is right.

**Mr VAILE**—With regard to the non-loan guarantee between the Commonwealth and Telecom super, have you got any information that you can provide to the committee on that?

**Ms Santamaria**—Yes, I have.

**Mr VAILE**—I am just interested in the background of that and whether that could fall into the same category as we just heard about the Commonwealth Bank.

**Ms Santamaria**—As a result of changes to superannuation legislation, either all super funds have to be fully funded, as you know, or the shortfall guaranteed. DoF has negotiated with Telstra a guarantee for the net present value of the shortfall. Telstra will make an annual payment of \$121 million to the Telecom super scheme until 20 October 2011.

**Mr VAILE**—But the point is that the \$749 million that is guaranteed by the Commonwealth is pre that agreement, is it not? Is that an outstanding liability of the Commonwealth prior to commercialisation? ANAO might be able to help us here.

**Mr Cronin**—Yes, Mr Vaile. What DoCA referred to there is actually the existing arrangement. The Commonwealth is committed to provide that \$121 million annually for a period of 16 years, but the number reported here is the net present value. The way it is constructed is that we report on the net present value, and, after discounting that figure of those 16 year payments, the net present value is \$947 million. That is what we are committed to, to top up the fund.

**Mr VAILE**—So that is an exposure that the Commonwealth is up for, and that is locked in on those arrangements with the corporatisation of Telstra?

**Mr Cronin**—Yes. Just to add a clarification, it is a top-up arrangement that can

come into play. It is a little bit complex in the way this one works—because there is an unfunded liability there—in terms of how it is actually funded and the role of the Commonwealth in that. I can pass over to one of my colleagues who can give you some further details about how we kick in on this.

**Ms Holbert**—My understanding is that Telstra makes the top-up payments to the super fund and what we are reporting is the Commonwealth's guarantee that Telstra will make those payments.

**Mr VAILE**—Is that part of the agreement that Telstra has with its shareholder as far the provision of dividend is concerned? Is it part of its dividend that actually makes that payment that is reducing the Commonwealth's exposure?

**Mr McPhee**—I am a bit hazy, and it is based on a prior life in Finance, but my recollection is that this was required to ensure that there were not any problems with prudential supervision of Telstra's superannuation arrangements and the Commonwealth was just guaranteeing that this liability would be met in the event that Telstra could not make the payment. But my understanding is that the obligation is on Telstra in the first place to be meeting this commitment. The Commonwealth was just coming in to say, 'This is a guarantee should Telstra not be able to meet their payments.' That would seem to match with this because it is shown as a guarantee rather than a direct liability to Telstra.

**Mr VAILE**—Mr Chairman, it is a pity that Finance is not still here; otherwise, we could ask Finance whether they are in the negotiations that may take place in the event of the sale of one-third of Telstra and whether the asset sales task force would treat that liability in the same way as they did the unfunded superannuation with the Commonwealth Bank.

**Mr BEDDALL**—That was my point. Maybe the ANAO could have a conversation with Finance that they think that perhaps that liability should not be retained with the Commonwealth and it should go from one shareholder to another. If people are going to buy a share in something they should take its assets and its liabilities.

**Mr McPhee**—Mr Beddall, these sorts of guarantees and indemnities do get looked at pretty closely in the sales process, as you would be aware.

**Mr BEDDALL**—Except that they did not know what they were.

**Mr McPhee**—Yes. The dollar amount, yes.

**Mrs STONE**—Could I ask a question of the Department of Industry, Science and Tourism? How can you identify and monitor the Commonwealth exposures in relation to your loan and non-loan guarantees with EFIC and AIDC? Particularly in my electorate, I



have had some experience of the people who have borrowed or been given some assistance through EFIC falling over and then their suppliers being in great financial distress. How do you monitor the activities of the corporation in relation to the issue of guarantees, and who is authorised to provide the guarantees under AIDC and EFIC?

**Mr Ryan**—That is a big, broad question which I will take in a series of parts, if you do not mind. Let me deal first with the AIDC—I might explain the way it operates and that might explain how the guarantee works.

There are two parties within the AIDC group. One is the AIDC Corporation and it is the corporation which under the act has the guarantee. It makes the borrowings and then it passes the funds to AIDC Ltd, which used to be listed on the stock exchange but it is no longer. The government has given some limitations around which the corporation must operate in terms of the use of the guarantee. It has given some broad guidelines on the way the corporation will use the guarantee and what the limits of the guarantee will be. Also within the act the corporation is required to operate under commercial principles and the government does not interfere with the operation in that sense.

In the case of EFIC, there are two components that you need to be aware of. There is what we call the national interest component which is really an account that EFIC manages on behalf of the government. The rest of it is a commercial account. Under its act the board must operate in a commercial means but there are limits on the size of the guarantee that the government has given the EFIC corporation.

**Mrs STONE**—In the table on page 72 we have listed there under AIDC and EFIC some very substantial liabilities—\$6.5 billion is listed there. Can you give me more detail?

**Mr Ryan**—In the case of EFIC there are limits on what the liabilities can be. The limits are that it has a \$3.6 billion limit on insurance and guarantee operations. It has a limit of \$750 million on overseas investment insurance, and it has a limit of \$3.5 billion on loans. They are the maximums that can be taken out at any point in time. At this point in time EFIC has a maximum exposure of \$4.9 billion as of 30 June. EFIC reports to its board every month on what its liabilities are. In fact, it runs quite detailed accounts so that at any point in time it knows exactly what its exposure is.

**Mrs STONE**—At what level are you authorising guarantees under these two schemes?

**Mr Ryan**—In the case of EFIC, it could go to a maximum of the aggregate of the three figures I gave you. That is \$7.85 billion for EFIC would be the absolute maximum.

**Mrs STONE**—I guess I was referring to, though, rather the opposite of it; where

are the liabilities actually engendered or where do you start to determine? Under the EFIC program, for example, you have got a series of small business people and others who are taking out loans and being assisted, so is the liability the aggregation of all of those small enterprises' liability?

**Mr Roberts**—The aggregation of those liabilities is reported to the EFIC board, as Mr Ryan mentioned, on a regular basis. EFIC runs a number of different facilities that fall within the broad categories that Mr Ryan mentioned and the aggregation of liabilities in those different products and services must fall within these regulatory limits which were established under the act of parliament that EFIC operates under.

**Mrs STONE**—I am sounding obtuse, perhaps, but if you get down to the small business person who under EFIC obtains thousands of dollars to export a product and the business venture then falls over, where is the liability in relationship to that? Where does it lie in terms of the Commonwealth's responsibility?

**Mr Roberts**—As Mr Ryan mentioned, EFIC operates on commercial lines. It is required to earn a profit and through the investment of that profit, build reserves to meet claims. In the instance you mentioned, if a small business exporter benefited from an EFIC service or product and subsequently failed and there was a valid claim then EFIC would pay that out of its reserves. It is not a direct call on the Commonwealth.

