COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE

of

PUBLIC ACCOUNTS

Reference: Review of the Auditor-General's reports 1995-96

CANBERRA

Tuesday, 23 July 1996

(OFFICIAL HANSARD REPORT)

CANBERRA

JOINT COMMITTEE OF PUBLIC ACCOUNTS

Members

Mr Somlyay (Chair)

Senator Baume
Senator Crowley
Senator Mackay
Senator Watson
Senator Woods

Mr Anthony
Mr Beddall
Mr Broadbent
Mr Laurie Ferguson
Mr Fitzgibbon
Mr Georgiou
Mr Griffin
Mrs Stone
Mr Vaile

WITNESSES

JOINT COMMITTEE OF PUBLIC ACCOUNTS

Review of Auditor-General's reports

CANBERRA

Tuesday, 23 July, 1996

Present

Mr Somlyay (Chair)

Mr Beddall

Mr Laurie Ferguson

Mr Georgiou

Mr Griffin

The committee met at 9.37 a.m.

Mr Somlyay took the chair.

CHAIR—I officially open today's public hearing, which is the first hearing in this parliament to review Auditor-General's reports using the new review procedures announced by the committee. The JCPA has a statutory responsibility to examine reports of the Auditor-General. In 1996 the JCPA will select reports of the Auditor-General that raise significant accountability issues for review at round table public hearings. It is proposed that such hearings will be held quarterly. The purpose of the hearings is to allow the JCPA to give immediate attention to recommendations of the Auditor-General; to enable differing views to be aired in public; and then to make timely reports to parliament on what further action, if any, needs to be taken by departments and agencies to protect the interests of the Commonwealth.

We will be running these hearings in a round table format, which means that all relevant participants will be present to hear what others are saying about an Auditor-General's report. I would like to remind witnesses of three key features of this format. Firstly, during the general discussion periods committee members will have the first opportunity to ask questions. Any subsequent questioning or discussions between participants will need to be directed through the chairman. Secondly, witnesses should for the benefit of Hansard identify themselves on each occasion they wish to make a comment. Thirdly, given the length of the program, statements and comments by witnesses should be kept as brief and succinct as possible.

I also remind you that the hearings today are the legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will be recorded by Hansard and will attract parliamentary privilege. The committee has resolved to allow the televising of the first session of today's hearing. As you can see, the Sound and Vision Office is video recording these proceedings.

I refer any members of the press who are present to a committee statement about the broadcasting of proceedings. In particular I draw the media's attention to the need to report fairly and accurately the proceedings of the committee. Copies of the committee statement are available from the secretariat staff present at this hearing.

The committee has also decided, pursuant to section 11 of the Public Accounts Committee Act 1951, to take confidential evidence about the JORN contract in camera. The in camera part of the evidence on the JORN contract will be taken at the end of the public hearing on audit report No. 28. Of course, this session will not be broadcast and we will need to ask all members of the public and the media to leave. In the meantime the committee will take most of the evidence on the Jindalee operational radar network project, covering all the issues raised publicly in the Auditor-General's report on the public record in public session.

[9.41 a.m.]

Audit Report No. 28, 1995-96, Jindalee Operational Radar Network Project

BARRETT, Mr Patrick Joseph, AM, Auditor-General for Australia, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2600

McNALLY, Mr Ray, Director, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory

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

MINCHIN, Mr Tony, Executive Director, Defence Branch, Australian National Audit Office, GPO Box 707, Canberra Australian Capital Territory

AYERS, Mr Anthony J., Secretary, Department of Defence, Russell Offices, F-2-Secretary's Suite, Canberra, Australian Capital Territory

JONES, Mr Garry F., Deputy Secretary, Acquisition, Department of Defence, F-2-65, Russell Offices, Canberra, Australian Capital Territory

HAMMOND, Mr Nicholas David Hunten, First Assistant Secretary, Defence Materiel, Department of Defence, Canberra, Australian Capital Territory

HEDGES, Air Commodore Richard Peter, Director General, Jindalee Project, Department of Defence, Russell Offices, Canberra, Australian Capital Territory

SHARP, Mr Peter K., Inspector General, Department of Defence, NCC-B1, 14 Moore Street, Canberra City, Australian Capital Territory

ARNOTT, Miss Jillian Mary, Solicitor, Telstra Corporation Limited, 231 Elizabeth Street, Sydney, New South Wales

KRASNOSTEIN, Mr David Milton, Group Director, Strategic Planning and Development, Telstra Corporation Limited, 242 Exhibition Street, Melbourne, Victoria 3000

MORRISON, Mr Malcolm Leslie, National General Manager, Telstra Applied Technologies, Level 3, Building 2, 540 Springvale Road, Glen Waverley, Victoria 3150

YELLAND, Mr Lindsay James, Group Managing Director, Retail Products and Marketing, 14/231 Elizabeth Street, Sydney 2000

CHAIR—I welcome representatives of the Auditor-General's, Defence and Telstra. We have convened this public hearing to examine the main issues raised in the Auditor-General's report on the Jindalee project. At the outset I would like to say that the JCPA regards this particular report of the Auditor-General in a very serious light. The auditor has raised fundamental accountability questions relating to the management by Defence of the JORN project.

In particular the Auditor-General has raised concerns that Commonwealth funds have been used to make progress payments beyond the earned value of the project just to maintain Defence expenditure. Serious concerns have also been raised about the management of the project, which is now well behind schedule and over budget. The JCPA will take evidence today on what action has been taken to remedy the deficiencies identified by the Auditor-General.

The Auditor-General's views have been set out in the report as have the initial responses from the audited agencies. For this reason, we are proposing to dispense with lengthy opening addresses. However, the committee is interested to learn whether any action has been taken or is planned to address the problems raised by the Auditor-General's report. To open proceedings, does anyone from Defence or Telstra wish to make a brief opening statement to the committee?

Mr Ayers—I will make a brief opening statement. The surveillance of the northern and western approaches is a key part of our defence strategy. JORN provides a mere continuous surveillance capability over the whole area and is the only affordable system to provide anything like this coverage. JORN will complement the airborne early warning and control aircraft which we are now seeking to acquire and will significantly improve their capability by providing early warning of any activity against which AEW&C might be directed. It is hard to underestimate the importance of JORN defence.

Such capability does not come easily. JORN is at the cutting edge of technology—an area where high risk is unavoidable. While the scientific concepts have been proven by the Jindalee radar at Alice Springs—and if at some stage the committee wishes to have a look at that project we would be very pleased to host that visit—the overall scale of the systems engineering task and the degree of design and development needed to meet the very demanding performance specifications make the task more difficult than anything similar previously attempted in Australia.

Building something like JORN, which pushes the boundaries of technology, is not like building, say, a carport. Schedule estimates for something which has never been done before can never be more than, hopefully, educated but still guesswork. It is not hard to find examples of systems that have taken longer or cost more to build than originally estimated but that have ultimately delivered unequalled performance.

An obvious example from an Australian perspective is the F111C aircraft. Despite

a five-year delay and a significant cost overrun, the aircraft is still today arguably the most considerable strategic strike aircraft in the world and for Australia has provided an enduring edge in operational capability. If we are to maintain our edge in operational capability we have no choice but to deal in the development of advanced technology. We need to accept that the projects which do so will not always proceed exactly according to plan.

In this context, I think it would be useful to put the problems faced by the JORN project into perspective. There is no doubt that the system will be at least three years late, and we are far from happy about that. Our expectation is that the costs to Defence will not exceed the approved project cost, the specified performance requirements will be met and the 70 per cent target for Australian industry involvement will also be met.

Turning to the audit report, Mr Chairman, because you asked us to tell the committee what we have done, Defence has accepted all the recommendations. Not all of them require additional action. Of the total of 21 recommendations, 10 relate specifically to the JORN project. Recommendation 6 requires no further action—it recommends continuation of assistance to the contractor from the Defence, Science and Technology's high frequency radar division.

Three recommendations relating to improving the prime contractors management of risk, its verification and validation processes and the software skills for the project are already complete—they are recommendations 1, 9 and 13(a). Action on the remaining six recommendations is in hand. Recommendation 2 deals with the projects office risk management plan. The plan has been revised and is currently being circulated for comment.

Recommendation 3 recommends improvements in the timeliness of cost schedule control system reporting. With the exception of one subcontractor, reporting is now generally satisfactory and we are addressing the problem with the remaining company. Recommendation 13(b) proposes a review of the results of the JORN technical audit to see whether we can improve quality assurance in complex engineering development projects. This recommendation was agreed with the ANAO immediately prior to the publication of the report and action is yet to be taken to implement it.

Recommendation 15 recommends progress payments be made against earned value reported by the cost and schedule control system rather than milestones. This requires a prime contract change and is currently under discussion with Telstra. Recommendations 16 and 17 deal with the administration of the intellectual property provisions of the contract. A plain English guide to these provisions and an intellectual property management plan are under development.

The remaining 11 recommendations relate to general Defence acquisition policy. Seven reflect longstanding practice and require no further action, five deal with more

recent Defence initiatives to improve our acquisition process and action on each of them is complete. One relates to the inclusion of provisions for technical and performance audits in contracts with significant risk. Action to include this as a standard provision in appropriate contracts is in hand.

I will finish by noting the productive relationship between the project and ANAO during the 18 months or so in which the audit was under way. This has helped in the development of a set of recommendations which are useful to Defence either in endorsing existing practices and initiatives or in proposing sensible improvements.

Mr Yelland—I would like to speak in support of Mr Ayers's opening remarks. This audit is really of the Department of Defence and its management of the project. Of course, we are keen to work with the Department of Defence in the implementation of the recommendations contained as an outcome from the audit. JORN will be the world's most advanced wide area radar upon completion. There is no doubt that it does push the boundaries of technology, as Mr Ayers has already mentioned. I do not know about the allusion to the carport but certainly, in its construct, it does not resemble a carport. The risks were high and are reducing but the benefits will be great, advancing Australia's border strategic interests within our area.

With specific regard to the Auditor-General's report recommendations, of the recommendations 10 related specifically to the JORN project and, of these, seven are of direct relevance or have impact upon Telstra and our performance within the project. Firstly, we do gratefully acknowledge the continued support of DSTO, which is recommendation No. 6. They have been invaluable so far in their support of the solution to some of the technical aspects of the radar. With regard to issues of potential impact to Telstra's work on the project, they fall broadly into three categories: risk management is agreed and I think now largely implemented as a result of progress during and as a result of the audit and projects that were already under way to mitigate risk within the conduct of the project; those related to reporting, quality assurance and tailoring of the nil standards on the matters with which we are working with the JPO; and, with specific regard to intellectual property, Telstra believes that we are contractually compliant at this time.

CHAIR—I invite Mr Barrett to make an opening statement.

Mr Barrett—Before addressing the specific audit, I would like to put on record that the ANAO welcomes the new JCPA review procedures and supports wholeheartedly the committee's desire to give encouragement and support to the efforts being made to improve public administration generally. The ANAO does, as always, stand prepared to assist the committee to achieve the objectives it desires from this new review process. I particularly welcome the opportunity to give evidence to the committee on our report on the JORN project. As you know, JORN is a $1 billion plus project for construction of an over the horizon radar facility. The project is highly complex, as has been indicated by the

Secretary of Defence. It is of considerable strategic significance for Australia and is important industrially because much of it is being built in Australia—as indicated, 70 per cent.

As the starting point for the audit, we took the view that Defence had prime responsibility for overall management of the project, although the work is done for Defence by a prime contractor. I stress that our objective was to assess Defence's management of the project in the light of accepted project management techniques. An important part of the audit was, therefore, to derive lessons to be learnt and recommendations that could be applied to the remainder of the project and, indeed, to other large projects. It is not simply a case of being wise after the event. On the contrary, it is more about dealing with perceived problems as they emerge.

We chose JORN for examination because it was about the next major Defence acquisition project in size after the new submarines and the Anzac ships projects. ANAO has, as you know, reported on these two projects in recent years. In short, these audits found that the Anzac ship project was proceeding satisfactorily and that Defence needed to be more on the front foot in dealing with the contractor on the new submarines. I mention this because on JORN 2 we found that Defence needed to be more pro-active with the contractor. The nature and complexity of the project required an experienced and commercially astute project management team which was capable and ready to deal with problems when they became apparent and to insist on receiving basic contract deliverables, such as risk abatement plans.

Defence might do well to review and assess its approach to developing and/or acquiring project management skills to cope with such demands. While it makes sense to adopt a mutually supportive partnership arrangement, particularly where there is a deal of uncertainty and problem solving involved, the Commonwealth's interests have to be protected to ensure a cost-effective outcome. It is, therefore, essential that managers of major projects have the necessary training and experience commensurate with the scale and complexity of the task. We were informed during the course of the audit that there was pressure on Defence project managers to maintain payments to contractors so as to meet overall annual Defence budget spending estimates. Clearly, that is not in the Commonwealth's interests, nor consistent with multi-year budgeting, and Defence has agreed to our recommendation on this issue. As well, progress payments should be directly linked to progress achieved.

If necessary, consideration should be given to withholding payments or other suitable measures if progress continues to be below the level agreed and required. At the very least, early action should be taken to determine the reasons for delay, particularly if the process is on the critical path, and timely decisions made to ensure minimal or no impact on other critical stages including, importantly, their financial impact.

The ANAO appreciates the advanced technical nature of JORN and the resultant

risks involved. Nevertheless, it is a very costly project for both parties and, as has been indicated, it will exceed its time and cost projections. It is, therefore, difficult to escape the conclusion that the Commonwealth's interests would have been better protected had Defence adopted a more disciplined and pro-active approach with the contractor as problems arose. It is clear that such projects demand a rigorous approach to planning, oversight and management if they are to achieve the required cost, time and standard of outcome. There are also implications for the broader policy endeavour of promoting greater efficiency in Australian industry.

Despite these concerns, the audit did have an overall positive outcome. Our report made 17 recommendations designed to improve project management on JORN and other major Defence projects. Defence accepted all of these, as we have heard. Defence also considers that a satisfactory technical outcome on JORN is within reach. Telstra has indicated that the audit findings and recommendations provide lessons that should be applied to other large projects and to the remainder of the JORN project. I recognise here at the table that Tony Minchin and Ray McNally were the senior audit staff involved with this audit. We are happy to respond to any questions of the committee.

CHAIR—I will open up the meeting now to general questioning. I put this question to Defence. The first issue which was of concern to the committee is that your annual report—the latest one tabled, 1994-95—states that JORN design activity was nearing completion, that confidence that the specifications would be met were high and that radar hardware was in production. Would anyone like to comment on that? Is there any lack of communication between the processes of reporting to parliament and what is happening in the project team?

Mr Ayers—Perhaps Mr Hammond could answer that.

Mr Hammond—I was involved in constructing that extract for inclusion in the report. At the time—May of last year—the statements that were made were made in good faith and, as far as we knew, were correct. The design was nearing completion. It was not until the completion of the technical audit, that is differentiated from the ANAO audit—the technical audit was led by the Lockheed Martin Corporation and conducted by Telstra and GEC Marconi—that a number of shortcomings in the design process were disclosed.

Had that information, which did not become available to us until about November 1995, been available at the time, we clearly would not have made the comment about the design nearing completion. However, it was true to say that the hardware was going into production: that, in fact, was the case. In summary, I would say that the remarks were made in good faith on the basis of the knowledge available at the time. Three or four months later we would have changed our views.

Mr GRIFFIN—At that time, what was the actual state of play with design? Where was it actually up to in November? Where did you think it was up to at that time?

Mr Hammond—At the time, our expectation was that the design work would be fully completed by about the end of 1995; that was not the case. It now appears that that will not be the case until about the beginning of 1997, although I would have to say that we are talking about the residual small elements of design rather than anything basic to the functioning of JORN.

Mr GEORGIOU—I am puzzled because, firstly, Defence have on two occasions queried the systems requirements review and the system design review as being inadequate. Secondly, they were on the verge of requiring an independent audit that was overtaken by the internal technical audit, and this did not register in terms of causing some degree of concern. These reviews did go to design. There was sufficient concern to be on the verge of asking for an independent audit and everyone was imbued with high expectations of success. That puzzles me.

Mr Hammond—I think we need to differentiate between two things. The design of the JORN proceeded in two directions, if you like. With the classic top-down design, you start from the basic requirements and decompose those to design a radar but, as is quite common with projects of this sort of complexity, it also started bottom up. You take existing pieces of hardware like transmitters and receivers and you work at what you have to do to those to make them adaptable for the overall design.