**Mrs STONE**—It is not a direct call depending on the commercial arrangement that has been organised.

**Mr Roberts**—Yes, that is right. The overall Commonwealth guarantee on EFIC's operations has never been called. It would only be called if the EFIC board in its judgment viewed its reserves as insufficient to meet likely liabilities or claims, and that situation has never arisen.

**CHAIR**—Are you confident that EFIC manages its exposures well, that its risk management is good?

**Mr Ryan**—The directors have a responsibility that they must manage the EFIC exposures. They do use a financial market model called the Washington Model which determines the capital adequacy that they have behind their exposures and it is on the basis of that model that they have never had to call on the Commonwealth because they have sufficient reserves there.

**CHAIR**—When you say they have a responsibility, is that under an act?

**Mr Ryan**—Yes, it is within the act.

**Mrs STONE**—Are you confident that this \$6.5 billion is the full extent of

exposures that we have under the AIDC and the EFIC? Are you satisfied that that is the full extent and that it is pretty well organised under those sorts of arrangements that you have just described?

**Mr Ryan**—We have the confidence that comes from past experience. EFIC has been in existence since about the late 1950s. We have not had to have a call on it yet.

**Mr VAILE**—I have a general question to the three departments. Are you satisfied with the role that the Department of Finance plays in risk management in your department and, if not, what further assistance or guidance could be given? Also, do you think that there should be a central register of all indemnities, loan guarantees and letters of comfort, with the Department of Finance?

**Mr Roberts**—From the point of view of EFIC, as I mentioned EFIC is basically an independent authority although established under an act of parliament. I am not sure of the figure and my colleague here might be able to give it to me but every year EFIC issues literally thousands of contracts with a range of exporters. I would see that it would be difficult for such a register to work in EFIC's case and, in any case, there are confidentiality requirements within the EFIC Act which we may have difficulty meeting.

**Mr VAILE**—Could you provide an aggregation of those?

**Mr Roberts**—Certainly, there is no trouble at all, it is just the fine detail and the number involved that would be more difficult.

**Mr VAILE**—Central to this inquiry is the Commonwealth's, and I suppose the parliament's, opportunity to know and understand the exact exposure the Commonwealth has. We as representatives of the taxpayers want to know what exposure the Commonwealth has. We are interested in having a finite figure on things, which at this stage we do not have. The second part of the question is: is there anything further that you think the Department of Finance could be doing to help with the operations, say, in DIST of accumulating this information and making sure it is accurately recorded?

**Mr Ryan**—From our point of view, it is not a big issue in the sense that we have only four items to deal with. So to report it I think is reasonable. Certainly, in the way that we have seen the ANAO report, we are in agreement with the recommendations and we can certainly comply with that. Within that context, there is the idea of making sure that we have our liabilities collected in a register. Whether that is then aggregated to Finance I do not see as a great difficulty.

**Dr Loy**—As I said at the outset, in the scheme of things it is not necessarily an enormous issue for us. Clearly, the indemnities in relation to CSL are unique and do present some complex and difficult issues. They were highlighted in the ANAO report on the sale and followed on in this report. The CRS indemnities that I mentioned are really

straight up and down, and very measurable and clear, and are not a management or matter of judgment problem at all.

The events of the ANAO reports have caused us to regularise and look at these issues in a consistent and overall way, and that is good. We have established our register. We would be happy to send that off to the Department of Finance if people saw that as being valuable, or we would be happy not to; we do not necessarily see it as something that would assist us.

**Mr VAILE**—I think the more important issue is that the information is readily available.

**Dr Loy**—Yes, that is right.

**Mr VAILE**—Across some agencies and departments, the evidence is that it has not been, and maybe that is the culture and the practice that needs to be changed and improved, I suppose. I am just interested to find out whether there is assistance in that area that could be gained from Finance or whether the individual departments and agencies would prefer to stay at arm's length from Finance on the issue. The key element is having the information available.

**Dr Loy**—I agree with you—that is the key element. In our case, the CSL case is difficult to tie down to a precise number; the CRS indemnity is straightforward to tie down. We are always happy to talk to our colleagues in Finance. In fact, we find it difficult to avoid them. And they are always helpful.

**Mr BEDDALL**—The Department of Finance says the whole responsibility of this rests with your secretary or CEO. So perhaps the secretary or the CEO should sign off the register, and then perhaps there will be further discussions with the Department of Finance.

**Dr Loy**—That is the ultimate responsibility in the financial structure.

**Mr BEDDALL**—But it is an abstract responsibility in a sense.

**Dr Loy**—Yes, that is true.

**Mr BEDDALL**—The secretary does not say, 'I know this is right.' But perhaps what we are looking at with this mechanism for all departments is to find a way in which there is a certification that due diligence has been followed. You will not always get it right, because what is a continuing liability if there was an outbreak of another disease such as HIV/AIDS? Then the continuing liability would be enormous. But that is less likely. I am sorry to interrupt the department.

**Mr VAILE**—I would be interested in a comment from the Department of Communications and the Arts.

**Ms Santamaria**—I agree with the comments made by John Ryan and John Loy. Communications and the Arts does work very closely with Finance on all these matters. Personally, I think it would be rather hard for Finance to maintain that consolidated register that you are proposing. But, generally, I think we get good help from Finance. Most of our information is with them and my understanding is that the amount of the indemnities is required to be included in the financial statements in the annual report.

**Mr BEDDALL**—Just a small question. What was the claim for \$314,000?

**Ms Santamaria**—There were actually two of them. They were many years ago.

**Mr BEDDALL**—Which international treasured work of art did we damage?

**Ms Santamaria**—I think both in fact happened at the National Gallery of Victoria. I suppose I should not do them in.

**Mr BEDDALL**—That explains it.

**Ms Santamaria**—One was a sword of an entombed warrior, in 1984; the other was a Picasso painting, *Three skulls*.

**Mr VAILE**—So that risk is just borne by the department. You do not download that with an underwriter anywhere?

**Ms Santamaria**—No.

**Mr VAILE**—Mr Chairman, I was wondering whether Mr McPhee might like to make a comment on that side of things.

**Mr McPhee**—Mr Vaile, I will just refer you to paragraph 6.14 in the report while I am speaking. Fundamentally, I agree with other departments that the responsibility is with the secretary of each department. But I would add also that, as we move to aggregate or whole of government accounts, we would expect to see in summary form an aggregation of the indemnities, guarantees, letters of comfort. In addition, in the report in 6.14, we draw on overseas practice to say that you can look at other overseas situations. In some parliaments they actually require threshold disclosure of guarantees, so, if a guarantee ticks over \$10 million, the minister has an obligation to report it to the parliament. So clearly the existing model can be built on if parliament wished to know a bit more about some of these guarantees.