The concern—which actually got as far as initiating an independent audit—was that the process of flowing the requirements both up and down to make sure that there were no discrepancies was incomplete. This was what prompted the action to initiate the audit. But I differentiate between that and the significant problems that we found with the design process as a result of the technical audit. So it is fair to say that we had some concerns, but our expectation at the time was that the design would be complete by the end of 1995. Our concerns were more related to the fact that that in itself was about 18 months late.

Mr BEDDALL—Taking into account that huge six-month turnaround that took place between May and November 1995, does the Department of Defence believe it has now identified all the possible risks that are associated with the project? If so, what risk management plans are in place to ensure the JORN project is back on target and that the contractors and subcontractors are fully accountable to the department?

Mr Hammond—It is fair to say that we have identified the main areas where risk remains in the project and they are essentially in the areas I have been talking about: the overall completion of the design—in other words, going right through the design to make sure that all the requirements in the specification are captured and reflected in the design; and that there are no ‘disconnects’, to use a term, between the individual elements of the design and the overall requirement. That is an area of risk. Telstra has put some very significant resources into addressing those areas and we are confident that that will resolve any residual issues.

I should say that I would not want this risk to be overstated. It is not uncommon to find problems with interfacing between subsystems when you are doing a design of the complexity of JORN. That is quite common. The ways that those problems are addressed is that if they will have a significant effect on the requirement, then there needs to be some rework. If they will not have a significant effect on the requirement—on the overall performance—then, typically, a concession would be granted.

Our expectation—and it is based on the surveillance of the project by the project office; discussion with the contractors and subcontractors who are doing the work; surveillance by DSTO; and discussion with Lockheed, who were involved in the audit—is that the probability of a major difficulty in the design is low. We expect to have the typical number of minor problems that you would expect with any design of this complexity once we start to integrate the radar and we will address those in the normal way.

The other area of risk that we have identified is in the development of the software for the system, and that is simply because at this stage that work is relatively immature. The delays in the design have caused a delay in the commencement of the software development. At the moment, it is about 25 per cent complete overall. The work is proceeding well. It is being well managed by the subcontractor that is doing it, but software is a notoriously difficult area of engineering development and at this stage it is simply too early to say that the residual risks in that area have been overcome.

Mr BEDDALL—I accept that it is normal procedure, but normal procedure in this case did not work according to the audit report we had and there were significant slippages, particularly in 1995. The question was: should any of those slippages happen again, what management plans are in place to ensure that the Department of Defence is across those before they become so apparent that the statement in the annual report is no longer about being viable six months later?

CHAIR—Mr Beddall, perhaps we ought to ask what has been put in place, given Mr Barrett's statement that the problem came about by a need to expend Defence appropriations before they entered the financial year, at a time when the Commonwealth is moving across the board to accrual accounting to get over that very problem. Has that been addressed by Defence in the context of the Auditor-General's report?

Mr Ayers—I wonder if I could ask Mr Jones to put that statement and its content in the report in its context because I think that is quite important.

Mr Jones—The payment regime adopted for a large and complex contract is a matter for considerable debate. If we had our preference, in a simple contract we would pay a fixed price on completion. Clearly that is not possible in this sort of endeavour and we have to find some way of providing adequate cash flow to the contractor in recognition of the effort performed without burdening the overall contract costs with an impossible

cost of money process. So there is a nice business trade-off for the Commonwealth in the mechanism that is adopted to pay the contractor.

Additionally, in a contract with a lot of risk, there is always a temptation to pay cost-plus—that is, to pay as you go. Some of the committee members will probably be aware that the US government in recent years has tried to run development contracts on a fixed price basis and has found that to be totally unsatisfactory. In this case the Commonwealth attempted to tread on what I think was a sensible middle ground and have a process where it was recognised that there was very considerable development involved in this contract and very considerable risk. That risk was shared in various ways between the Commonwealth and the contractors.

A lot of debate and effort went into trying to assess how that risk would be shared. Part of the sharing of that risk is the identification and determination of the way the payment regime will be applied throughout the contract and/or the incentives and disincentives that may apply for superior or inferior performance both in schedule and in technical areas.

In this particular contract, at the starting point it was determined that the most appropriate method seemed to be to pay on milestones that were predetermined at the beginning of the contract. The effort was identified at the beginning, estimated roughly in terms of cost, and milestones were identified to be paid against.

It is important to note that this contract and virtually all Defence contracts pay on progress. Whether the progress is by earned value—something you will probably want to discuss later—or by milestones is something of a moot point. The payment is by progress and, indeed, on occasions we will make partial payments.

Importantly, the actual payments that are made, given that they are based on progress, are really the end result—they are a lagging indicator, if you like, of the actual physical progress. The thing that matters, obviously, in this respect in these projects is: has the contractor performed to the quality and to the time that we are seeking? The last thing that happens if there is a schedule delay will be the payment. The last thing that I will see, for example, in the management of these contracts is delay in payment.

The so-called pressure that has been quoted in the report is really, in my view, no more than an attempt to ensure that the project office in Defence and the contractor, both prime and subcontractors, maintain the progress that has been aimed at. The clearest manifestation of the achievement of that progress is the payment schedules. It is kind of back to front to say that it is wrong to apply pressure on the contractor and the project office to achieve their objectives, which includes the payment regime as we go through the project.

I think it is fair to say that in any large contract like this there will be pressure on

the project office and on the prime contractor to achieve what they set out to do and, therefore, to pay the funds that have been estimated against the milestones that have been adopted.

Mr GRIFFIN—Do I take it from that that 80 per cent of the money of the contractors has been paid yet only 28 per cent of the software has been completed or something like that? Do I take it from that that your milestones are totally stuffed, not to put too fine a point on it, and you are in a situation where you are saying you have effectively met milestones, which has meant that you have paid out 80 per cent of the contract, when less than a third of it has been completed? Is that right?

Mr Jones—My view is that that is an incorrect view of the project progress. The figures are more like: 73 per cent has been paid against the current ceiling price in the contract—that is the Commonwealth's maximum exposure—and the measures of progress adopted in the report tend to be misleading. What the Commonwealth has paid within a relatively small band is for the work that Telstra and their subcontractors have performed in accordance with the requirements of the contract. In other words, 73 per cent of the funds have been paid and somewhere in that order of the actual physical progress, the effort involved, has been achieved. It is nothing like the figures you quoted.

Against the original milestone estimates—and, let us face it, those estimates were some years ago in a project that was hard to estimate every step you needed to go through to get there, as Mr Ayers said; but the estimates were not that far wrong—we have paid 73 per cent of the ceiling. Even against this notion of earned value, which you heard the Auditor-General talk about, the progress payments are much in the same order—nothing like 20 per cent.

While you could debate which is the best way to make progress payments, it is generally the Commonwealth's policy to pay as you go in these contracts. We think it is not unreasonable that, when a contractor has demonstrably incurred expenditure against something that the Commonwealth will eventually own, we should make progress payments, secured appropriately with financial guarantees and other things. The alternative is not to pay until the end and that will add an enormous cost to the overall contract because of the cost of money.

Mr GRIFFIN—I do not think anyone is arguing with that. There has been quite a bit of talk around about the question of just how far down the track is this contract in terms of completion. There have been figures bandied around along the lines I mentioned earlier. I do not have a problem with progress payments, but this question relates to those progress payments being relevant to progress. You are saying to me, I think, that they are relevant to progress. That seems to be at odds with some of the information that has been presented to the committee on the public record previously.

Mr Jones—I might ask Mr Hammond to elaborate on the actual figures, but I will

make the point that it is nothing like the figures quoted in the report.

Mr GRIFFIN—What are the figures?

Mr BEDDALL—Can I add a little bit to that. You have said that 73 per cent of the ceiling price has been paid—not the target price of $840 million—and that if we pay the final 27 per cent we will have the project up and running?

Mr Hammond—Yes. The correct measure of payments is the percentage of what you expect to pay at the end of the day. Currently, the projected target price is very close to the ceiling price and we expect it will be at the ceiling price after the exercise that Telstra is doing now on replanning. On that basis, the progress payments that were made at the time of the report are about 73 per cent of the price we expect to pay.

The cost schedule control system earned value—which is the value that the Auditor-General has recommended that we use for progress payments—at that time was about 65 to 67 per cent. The situation is that at that stage we had paid 73 per cent against a progress of about 67 per cent. I might add that because of the nature of the milestone mechanism this has fluctuated. There have been times in the project where we have actually paid less than the earned value; there have been times when we have gone over it.

In the contract there is a provision that if we have overpaid as a result of a particular milestone payment by more than 10 per cent of Telstra's actual costs plus profit then we are entitled to either recover the amount of the overpayment or to be paid interest by Telstra on that overpayment. That has been invoked two or three times during the contract.

Mr GEORGIOU—Defence keeps on saying, with all due respect, that all the exposure over the ceiling price is Telstra's. Does Telstra accept that, and can it give us some indication of what sorts of costs will fall on Telstra? It is very important because it is constantly reiterated both at these hearings and in the responses of Defence that essentially 'we are safe because we have a ceiling price and after that ceiling price the cost is all Telstra's.' Is that so and how much is it?

Mr Yelland—With regard to the specific concept of the milestone payments, in the original negotiation of the contract that was and remains Telstra's view of the situation and it reflects the contractual circumstances between the parties. There is nothing unusual in such arrangements. We cannot comment on DoD's contracting in other projects, but that was the mechanism that was elected to be used in this project. If Defence want to renegotiate the contract, we would stand ready to have discussions with them to see if we can accommodate those objectives.

With regard to costs over and above the nominated ceiling price, because, as Mr

Ayers has mentioned, the nature of the project is such that we had an agreed radar that was to be built, and as we have worked down the path of designing the radar we now understand that it is far more complex than was originally intended, Telstra at this time has made a provision in its accounts to accommodate a change in the expected cost of the implementation of the project. I do not believe it is appropriate to discuss that amount at this point, but it can be explored later if the committee so desires.

We would reserve our position about the concept of scope creep, which has occurred along the project. In particular, the ultimate ceiling price will not be known until the end of the project because we have yet to complete the building of the radar.

CHAIR—Are you going to make a profit or a loss on the project?

Mr Yelland—I believe we will make a loss on the project.

Mr GEORGIOU—Does that mean you do accept that there is a ceiling price, which is the opening price plus some provision for the price increases plus foreign exchange? Does that mean that you accept that Defence has got a ceiling price and you will pick up 100 per cent of any excesses to complete the project over that ceiling price?

Mr Yelland—I do not believe that the ultimate ceiling price will be known until the end of the project.

Mr BEDDALL—I thought it was $894 million?

Mr Yelland—At this point in time there has been scope creep, and we have not yet explored whether there will be additional features or requirements that Defence requires out of the radar.

Mr BEDDALL—Is that a view shared by Defence?

Mr Hammond—I understand Telstra to be saying that the ceiling price may be affected by later contract changes. That is the correct position contractually; we would not disagree with that.

CHAIR—But within the present contract?

Mr Hammond—Yes, within the present contract constraint.

Mr BEDDALL—When we say we have met 73 per cent of the projected ceiling price we do not know what the ceiling price is; so how can we say we have met 73 per cent?

Mr Hammond—We know today that if there are no further changes to the

contract the ceiling price will be $895 million and we have paid about 73 per cent of that.

Mr BEDDALL—But there seems to be a general view that there will be a change to the ceiling price.

Mr Hammond—We are not anticipating any changes.

Mr Jones—Technically, that is correct, there will be, because the price is expressed in today's dollars. The ceiling price varies over time because of the escalation and exchange rate clauses. So Mr Yelland is correct: nobody today really knows what the end ceiling price is. But the principle of the matter is that in today's dollars we do know what the ceiling price is, and apart from any agreed changes of scope to the contract it is our very firm view that when the amount reaches the ceiling price the financial responsibility then lies 100 per cent with Telstra.

Mr BEDDALL—But does the Department of Defence expect a change due to the scope that you refer to?

Mr GEORGIOU—How does it feel about scope creep?

Mr Hammond—There are a number of minor contract change proposals outstanding. There will be some minor changes as a result of that, but we are not expecting any significant change in the ceiling price.

CHAIR—With the exchange rate, it is possible for the ceiling price to come down.

Mr BEDDALL—Does Telstra agree that changes because of scope may be only minor?

Mr Yelland—The requirement specification must be definitely closed down and accepted. I think that was set out in the report. The remaining work to complete must be replanned and become the subject of a revised completion schedule that is contractually accepted and implemented by the JPO. Without these two prerequisites, payment milestones will necessarily continue to be arbitrary and unverifiable until we are able to achieve that resolution. We expect to have another pass at the system engineering, which is the overall view of the radar, completed at the end of September. That will, I believe, lead to close-out of that design.

CHAIR—There are press reports and reports from other sources that Telstra is considering selling their involvement in this project. Would you like to comment on that?

Mr Yelland—Certainly. We have continued to review our future with regard to our investment in defence contracting generally. The times are changing for Telstra. With regard to that, we would suggest that, if the committee wants information about our

activities in that, we conduct that as part of an in camera session because the information that we would need to share with you to reveal our plans in that regard clearly is commercially in confidence.

CHAIR—If we talk specifics, but from the point of view that you have stated you will make a loss on the project, I find it difficult to understand how you would sell something that is making a loss.

Mr Yelland—It is possible that we might incur a loss on JORN. We do have a significant defence and commercial contracting operation. Overall, that operation does not make a loss. We are continuing to examine our options with regard to what our future intention might be.

CHAIR—I turn now to the role of the Department of Finance in selection of the successful contractor. What has been Finance's involvement since then, given its brief to oversight Commonwealth expenditures?

Mr Jones—The Department of Finance, to the best of my memory, was involved in the original selection process of the contractor, which is not an uncommon process. Indeed, one of the other ANAO reports on defence project management has observed that. They were involved, in the early days of the project, in the setting up of the structure and framework. However, I think it is fair to say that to the best of my knowledge the Department of Finance has had no direct involvement in the management of the contract subsequently. That would be in accordance with the normal devolved arrangements for the administration of departments of state.

Mr GEORGIOU—How does Defence feel about Telstra selling out?

Mr Ayers—We have no problem with the decision for Telstra to sell, providing certain conditions are met, which perhaps we could talk about in the closed session. Telstra are aware of our conditions and are happy enough to abide by them.

Mr Yelland—No absolute decision has been made to sell at this time. I would just like to state for the record that we are examining our options, but there is no concrete decision which has been made at this time.

Mr BEDDALL—When did Telco first realise that it had been disadvantaged when Telstra in 1991 granted a UK subcontractor a sublicence to commercialise the intellectual property of the project? What did the JPO do once it realised that Telstra had started the commercialisation of the joint intellectual property?

Mr Hammond—I think it is important to put this in context. The subcontractor we are talking about is GEC Marconi. GEC Marconi at that stage was responsible for the system design of the radar. The scope of its subcontract has been changed and Marconi is

now responsible for producing the radar transmit subsystem, one of the radar receive subsystems and the frequency management system. That GEC Marconi could commercialise the joint IP—in other words, could build an over-the-horizon radar on the basis of the intellectual property it has developed as part of the joint project—is not possible. It would not be possible for Marconi to do that without the participation of both Telstra and Telstar, the software subcontractor.

Mr BEDDALL—What if Telstra sells to GEC Marconi?

Mr Hammond—If Telstra sells to GEC Marconi, then I expect that that company, together with Telstar, the software subcontractor, could commercialise the JORN. But, of course, Defence would have to be involved in any novation of the contract to GEC Marconi and we would have the ability then to insert whatever provisions we wished to to make sure that the commercialisation was to the benefit of Australia.

Mr BEDDALL—This is one of the crucial points, apart from the costings. This is an Australian innovation that is state of the art, yet there is a feeling or a statement that intellectual property of this Australian innovation is now under threat. Does the Department of Defence feel it is in a position to protect that intellectual property, no matter who is the final owner?

Mr Hammond—The answer to the question is yes for the reasons that I stated. GEC Marconi has a piece of the intellectual property, but with that piece it cannot do much in the way of developing an over-the-horizon radar. All it can do is participate with the holders of the licences of the two other pieces of intellectual property that are required to build a complete system. For that reason, although we believe that Telstra should not have granted that sublicence without our approval, it is a small, administrative, contractual issue rather than being a threat to the intellectual property owned by Defence.

CHAIR—At this stage I ask Mr Barrett if the audit office would like to comment on the obvious conflict about the figures involved in the ceiling price of the project. I think the audit office quoted 80 per cent and 20 per cent. There is some disagreement between those figures and the figures quoted by Defence.