Similarly, getting to the point I think you were raising, some of the registers could

be open to public scrutiny in some way, as long as the public interest was protected or the sensitivity of commerciality was protected. That is the way the annual report has tended to go; rather than blow up annual reports with a lot of detail, to say, 'If you want more information, here is the contact in the department and, subject to sensitivities, the information will be made available.' My view anyway is that we should extend or build on the existing reporting mechanisms, plus the awareness raising that we spoke of earlier, to enhance the system.

**Mr VAILE**—That is a very valid point. The thing is that, as long as you get that aggregated figure in an annual report, we are satisfied that everything is in, and also that the people in the departments, from the head of the department down, appreciate that this individual element of risk might be small in its own environment but aggregating the whole thing across the Commonwealth, as we have seen in this report, \$222 billion is not to be sneezed at. So I think it is important to reinforce that with people working within the Commonwealth departments, right down the line; that, as it is all aggregated together, it builds up to a fair amount of exposure. I think that is the thing that is very important. The point you make is very good. Thank you.

**CHAIR**—On page 76 of the report of the Audit Office, there is an indemnity for the ANL board. What does that mean? Is it usual to indemnify directors of boards of Commonwealth authorities? How does that differ from what happens in the private sector and responsibilities of directors in the private sector?

**Mr Cronin**—The Department of Finance would be best placed to answer this, in an overall sense. But it can operate at a number of levels. Finance Direction 21 provides a general indemnity, and it has been used, for example, in the sale of CSL to cover the directors involved in the sale of CSL. There is also a specific instrument that has been issued for GBE directors. That is two aspects. In the private sector, you generally have directors either taking their own insurance—professional indemnity—and I think there has been, or there is about to be, legislation changing the Corporations Law that will enable the company to actually take insurance for the directors. But that is just a feel. So there are a number of mechanisms in place. This would not be unusual in terms of some of the boards, particularly those involved in coming up to asset sales or going through the asset sale process.

**CHAIR**—I will put the same question to each of you here. Have you got any boards where the directors are given an indemnity by the Commonwealth?

**Mr Ryan**—As I said in my opening statement, we do have the particular circumstances with the Australian Technology Group, where there was a particular litigation in place, but that is now past and that issue has been resolved. Otherwise, I think all of our GBE boards are covered by that general Finance provision.

**Ms Santamaria**—I believe that applies to us as well.

**CHAIR**—And Telstra?

**Ms Santamaria**—I would like to check that and come back to you on it.

**Mr BEDDALL**—Just check specifically on Telstra.

**Ms Santamaria**—Yes, I will.

**Dr Loy**—I do not think we have any organisations that would fall outside the arrangements under the Finance direction. Again I would like to check my conscience on that.

**Mr BEDDALL**—Telstra and Australia Post.

**Ms Santamaria**—Okay.

**Mr VAILE**—I have a question to the ANAO. In compiling that list and during the inquiry, with that particular issue, on the next line underneath the one that the chairman raised with regard to ANL there is the indemnity for air safety functions to the Civil Aviation Authority, which I presume is now CASA. Does that relate to the board or to the entire operations of CASA?

**Mr Cronin**—I will get Fran Holbert to answer that one.

**Ms Holbert**—It is an indemnity instead of commercial insurance, following the government decision after the Monarch and Seaview disasters. So it is for their air safety functions.

**Mr VAILE**—For all air safety functions. That is unspecified; it could be \$10 million or it could be \$10 billion. It depends on what may happen.

**Ms Holbert**—Yes. They pay a commercial level premium for the indemnity, more or less equivalent to the premium they were paying to private insurers prior to the disasters which triggered the government decision.

**Mr VAILE**—They pay the Commonwealth a premium that they were paying before. What was the sum insured before, just out of interest?

**Ms Holbert**—I have seen the deed of indemnity but I cannot recall a cap on the liability. I would have to check it to be certain. The premium they pay is equivalent to the commercial premium they were paying to underwriters previously.

**Mr VAILE**—Would it be possible to get back to the committee with those figures? Would you be able to get access to them?

**Ms Holbert**—Yes. I have a copy of—

**Mr VAILE**—Although that is listed in this report as CAA, that would be with CASA?

**Ms Holbert**—Yes. It is because of the time frame. Because we were looking at as at 30 June 1995, what you had was that CAA had an indemnity for the same purpose, which had been issued in 1994. Letters of comfort were issued at around this period when we were closing off the figures, to cover any possible interregnum when CASA came in in July 1995.

**Mr VAILE**—But the letter of comfort would cover only the transitional period?

**Ms Holbert**—It was only for the transitional period. There is now an indemnity which CASA has.

**Mr VAILE**—So there would be an indemnity now with CASA. Would you mind getting back to the committee with how much the premium is that they are paying, and what the sum insured or the cap on the liability was when they were commercially insured. Under the circumstances that exist at the moment, following the report of that royal commission, I think that is fairly important.

**CHAIR**—This question of letters of comfort does not give me any comfort. Does the audit office want to comment on letters of comfort? You raise it in the report that one of the problems is that nobody knows what it means. I have asked the departments here today and they do not use them. One of the criticisms also in the report was that agencies do use them but do not know that they are using them. Do you want to put something on the record about letters of comfort?

**Mr McPhee**—Briefly, Mr Chairman, on page 3 we do give a definition of a letter of comfort. But, fundamentally, the most important message is that the Attorney-General's Department has suggested that anyone seeking to give anyone comfort really should take some legal advice, because it is a difficult area that could end up in the courts. It also, I guess, creates arguably moral obligations on the Commonwealth to act even if there is not a legal obligation. So they are instruments that should be used with great caution.

**CHAIR**—Maybe you ought to take that up with the Department of Finance.

**Mr McPhee**—On the issue of not knowing where they are, it may be that departments or ministers have written to any number of bodies giving them some sort of comfort, without going so far as giving them a guarantee or an indemnification. It may not even be known that this may create an obligation on the Commonwealth downstream, and the report is saying, 'Be careful in this area and take legal advice.'



**Mr Cronin**—The reason we have got the eight there is that they have all passed through Attorney-General's. If they have not passed through Attorney-General's and it is in the corporate memory of the agencies, it is unlikely that we have picked them up. We would doubt that we would have picked up what these are, because it is a question of whether people actually knew what they were committing themselves to. Therefore they would not be reporting. The eight we have reported, which are in the two portfolios of transport and finance, have all passed through Attorney-General's so we are quite comfortable in terms that good processes have been gone through in these cases. It is the other ones, which may or may not exist, that we do not know about.

**Mr VAILE**—But in theory a letter of comfort should have a sunset on it, shouldn't it?

**Mr Cronin**—I guess you would like something to be always capped as to time and as to amount. Yes, there may be cases. It would depend on the legal circumstances and that may not be possible. The English have a very good system, which is not to issue them. Therefore you know exactly that whatever you are doing it is not into this grey area; I think that has got something going for it. As a first line of defence, do not issue them, but okay, there are obviously commercial occasions where some kind of assurance is required. Treat those definitely on a case by case basis. We are certainly not comfortable with them.

**CHAIR**—There is only one mentioned in your report that has a dollar value.

**Mr Cronin**—Yes. That is the Australian National Line. It was to support the financing of ANL during the period of a sale-refinancing arrangement. The other seven are uncapped.

**Mr VAILE**—In considering our report, in taking this evidence today, we or someone should be having a look and maybe revisiting these and reviewing them. An example is the bottom one, Department of Transport/CAA/CASA Deed of Agreement Indemnity. Surely that is only the letter of comfort we would have been talking about in that transitional period. That should now be redundant, shouldn't it?

**Ms Holbert**—It depends on whether an event occurred that may result in a claim, where it may not be clear that either of the two indemnities were in place—the CAA indemnity followed by the CASA indemnity—is in operation. Those letters of comfort are there so that, at that point in time where any gap might occur—and they did their best to ensure there would be no gap, but if there is any perceived legal gap between the two indemnities—the letters of comfort will provide assurance that the government will honour the intent to indemnify the air safety functions.

**Mr Cronin**—There have been some instruments in which it has been attempted, as in a letter of comfort like this, to roll up an indemnity and a guarantee to overcome any lapses in the time. I guess it is a good one if you can get it. These things are quite

complex and people are trying to cover all legal eventualities.

**CHAIR**—Last question.

**Mrs STONE**—This must be a simple question. I am intrigued by the two shopping centres listed for \$5 million each in indemnity. They are at page 74, under the Department of Defence. Do you recall what those were?

**Ms Holbert**—Yes. They are very simple. Defence conducts all sorts of recruiting and training activities. The shopping centres would be recruiting perhaps for the army reserve, perhaps for the regular army, simply setting up a stall. It is instead of public liability insurance so that the shopping centres will be assured that, if Defence creates a situation where someone is injured or property is damaged, it is covered.

**CHAIR**—It is not a shopping centre built on a UXO field?

**Mrs STONE**—No. I was wondering whether we had a nuclear waste bill, or soldiers running amuck or something!

**CHAIR**—We will finish up there. I thank the officers from the agencies and the audit office for giving evidence today.

[11.34 a.m.]

**COMMINS, Mr Michael, Assistant Director General, Sectoral Policy and Review Branch, AusAID, 62 Northbourne Avenue, Canberra, Australian Capital Territory**

**STOKES, Ms Deborah, Acting Director General, AusAID, 62 Northbourne Avenue, Canberra, Australian Capital Territory**

**WHEELER, Mr Christopher, Acting Director, NGO Programs and Liaison Section, AusAID, 62 Northbourne Avenue, Canberra, Australian Capital Territory**

**MCKENNA, Dr Helen, Acting Executive Director, Performance Audit, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory**

**MEERT, Mr John, Group Director, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory**

**CHAIR**—In this session, the committee will examine the main issues arising in the Auditor-General's report no. 5 for 1996-97 *Accounting for Aid—The management of funding to non government organisations, Australian Agency for International Development*. Does AusAID wish to make a brief opening statement to the committee?

**Ms Stokes**—Yes, we would, Mr Chairman. We would like to thank the Chairman for this opportunity of talking about the audit. The report which the committee is examining relates to a significant part of Australia's aid program. It relates to approximately eight per cent of the aid budget and so therefore its findings do have some significance for us in managing the aid program.

We would like to emphasise how the audit was a very productive process for the agency. There was a very positive working relationship between us and the ANAO and, importantly, the findings and the recommendations of the report have been very helpful to us in re-engineering our processes for managing NGO programs. The findings of the audit did not come as a surprise to us in AusAID. We have been aware for some time of the issues raised and have been working to resolve them. An important context for the committee's consideration of the report is the significant growth in aid funding through NGOs over the past decade or so and as the report mentions, since 1985, the percentage of the aid budget that has been channelled through NGOs has increased from less than one per cent to eight per cent. This growth reflects a worldwide trend in aid programs as donors have sought to address poverty at the community level and to promote participatory development. Also importantly the growth in humanitarian emergencies since the end of the cold war has also provided significant growth opportunities for NGOs. Going along with this growth in funding has also been an expansion in the number of schemes within AusAID for NGO activities. Along with this trend, there has also been a variety of guidelines associated with the schemes, and this has been one of the problems highlighted in the audit report. In 1995, we had approximately 30 NGO funding

mechanisms. I do not believe that we had 30 sets of guidelines that were all different, but there was a great degree of variety in the funding guidelines.

As I mentioned before, we have been involved for some time in a process aimed at streamlining management of NGO programs and we have been doing this in consultation with the NGO community. Part of that process was a review of the effectiveness of our NGO programs, which we completed last year and which is this document here. That review provided conclusions about the effectiveness of their programs and also the relationship between the official aid program and NGOs, and it also made recommendations about improving the management of our programs. Negotiations with NGOs on implementing some of those recommendations were interrupted by the election earlier this year. I should add that our own audits of NGOs in the past year or so have also pointed to the need for improvements in efficiency and accountability.

As I mentioned before, the ANAO audit has been very helpful in our taking the reforms forward. A package of reforms to streamline administration was announced in the budget, and AusAID has continued to consult with NGOs about the details of that reform package. In designing the reform package we have sought to reflect the recommendations of the ANAO review as well as some of the best features of our existing NGO programs and to translate those to the other schemes.

I will just run through the key elements of the reforms. We are going to standardise NGO scheme guidelines. This will be a major step forward. These will apply from next calendar year. There will be an accreditation system for all NGOs seeking to obtain AusAID funding. There will be two levels of accreditation. The accreditation process, which we hope will be a rigorous one, will examine the capacity of NGOs to design, appraise, implement, monitor and evaluate development activities. It will also examine NGO systems for managing and accounting for government funds. The new accreditation criteria have been developed in consultation with NGOs, and these are linked to their own code of conduct which the NGOs have developed over the last year or so relating to financial accounting and reporting.

An umbrella contract for all NGOs, with exchanges of letters for individual activities, will also be implemented. That contract has been negotiated with ACFOA—which is the umbrella NGO organisation—and is being forwarded to NGOs for signature this month. We also plan to undertake training for both NGO and AusAID staff to improve their understanding of the requirements for contract management. This training is being undertaken jointly with ACFOA and is expected to commence in December.