Mr Barrett—I will ask the audit officers directly concerned with the audit if they have any comments, but it seems to me that those figures quoted there have already built-in adjustment factors which Mr Jones referred to which should not obfuscate the important points made about the ceiling price and the contract price. If the issue is that there is no further Commonwealth liability beyond that ceiling price, so be it. The issue that this committee has rightly put its finger on is about scope creep. The issue is whether we are still talking about the same product or not in a generalised term. That is an issue, it seems to me, between Telstra and Defence.

We would have to get legal opinion about whether the contract is that elastic. I

would have thought that, all things being fair, if there were considerable differences in the work that was intended to be undertaken and what work actually is undertaken then the contractor might have some rights in that relationship, but that is outside our bailiwick. I simply make that comment. I ask Mr McNally or Mr Minchin if they have any comments they would like to make on those particular figures.

Mr McNally—The figures that have been published in paragraph 3.17 of the audit report are based on the only full set of milestones that have been used in the JORN project, and they are the original ones. The current milestones only run for the next 12 months, therefore the performance measurement baseline that we have in place now does not run to the end of the project. Therefore, the figures that may be used to assess whether they have paid 60 per cent or 70 per cent of the performance I think are a little questionable.

I had to go back and revise the original milestones because they seemed to be what was considered to be the ideal way of measuring progress. They contained milestones which were pretty well tied to the development methodology used for JORN. They contained milestone values and amounts appended to technical reviews and audits through the development cycle and tests and evaluations during its integration and test cycle. Therefore, I thought they were quite a good indication of progress.

The current milestone payment regime and payment milestones, I believe, are not a clear way of indicating progress. Many of them are based on what they call design walk throughs which are not as accurate as those specified in the original milestone regimes. For instance, they do not test whether the progress achieved can be properly aligned to the original requirements in the contract in the specifications and therefore the measurement of progress again is quite questionable. Therefore, I believe that our figures in 3.17 and used throughout the report are probably more reliable than the figures that can be produced based on the milestones now being used.

Mr GEORGIOU—Mr Ayers, at the beginning, outlined the significance of JORN. He also said that these sorts of enterprises were inherently risky and subject to time loss. When the contract specified a completion date was that just pulled out of the air? Presumably there were other contractors who bid on this contract who also had a notion of time. Given that we are spending lots of money for something that is a real product that will enhance Australia's security, what are the implications for at least the 50 per cent loss in time above the original estimates? Presumably we did not just pluck it out of the air and not care. We thought that was a reasonable time for conclusion. Other people bid on the contract against the time factor as well as the cost factor. I am just a bit puzzled about the indication that this was inevitable.

Mr Jones—The process we went through was to issue a request for tender. As you are probably aware, we had a process where there were several contractors competing and eventually we narrowed it down to two contractors. They offered us a particular milestone

schedule to complete the project. Presumably they felt those dates were achievable at that time.

Nevertheless, we did recognise that there was significant risk in this project and in many ways we felt one of the ways the risk would manifest itself would be in schedule. So we constructed the framework of incentives and disincentives in a way that recognised that. There is very real cost to the contractor in running late in terms of extra overheads. There are, however, real costs to the Commonwealth in the capability forgone. It is a little hard to quantify what that cost to the Commonwealth would be because it is not a capability that exists today. It is unlike replacing a warship or an aeroplane.

Mr GEORGIOU—Could you give us a feel for it?

Mr Jones—I could not place a monetary value on it, I don't think, in any real sense.

Mr GEORGIOU—Qualitative feel?

Mr Jones—I think there is no doubt that this capability will be enormously important to Australia in terms of its surveillance capability. The sort of dollar per square kilometre cost for surveillance out of this system is very attractive to Australia in its particular circumstances and we are very lucky in the sense that it is a conjunction of this technology that was largely developed here, the geography of Australia, which means the need for stand-off distances in this system, and the characteristics of the equatorial ionosphere, which are also relatively benign, which give Australia a really nice advantage in terms of this technology. It is still a very complex thing and still therefore very difficult to estimate exactly how long it will take.

The other point I would make to you is that, from my perspective, if I had to compromise on the capability we are to get or the time it takes, I would first compromise on the time. I think the capability is much more important.

Mr GEORGIOU—What things would you be doing differently in 1997 if the thing was actually brought in on time and on specification? How different would Defence look?

Mr Jones—Defence would, in 1997, have an additional increment in its surveillance capability which it will not have until this system is delivered. I have no way of placing a direct value on that.

Mr BEDDALL—My understanding is that the system was trialled through Alice Springs in Kangaroo 95.

Mr Jones—Yes.

Mr BEDDALL—How did that measure up to what you expected the capability to be when completed?

Mr Jones—The system has a long heritage of development through our Defence, Science and Technology Organisation, starting many years ago with a very simple narrow band radar out of Alice Springs to this current Alice Springs development, which has many of the features of JORN, but not all, and is used essentially as a combination of an operational radar for Air Force, and other Defence and government applications, and an experimental test site. We are using that to test developments in software, algorithms, technology and things like that. It already provides a very useful capability, but for a whole lot of technical reasons will never have the capability that JORN will provide; although it is currently our intention to maintain and probably enhance the Alice Springs site to complement the other radars in the network.

Mr Ayers—We will be using that particular site in Operation Pitch Black, which is currently under way.

CHAIR—I ask Telstra: when did you have your first indication that there were time blow-outs and cost blow-outs? Obviously you signed a contract which had a ceiling. You must have thought it could work within that ceiling. When did you first think that the cost effects were such that that ceiling might mean that Telstra had to bear a cost out of its own budget? When did you communicate that to Defence?

Mr Yelland—Maybe I can answer the last bit first. I guess it became obvious to Defence at the same time that it became obvious to us, because it is a mathematical extension of the reporting that is provided to Defence. Under CS^2, they have their Defence personnel working within the project, and they, in fact, monitor the reporting as it is put into the computer system that reports the progress against the schedule and, therefore, the costs associated with the management of the project.

Around late 1993, we became aware that there was going to be significant difficulty in bringing the project in within the original budgeted cost. When did it go to ceiling? We believe that, within the current replan of the project, it will go to ceiling; in fact, at this time we are planning on that contingency. As I mentioned before, we have made a provision for it. So it has been a progressive thing. We have managed each event as it has occurred, and communicated what our intention is to handle the situation.

Mr GRIFFIN—I have a question to the ANAO on an earlier matter just to make it clear in my own mind. Basically, as I saw it, Mr Hammond said before that 73 per cent of the ceiling price on the contract has currently been paid and, on his estimation, about 67 per cent of the work has been done.

Looking at paragraph 3.17 in the report, which Mr McNally mentioned earlier, you would not get any idea that the contract has progressed as far as that. As a lay person,

could I get some comments on why Mr Hammond's position on this issue seems to be at odds with yours?

Mr McNally—I am not quite sure what measurement system Mr Hammond used. In the issues papers which preceded the report on JORN, Mr Hammond commented that the measurement we used to indicate progress was not valid. However, he did not provide us with an indication of what his measurement system was.

The reason I am confident now that 3.17 is correct is that I believe we have to use the only reliable performance measurement baseline available—one that provides a time phase list of costs right till the end of the project. The only performance measurement baseline—PMB—which ends at the contract termination date of July 1997 is the original one.

I also believe our figures are quite conservative because, as you see in paragraph 3.18, there are some pretty heavy qualifications on what has actually been achieved so far. The design reviews are under question because of those factors in dot points at paragraph 3.18. Also, throughout this report we have quoted very significant findings of the joint technical review. Therefore, I believe what is published in 3.17 is conservative.

Mr GRIFFIN—Mr Hammond, would you like to comment on what has just been said from the ANAO regarding this matter?

Mr Hammond—Recommendation 15 of the report says:

The ANAO recommends that Defence, when negotiating changes to the JORN contract, seek to provide for progress payments to be made on the basis of a Cost and Schedule Control System's earned value calculation.

I said in my previous answer that, at the time of the report, the cost schedule control system earned value was indicating an earned value of about 65 per cent. I also mentioned that Telstra was undertaking a replan. That may affect that value, but it will only affect it slightly.

Mr GEORGIOU—This is a point that was made earlier on: that a high degree of confidence was manifest in 1994-95, and now we are getting high confidence statements again about completion of specifications. I would refer Defence to the Telstra technical audit on page 27 which says:

There are few or no functional requirements in the specifications. There are few or no derived requirements in the design with the possible exception of the Radar itself. As a result the hardware and software designers try to fill the gaps with their own interpretation of the Network requirements.

I will leave the rest, but the bottom line is:

This will lead to massive problems during the systems integration and potential failure of JORN to achieve its many performance goals, or require rework of an unknown number of hardware and software CIs [configuration items].

Has that now been overtaken? Have we met those problems and resolved them? You will recollect that this was what threw our original confidence off.

Mr Hammond—Yes, I think it is fair to say that these are the sorts of problems that the engineering effort that Telstra mentioned earlier was directed at. They are putting significant amounts of effort into risk mitigation and revisiting the systems engineering process, which is what this extract is discussing, precisely with the objective of rectifying the sorts of problems that are being discussed there.

Mr GEORGIOU—Have they been rectified? There will not be massive problems during the systems integration phase?

Mr Hammond—There will certainly be problems during the systems integration process. There are always problems during the integration of complex systems—that is a given. My personal view, based on discussion with the contractors and the DSTO HF radar division is, as I said before, that we are not expecting massive problems in the sense of problems which are insurmountable. But we are certainly expecting problems; they are always there.

The work which Telstra is doing at the moment is, firstly, to endeavour to highlight areas where there may be difficulties before we get the systems out in the desert and start trying to integrate them and, secondly, to provide some documentation so that, where there are problems, the rectification of those can be done in a disciplined manner. Telstra would be better able to discuss the state in which that work is going, but we are happy with the approach that they are taking.

Mr Yelland—I am from Telstra. I suppose I have two comments. Firstly, the system engineering work that is being done at this point in time is designed to alleviate the risk associated with the inter-task dependencies and the difficulty in discovering problems when we are trying to integrate and test the radar. There are some other risk mitigation projects which have been undertaken. They include, for example, the ability to use the joint facility at Alice Springs. We have installed connections between that and the joint control centre in Edinburgh so that we can test at the subsystem level—the component level—the integration of the radar in a working environment and, I suppose, provide a possible facility for the Commonwealth should it decide to avail itself of it in the future with the possible then remote operation of Alice Springs from the JCC.

We have also undertaken a review of the system engineering to the extent where the subcontracted parties have taken a different approach to the work scope that each one is performing. Specifically, the people who are designing specific things will be

responsible for implementing them and, in fact, implementing them at the subsystem level thereby eliminating many task hand-offs between various component parts of the radar. We believe that that will, therefore, lead to a more robust system engineering and design and fewer problems at the time of integration and test. That is being done as part of the risk mitigation program.

Mr GEORGIOU—Are you still confident in the completion date of 2000?

Mr Yelland—I think we are as confident as we can be, yes. It is, of course, difficult because we cannot see what obstacles we will come across between now and then—and, as Mr Ayers said, we are not building a carport. However, it is our expectation to be able to use the radar at that time, yes.

Mr GRIFFIN—I have a question for Telstra on the intellectual property question. Given that there have been some concerns raised about the contractor and the agreement reached on intellectual property with the UK subcontractor, why did Telstra get itself into a position of negotiating an agreement with that company which appears to be at odds with its agreement with the Department of Defence?

Mr Yelland—First of all, the licence to which you are referring was signed on the same day as all of the JORN contracts; it was signed, in fact, in the same room and, to our way of thinking, was part of the same set of contracts, part of the original construct. Paragraph 6.37 of the audit report refers to the subcontractor—and we presume it is Marconi:

. . . Australian subsidiary claims to own or has the exclusive right to commercially exploit JORN IP [that it has developed] and that the subcontractor is not transferring that technology to others.

Telstra, that is we, are not aware of that claim. However, the intellectual property created for the purposes of JORN, under the terms of all of the subcontracts, belongs to Telstra and hence the Commonwealth and is the subject of licence back to Telstra under the terms of the Telstra licence.

Mr GRIFFIN—So, given what has been said about this issue, you do not think you have done anything that is incorrect. Is that it?

Mr Yelland—Our legal advice is that we have not done anything that is incorrect. It is possible that the claim made by the subcontractors' Australian subsidiary may have been misinterpreted, but we cannot illuminate that all. That claim may well be to ownership of background intellectual property relating to JORN—that is, intellectual property which existed before the JORN project which may well be owned or exclusively licensed to the Australian subsidiary of Marconi.

Mr GRIFFIN—Just to clarify my hearing, did you say it was your view that the intellectual property belonged to Telstra or to the Department of Defence?

Mr Yelland—It belongs to the Commonwealth, sorry, yes.

Mr GRIFFIN—Can anybody qualify what the cost to the Commonwealth would be in the loss of these intellectual property rights?

Mr Hammond—I would hazard a guess that it would be zero. As I said before, the rights to some of the intellectual property, particularly the part that Marconi has, do not get it anywhere in terms of developing over-the-horizon radar. The mechanism of loss to the Commonwealth would presumably be the development in the United Kingdom of a competing over-the-horizon radar. As far as I can see, the probability of that happening is close to zero.

Mr McNally—We have been seeking legal opinion on this issue. We have not yet arrived at the final decision of the possible cost of this sublicence issue or whether Defence has pursued the matter as vigorously as it is legally able to. I believe that we probably would be in a position to provide some information on this issue within the next week or so.

Mr GRIFFIN—Do you want to comment on my question about the cost to the Commonwealth?

Mr McNally—The loss of intellectual property to the subcontractor would be very difficult to measure. You would need to have quite a detailed analysis of what background and foreground information on intellectual property has been produced by that subcontractor and the intellectual property the subcontractor brought to the contract through its own resources. Therefore, I believe it would be quite difficult to achieve a measurement of commercial loss.

Mr GEORGIOU—Coming back to milestones for a moment, I must say I do not honestly understand the concept. It seems to be a mixture of time and performance. Defence's response to milestones is that partial withholding of milestone payments has been used in the JORN contract. Can you tell the committee about that? What were the withholdings? What were the issues that led to withholding? How much was involved?

Mr Hammond—Mr Chairman, I do not have the numbers involved. Typical milestone payments range from, say, $5 million up to about $40 million. Where milestones have been against items that were under the contract—for example, plans or design reviews—and the Commonwealth has not accepted those deliverables because they were deficient in some way, the milestones have either been deferred until they have been accepted, or where a significant amount of the work has been done but there were still some residual deficiencies, the milestones have been paid in part, with the remainder paid on completion of the work.

Mr GEORGIOU—Can you give us some feel about how often this happened?

Mr Hammond—From my recollection of discussing it with the project, it has happened around five to six times—a small number of times. We can provide that information.

Mr Ayers—We can provide that. If you take it on notice, it would probably be better to grind it more—

Mr GEORGIOU—That would assist Defence's argument that it did apply milestones, not just as automatic payments but also with some degree of evaluation.

Mr Hammond—Mr Chairman, I make the point that none of the milestone payments have been paid without the milestones being evaluated and our being satisfied that they were complete. The audit report discusses two particular ones: the system design review and the systems requirements review. I have asked people who were there at the time about that. The response I have had—which I accept—is that, at the time that those milestone payments were made, the project was satisfied that the contractual requirements for payment of the milestones had been met. It was only subsequent to that that deficiencies in the work underlying the milestones became evident and then there was some correspondence between Defence and Telstra.

Mr GRIFFIN—Seeing you are in a position where, if you take the Defence review, 73 per cent of the ceiling price has been paid, would that mean that there would be no more milestone payments until 73 per cent of capability was in place?

Mr Hammond—We have accepted the ANAO's recommendation to move to an earned value-linked progress payment regime. On that basis, assuming we reach agreement to the change with Telstra, no further payments would be made until earned value came up to the 73 per cent that we have paid. Given that it was at 67 per cent, we do not expect that would take very long.

Mr GRIFFIN—I am a wee bit confused still. As I understand, 3.17 in the report talks about very few milestones having been met with respect to the milestone listing that was in the original contract. Is that right? I am still getting a view from ANAO that nothing like 73 per cent of the contract has been done, or they are not able to establish where it is up to in terms of how much has been completed. Certainly, in terms of their listing of the milestones, very few of them have been met. This is versus the situation where Defence are saying that somewhere in the region of 67 per cent of their earn values have been created, but 73 per cent—I am not going to quibble over that six per cent or so—of milestones that have been set have been met. I am just wondering about why there is a difference in terms of outlook in what it is up to.

Mr Hammond—The ANAO have said that they do not believe that milestone payments are appropriate in this contract, and we agree with them. With hindsight we can say the notion that, at the beginning of the contract, you can set a specific set of

milestones that are going to apply through the entire duration of the contract and are not going to change was not a very good assumption on which to base the progress payment mechanism. Because of the uncertainty involved in engineering development, it really is not possible to predict that far ahead the precise way the design is going to proceed and the precise way it is going to be done. We agree with the ANAO that milestones are not a good mechanism.

Milestones were originally included in the contract, but there was a contract change in 1994. That change essentially deleted the remaining milestones that were predicted out to the end of the contract schedule and introduced a regime where milestones were negotiated and agreed between the Commonwealth and the contractor on a 12-month rolling schedule. That is imperfect. One of the reasons why we are currently ahead of progress in our progress payments is that the milestones are a fairly coarse measure to use to link it.

Earned value is a much finer measure. It involves measuring actual work that is being done right across the project and aggregating it. We have accepted the ANAO's recommendation to move to earned value. What we expect to do then is delete all the milestones from the contract payment arrangements, with the possible exception of a final milestone. There would be a final payment on completion.

Mr GEORGIOU—Can I come back to your point about the full milestone payments for the SRR and the SDR. They were regarded as unsatisfactory by Defence at the time and, subsequently, the JORN audit report commissioned by Telstra said:

> Due to its lack of adequate content, the customer should never have approved the System Requirement Review . . . conducted at the start of the project or have accepted or paid for documents which do not have the necessary design work to back them.

You are actually underscoring the fact that Defence's full payment on the milestones was paid in the presence of substantial and validated dissatisfaction at the time and by an independent review.

Mr Hammond—This is way before my time, but my understanding based on the discussions I have had with the project is that, at the time, the contractual requirement for the milestone payment to be made was believed to have been met. It was only subsequently that Defence became aware of deficiencies in the underlying work.

It is a fairly difficult assessment task. The contract lays down requirements for the conduct of the review. That includes such issues as the coverage of the design and an agreed list of actions to be undertaken following the review. My recollection is that the reason Defence became dissatisfied was their realisation that, although the agreed list of actions to be taken was relatively small, it involved a significantly greater amount of work than had been understood at the time.

Mr GRIFFIN—Is that because there is a lack of technological knowledge of what has been required by those who are making decisions within Defence on this issue?

Mr Hammond—I would say that is probably a partial explanation.

Mr GRIFFIN—Does moving to earn value in terms of effective milestones actually fix that if you have not got the people in there who can actually do the job? Is it the case that we now have people in there who can make those sorts of decisions and who have those sorts of expertise?

Mr Jones—Can I comment on the generality. The audit office supports earned value and, in general, I do too. But it is not the panacea. Like anything, it involves a pre-estimate of what is involved in the task. Earned value is a method of dividing the project down into lots and lots of little bits and then measuring your progress against those lots and lots of little bits. The problem is that, if you did not estimate the lots of little bits right in the first place, you can delude yourself as to where you are in terms of progress. There is no perfect method for these in these complex projects.

Mr GRIFFIN—Does this highlight a problem with respect to expertise within Defence in this area—that is, in being able to evaluate what is occurring around the contract?

Mr Jones—I think the first issue is that we depend on the expertise of the contractor to develop the programs to the plans and the detailed schedules. We endeavour then to review those for reasonableness. But, at the end of the day, if there is some doubt about whether something is achievable or not, the contractors have to have the benefit of the doubt, because they are the people who are contracted to do it. If they say they can do it, our review process has its limits.

Mr BEDDALL—It is incumbent on you to have all those little bits as right as you can get them at the start, because the government makes the decision as to whether it goes ahead or not on the sum total of the little bits and the total cost of the project. If the project price was subject to massive escalation, the government may not have made the decision to go ahead at the time.

Mr Jones—In these sorts of complex projects, nobody in the world can provide a detailed estimate of every activity at the beginning of the project. It is like NASA building the shuttle or something like that. People will use engineering estimates, and contractors obviously have the main task in terms of that. But, as the project progresses, those estimates will be refined. It is inevitable in that sort of undertaking that things will change. The important aspect is that, in this contract, we had a price we were aiming for, and there was a risk sharing arrangement between target and ceiling at which point Telstra absorbed all further risk.

Mr BEDDALL—NASA has scaled back its construction of shuttles because of the cost overruns.

Mr Jones—Indeed. I feel that the view we expressed—that we have constrained the risk and cost to the Commonwealth in this project—was the sensible way to go about it. The thing that was less constrained—and it was a deliberate intent—was the schedule.

CHAIR—Do you mean the cost to Commonwealth or the cost to Defence? Because if you pass the cost on to Telstra, the bottom line is that there is a cost to the budget if there is an overrun, and Telstra has to bear the cost. Am I right in assuming that the Commonwealth's dividend from Telstra will be less?

Mr Jones—I guess technically that is correct. But we were directed—and we went to great pains in this contract—to treat Telstra at arms-length, as if it were a private company and not a part of the Commonwealth.

CHAIR—I guess I am asking whether a certain complacency developed in Defence because they had Telstra there as the wicket-keeper. You knew that your total exposure was limited by the ceiling, so did this develop a complacency in Defence about the total cost of the project?

Mr Jones—I have difficulty in agreeing that it would lead to that. In any large contract of this size, we would normally seek to do business with a large, substantial company—typically, with US companies which have tens of billions of dollars of turnover. We expect those companies, when they sign a contract with Defence, to meet their obligations. Indeed, we treated Telstra no differently.

Mr GRIFFIN—Can I come back to the earlier point. The situation was that it could not be reasonably expected that a minutia of detail had to be established at the start, and I agree with that. As I understand it, several milestone payments were made on the basis of advice received from the contractors that certain things had been done and, therefore, those milestones had been achieved. Therefore Commonwealth moneys, through the Department of Defence, were paid out as those milestone payments. Subsequently, it was discovered that those milestones had not really been met or, alternatively, that the milestone was not the milestone it was supposed to be.

I am asking several questions within that. Was advice incorrect from Telstra in the first place regarding the meeting of those milestones? If so, is there anything in the contract as it is structured as a penalty to them? Was there sufficient expertise in Defence to be able to review what had been said by the contractor regarding those milestones and to establish independently of the contractor whether those milestones had been met? I ask those questions of you guys first. I also ask for comments from Telstra and the ANAO.

Mr Hammond—I think it would be a misinterpretation to say that Telstra had

provided incorrect information.

Mr GRIFFIN—Before you go any further: I am not saying that that is the case either. What I want to do is to try to cut through some of the crap and actually get to the point.

Mr Hammond—Indeed. The task is complex; it is not easy to estimate. I have no doubt that Telstra in good faith went through the system design review and that the Commonwealth personnel reviewed it in good faith. What has become evident is that, underlying the work that was done, there were some significant deficiencies. It has taken us a nine-month technical audit, undertaken by Lockheed, Martin, Telstra and GEC Marconi, involving an enormous amount of diversion of effort, to come up with the full list of those deficiencies. So it is fairly unreasonable I think to be blaming the personnel who either produced or reviewed that information and to be saying that they failed to see it.

On the issue of whether there are contractual provisions: there are provisions in the contract, as I recall, to recover milestone payments that have been incorrectly made. But they were not invoked at this time and I think the gradual realisation of the deficiencies in the design and systems engineering process was such that that would not have been practical.

On your final point of the experience on the Commonwealth side: I would say that it is a fair comment that experience right through Australia—industry and Commonwealth—in projects with this level of advanced engineering development is much thinner than we would like it to be. JORN and a few other projects are helping to build it up, but it is still very thin. One of the advantages and one of the reasons why we have accepted the ANAO's recommendation to move to the cost schedule control system earned value is that that works, as Mr Jones has said, by breaking it down into much smaller components and it is much easier to look at a small task and estimate whether it is one-third, two-thirds or complete than it is to look at something enormous like the complete design.

Mr Yelland—Firstly, Telstra has never deliberately misled the Department of Defence with regard to completion of task.

Mr GRIFFIN—I did not really think you had, but I thought I would stick it out in the open.

Mr Yelland—It is fair to say that there has been some difficulty with the preparation of specifications, especially for component parts of the radar. The study that is currently under way to close out the system engineering design is designed specifically to look at the interaction between the component parts within the radar. The risk mitigation program that I alluded to earlier is in fact designed also to mitigate risk in the component

parts of the radar not correctly interfacing at the prescribed interface levels. The parts, as they are designed, are designed with functionality in mind. It is after visiting the overall systems design that I think we now find that they were not completed to the level that we would have believed at the time.

Mr Barrett—I would hope what has been suggested is that we are not suggesting they lose sight of the whole by looking at the parts. That certainly was never the intention of the recommendation. I think the important points here are that this is not only a technical problem—and we heard how complex a technical problem it is—but also a management problem. One of the problems is how to manage risk. We are learning more and more in the Commonwealth about how to manage contracts and the risk associated with contracts. There are all kinds of risks we know in all kinds of contracts.

The issue is whether or not the teams concerned get down to specify reasonably the levels of risks and then do some kind of sensitivity analysis to put up some warning signs so that, if things are not going according to Hoyle, there is a red light flashing and saying, 'Hey, we need to sit down again and redo it and rethink it through.' What we would hope is that the experience gained so far on this project would allow the successful completion of this program, which is what we all hope for, and that we get some better reconciliation, which is referred to in the audit report—not our audit report; the JORN audit report—between obvious difficulties of commercial verses engineering problems.

So they need to be sorted out, and they need to be sorted out by people who know their business. We do not know their business. What we are simply saying is that all the comments from people concerned are that there were a number of areas in which people should not have taken the decisions they have taken.

We should now be concentrating on the lessons learnt category. We should be asking Defence and Telstra whether, based on their experience, they believe they have put in appropriate risk management initiatives so that they can look at not only the bits but also the whole and therefore concentrate on getting the result and outcome that we all hope to get.

CHAIR—I might ask that question which Mr Barrett so eloquently asked for us. Would you like to comment on that, Mr Ayers?

Mr Ayers—I think various members from both Defence and Telstra have said that there are still risks. There is no question about that. In closed session, I will give some information which gives me confidence in saying that we have a reasonable degree of confidence in the project being completed successfully. There will be problems as we go through, as Mr Hammond and Mr Yelland have said. There is no question about that. The people who might be interested in purchasing this if Telstra goes down that route are people who know their business. My understanding is that they are very confident that they can bring the project in.

CHAIR—There must be enormous benefits for an organisation like Telstra being involved in the engineering and technical aspects of this project. Do you want to say anything about that? There must be a long-term benefit that will accrue for your organisation.

Mr Yelland—We are reviewing what our core business is at this time. We will perhaps discuss that more in the in camera session. We firmly believe that when the radar is built it will be the best over-the-horizon radar in the world. It is now designed to be a programmable asset—in other words, to be the first of a number of potential generations of radar using the same construct. It is designed for longevity and possible expansion should the need arise. It will deliver great benefits to Australia and is capable of looking into Australia's economic, strategic and defence interests. The commercialisation aspects of the data and the radar have not escaped us both in the construct of the contract—the way intellectual property was handled—and Telstra's decision, although I was around at the time, to proceed with the contract. It is our intention to make sure that, whatever arrangements are made, the radar is completed and realises its full potential.

CHAIR—If there are no further questions, I will close the public hearing for the time being and we will go in camera.

Evidence was then taken in camera, but later resumed in public—

[12.05 p.m.]

Audit Report No. 11, 1995-96, Department of Defence Management Audit

BARRETT, Mr Patrick Joseph, AM, Auditor-General for Australia, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2600

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

MINCHIN, Mr Tony, Executive Director, Defence Branch, Australian National Audit Office, GPO Box 707, Canberra Australian Capital Territory

SMITH, Mr Graham, Senior Director, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory

AYERS, Mr Anthony J., Secretary, Department of Defence, Russell Offices, F-2-Secretary's Suite, Canberra, Australian Capital Territory

SHARP, Mr Peter K., Inspector General, Department of Defence, NCC-B1, 14 Moore Street, Canberra City, Australian Capital Territory

CHAIR—Mr Ayers, would you like to make an opening statement?

Mr Ayers—I would like to make a brief opening statement and then perhaps ask the Inspector General, Mr Peter Sharp, to say a bit more. I welcome the ANAO report on the management audit branch. In fact, the audit by the ANAO is the major and most important quality control mechanism for our internal audit function and it is a primary means by which I can receive an independent expert assessment on how the audit branch is going. Defence has no difficulties, again, with the ANAO report on MAB.

Of the 22 recommendations, we disagreed with two, since changed to one and, quite frankly, ain't going to die in a ditch on that if it comes to the point. Of the 21 recommendations, implementation is under way on all and implementation is complete for all practical purposes on 11 of them. The management audit branch is part of the Inspector General's division. The Inspector General is directly accountable to me and the Chief of the Defence Force under a directive that we jointly issue. The role and responsibilities of the management audit branch are set out in a specific Defence instruction that has been formally promulgated throughout the portfolio.

In addition, the senior Defence committee, the Defence Program Management Committee, has established a subcommittee, the Defence Audit and Program Evaluation Committee—like all good committees in Defence it has an acronym, DAPEC—to

oversight the audit function. The committee is chaired by my Deputy Secretary (Budget and Management) and meets regularly to consider matters and make recommendations to the Chief of the Defence Force and me on the audit strategy and the detailed annual work program. The committee already meets the expected requirement under the foreshadowed Financial Management and Accountability Act for agencies to have an audit committee.

The work of the management audit branch complements that of the ANAO, and regular meetings between my Inspector General and senior ANAO officers assist in the selection of audit topics. The ANAO is a member of the Defence Audit and Program Evaluation Committee.

The relationship between MAB and ANAO officers appears to be good. I am pleased to have an ANAO officer on secondment as a section head. Senior ANAO executives have recently begun a program of discussions with their counterparts in each of the Defence programs in order to improve the understanding of Defence's business. I welcome this initiative, and I also welcome their initiative to discuss future work programs. I ask the Inspector General to talk a little about the audit strategy and elaborate on some of those issues.

Mr Sharp—This report was published last year and there have been a few developments since. As the Secretary said in his opening statement, the management audit branch is primarily concerned with that Defence objective directed at the efficient and effective use of resources. Within that overall objective, audit work is focused at present on the major resource management issue reforms in Defence which, in turn, are directed at the transfer of resources from administrative and support overheads, including operating costs, to capital investment and operations.

The first of those is competitive testing of non-core functions, which continues as the primary mechanism for testing value for money. Also continuing to evolve is the adoption of arrangements whereby one program provides the management of a function on behalf of one or more other programs. In the capital investment area, improvements in project management and contract arrangements retain their priority as Defence seeks best value for money in its equipment acquisition and major facilities projects.

In day-to-day management, the continuing challenge is to raise the confidence and competence of commanders and managers at all levels in operating in the devolved environment. Improvement in management processes remains of abiding interest.

Other important issues include increasing the value added to decision making and work at all levels by capitalising on Defence's investment in information technology, improved utilisation of assets and improving the usefulness and transparency of Defence's planning and accountability, and that includes performance evaluation reporting processes. These issues provide the framework for the development of the audit strategy. Audits that do not fit within the above tend to receive lower priority.

Within this overall framework the audit program is developed with the objective at national, functional, regional and local levels of adding value to management. It can provide a view of the resource management health of the organisation in terms of compliance and efficiency and, to an extent, effectiveness. A number of other audit reviews—notably ANAO outside Defence, independent program evaluations and ad hoc reviews within Defence—contribute to this diagnosis.

In choosing audit topics, consideration is given to a range of factors including materiality; the risk or exposure to non-compliance or inefficiency; the risk or exposure to fraud; scope for identifying worthwhile savings; new policies or major activity areas; extent of recent audit coverage, including ANAO coverage; likely extent of commanders-managers' requirement for scrutiny of a problem area; and the requirement for systematic confirmation of the integrity of Defence's financial systems.

That is a broad outline of the current strategy. As the Secretary has said, we have agreed with all but two of the recommendations in the ANAO report. Of those, we are now actioning one. I have a short summary here. I could go through it, or perhaps I could take questions on any of the recommendations.

CHAIR—Can we have a copy of that?

Mr Sharp—Sure.

CHAIR—I have a very quick question. Has the management audit branch done any work on the JORN project? Does it plan to do so?

Mr Sharp—When the JORN project was approved, the national audit branch commissioned a consultant to set up a strategy and identify areas at risk. The MAB branch conducted five audits from 1992 through to 1994 and suspended those audits when ANAO took up the running.

Mr Ayers—Material was made available to ANAO.