We are also going to develop performance measures for our NGO schemes. The aim is to link the assessment of success at the individual project level to a measure of success at the scheme level. We expect to introduce those performance measures also in new funding rounds in 1997.

In developing the package of reforms we have taken some very deliberate risk management decisions. It would not be cost effective and resources do not allow AusAID to micro manage NGO activities. We are aiming to concentrate our efforts on a rigorous accreditation process to ensure the NGOs have the systems in place. In return for these tighter requirements at the agency level there will be reduced reporting requirements on individual activities and less direct monitoring by AusAID of the actual activities. The responsibility for monitoring and implementation of activities is firmly placed with NGOs.

At the project level, our efforts will focus on the scrutiny of proposals at the front end of the project when they are seeking funds. In relation to the evaluation of performance, we will periodically undertake an evaluation of a sample of NGO activities in the field along the lines of our recent NGO effectiveness review. In making these reforms, we have sought, obviously, to provide accountability for Commonwealth funds, while also taking into account the need to not overburden non-government organisations with excessive red tape and compliance requirements beyond their capabilities.

Finally, I should also mention that the Minister for Foreign Affairs, Mr Downer, has asked the Simons aid review, currently under way, to examine the policy basis of government-NGO cooperation, including the issue of cost sharing. Cost sharing, which was a recommendation out of this earlier effectiveness review, requires government funding to be provided on a matching basis with funds provided by the non-government organisations. In other words, 100 per cent grant funding from the government for NGO activities would be the exception rather than the norm which is the case at the moment.

This is a complex issue and one on which NGOs hold some strong and mostly negative views. As I said, this issue is being examined by the Simons committee and that may, depending on how they come out on that issue, lead to further changes in our arrangements in future years. I will leave my comments there. Thank you.

**CHAIR**—Mr McPhee, would you like to comment?

**Mr McPhee**—Deborah Stokes has provided a fairly comprehensive opening statement on the reforms that AusAID is undertaking and touched on what they are doing in response to some of the audit recommendations, so I will just briefly focus on the conclusions of the audit to provide some background to the committee, and then we would be happy to take questions.

Fundamentally, the audit reviewed AusAID's management of funding to NGOs. The NGOs themselves were not subject to audit by this office. However, some of the conclusions were developed about NGO compliance with AusAID accountability requirements. These findings related only to the management of Commonwealth funds and are not a comment on the effectiveness of NGOs in delivering aid per se.

The audit findings focused on four broad areas. The ANAO found that AusAID's

regime for the management of funding to NGOs was generally of a high standard, and some aspects of the management framework are at the leading edge of what we considered to be international best practice. The one area of weakness identified in the audit was a lack of readily available information about the performance of grants schemes, although such can be extrapolated from performance data available on individual projects.

We also found the administrative guidelines for grants schemes were of a high standard. However, the multiplicity of guidelines is confusing to both AusAID staff and to NGOs and, consequently, did produce some inefficiencies. AusAID had also recognised this problem and had introduced some steps to address it. We have recommended that a single or more uniform approach be adopted in 1996-97.

We also found some widespread deficiencies in the application of administrative rules, particularly in relation to contract monitoring procedures. The audit office found contraventions of contracts by NGOs in 41 per cent of records examined, particularly in the late or non-submission of financial reports. In most of these cases, AusAID systems failed to signal these occurrences in a timely fashion.

New systems have been introduced which should overcome AusAID's problems and the audit office has recommended that AusAID give further priority to improving contract monitoring and that AusAID provide additional training, including to NGOs, on grants administration, contract management and contract responsibilities on a cost-effective basis.

The ANAO found that these weaknesses in the implementation of administrative guidelines identified previously also affect AusAID's capacity to provide adequate assurances about the efficiency, effectiveness and economy of expenditure for all funding to NGOs. These weaknesses had already been partly identified by AusAID and remedial action initiated. The ANAO supports this effort and has made recommendations aimed at complementing and extending AusAID's endeavours.

I will leave it at that. AusAID has responded very positively to the audit and accepted the six recommendations made by the ANAO. Dr Helen McKenna was the audit team manager, and she, John Meert and I would be more than happy to answer any questions from the committee.

**CHAIR**—Ms Stokes, would you please explain to me and the committee how you distinguish between government policy and the policy of AusAID in determining what type of project is approved for an NGO? I have a few documents here, which are of a very broad scope, on projects which are funded. Does the government set down guidelines as to what they define as foreign aid that is appropriately funded?

**Ms Stokes**—There is of course government policy for the overall directions of the aid program, and it is understood that that would guide the choice of activities funded

through various programs—not only NGOs, of course, and not only NGO programs. Perhaps I will focus on the NGO part of the aid program. You are right in saying—

**CHAIR**—The next question is how do you become an NGO and get funded?

**Ms Stokes**—Can I just say on the guidelines that certainly every scheme has a set of guidelines. We are moving to standardise those and, as part of that process, we are going to have a clearer definition of the sorts of activities that should be funded underneath NGO programs. We are in the process of doing that. In relation to how does an NGO get funding—did you say?

**CHAIR**—How does an organisation become an NGO for the purposes of funding?

**Ms Stokes**—I think in the past there were two answers to that. We had one scheme, if you like, the backbone of our NGO, the AusAID/NGO cooperation program, and that had a fairly well-defined accreditation process. The problem was that we did not have an accreditation process for other NGO programs, and that put program managers in a difficult situation because they had to judge on a case-by-case basis whether this was an authentic, legitimate NGO. One rule of thumb was whether that organisation had tax deductibility status, because that indicated that they had gone through a process of checking and scrutiny that had led to them being awarded tax deductibility. I don't know—are you familiar with that?

**CHAIR**—Yes, but you said before that many NGOs are 100 per cent funded by the Commonwealth. Where does the tax deductibility come in?

**Ms Stokes**—Their activities that are funded by the government are 100 per cent funded. That NGO may indeed have other activities which they fund themselves. There are some NGOs for which government funding is the majority of their budget, and there are other NGOs where government funding is a very small percentage. It varies immensely. On the question of the system we are moving to, there will be quite clearly defined accreditation criteria and, if you would like more detail on that, my colleagues could provide that to you.

**CHAIR**—An NGO cannot do what it likes in a country without some sort of cooperation from the government of that country, surely?

**Ms Stokes**—I think this is an interesting issue. The very nature of non-government organisation activity is that they are non-government. Usually Australian NGOs work in partnership with non-government organisations, community organisations, in the developing country, and I do not believe it is the case that such activities always have the approval of that developing country government. It may be in some countries that that is required, but in others it is not.

**Mr BEDDALL**—If you look at table A on page 41, it seems to me that World Vision—which I would have thought was a very successful fundraiser in its own right—gets a quarter of the total NGO budget. Does that strike anyone as unusual? It gets more than UNICEF. I assume ‘WV’ is World Vision. Why such a large amount for one NGO? UNICEF is \$5 million less than that.