Mr Sharp—ANAO had access to the reports.

CHAIR—I invite Mr Barrett to address the committee.

Mr Barrett—This is the second of the Defence audits being looked at today. We regard the activities of the management audit branch to be of considerable importance. As indicated, it has the potential to add considerable value to the management of Defence. It is not a substitute for external audit; we regard it as being complementary. To that extent, as also indicated, we have to be satisfied about the standard and quality of the services provided by the internal audit—in this particular case, the management audit branch.

Certainly, we have stressed the importance of a good internal audit unit for accountability and for management improvement. It is certainly one area that obviously cannot be looked at by the internal audit unit itself. Our previous work in this area includes our 1993 publication *A practical guide to public sector internal auditing*. The ANAO has also reviewed Defence internal audit periodically the last two occasions—1982 and 1988.

Our audit of the branch is an example of one of our smaller audits but, in our view, it is very useful audit product. It was completed and tabled in seven months, including the time taken for Defence to comment on various drafts and, as also indicated, to take over and look at the work that they had done and to satisfy ourselves as to the quality of that work.

The audit itself addressed each of the main areas of management and the conduct of internal audits. These included, importantly, the role of audit committees, the overall planning of the audit program and the planning conduct and reporting of individual audits. We found that the branch's audits were generally well accepted by the auditees throughout the department, especially in the case of smaller compliance audits, and that overall the branch was providing a useful and competent service to the Defence organisation.

Nevertheless, as indicated, we had 22 recommendations where we believed that these could provide the basis of an improved and more effective service. As you have also heard, it appears now that all but one have not agreed at this stage. I assume that one is in relation to the outside representation on the audit committee.

Mr Smith—That is the one who disagrees, yes.

Mr Barrett—I think, again, as the secretary has said, this is not an issue that anyone would die in a ditch over. It is just simply that, for a very large organisation like Defence, some external independent participator on the audit committee is not a bad idea—just for the reassurance of the committee members themselves as well as for the secretary, in my view. But that is something for the secretary and his senior people to consider.

Since the report was tabled, we have had extensive consultations on the implementation of the recommendations. You now have that document referring to that implementation. The new inspector general and the new branch head both indicate a willingness to review the branch's procedures, and the Audit Office trusts that the audit report will continue to be useful to the branch as it continues to seek improvements to efficiency and effectiveness. In this case, Tony Minchin and Graham Smith on my right were the senior audit staff involved with the audit, and we would be happy to answer any questions.

Mr BEDDALL—Who would you envisage being the independent member of the

audit team?

Mr Barrett—It depends on what the secretary might be looking for. But certainly what a number of departments have now done is got, in some cases, an ex-partner of one of the big six accounting firms, someone who has retired, someone who has a lot of expertise in financial reporting and financial management.

In that particular department, someone with a commercial background, I believe, would also be another potential source. I can think of a couple who, if they retired tomorrow and I were Tony Ayers, I would be running out there to tap on the shoulder. One particular chap has the first name of Ralph. I think such a person who has both accounting and commercial background for a large organisation could be invaluable, particularly for Defence which is getting more and more involved in a whole range of commercial type contracts and with the move that is taking place to a more commercialised Defence portfolio, indeed, as are most other Commonwealth portfolios today.

Mr Ayers—I would not die in a ditch on the issue, Mr Chairman. I have to say that it does not worry me particularly. I generally follow the view on consultants of Norman Augustine, the CEO of Lockheed Corporation: consultants turn problems into gold—your problems into their gold. But I do not mind having an external person, in the same way as the Auditor-General suggests, who is a retired senior partner or someone like that of one of the big six.

CHAIR—I propose, Mr Barrett, if you have time, we go back in camera for five minutes.

Mr Barrett—Of course.

CHAIR—I thank Defence. Before I close the meeting, we need a couple of resolutions on exhibits.

Mr GRIFFIN—I move that the following documents be accepted as confidential evidence and included in the records of the Auditor-General's sectional committee as exhibits to the review of the 1995-96 reports of the Auditor-General: No. 1, a letter of 15 February 1996 from Ian Macphee ANAO to A.J. Ayers AC, Secretary of the Department of Defence, re JORN project, which was tendered by the Australian National Audit Office.

CHAIR—There being no objections, it is so resolved.

Mr GRIFFIN—I move that the following documents be accepted as confidential evidence and included in the records of the Auditor-General's sectional committee as exhibits to the review of the 1995-96 reports of the Auditor-General: No.2, a letter of 6 March 1996 from A.J. Ayers AC, Secretary of the Department of Defence to Pat Barrett,

Auditor-General, which was tendered by the Australian National Audit Office.

CHAIR—There being no objection, it is so resolved.

Mr GRIFFIN—I move that the following documents be accepted as evidence and included in the records of the Auditor-General's sectional committee as exhibits to the review of the 1995-96 reports of the Auditor-General: an ANAO report on MAB status of implementation of agreed recommendations, which was tendered by the Department of Defence.

CHAIR—There being no objection, it is so resolved. I close this part of the meeting to go back into in camera.

Evidence was then taken in camera, but later resumed in public—

CHAIR—I call the committee to order. I thank ladies and gentlemen for coming. We will be running this hearing in a round table format. It is a new concept the Joint Committee on Public Accounts has adopted. I am required to read a number of things out. First, only members of the committee can put questions to witnesses if this hearing is to constitute a formal proceeding of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I ask them to direct their comments to me and the committee will decide whether it wishes to pursue the matter. It will not be possible for participants to directly respond to each other.

Second, the witnesses should assist *Hansard* by identifying themselves whenever they wish to make a comment. Third, given the length of the program, statements and comments by witnesses should be kept as brief and succinct as possible. The Auditor-General's views have been set out in the report as well as the initial responses of the agencies which have been audited. For this reason, we are proposing to dispense with lengthy opening addresses, however, the committee will be interested to learn if any action has been taken to implement the recommendations in the Auditor-General's report. In a moment I will ask you to make a brief opening comment on behalf of your agency. I ask those who were not sworn this morning to stand and take the oath or affirmation.

[1.37 p.m.]

Audit Report No. 14, 1995-96—The Sale of CSL

BARRETT, Mr Patrick Joseph, Auditor-General for Australia, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2600

CRONIN, Mr Colin Douglas, Executive Director, Economic Coordiantion Branch, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2600

McPHEE, Mr Ian, National Business Director, Performance Audit Unit, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2600

WALKER, Ms Victoria Simone, Senior Audit Manager, Performance Audit Unit, Australian National Audit Office, GPO Box 707, Canberaa, Australian Capital Territory 2600

DANAHER, Mr Mick, Director, Medical Benefits and Research Section, Department of Finance, Newlands Street, Parkes, Australian Capital Territory 2600

HUTCHINSON, Mr Michael James, Deputy Secretary, Department of Finance, Newlands Street, Parkes, Australian Capital Territory 2600

O'BRIEN, Mr Timothy John, Director, Accountability Projects Section, Department of Finance, Newlands Street, Parkes, Australian Capital Territory 2600

SMITH, Mr Ross, Chairman, Task Force on Asset Sales B, Department of Finance, Newlands Street, Parkes, Australian Capital Territory 2600

GREGORY, Mr Andrew, Assistant Secretary, Audit and Payments Control Branch, Commonwealth Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory 2600

LINDENMAYER, Mr Ian, Deputy Secretary, Commonwealth Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory 2600

MOSSOP, Mr Michael, Director, Special Access Programs Section, State Financing Group, Health Services Development Division, Commonwealth Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory 2600

WELLS, Mr Robert, Acting Principal Adviser, State Financing Group, Health Services Development Division, Commonwealth Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory 2600

CABLE, Dr John, Acting Director, Confirmity Assessment Branch, Commonwealth Department of Health and Family Services, Therapeutic Goods Administration, GPO Box 9848, Canberra, Australian Capital Territory 2600

JAMES, Mr Garry, Director, Chemical and Non-Prescription Drugs Branch, Commonwealth Department of Health and Family Services, Therapeutic Goods Administration, GPO Box 9848, Canberra, Australian Capital Territory 2600

SLATER, Mr Terry, National Manager, Therapeutic Goods Administration, Commonwealth Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory 2600

TRIBE, Mr Robert, Head of Good Manufacturing Practice (GMP), Audit and Licensing Section, Chief GMP Auditor, Conformity Assessment Branch, Commonwealth Department of Health and Family Services, Therapeutic Goods Administration, GPO Box 9848, Canberra, Australian Capital Territory 2600

CHAIR—I now invite the agencies to make a short comment.

Mr Lindenmayer—The Department of Health and Family Services has regarded the audit as essentially an audit on asset sales and therefore essentially an audit on a function discharged by the asset sales task force of the Department of Finance. Our role in that process was essentially a supporting role. There is nothing in particular that we would wish to say by way of a formal introductory statement about that supporting role we played and the Auditor-General's comments on that role.

Mr Hutchinson—As an asset sale, the Department of Finance was quite pleased with the outcome of its sale of CSL Ltd just over two years ago. The sale was completed at a price of $292 million. That represented a multiple of 17.1 times on the prospective forecasts of 1993 after-tax earnings and 14.2 on the forecast 1994-95 earnings.

This was the first Commonwealth asset sale to proceed by way of a public share offer and it paved the way for the government's subsequent successful public share offers for CBA 2, Qantas and CBA 3. The company appears to have responded well to the opportunities for privatisation in the intervening two years and has taken a number of commercial initiatives that have further strengthened it but that were probably inappropriate or unavailable to it previously under 100 per cent government ownership. The sale process has also locked in a commercial basis for the supply of product to the market, including the Commonwealth, on what we understand to be a sustainable competitive basis relative to world prices.

The Department of Finance has welcomed the review of the sale process by the ANAO, especially as those who were engaged in the process were acutely aware that they would have much to learn from this first public share offer. Although the report was not

issued until November last year, the findings have informed later asset sale processes as part of the efforts by the Department of Finance at continuous improvement and learning. We have no doubt that these later asset sales have been the better for those findings and recommendations, just as we expect the ANAO's forthcoming review of those later asset sales to assist in the planning and executing of others that are in train or in prospect. My colleagues and I are at the disposal of the committee to assist in its deliberations in whatever way we can.

Mr Barrett—The ANAO tabled two asset sale audit reports in November 1995. The first was on the trade sale of the Moomba to Sydney gas pipeline system and the second was on the public float of CSL Ltd.

In undertaking asset sale audits, the ANAO aims to review the effectiveness and efficiency of selected individual sales, having regard to the overall framework in which the sale was undertaken. Our future aim is to identify areas of better practice for future sales.

As Mr Hutchinson just indicated, the sale of CSL Ltd was the first 100 per cent public float undertaken by the Commonwealth. Indeed, the sale was quite complex, given the particular nature of and the sensitivities associated with the industry, as well as the extensive involvement by the Commonwealth in providing product indemnities to CSL and through entering long-term contracts for blood products with CSL.Under the plasma fractionation agreement, the Commonwealth will fund CSL fractionation of the national blood supply to the year 2004, at an estimated cost of nearly $1 billion over the life of the contract.

The ANAO's main objectives in auditing the sale were threefold, namely, to review the extent to which the government objectives for the sale were achieved; to review the management of the sale process; and to assess the ongoing Commonwealth exposures and responsibilities.Indeed, the ANAO found that the government objectives for the sale of CSL were met; that the sale was completed on time; and that the total sale costs were reasonable, given that they amounted to $9.2 million, which was three per cent of the total sale proceeds of $299 million.

The ANAO made 15 recommendations, of which 13 were agreed or agreed in principle by agencies. Agencies accepted ANAO's recommendations, including those for the engagement of consultants; due diligence reporting; completion of external regulatory audits; preparation of timely and comprehensive public reports by relevant agencies on asset sales; seeking relevant ministers' views before entering into indemnity agreements; the need to consider options for risk transference; developing strategies for a more market oriented demand framework for blood plasma products; and review systems for regulating foreign sourced plasma processed in Australia.

The Department of Finance disagreed with one recommendation concerning

clawback arrangements to the Commonwealth in future property sales. The ANAO recommended that agencies responsible for future asset sales involving substantial property assets evaluate the opportunity to include clawback arrangements to the Commonwealth where there is the potential for significant realisation of gains from future property sales. This is particularly difficult where there is no prior or related market experience on which to base a realistic sale price and the ANAO recognises that. As well, the conditions of sale often tend to constrain the purpose for which the asset is being used. The consequent uncertainty would therefore, in the ANAO's view, tend to create downwards pressure on any negotiated sales outcome. The Department of Finance argued that all such potential gains should be captured at the point of sale, which is a compelling argument in a perfect market situation.

The then Department of Human Services and Health disagreed with the recommendation that the Therapeutic Goods Administration seriously consider conducting a formal evaluation of the merits of adopting a specialised code of good manufacturing practice for fractionation of blood plasma products as part of its overall risk strategy assessment. The ANAO's recommendation was directed to ensure that the national interest is fully protected by ensuring that Australia is at the forefront of international good practice in manufacturing blood products.

The ANAO has continued its audit coverage of indemnities provided by the Commonwealth, undertaking a cross-portfolio performance audit into Commonwealth guaranteed indemnities and letters of comfort, which are scheduled to be tabled in September 1996. The ANAO will also be undertaking future asset sale audits with a study about to commence into the recent sale of the Commonwealth bank, as referred to by Mr Hutchinson. The senior auditors associated with this particular audit were Colin Cronin and Victoria Walker who would be pleased to take any questions from the committee.

CHAIR—We propose to look at specific recommendations and then ask questions about those before moving on to other areas. Firstly, on the question of indemnities and ongoing commitments, recommendations 5, 6 and 7 mention the agencies responsible for an asset sale should ensure comprehensive public reporting detailing the outcome of asset sales and any ongoing Commonwealth commitments, consultation with the responsible minister prior to entering into indemnity agreements, the quantitative assessment of potential liability under proposed indemnities and consideration of all available options for risk transference and management, including the possibility of share arrangements. This is a question to health. Could you provide the committee with a ballpark estimate of the Commonwealth's potential exposure under the product indemnities issued to CSL? Has an actuarial study been commissioned?

Mr Lindenmayer—I am not able to provide you with a figure. I think it is important to emphasise that, unlike most commercial risks, this is a risk where there is a sample of one as the CSL is the only producer within Australia of a range of products, particularly the critical products covered by the indemnification arrangements. CSL has

certainly confirmed the department's previous experience that it has not been possible to find insurers prepared to provide insurance against liability at an affordable rate. The reason for that is essentially that the probability of an adverse event is almost impossible to calculate and the extent of public damage and, therefore, the exposure to adverse court decisions on damages, is also almost impossible to calculate. It is essentially for that reason that it was decided to provide Commonwealth indemnification, rather than simply to require the company to take out normal commercial insurance against such liabilities with the cost of that insurance being factored into the price of products.

Mr GEORGIOU—So the Commonwealth is the insurer.

Mr Lindenmayer—The Commonwealth, therefore, in effect, is the insurer.

Mr GEORGIOU—How much would it cost if we insured with commercial insurers?

Mr Lindenmayer—In respect of the things that are covered by the indemnities, it would be extremely high.

Mr GEORGIOU—How much?

Mr Lindenmayer—I cannot give you a figure because reliable figures have not be obtainable. CSL has informed the department of a number of attempts to secure domestically and internationally insurance on anything like remotely affordable and reasonable terms. It has been unable to secure that.

Mr GEORGIOU—Was ministerial approval given to the indemnity?

Mr Lindenmayer—The issue of indemnification was an integral part of the proposal to sell. That was made clear in the documentation that went to ministers at the time the matter was being considered by cabinet. I think one can say the answer is yes.

Mr GRIFFIN—The Auditor-General suggests in the report on the sale of CSL that options for the Commonwealth sharing product supply risk with CSL rather than picking up the tab for the lot should have been explored. Possibly that has partly been answered by Health just now, but is CSL's liability for faulty product limited to claims resulting from its culpable negligence as a manufacturer?

Mr Smith—My recollection is that CSL is not covered for any negligence or wilful damage. There are a couple of clauses, but I cannot remember the actual contract. But there were some specific exclusions in relation to wilful damage, negligence, and so on which, if that was proven then indemnity would not enforceable.

Mr GRIFFIN—Mr Lindenmayer, do you want to comment on that?

Mr Lindenmayer—Yes. In general, the language is along the lines of 'indemnification is provided in relation to' certain things 'unless CSL has failed to meet its obligations to comply with legal requirements or standards of care in manufacturing practice'.

Mr GRIFFIN—Did Finance or its business advisers seriously consider options for CSL accepting a proportion of product risk beyond culpable negligence? Was the issue considered?

Mr Smith—I actually cannot recall that, to be honest. The issue of an indemnity was a matter for the Department of Health and for the finance policy side of Finance and not for the task force, so I am afraid I cannot answer that question. But, in terms of business advice, I do not think that that was addressed by the business advisers to the task force.

Mr GRIFFIN—Health?

Mr Lindenmayer—I am sorry, we cannot add to that.

Mr GRIFFIN—Again to Finance: what is the Commonwealth's general policy on contracts of indemnity in relation to asset sales?

Mr Hutchinson—Our general policy is, first of all, to minimise the granting of indemnities to those cases where the indemnity is necessary to progress the sale satisfactorily; fair, having regard to the interests of all the parties involved; and as narrow as is required to fulfil its objective. In particular, we are always anxious to ensure that there is no indemnification against actions that would be criminal, a breach of good faith or which would involve negligence or gross negligence. They are the general guidelines. Within those guidelines, it is our practice to always secure ministerial concurrence to the granting of indemnities in connection with an asset sale.

Mr BEDDALL—I come back to Health or the task force. Further to my previous question about ministers being advised, if the Department of Health cannot give us a ballpark figure for the possible liability that could accrue to the Commonwealth now, how were ministers advised of the potential liability of the Commonwealth at the time that this sale was proposed? Surely a figure quantifying the possible risk to the Commonwealth would have to have been part of documentation going to ministers for consideration.

Mr Lindenmayer—My understanding is that it was simply not possible to put a particular figure on the extent of liability. You will appreciate that in relation to therapeutic goods—I am thinking here of medicinal drugs in particular—there have been, over several decades, a number of very high profile cases where the liability of the manufacturer or the supplier of the product was in the region of hundreds of millions of dollars when that product was found to have very serious side effects for the users. The probability of that occurring with any single product, of course, is very low indeed.

Were there, at the time of the sale, strong reasons to believe that a particular product's threat to the community would have been out of proportion to its value to the community as a therapeutic good, it would certainly no longer have been supplied. But the range of the potential liability would have been very large indeed, and no attempt was made—to the best of my knowledge—to quantify it.

Mr BEDDALL—This is a privatisation where you capitalise your profits and socialise your losses, isn't it?

Mr Lindenmayer—I think in this case the indemnification arrangement needs to be seen as a means of ensuring continued supply of a group of products which were deemed to be of vital importance to the health of the Australian community. Without the indemnity there would have been some prospect of the supply of products being interrupted.

Mr BEDDALL—Or it could have stayed in public ownership.

Mr Lindenmayer—That is another option.

Mr GRIFFIN—Comparable operations overseas are insured, I guess, are they?

Mr Wells—We have no information on that. Those insurance arrangements are usually commercial-in-confidence. There were a few—

Mr GRIFFIN—But you should be able to find out whether there is or there is not an insurance policy, I would have thought.

Mr Wells—I suppose the point is that CSL has tried, as required under the contract, and have reported to us that they have been unable for two years now—and they have to repeat this process every year—to secure insurance. We just do not know what the insurance arrangements are for overseas producers.

Mr GRIFFIN—CSL may well have to make inquiries along those lines. I guess I start from a point where it seems from the evidence so far that the argument is that you cannot get insured for this sort of coverage. Yet when the question is asked, 'What about overseas, in terms of overseas companies doing the same sort of activity?' the answer is, 'We don't know whether they are insured.' I would have thought that would be a principal starting point, because that would also give us some idea whether attempts had been made in a very serious sense to pursue the question of insurance or whether people have been going through the motions.

Mr Wells—What I said was that we do not know what their insurance arrangements are, so we do not know whether they are insured or, if they are insured, what premium they pay or what arrangements they have.

Mr GRIFFIN—I take the point on commercial-in-confidence, but I would have thought that a company overseas doing the same sort of activity ought to be able to say, without breaking any confidentiality questions, 'We are insured' or 'We aren't insured.' Has that question been asked? If the answer is that it has been asked and no answers were forthcoming, that is one thing. If the answer is that those questions have not been asked, then I am just wondering with what veracity the matter has been pursued. So is the answer, 'We don't know,' or is the answer, 'We haven't tried to find out'?

Mr Wells—I cannot answer the question that has been asked. I do not know.

Mr GRIFFIN—You do not know. Is there anyone from Health that would know?

Mr Wells—We would have to search our files, but nothing has been brought to my attention in the research we have done that would suggest that we have an answer to that question.

Mr GRIFFIN—It seems a bit bizarre, don't you think?

Mr Wells—I think the judgment was made at the time—

Mr GRIFFIN—If the judgment has been made that, essentially, for cost or whatever reason, there is no point in pursuing the question of insurance, that is a call that can be made or cannot be made in the circumstances. That is a judgment that can stand on its own. But if the answer is, in reality, we do not know what the situation is overseas because we cannot find out or, alternatively, because we have not tried to find out, then that is a very different answer.

Mr Wells—I understand that. All I am saying is that the facts are we cannot answer the question. To date CSL has been unable to obtain the cover anyway.

Mr GRIFFIN—How long does that indemnity last? Is it in perpetuity?

Mr Wells—It is for the period of the contract, which is 2004.

Mr GEORGIOU—It has not been able to obtain the cover or it has not been able to obtain it at a price that it regards as affordable, which I understand was Mr Lindenmayer's point. It seems to have developed since then to: it cannot obtain one, period.

Mr Lindenmayer—It can be said that insurance against almost anything can be obtained if one is prepared to pay the price that is demanded. In an environment where the highly infrequent and unlikely major disaster occurs, the payments by the insurer could be hundreds of millions of dollars. For a medium sized Australian company like CSL, that would impose one of two options: operating at a major loss to meet the premium that

would flow from that or, alternatively, coming back to government with a view to imposing a price for its product which would be punitive on the community or punitive on the public through the taxpayer—or both.

Mr GEORGIOU—When CSL goes back every year and tries to get itself insured, can you tell us the last price it was offered for cover that was unaffordable?

Mr Lindenmayer—I do not know that.

Mr Wells—We do not have that information.

Mr GRIFFIN—Do we know if it was offered a price? I am not sure what the earlier comments meant—'They were unable to get insured'. As Mr Georgiou said, is it that they were unable to get insured full stop per se or was it a question that the price was too high?

Mr Lindenmayer—Can I suggest that, instead of seeking to answer this on the basis of the department's relatively limited knowledge, the committee agree that we consult with CSL and write to the committee about the matter?

Mr GRIFFIN—I do not have a problem with that in the circumstances, but I have a further question arising from that. If the circumstances are that it is possible to get insurance for such a matter, then there ought to have been figures available at the time of the sale being conducted and those figures should have been taken into account in any negotiations about cost, price, et cetera. If there were, what were the prices? If there were not and there are prices now, why the hell was that? If you do not know the answer to that one either, which you may not, that is something else we will need to know.

CHAIR—Could I ask at this point if Mr Barrett would like to make a comment about whether this is a serious issue for the Commonwealth. Should we be concerned about it, as we are?

Mr Barrett—I regard all these kinds of arrangements—as we will indicate in the report which I referred to as coming out in September this year, *Guarantees, indemnities and letters of comfort*—which were also indicated in the audit commission's report, as being quite serious matters. The issue in a sense is very much a commercial one. It is an issue that the company is going to have to face long before the contract runs out. It is going to have to decide whether it is of such a kind that it will not be in the business of blood fractionation any more or, if it seriously is, what it does.

I think it is a fair enough question to ask. Is there some kind of assessment that is possible in the light of advice from reputable insurance brokers? The Commonwealth is on record as going to international insurance brokers to get prices on insurance that is not available in Australia or was not available in Australia at that time in order to get some

sort of handle on what the cost might be. The next question is whether that insurance would be made available in Australia and the next question after that is the one you are asking—what is the cost associated with that. It is an issue that exercised our minds. It is not one you can speculate on and say, 'It is hundreds of millions of dollars.' I really do not have any idea, and I say that honestly.

The fact of the matter is that, as our friends in CSL would no doubt tell you, the blood business is changing. Technical factors are now entering into the provision of blood products that are mitigating the risks that we were seeing some time ago when indemnities were likely to be required. Today that situation is different. In those sorts of changing circumstances one should seriously start to look at this and decide for future decision making what the insurance premium we are paying is. I understand why you are looking at the past, but I am trying to look to the future.

CHAIR—Should the Commonwealth continue to bear that risk?

Mr Barrett—Yes. As I said, the question, in the assessment of that risk, is whether the risk today is the same as the risk was even when the sale was made; and I suspect it is not.

CHAIR—Does the department of health want to comment on that?

Mr Lindenmayer—I think Dr Cable might talk about the changing risk in blood products.

Dr Cable—There has been a number of developments in the last five years which have served to increase the level of safety in blood products by the introduction of improved screening methods and requirements to include validated viral inactivation steps in the manufacturing processes. Basically, in trying to ensure the quality of these products you have three levels of control: firstly, at the donor level in terms of the screening by questions of lifestyle and so on and the actual screening of a donation. The next one is when the plasma arrives at the fractionator, at which point there is pool screening. It has been introduced in the last couple of years. The final one is in the actual processing, as manufacturers are now required to validate the process to show, in a model system, that viruses if present, if they had escaped the first two steps, would be inactivated. So there are three steps.

The documentation and guidance on that shows that there has been tremendous activity in that area in the last five years. From an Australian and TGA point of view, this flows from the adoption of the European Union requirements post the Baume review in 1991 in which we decided to align our requirements basically for the registration of products with those requirements of Europe.

There has been a lot of work done on how one goes about validating this and the

requirement to submit that information to the regulatory agency for independent assessment. We have been quite active as an agency in keeping in touch with the European Union, which developed these documents, and in insisting that they be introduced here.

There are other risks that clearly need to be addressed. One can never predict that you have actually got on top of all the potential risks. One that is topical at the moment is the question of the relationship between bovine spongiform encephalopathy, BSE, in the UK and the occurrence of the 10 forms of variant Creutzfeldt-Jakob disease, otherwise known as CJD, and what sorts of issues that poses. They are the sorts of issues which are continually being reviewed and looked at both by fractionators and by regulatory agencies around the world. You can never say that you actually know every potential transmissible agent that may or may not be present, but certainly there has been tremendous progress in the last five years in relation to these.

Mr Barrett—With the indulgence of the committee, I would like to invite Mr Colin Cronin to make a comment on the insurance issue that pertains in New South Wales which could be at least indicative if not instructive.

Mr Cronin—It is our understanding that some of the states operate managed insurance funds for themselves which involves them actually assuming a level of risk a bit like an excess and seeking reinsurance cover above that excess. These are to cover essentially very catastrophic type events—maybe art exhibitions through to high level exposures which can extend into pharmaceutical activities. That is one aspect.

In terms of the actual size of insurance and what is offered in the international reinsurance markets, the extent of the premium is pretty much dependent on how much excess you are prepared to wear. It is a probability game and, provided probabilities can be determined, they can generally structure products to take on some of that risk.

As we note on page 29, paragraph 3.9, one option is to look at the question of deductibilities or excesses. That can actually ameliorate tremendously the amount of premium that can be paid. The international insurance reinsurance market is a fairly dynamic beast and it offers all sorts of products. That is one of the reasons why we put this in terms of page 29.

Mr GRIFFIN—I have a question for the task force about the various comments that have been made on this issue. Do you need to seek further advice as to Finance's role in this sale as to whether in fact inquiries were made on your behalf to Health or whether something more should have been done?

Mr Hutchinson—Subject to any supplementary comments Mr Smith may wish to make, I think the Department of Finance would be satisfied that this was primarily an issue for the department of health. In executing the sale transaction, it was our view that

the indemnity put in place simply continued the prior situation where the Commonwealth accepted the risk and that the arrangement that the department of health put in place did not change that situation as a consequence of the sale.

Mr GRIFFIN—Would that be usual with an asset sale, though? I understand this is a fairly specific business, but at the same time I just ask that question.

Mr Hutchinson—It would depend greatly on the issue under consideration and the nature of the asset sale as to whether there was an issue, whether that issue was a matter, as it was in this case, for the regulatory portfolio, whether it was an issue for the sale portfolio—the Department of Finance—or whether it was an issue more widely for government.

A broadly related issue might arise in other asset sales when we come to issues such as the warranties the Commonwealth may be required to give in an asset, concerning environmental cleanliness or contamination for example. That would depend upon the history of the site and the history of the issue. These things, I think, are all best dealt with case by case.

Mr Smith—If I could make a specific comment about the CSL sale, from my perspective it was my obligation to make sure that all the risks were exposed or revealed in the prospectus. The business adviser identified quite early in our process that issues relating to fractionation of blood and the consequences of that were going to be critical for investors. We took the issue up with Health. From my point of view, Finance's obligation at that point finished in that we raised the issue and Health responded in terms of continuing with the indemnity which existed prior to sale. We put that in the prospectus and made investors aware of that.

Mr GEORGIOU—The Auditor-General reports that the Commonwealth extended indemnities to the board and to two of the experts assisting you. Why was that necessary? What was the potential exposure to the Commonwealth of those?

Mr Hutchinson—It is quite customary, where officers who have no duty or obligation carry out a function which is nonetheless necessary as part of the asset sale, for indemnity to be granted, provided they are confined in line with the policy I outlined earlier. I would ask Mr Smith to reflect on the particular circumstances.

Mr Smith—The minister for health, upon appointing the board members, issued the board members with an indemnity under Finance direction 21. That indemnity prevailed through the sale process. There was a letter of clarification that went to the board clarifying that for the purposes of privatisation the indemnity would in fact stand. It was not that a new indemnity was issued. There was a clarification of an existing indemnification that was issued some time before the sale process.

In relation to the two experts that looked at Broadmeadows, we looked very far and wide for people who were capable of giving us a technical report on whether this new facility at Broadmeadows, which was a highly sophisticated facility, a leader in the world, was in fact going to be a viable facility. We wanted to make a statement to that effect, one way or another, in the prospectus to declare that to all prospective investors.

There were very few people in the world who had the ability to look at such a facility. We found these two gentlemen in the United States. They had in fact built a fractionation facility some many years before in the United States. They were two individuals who were retired. Whilst they had very good skills, they had no financial backing to provide us with a report without an indemnity.

Mr GEORGIOU—What is the connection? They were retired and they didn't have financial resources. How does that jump to indemnity?

Mr Smith—The only people we could get in the world were these two gentlemen, who were prepared to sign off a report that would be revealed in the prospectus. Under the corporations law, as you would understand, they would be exposed to claims made against them. Without that indemnity, they were not prepared to put such a report in the prospectus. There was a judgment made at that time as to whether or not we would have a report to give some clarity to investors. With clearance from the minister, we undertook to grant indemnity in this particular case.

Mr GEORGIOU—What was the potential risk? What was the potential exposure of the Commonwealth as a result of these indemnities? They must have made a calculation that it was not worth their while, for the money they were making, to put their names to it in case their got sued. Why?

Mr Smith—I cannot remember the actual insurable cost for that, but there was some analysis done at the time. It was decided—and the minister agreed—that the costs were prohibitive. I can't recall the actual figures.

Mr BEDDALL—On the broader question of indemnities for board members of Commonwealth business enterprises or statutory authorities that are privatised, are you saying that there is a normal indemnity for board members under the Department of Finance rules? It would not happen anywhere in the private sector.

Mr Hutchinson—There are two provisions that it is worth reflecting on. The first is Finance direction 21. That provides for the Commonwealth to undertake the defence and pay the civil penalties of any Commonwealth officer against whom action is taken for things they do in the course of their work. Provided the officer has acted in good faith, with a proper diligence, without negligence and the like, but nonetheless action is taken, then the Commonwealth will pick up that defence. The definition of 'Commonwealth officer' under Finance regulations is cast quite widely.

Secondly, there are explicit indemnities which actually provide rights to the indemnified person to require the Commonwealth to essentially do the same thing in specific circumstances. Those indemnities are granted to directors of companies, for instance, that are undergoing privatisation for their engagement in the act of preparing a prospectus so that any liability they may incur as a consequence of preparing that prospectus, other than liability they might incur because of lack of diligence, lack of good faith or negligence, is underwritten by the Commonwealth because the Commonwealth is the beneficiary of their activities in undertaking that work.

The person is not the beneficiary. The company is not the beneficiary. The Commonwealth is the beneficiary because the Commonwealth receives the proceeds. I understand that it is quite customary for companies to indemnify their directors in like circumstances. Indeed, the articles of association of most companies provide scope for indemnification and most companies will provide indemnification in like circumstances.