**Ms Stokes**—There is probably not one answer to that. We do not at the outset of each year decide that we will give individual NGOs X amount. The NGOs usually compete with other NGOs for funding through particular windows, as we call them, in AusAID. The fact is that World Vision is or has been—I am not exactly sure what the figures are this year—the largest NGO in Australia. So I suppose it follows from that that they have the capacity to prepare the proposals and to compete fairly strongly for funding. That is the only answer I can give to you on that. There is no decision in advance to allocate money to particular NGOs.

I should qualify that in relation to the ANCP, the scheme I mentioned earlier—the AusAID/NGO cooperation program. The funding allocations there are based loosely on how much money the NGO understood they could raise from the Australian community. So, in the ANCP, World Vision probably gets one of the largest amounts—25 per cent.

**Mrs STONE**—Could I ask AusAID, perhaps Ms Stokes, on page 41 again, on the second page there, we had the ACTU in receipt of a country program for \$359,900. Could you explain to us what that particular program is or under what category of funding that came?

**Ms Stokes**—No, I couldn’t tell you. I don’t think we have the detail of that. I will have to take that on notice, I think. It is not APHEDA, which I immediately thought it was. APHEDA is the NGO arm of the ACTU.

**Mrs STONE**—Since we have a separate entry for APHEDA and then we have the ACTU separately, we are aware of that connection.

**Ms Stokes**—That is right; that is why I am saying it is not APHEDA. I don’t know what it is. I will have to let you know by taking that on notice.

**CHAIR**—This is why I asked the question about the type of project undertaken by NGOs. Quite a few of the projects by APHEDA are for setting up a trade union movement in other countries.

**Ms Stokes**—Could I just correct you on that? In fact, we have been examining these issues with our parliamentary secretary in some detail, and we have been looking at APHEDA, in fact all small grant schemes. The bulk of APHEDA activities are in fact human resource development. They are training activities not necessarily related to trade union development. It may sound odd but that is the reality.



**Mrs STONE**—So you will get back to us on those sorts of details?

**Ms Stokes**—Yes.

**Mrs STONE**—In relation to the deficiencies identified by the audit, concerns about the plethora of guidelines and so on—and you have already explained you are dealing with those—there is some reference there to high staff mobility and how that also exacerbates your problem of multiple guidelines and boiling that down. Are you referring there to the high staff mobility of AusAID or the NGOs? Where is the high staff mobility that you are referring to?

**Ms Stokes**—It is AusAID.

**Mrs STONE**—It is within AusAID. Can you say why we have that high mobility?

**Ms Stokes**—Yes, certainly. There are two answers to that. In one sense, we have a number of positions overseas and so there is probably an additional requirement for movement compared to other government departments which require staff to move perhaps more than they might. However, in contrast to that, we have recently participated in a benchmarking exercise on personnel practices, and that showed that our mobility actually was about standard for the APS. We were a bit surprised to hear that ourselves, but that is the fact of the matter: we are about standard in terms of the turnover of our staff, or moving from one position to the other. This is a perennial one, and we do try to address it and realise that there does need to be continuity in program management. It is not always possible to achieve, but we do try to address that.

**Mrs STONE**—Can I just follow on? This is not quite so closely related, but you referred in your opening address, Ms Stokes, to the fact that you are now looking at less direct monitoring of activities by AusAID. Instead, you were looking at the front end, as you described it, how they appear to be complying with their initial contract and so on. But, of course, we would be concerned that maybe you can always dress something up to look like a success without some independent monitoring on the ground. What sort of role would our embassies have in these countries, or the governments of the developing nations? Are you going to have any independent audit of the actual performance to see that it matches the activities as actually reported to you?

**Ms Stokes**—It very important to emphasise the accreditation process. We will be examining the agencies and their systems in all aspects of operations. It will be their agency structure, whether they are an NGO, relating to the Chairman's earlier comment. We will be looking at their development professionalism, their ability to design, implement, monitor and evaluate. We will also be looking at their management and financial systems. We will be looking at the agency as a whole and whether they meet the standards that we have set down for competent management of overseas aid activities. As I said before, we have agreed on those criteria in conjunction with the NGOs this year.

That is a very important part of the new arrangement.

We will be looking also at the up-front scrutiny of project proposals when they come in, using the new standard project formats in line with the new standardised guidelines. There will be just the one committee in AusAid with one chairman of that committee that will look at all NGO schemes and proposals. So there will be a higher level of continuity in that process as well.

With respect to your other questions on monitoring in the field, we will be conducting an evaluation of NGO activities on the ground from time to time. We have not set out the time frame exactly but I imagine it would be in the league of three to five years. It will be a comprehensive effectiveness review of the kind that we conducted last year. We would not be able to assess all activities in the field, there are just too many of them, so it will be a sample. In the course of doing that sample we will be using very similar methodology to that which was used in here in the sense that we would be checking what we see in the field of a sample of activities against the NGO's self-assessment.

We found when we did this that there was a reasonable degree of correlation between the NGO's self-assessment and what we saw in the field. There were some areas of weakness in NGO performance, mainly relating to women in development and project sustainability, continuing activities after the NGO inputs stopped, but overall we found that there was a reasonable degree of performance and that it correlated with their self-assessment. We see that as a key means of continuing the assessment of their performance in the field.

With respect to our own overseas posts, we have had to make a decision based on an assessment of risk and where we need to put our scarce resources that are overseas. Having someone in a post is very expensive, and I think you might have examined this issue not long ago. We do not believe that it is cost effective for our posted officers to be monitoring what are usually very small projects in their countries. Also, many of these NGO activities are in countries where we do not have posts. We do not rule out that there might not be some posts with officer involvement, in particular where there are emergencies or some other problem arising but, in general, we do not see that as the norm and we have made that as a deliberate assessment.

**Mrs STONE**—You are saying that you are going, in a sense, to more self-assessment and reporting and yet the audit showed that almost 41 per cent of the sample NGOs did not comply with their performance reporting, their monitoring. What are you doing to make sure that there is that substantial shift so that self-assessment is in any way valid? What about the feeder, the subcontracted agencies, where the agency which is reporting to you has had to extract some very high level of monitoring from their sub-agent or client that they have contracted to on the ground?

**Ms Stokes**—What we have found, not only through the ANAO audit but through our own experience through a variety of means—we have had audits and we have had spot checks—is that we created an administrative framework which was far too complex for the NGOs and for us and so we almost set ourselves up to fail. We were requiring quarterly reports from NGOs, which were progress reports but also financial reports, and we have made an assessment that that is excessive and it was no wonder that they were not performing and we were not performing either.