Mr GEORGIOU—So the directors of CSL are essentially like the directors of a lot of private companies who are simply indemnified.

Mr Hutchinson—That is my understanding.

CHAIR—We might move on to recommendation 9—ministerial approval of large supply contracts. A question to health and finance: why was ministerial approval not required or sought for the change in the terms of the plasma fractionation agreement entered into between the Commonwealth and CSL? It is a billion dollar contract.

Mr Wells—The department is of the view that ministers were informed, that this was within the parameters of the original framework set by the government, that the outcome was successful and that ministers were advised progressively and ministers endorsed it. We agree with the recommendation but we regard it as a practice we follow.

Mr GRIFFIN—So they were advised or approval was required from them. I am not quite sure on that.

Mr Wells—Ministers were advised.

Mr GRIFFIN—So they were told what was happening but they didn't have any sort of role in approving or disapproving what was happening. Is that right?

CHAIR—Can I draw your attention to page 46 of the report—4.44? That is what we are quoting from. Therefore, Mr Wells, are you disagreeing with the Auditor-General?

Mr Wells—No. The Auditor-General says in 4.44 that the department 'did not provide a documented briefing'. I am not disagreeing with that. But what I am saying is that the department regards that the minister was briefed.

Mr GRIFFIN—Verbally briefed, sent a telegram, pigeon?

Mr Wells—Verbally briefed.

Mr BEDDALL—There is no paper trail. There is no piece of paper that says this happened.

Mr Wells—Well there was the original cabinet submission on the sale which raised certain issues.

Mr BEDDALL—The point the chairman is making is that the Auditor-General's point was that there was no written briefing.

Mr GRIFFIN—Would that be usual with a matter like this?

Mr BEDDALL—The officers briefing surely would have had documentation from which they briefed the minister.

CHAIR—The original question was: was approval required or not required? That would have been done in writing if it was required.

Mr Wells—If it was required. But the actions that were taken were undertaken within delegated authority. So in that sense it was not necessarily required.

Mr GEORGIOU—So what happened? They said, 'Sell it.' You said, 'Fine,' and everything after that was delegated. What was the process? There was a decision. What advice was provided to the minister after the decision was taken about what was happening?

Mr Wells—There was the original process to cabinet. There were then oral briefings of the minister and the parliamentary secretary throughout the sale process. There was the scoping study report provided to the minister and the parliamentary secretary in December 1992. Then there was a briefing provided to the minister and the parliamentary secretary for the second reading speech on the CSL sale bill. They were the points of formal written briefing or submission.

Mr BEDDALL—A question to the Auditor-General: is that the normal procedure that is expected to take place?

Mr Barrett—I can only speak from my own experience as a long time departmental officer. I would have to say to you that if a matter of this importance were discussed with a minister I personally would always have a note for file if I did not actually have a briefing, particularly if a decision is taken. I do not think most public servants would take it upon themselves to just simply orally hear a decision and act on it.

I think there would be some recognition of the fact that a decision was taken and, if necessary, sent across to the minister's office at least to be endorsed. I can only tell you from my own personal experience that it would not be normal practice for a public servant on a project of this importance.

CHAIR—The department is saying that it was not necessary to get agreement. This was merely a briefing, a verbal briefing, and it was done under delegated authority.

Mr Wells—The minister had delegated that authority.

Mr BEDDALL—Can we get a comment from Finance?

Mr Hutchinson—There are two issues here in our view. The first is whether the specific approval was within the delegation of the officer who approved it and what information the health portfolio minister received on the matter. Our view on that was that was entirely a matter within the health portfolio and not one that we who have responsibility for asset sales would have a view on. The issue we addressed was whether the action in changing that contract on the assumption that it was being done properly within authority, as indeed I think it was done, was consistent with the cabinet authority that underpinned the sale process.

That was the reason that the asset sales task force sought the advice from the Department of the Prime Minister and Cabinet in paragraph 4.42, which was to check with them, as the authority for interpretation of cabinet authority, to ensure that we were staying within the cabinet authority that would circumscribe the exercise of delegations.

The check we did in our interest—whether we were still within the right authority we had from cabinet—was positive. The execution within that positive check was a matter for the department of health, and we have no view on that.

Mr GRIFFIN—You do not have a view on the question of what sort of commitment should be done through departmental processes legally—I am not saying for one minute they were done illegally—which involves significant potential budget outlays over a number of years. Does Finance have a view on that?

Mr Hutchinson—As the Department of Finance, clearly the control of commitments, in line with forward estimates and the like, is a matter of concern to us. There are overarching arrangements in place that deal with those matters that were not the subject of this sale process. To the best of my knowledge there was no commitment entered into in this process that would breach those arrangements.

I thought the matter at issue here was whether, given the nature of this particular delegated approval, a minister within the portfolio should have been informed. My understanding of the evidence so far is that the department of health agrees with the

general view, which is, yes, the minister should have been informed. They informed him orally, and it seems the view is that he should have been informed in documentary form.

Mr GRIFFIN—I think it is a little different to that. Going to the recommendations from the report, I think it is a wider question about the question of ministerial approval, as I take it, in terms of significant outlays. That is why I am a little concerned about the response initially from Health. The words that we used relate to the fact that, yes, the minister was advised. That is not what we are talking about here. We are talking about accountability. The question of advice and the mucking around we had to go through to work out exactly how they were advised, I found a bit irritating.

The question relates principally, say, to that recommendation which goes to the question of approval for significant outlays. I am not for one minute suggesting that Health has not done entirely what it should have done under the current rules. What I am suggesting is that maybe we need to be looking at whether there needs to be tightening up there, which is what the recommendation relates to.

Mr Hutchinson—On the general issue, it has always been, and it remains, a matter for each minister as to how he delegates his authority within his portfolio for the expenditure of his appropriations. That is not something that the Finance Department has, in the past, sought to intervene in at a general level beyond the fairly strict provisions of the finance act, the Audit Act, finance regulations and the like.

Mr Smith has a specific comment on this particular case. But, in general, it is a matter for each minister to settle within his or her own portfolio at what level and in what circumstances he or she will delegate his or her authority to officials.

Mr Smith—Mine is not so much a specific comment. I was going to make the point that Mr Hutchinson just made and also to add to that. In the previous purchasing regimes which existed prior to the FMIP review of purchasing arrangements back in the late 1980s, there were thresholds upon which these acquisitions had to be referred to cabinet—to ministers and so on. That was consciously considered by the previous government. It was decided that this responsibility should be devolved to ministers. So it was, in fact, a change from what you are suggesting back in the late 1980s.

Mr BEDDALL—When there is a change of minister, is each minister then made aware of the amount of delegation that was made by his or her predecessor?

Mr Hutchinson—The first point is that I understand that the Acts Interpretation Act provides for continuity of those delegations because the delegations are from the office. It is recommended good practice that, within a relatively short period of a new minister taking office within a portfolio, the minister should at least be advised of the delegations that are in place and given the opportunity to indicate whether they are acceptable. It is even better practice for a new minister to remake delegations, even if they

are merely to confirm the established arrangements.

The problem with that good practice is that the volume of delegations tends to be very large in most portfolios. It is a very large and procedural bit of work to be addressed and therefore it does not perhaps get day one priority from ministers. Nonetheless, it is recommended good practice for successive ministers to reintroduce them to delegations and seek either their confirmation or variation.

Mr BEDDALL—It may be something that the Auditor-General wants to consider when looking at contingent liabilities. There are a lot of instances where delegations are some years old—some number of ministers old—and have never been brought to the attention of ministers until asked for.

Mr Barrett—If I could make a comment on Mr Beddall's comment. I certainly agree with his suggestion. It is something we will look at. We are really talking about prudential behaviour. The report is talking about what might be considered for the future. Let us not forget that, in a sense, a $1 billion debt was incurred as a result.

What we are suggesting is that consideration be given in such circumstances and that it be brought to the attention of the decision makers and whether or not, in those circumstances, individual ministers would be so happy about having that decision taken unilaterally by public servants. That is all we are suggesting. In that sense, it is a prudential matter in terms of the accountability framework.

Mr BEDDALL—But there is no question about who is finally accountable.

Mr GRIFFIN—This question is directed to both Health and Finance. We gather from the Auditor-General's report that the pricing for products supplied to the Commonwealth under the plasma fractionation agreement was calculated to afford CSL a rate of return consistent with major international pharmaceutical companies. Was this not exceptionally generous, given that the Commonwealth carries much of the product risk for CSL, whereas other pharmaceutical companies carry their own risks? The business advisers for the scoping study identified that the pricing form of the blood plasma should limit price increases to 60 to 70 per cent of world parity prices. Has this been achieved under the plasma fractionation agreement?

Mr Wells—The first parts certainly matter for Finance.

Mr Danaher—The price negotiated for the blood products was certainly not based on a target range for what was achieved by international pharmaceutical companies. It was based on CSL's particular circumstances in moving from being a government business enterprise where the government carried basically all of the risks of the business to being in the private sector where CSL saw a substantial risk in operating the plant and producing the products. The price paid at the old Parkville plant was not a commercial price. It was

a cost plus arrangement whereby CSL got a mark-up on variable costs and, moving into the private sector, the price paid was a fully commercial arms-length arrangement for those products.

Mr BEDDALL—It was, I think, a 143 per cent price increase for that.

Mr Danaher—It was, but it reflected, first of all, the enormous change in the plant, that is, from the Parkville plant which was basically run down and had very outdated technology, to a modern high-tech plant with all the necessary quality controls built into it. It also reflected the assumption of operating risk by CSL for operating the plant.

Mr BEDDALL—We could not quantify the overall risk, but we could quantify the operating risk. Do they carry insurance for that?

Mr Danaher—No. The operating risk is a normal business risk of any business enterprise. They carry the risk that their product is suitable to be sold or used in the market. They carry the risk of investment that keeps the plant going. They are the normal operating risks of running any manufacturing business.

Mr BEDDALL—Let me get this right. We had an old run-down plant producing blood products—it was state of the art—and it got dearer to do it the modern way than the old way. Usually when you modernise a plant, it is to bring the unit cost down, not to increase the unit cost.

Mr Danaher—There are two issues there. It got dearer because we were moving to a commercial arrangement which reflected the full costs of operating the plant, including depreciation. Under the old arrangements, the price did not reflect the full commercial costs of operating the plant.

Mr Hutchinson—I think it is fair to talk about the change in pricing as being the sort of change in pricing you would have got by moving from a straight cash basis accounting arrangement for the old plant to an accrual and commercially sustainable based accounting system for the new plant. It is not unusual, when you break out of a cash based public service accounting for a service into a fully commercial accounting for a service, to get fairly significant changes, particularly when the production of a product, as it is in this case, is heavily capital intensive and therefore the plant and depreciation factors work through.

Mr GRIFFIN—We are starting to hit time constraints. Would the Auditor-General like to make any comment on that issue? He does not have to if he does not want to.

Mr Barrett—I am just trying to check the facts. But I was of the view that the old plant was on an accrual basis. I do not negate the point that Mr Hutchinson makes about

the capital intensive nature of the processes et cetera, or the new plant; clearly the price is going to go up quite extensively. We may have to check this out, but my memory is that that was priced on a full accrual basis.

Mr GRIFFIN—Perhaps you could get back to us about that in the next week or so. I will move on to blood product funding, recommendations 11, 12 and 13. This question is directed to Health: what action have you taken or do you propose to take in relation to the recommendations that the Auditor-General made about blood product funding? I will go through a number of these points and ask you to address them in response. Does your system for blood product payments now have the capacity to reconcile CSL invoices with records of receipt of goods by the Red Cross? Has Health examined any strategies for establishing a market oriented demand for blood products? What action has Health taken to clarify the rights and obligations of the Commonwealth and CSL in relation to validation of the Broadmeadows plant? And has Health been able to identify any offsets in revenue relating to Commonwealth funding for validation of the Broadmeadows plant?

Mr Lindenmayer—We will need to split that between us.

Mr Wells—On the first question of the more market oriented approach, we accept this in principle. Part of the difficulty is that, of course, the base product on which CSL is working is freely given by blood donors and it is also covered by the various tissue acts of the states. So there are restrictions on what we can do. But we certainly would see that as a desirable objective. As part of our negotiations with the states around the COAG arrangements of greater devolution, that is certainly one of the issues we would be taking up in that context.

On the recommendation relating to validation, we have introduced a process of sampling, based on a methodology given to us by ANAO. We have tested that process of sampling batches of goods despatched from CSL and then cross-checking with receipts from the hospitals or organisations which are supposed to have received them. We have tested that, and that will be implemented fully shortly; next month is our planned implementation date. As I say, that is a system based on an ANAO package.

Mr GRIFFIN—Do systems for blood type payments have the capacity to reconcile CSL invoices with records of receipt of goods by the Red Cross?

Mr Wells—Yes. That is the sampling process.

Mr GRIFFIN—Is there any comment from the ANAO? With recommendations 14 and 15, which relate to blood product regulation, I have a question to Health again. Do you agree with the recommendation that there should be a specialised code of manufacturing practice for blood products: the Therapeutic Goods Act?

Mr James—The short answer is that the ANAO comment on 5.17 essentially sets the same issue that we are supportive of, that is, that Australia should stay at the forefront of international best practice. Our disagreement with this recommendation was not in the context of objecting to that issue; it was the formal evaluation component. The TGA has been very deeply involved with the international developments in blood for some time and we thought we were at the forefront of the international activities.

What we agreed to do, rather than formally undertake that evaluation, was to take the matter to the Pharmaceutical Inspection Convention, of which Australia is the only non-European member. This was a considerable achievement by TGA some years ago. Mr Tribe is the TGA's Chief Auditor and he took the issue to that organisation with a view to asking whether or not that was an appropriate way to go. I hand over to Mr Tribe, who will now take us through the discussions on that at the Pharmaceutical Inspection Convention and bring you up to where we are now.

Mr Tribe—The committee of officials of the Pharmaceutical Inspection Convention saw no need to prepare a special coded GMP for blood fractionation, because the existing European guidelines cover blood fractionation, amongst other things. Those guidelines for blood fractionation cover important issues such as viral inactivation. TGA has adopted those European guidelines into the Australian guidelines for the registration of drugs. These are followed by drug evaluators and GMP inspectors in Australia at this very moment.

Mr GRIFFIN—Mr Barrett, would you like to respond to TGA on that issue, given that it is against the recommendation?

Mr Barrett—No, sir.

Ms Walker—The ANAO believe that the merits of adopting a specialised code of good manufacturing were worth formal evaluation. I did not understand, Mr Tribe, whether you were going to revise that following your meetings. The one that we examined was a general code that applied to the production of injectable drugs. In our view, there was a much higher risk involved in blood products because of their human source. We thought that Australia should really be in the forefront of examining a more systematic code that was set down and which CSL would have to follow. Following your discussions, are you saying that this code is now going to be revised? This was the position at the time of the audit. Perhaps the other evidence you received is telling us that the situation is now changed.

Mr Tribe—Yes, we do have a general code of GMP which covers a wide range of non-sterile and sterile medicinal products. It is virtually identical to many other GMP codes around the world, including those in Europe. We have adopted the European guidelines on blood fractionation as guidelines for use by GMP inspectors and drug evaluators. So the code has a dual purpose, you might say. It has not been adopted as a

code of GMP, but it has been adopted as guidelines in our drug evaluation procedures.

CHAIR—On that same subject, is there any risk of cross-contamination of Australian blood product supplies from imported plasma processed in CSL facilities and exported?

Dr Cable—This certainly has been a question which has troubled people over quite a long time, going back to various reports when plasma was pooled in the mid-eighties and so on. There is one fractionation plant there. We have looked at how the plant is operated in accordance with the code of GMP. In other words, the things are processed separately but the real question is whether it is two batches of Australian blood or plasma, or whether it is batches from anywhere else. The procedures in place require everything to be properly cleaned between runs.

This is audited by DMP auditors, so there is no potential for batches to be mixed, even if they come from different areas, because the product from imported plasma fractionate has to be returned from Australia back to the donating country. It is not sold here. The entry on the Australian register of therapeutic goods only allows it to be exported, so it is brought in for fractionation and then re-exported. To the extent that there is one set of equipment, the coded GMP has requirements built into it, whether it be for two batches of plasma for fractionation from Australia or for two from anywhere.

Mr Barrett—Mr Chairman, my observation on this is that, at the end of the day, the Commonwealth bears the cost of getting it wrong. That is what we talk about when we talk about the overall risk of setting strategy assessment. If the TGA has done its analysis and considers that the guidelines that they have adopted do what this recommendation is suggesting, then obviously it is superfluous. I simply reiterate that we are talking about that, if things go wrong, it is the Commonwealth that bears the cost.