Our aim is to try to have an administrative arrangement that is realistic for NGOs. We have to recognise that a lot of NGOs do rely on voluntary services to carry out their functions and so we are conscious of their limitations. The system we have designed does address that. We now are going to have annual reports from NGOs. We believe that they will be able to provide those and, if they do not, then I think they will have problems in us pursuing those reports. It will also be a more realistic goal for AusAID staff to aim for. Quarterly was really just unrealistic. So that, I hope, has addressed that point.

**Mr BEDDALL**—Could you just satisfy a question for me. I have always found that the NGOs tend to be more focused on Africa than general aid is. Could you take on notice to give us a proportion of how much of this money went to the African continent compared to the region?

**Ms Stokes**—We probably have that information here. We would be able to say how much AusAID money, through NGOs, goes to Africa but we probably do not have in there how much of NGOs' own money goes to Africa.

**Mr BEDDALL**—No, I mean the AusAID money.

**Ms Stokes**—Yes.

**CHAIR**—On balance, the Auditor-General found the management of funding of NGOs was pretty good and I think you got a tick in pretty difficult circumstances. But I have a question for the ANAO. You did a sample of NGOs. How many NGOs did you actually examine?

**Dr McKenna**—I think for that year, the total number of grants to NGOs was in excess of 900 and we took about 10 per cent.

**CHAIR**—And you are satisfied that you were given all the information regarding those from DFAT or AusAID?

**Dr McKenna**—We are satisfied.

**CHAIR**—Did you have access to complaints from our foreign posts about any NGOs or projects or—

**Dr McKenna**—AusAID provided us access to the actual files, so we had access to any information they had and, yes, there were some summaries from posts about monitoring of particular projects.

**CHAIR**—Can you tell us about some of those? Not in detail, but did they highlight problems that may not be in your report?

**Dr McKenna**—No, I would say that they were in accord with the general problems highlighted, including complexity of administrative guidelines and the multiplicity of them, making compliance on the ground—often in areas where English was not the first language—and understanding of the requirements difficult. That was exacerbated by the often remote locations of some of the projects that were being funded. This imposed difficulties on the physical transmission of reports and, in that case, the requirement for quarterly reports became quite onerous, as reported by some of the posts. There were other post reports where compliance was not a problem and the projects appeared to be well managed.

**CHAIR**—Does misappropriation occur?

**Dr McKenna**—We did not see any evidence of misappropriation.

**CHAIR**—Can I ask that of Ms Stokes?

**Ms Stokes**—We have not, in our audits, seen evidence of misappropriation, if you mean by that—

**CHAIR**—I mean by that that the money goes into someone's pocket instead of to the project, or to buy a vehicle that someone uses privately instead of the project.

**Ms Stokes**—The only exception I should make to that is the reasonably well-known case of the CARE audit of several years ago—and a matter relating to that is still with the AFP—but apart from that, we have not had any instances. I should say, of course, that the jury is still out on that matter. It is inconclusive. In our other audits we have not found evidence of misappropriation.

**CHAIR**—Who audits the financial statements on project expenditure submitted by NGOs to AusAID?

**Mr Commins**—We do not audit the statements as such. These are financial statements submitted by NGOs accounting for funds we have provided to them. We do, however, as Ms Stokes mentioned, conduct spot checks on NGOs. We look at their financial and management systems. Those checks involve AusAID staff.

In addition to that, we have under way a program of audits of selected NGOs.

Over the last year, I think we have done about six or eight of these. These audits are undertaken by professional commercial auditors in collaboration with the agency. Part of the arrangement, as I understand it, for NGOs is that they must themselves have audited statements as part of their normal day-to-day existence. As part of our auditing of NGO agencies we, of course, review their audited statements as well.

**Ms Stokes**—I should also add that—as part of the accreditation process that we are putting in place—to maintain accreditation, each NGO will submit to AusAID its annual report and audited financial statement within five months of the end of the agency's financial year.

**CHAIR**—What is done to check with the multinational NGOs or recipient organisations bidding for and receiving funding for the same projects from various governments?

**Ms Stokes**—Chris might be able to answer that in more detail, but we make it very clear in the guidelines that that is ruled out. So the onus is on the NGO. To date I do not believe we have found any firm evidence that that has taken place. In a number of instances, we have done some checks, but I do not believe we have found evidence that that has happened.

**CHAIR**—When allegations of misuse arise, if they arise, what is the procedure for investigating such allegations of the NGO, the Australian embassy, the high commission or AusAID?

**Ms Stokes**—It depends a bit on the nature of the allegations. We have some general guidelines for handling allegations of fraud. They require in the first instance, if you like, a preliminary study of the issues to work out what is the best step to go the follow-up route to pursue it further or, indeed, it may not require further elaboration if the allegation does not seem to be fairly based. That is the process that we would handle for any allegation, not only relating to NGOs, of course. Mr Commins might be able to talk about other processes in more detail.

**CHAIR**—Can we have a copy of those guidelines some time?

**Ms Stokes**—Yes.

**Mr Commins**—I just want to add to that. If we think there is evidence of fraud or misuse of Commonwealth funds, we would normally undertake a formal investigation through the post. This may also involve, depending upon the circumstances of the case and the nature of the misuse, a detailed audit either involving our own auditors in AusAID or perhaps engaging auditors from outside.

**Mrs STONE**—I just want to follow on from that. You are saying that you have

not had any major inquiries. You said you spot checked about five or six NGOs this year.

**Ms Stokes**—And we have audited about the same.

**Mr Commins**—Yes.

**Mrs STONE**—You have audited about the same, but you have not had to respond to posts, highlighting what they suspected was misappropriation or an inappropriate use of government funds for the last two years or so. You have had none of those situations.

**Mr Commins**—I think we had recently a case of a claim and we are still looking into what action, if any, needs to be taken. Our audits and spot checks, I might add, are primarily directed at the head offices of the NGOs in Australia. The formal audits are quite comprehensive. I mentioned earlier that they are undertaken by professional auditors from private companies in Australia and so far, in the six or eight we have done over the last year, the auditors have not noted any misappropriation or misuse of funds. But I stress that this is at the Australian end. If we did in fact find—

**CHAIR**—Who are those auditors? They are employed by whom? Private companies or—

**Mr Commins**—Widin Williams, for example, and Ernst and Young—they are the large companies that have been appointed after a rigorous selection process and, essentially, they are on period contracts to the agency.

**CHAIR**—I think we will face this problem more and more as the government moves towards contracting out of how the Auditor-General can sign off books of organisations that are in the private sector, and how the parliament can be convinced that the taxpayers' dollar is being spent on what it should be spent on. I think there is a perception in the community that a fair bit of aid funding goes in different directions, and we must ensure that everything is in place that we can possibly put in place to make sure it does not.

**Mrs STONE**—I would still be concerned that you are auditing the head office, so to speak, in Australia. What capacity have you to go back on the ground and see that the vehicles purchased or the salaries said to be paid and so on, in fact, have been. It seems as though you do not have any ability to check out the facts on the ground. Again, it is virtually a system of trust, is it not?

**Mr Commins**—You are correct. It has been, to a certain extent, a trust relationship. But just reverting to the comments Ms Stokes made earlier about this very rigorous accreditation process which we are now pursuing, and taking into account that we are dealing with about 900 projects on the ground—there is a multiplicity of small projects—if our investigations in Australia disclose some concerns that all might not be

well overseas, of course we will then pursue those. We have, as we mentioned earlier, periodic reviews on effectiveness of NGO programs and they will continue under the new arrangements.

With the requirements for asset registers and for more rigorous accounting and financial reporting, albeit on an annual rather than a quarterly basis, taking into account issues relating to risk management, our view is that what we have in place is sensible. I think we have the checks and balances. If we do feel there is something that should be pursued—and, as Ms Stokes mentioned earlier, we are working in countries where we have no diplomatic representation—and if we had the suspicions or the evidence, there would be no question that we would follow it up.

**Ms Stokes**—The point that you are making is an important one which has arisen in our own investigations. It is this fact that NGOs do work in partnership with partners in developing countries. The accreditation criteria address this head on and require that they do ensure that their partners have adequate systems in place. We have addressed that to the best of our ability. This is an area that we will need to keep an eye on. In the case of some NGOs who definitely do operate on the basis of trust with their agencies, I think this will require some change. We will just have to keep an eye on that. The issue you raise is a real one and we have sought to address it.

**CHAIR**—I think everybody on this side of the table recognises the value of aid. I have seen projects in Thailand and Cambodia and you are to be commended on the work you do. The fact remains that it is difficult to measure program performance and program delivery. I ask the audit office: did this audit examine AusAID's investigation and audit strategies? Did you have a look at that?

**Dr McKenna**—Yes. We had a look at the whole system that AusAID has in place. There are several different components of that, as Ms Stokes has mentioned—the spot checks, the internal audits, the requirement for externally audited financial statements and the capacity for taking investigative action if there appears to be a discrepancy in any of those or in any project that is being funded.

**CHAIR**—Ms Stokes, you have told the committee that there are some major changes about to occur—some reforms in procedures. What sort of timetable do you put on that?

**Ms Stokes**—In 1997 we hope to have everything in place. The key point to mention, I suppose, is that we do need to work closely with the NGOs themselves and reach an understanding with them, and that adds to the time factor. As I mentioned, we plan to have the umbrella contract organised with a month. So that is under way. But the other changes will be introduced next year. Because of the complexity in existing arrangements, there will need to be some transition arrangements. Some NGOs, for example, have ongoing funding under some of the programs and we cannot move the goal

posts midstream, as it were, so there will be some transition arrangements in various programs. But the aim is for any new window or any new funding phase of a scheme to have to follow the new arrangements, starting next year.

**CHAIR**—Some of these new arrangements are caused by policy changes, aren't they? You mentioned the need for matching funding in—

**Ms Stokes**—That issue is not resolved yet. The aid review is going to be looking at that. The aid review is due to report early next year, 1997, and it really depends on where the review comes out on that issue whether in fact there will be any changes.

**CHAIR**—Could this committee have a copy of the terms of reference of the review, if you have that?

**Ms Stokes**—Yes, certainly.

**Mr BEDDALL**—Does the total amount of money here include money that is allocated, say, under special circumstances of famine or to Rwanda and all those sorts of things? Is that all included in the money total? They are not in a separate bucket anywhere?

**Ms Stokes**—It is perhaps a bit misleading when we talk to you about eight per cent of the aid budget going to NGOs last financial year. The fact is that that money, that eight per cent, came out of many buckets. One of the buckets was certainly humanitarian relief, and there would have been NGO funding for emergency activities as well as what we describe as humanitarian, often reconstruction activities after an emergency. If you would like more detail on that we could provide that. We have this publication which lists all the NGO activities that we fund in 1995-96. It is broken down by various means and we are just trying to go through it now to see if we can find the ACTU activity.

**Dr McKenna**—Mr Chairman, appendix 1 of the report is an extract from the 1994-95 version of the document that Ms Stokes has just shown you. Just through of the timing of the report, the detail was not available for 1995-96.

**CHAIR**—We talked before about allegations of misuse of funds, and you mentioned that one project was under investigation. Were you referring to a project in the occupied territories in the Middle East?

**Mr Commins**—I was, yes, Mr Chairman.

**CHAIR**—Can you tell us what the progress is of that investigation, or is it not proper to do so?

**Mr Commins**—Frankly, I do not know what the current situation is with regard to



these allegations. I can tell you, however, that we have had extensive reporting from our posts on the allegations and this information has also been passed on to the Australian agencies concerned. I myself have not seen the response from the agencies but I will just check with my colleague about whether he has any later news.

**Mr Wheeler**—We have had a comprehensive response to it. We asked the agency to provide information about the allegations and they have come back with a comprehensive response to that, which we received just last week. We are examining that at the moment. Our initial assessment is that they have provided a very good answer and thrown considerable doubt on the allegations, at the very least. But we will obviously be having to look at that further, talk to them about it and ask them—

**CHAIR**—It must be difficult: if you do get allegations, what can you do about it? You have no jurisdiction in the country.

**Ms Stokes**—When we get allegations we always take them seriously, but we always look at them in the course of a due process and try to get all sides of the story. Now that we have got this input from the agency concerned, we will obviously have to make an assessment of what the next step might be. I suppose that until we have done that we will not know.

**Mrs STONE**—I guess that, if there were a situation where it was found that the funds had not been expended in the way that been agreed, the only recourse open to you would be to cut off the funding, to terminate the program. Is that the only recourse that you have?

**Ms Stokes**—I think there are a number of recourses. That is one of them, obviously. I should say that in the course of our own audits we have found that there have been a number of instances where NGOs—not this one in particular that we have been talking about—have signed an agreement with us that says that they will do A, B, C and D, and then the exact nature of A, B, C and D has actually varied a little in the course of implementation, possibly for very good reasons.

When we have found that, we have looked at each of those on a case by case basis, having regard to the program area concerned and the NGO. If there are very good reasons then we arrange a contract amendment to cover those changes. If not, we deduct that amount from the next payment. We do not agree to pay for that amount. Obviously, the lesson for the NGO is that, if they wish to vary what they plan to do in the field, they should get approval in advance. These are the sorts of ways in which we can handle these situations.

**CHAIR**—We have come to a conclusion. Thank you very much for the comprehensive way you have answered all the questions. We look forward to seeing the results of the review, and the committee will bear it in mind that the audit office did

commend you on the management of the funds for the NGOs.

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

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 12.27 p.m.**