CHAIR—Do you consider that was an adequate response to your recommendation on this subject?

Mr Barrett—Frankly, because I do not have the technical background, we would need to talk to the people concerned so that we understand exactly what it is that the application of the guidelines really means in practice. As I heard it, it was a fairly broad guideline as opposed to the one that was being suggested, which was a more narrowly based guideline.

We would actually have to look at that and see, in terms of risk assessment, whether or not it was worth the cost. Certainly, we would not be recommending anything that was not cost-effective in that sense. The one who is bearing the cost of the insurance at the end of the day is the Commonwealth. Again, not putting a price on it means that we do not know the cost associated with not getting it right.

Dr Cable—If I might elaborate a bit, because I realise that we did not touch on all the issues that were raised in the actual recommendations, the recommendations set out that we should review the regulatory arrangements and advise ministers whether there was a need to amend the legislation to provide greater control over imported plasma. There is one correction which the ANAO has noted and accepted in relation to 5.31. It basically says that the TGA does not have a role in relation to plasma pool testing. We have corrected that. We do have a role in relation to plasma pool testing.

In the three points of control that I outlined earlier, one is control of the donor and another is control of the plasma pool testing. That is done here in Australia, so we have control over that. It is set out in the European pharmacopoeia monograph adopted under part 2 of the act. Therefore, countries are required to meet the requirements that are set out in terms of screening pools before they are processed. We have control over the fractionation process because that sets out the viral inactivation steps and so on that need to be observed for Australian plasma. They are exactly the same for any other product. That is in the legislation, too.

The area which is more difficult—and this is the point the ANAO was referring to—is what control we can exert over the quality of control at the point of collection. Obviously, we are not able to license those collection centres because they are in other countries. In February, we met with the Australian Quarantine and Inspection Service, the Red Cross Blood Transfusion Service, the TGA and the CSL bioplasma division and discussed a guideline document that was being developed by the European Commission. That document basically sets out the criteria fractionators should include in their contracts with suppliers.

Blood fractionation on behalf of other countries is not unique to Australia. For instance, Canada has all of its plasma fractionated in the United States. In Europe there are also fractionators who fractionate on behalf of other countries. So the Europeans have developed a very useful document which sets out the sort of information that has to be included in that contract. We have negotiated with the Commonwealth Serum Laboratory for those contracts that are established with suppliers—including the Australian Red Cross—to state exactly what needs to be in place between the fractionator and the supplier, in addition to those other two points of control.

We have received written assurances from CSL that they will implement those, and they are in the process of doing that now. Our advice to the minister was to change the legislation in relation to those products from listed to registered under part 3 of the act. We will await the success of their implementation. We are in the process of having those contracts revised. They currently have agreements and they need to revise those agreements. One of the conditions is that we are provided with copies of those.

Having said that, the agreement sets in place some information. If you do not have evidence that people are complying with it, it is not terribly useful. They are, in addition

to those agreements, required to conduct audits of the collection centres in the other countries and provide copies of those to the TGA for review. They are to hold those and provide them to the GMP auditors when they visit the factory or if we should require them. Each batch of plasma brought in has to be certified as complying with the requirements of the monograph in the European pharmacopoeia of human plasma for fractionation.

Those controls, if you like, are able to be exercised under the current legislation. So we do not actually see a need to change them at the moment. We do see a need to make sure the evidence is provided. If it is not, tightening that legislation would be another avenue.

CHAIR—The last area I would like to quickly cover is the task force. The Auditor-General made a series of recommendations about correct procedures for future asset sales—for example, the need for the task force to identify conflict of interest between the Commonwealth in its role as seller and in its role as regulator, and the need for regulatory agencies to provide written reports to the due diligence committee. What improvements in the handling of asset sales have resulted from the CSL experience and from the Auditor-General's recommendations on the CSL sale? Can you give examples of how lessons learnt on CSL have had an impact on the sale process for Commonwealth assets currently on your books, if any?

Mr Smith—There is an inherent difficulty for those of us who are trying to sell Commonwealth assets, in the sense that it is often difficult for us to get access to information which, by statute or some other regulatory environment, is information contained by other parts of the bureaucracy.

It was a particularly difficult issue for the CSL sale. We, as a group, decided that the best way to handle that potential conflict, as I see it, or contradiction was to have the Australian Government Solicitor operate on our behalf to make inquiries of those agencies and then to advise us on an exception basis were there any material issues which we should be addressing. The due diligence committee, which comprised the CSL board, all our advisers, the lead manager of the float, the investigating accountant and the board's own legal advisers, decided that that was a fair way to proceed and we made that known in the prospectus.

In terms of subsequent processes to the sales that I have been directly involved in since that time, it was not an issue because any regulatory environment that we got access from and agencies did not have these issues arise. The one that I am currently involved with is airports. Again, it is not a specific issue in that regard.

But I have to say that it is an inherent dilemma which I am not sure has an easy solution. I think the auditor has recognised that there is a very real need for the due diligence committee to have access to the information in the sense that we have an

obligation, in our prospectuses in particular, to make known all the material risks that we are aware of.

In terms of other sales, obviously we would need to look at them on a case by case basis. But, from where I sit, I do not think there is an easy solution to that problem. How you cut across the obligations of agencies which have statutory obligations to protect information—like the Australian tax office and so on—is a very big dilemma in this particular area.

My responsibility, as I saw it, was to ensure that I could do the best I could in terms of my inquiries to identify those risks. We did that to the satisfaction of the due diligence committee and we made those risks known in the prospectus. In terms of the future, as I said, it is obviously a matter that we need to look at on a case by case basis; but I do not think there is a ready model that fits all cases.

Mr Hutchinson—Both those issues are picked up within the scope of work that we do in a scoping study prior to initiating a sale to settle how best we can address the Commonwealth's obligations both in terms of identifying risk and in terms of doing due diligence inquiries of the agencies of the Commonwealth. In subsequent asset sales we have sought to go as far as it is proper to go in pursuing the lines that the ANAO report has recommended. But, again, I think each one has been a case by case approach.

CHAIR—Mr Barrett, do you consider that an appropriate response to your recommendations on asset sales?

Mr Cronin—Picking up the points: each sale is different; but, with each sale, the Commonwealth needs to act on a whole of government basis. There were elements in this sale where the proposal at one stage was that the Department of Health was essentially going to treat TGA's involvement with CSL as if it were any other business—as if it was in the private sector. At the Commonwealth level we operate as one entity and that sort of stand is not applicable because we need to make full inquiries under the due diligence process. That is picked up in terms of the report.

CHAIR—Thank you, everybody.

[3.15 p.m.]

Audit Report No. 12, 1995-96, Risk Management by Commonwealth Consumer Product Safety Regulations

ASHER, Mr Allan, Deputy Chairman, Australian Competition and Consumer Commission, Benjamin Offices, Belconnen, Australian Capital Territory 2615

LEWIS, Mr Colin, Project Manager, Enforcement and Regional Coordination, Australian Competition and Consumer Commission, Benjamin Offices, Belconnen, Australian Capital Territory 2615

BARRETT, Mr Patrick Joseph, AM, Auditor-General for Australia, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2600

BOYD, Mr Brian Thomas, Director, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

COCHRANE, Mr Warren, Group Director, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory

LEWIS, Mr Michael Kenneth, Executive Director, Australian National Audit Office, GPO Box 707, Canberra, Australian Capital Territory 2601

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

HANSEN, Mr Lyn Anders, Director, Safety Policy, Safety, Liaison and Legal Branch, Federal Bureau of Consumer Affairs, Department of Industry, Science and Tourism, GPO Box 9839, Canberra, Australian Capital Territory 2601

NOONAN, Mr Philip, Executive Director, Federal Bureau of Consumer Affairs, Department of Industry, Science and Tourism, PO Box 9839, Canberra, Australian Capital Territory 2601

RODGERS, Mr Trevor Roy, Assistant Secretary, Safety, Liaison and Legal Branch, Federal Bureau of Consumer Affairs, Department of Industry, Science and Tourism, PO Box 9839, Canberra, Australian Capital Territory 2601

GRAY, Dr Peter, Director, Injury Prevention and Control Section, National Health Promotion and Protection Branch 1, Public Health Division, Commonwealth Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory

GREGORY, Mr Andrew, Assistant Secretary, Audit and Payments Control Branch, Commonwealth Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory

LINDENMAYER, Mr Ian, Deputy Secretary, Commonwealth Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory

ANYON, Mr Peter, Director, Audit and Safety Investigations, Motor Transport Branch, Federal Office of Road Safety, 15 Mort Street, Canberra, Australian Capital Territory 2600

GOONEWARDENE, Mr Dhammithalal Wije, Principal Engineer, Audit and Safety Investigations, Motor Transport Branch, Federal Office of Road Safety, 15 Mort Street, Canberra, Australian Capital Territory 2600

MAKEHAM, Mr Peter Martin, First Assistant Secretary, Federal Office of Road Safety, 15 Mort Street, Canberra, Australian Capital Territory 2600

CABLE, Dr John, Acting Director, Confirmity Assessment Branch, Commonwealth Department of Health and Family Services, Therapeutic Goods Administration, GPO Box 9848, Canberra, Australian Capital Territory

JAMES, Mr Garry, Director, Chemical and Non-Prescription Drugs Branch, Commonwealth Department of Health and Family Services, Therapeutic Goods Administration, GPO Box 9848, Canberra, Australian Capital Territory

SLATER, Mr Terry, National Manager, Therapeutic Goods Administration, Commonwealth Department of Health and Family Services, GPO Box 9848, Canberra, Australian Capital Territory

TRIBE, Mr Robert, Head of Good Manufacturing Practice (GMP), Audit and Licensing Section, and Chief GMP Auditor, Conformity Assessment Branch, Commonwealth Department of Health and Family Services, Therapeutic Goods Administration, GPO Box 9848, Canberra, Australian Capital Territory

ABBOTT, Dr Peter James, Principal Toxicologist, (Acting Director Food, Science and Safety), Australia New Zealand Food Authority, PO Box 7186, Canberra, Australian Capital Territory 2610

BURCH, Dr Gordon John, Scientific Director, Australia New Zealand Food Authority, 55 Blackall Street, Barton, Australian Capital Territory 2600

PRESTON, Mr Christopher, Principal Legal Adviser, Australia New Zealand Food Authority, 55 Blackall Street, Barton Australian Capital Territory 2600

CHAIR—We come to the final report. We will be running this hearing in a round table format. I must ask participants to strictly observe a number of procedural rules. Firstly, only members of the committee can put questions to witnesses, if this hearing is to constitute a formal proceeding of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I would ask them to direct their comments to me and the committee will decide if it wishes to pursue the matter. It will not be possible for participants to directly respond to each other. Given the length of the program, statements and comments by witnesses should be kept as brief and succinct as possible.

The Auditor-General's views have been set out in the report, as well as the initial responses of the audited agencies. For this reason, we are proposing to dispense with lengthy opening addresses. However, at the outset of the hearing I would like to provide an opportunity for any of the parties giving evidence to inform the committee of any action that has already been taken to implement the recommendations in the Auditor-General's report. Does anyone wish to make a brief opening statement to the committee before we proceed to questions?

Mr Makeham—I want to make a number of opening remarks. Our organisation was one of the organisations that was audited by the ANAO. We saw it as a useful activity to get an independent overview of our activities. We generally agree with the content of the recommendations of the Auditor-General's report which found that we adopted a data driven approach to risk identification analysis in terms of standards development. The report did, of course, indicate a number of areas where we could make improvements. It indicated a need for greater interaction with other regulatory agencies. Enacting on this recommendation, the Department of Health and Family Services, as the nominated contact agency, has convened a forum in which we participated.

That forum has agreed to meet, as I understand it, every six months on a regular basis but not to set up a formal structure. It also identified a number of areas where the Federal Office of Road Safety might improve its activities. The first is in terms of greater legislative powers. We are looking at amendments to our legislation, but that, of course, is an issue of priority for the parliament at the present time and is being worked through the system.

We have also done a review of risk management, starting with the activities relating to the audit of motor vehicle testing and production facilities. These initial reviews will be folded into a formal departmental review of both the audit process and the safety investigation recall procedures in the latter half of 1996. Our minister has responded to the individual recommendations but, broadly, we support the thrust of it and we are seeking to implement risk management in our organisation where it is not in place already.

Dr Burch—Consistent with my colleague's statements we welcome the report of the ANAO, particularly with respect to some of the aspects of risk assessment that have

been identified in the report. Since the time of the report, when we conducted extensive discussions with ANAO and formally replied to many of the recommendations that are contained within the report, there have been some significant changes to the authority, the first of which is evident in our name. We are now a joint authority with Australia and New Zealand, which gives us dual responsibilities in terms of responsibilities to the minister or ministers represented in Australia and similarly for New Zealand.

The second is that the authority is just completing a major review of its internal working relationships and our external responsibilities in the sense of the new arrangements with New Zealand and the implications that might have for our state and territory partners in the sense of a 1991 agreement with the states and territories for sharing the role of administering food law in Australia in setting standards, and the adoption of those standards by states and territories by reference.

There have been a number of useful issues identified in the ANAO report. It is our contention that, in responding to this, particularly the setting up of a program structure within the authority to allow us to incorporate the particular new responsibilities we have to New Zealand and to focus the works of the authority on the core responsibilities and statutory objectives of the authority, it allows us to pick up the important areas that have been identified; that is, to strengthen our approach to risk analysis and management. Secondly, it allows us to enhance our organisational capability to respond to emerging demands on our regulatory responsibilities.

Consistent with the recommendations in the report we have initiated an overall national food safety strategy; a component of which is, importantly, a complete reform of hygiene regulations in Australia. In effect, this will mean that there is a second arm of regulatory responsibility for the authority. The first arm is composition and labelling for food standards in Australia and the second arm will now be hygiene standards established for Australia.

In a discussion at the ministerial council on 5 July, New Zealand indicated that, although their treaty excluded the reforms to hygiene that we are undertaking, New Zealand would work with Australia to bring in, hopefully, a comparable if not the same system in New Zealand as well. The other major area that was discussed at the ministerial council was revisions to the food recall system. There will be approaches through the Commonwealth minister to have a transfer of powers to initiate recalls, as proposed, from the Minister for Consumer Affairs to the minister responsible for food.

The final thing I should mention is that, as part of the national approach to food safety in Australia—again identified within the ANAO report—we have undertaken to develop a national surveillance and enforcement strategy with the states and territories and local government. This is a very difficult area for the authority in the sense that we have no immediate responsibilities for surveillance. A recent report by the Office of Regulation Review on the topic of enforcing Australia's food laws recognised that the lack of

resources available to the states and territories to effectively bring about consistency in enforcement and monitoring of food law in Australia put quite severe limitations on getting consistency nationwide.

Nevertheless, the authority is now working with the states and territories and local government to put in place what we are calling minimum service agreements whereby, in partnership, the states and territories will come to some common agreement about the level of surveillance and compliance that can be introduced. This is important because of new commitments that Australia has—through the World Trade Organisation—to there being consistency between standards applied at the export-import barrier compared with what is applied domestically. So there are commitments and obligations in our being a member of the World Trade Organisation that have to be satisfied through that process.

Mr Asher—I would like to make a short introductory comment and, if I may, tender some written material for the benefit of the committee.

In our assessment, the audit report raises a number of issues that are fairly central to the work of the commission. They relate to risk assessment; coordination between other bodies responsible for consumer safety; enforcement issues; education; reporting; and, finally, the call for agencies involved in this area to be more pro-active. Since the publication of the report the commission has taken a number of steps in each of those areas, and one of the materials that I would like to submit to the committee is a written response to each of the 11 of the 18 recommendations that apply specifically or in particular to the Competition and Consumer Commission.

In addition, I would like to hand up for your consideration a number of internal documents developed by the commission that might show the commitment that we have made. In particular, since the time that the report was done the commission has prepared a table of all of the standards it has the task of enforcing and in relation to each one it has gone through a risk management analysis to see the consequences of product hazards.

We have established a monitoring program to look at all of those standards. I will also submit a monitoring chart which shows which of our offices—and we have offices in every capital as well as rural New South Wales and Far North Queensland—are now regularly monitoring the stores to test compliance with those standards.

I would also like to hand up a copy of an assessment form now used by the commission in its determinations as to whether it should take enforcement action or not. As you will see, this incorporates a whole section on consumer safety and liability. That gives us a way of giving the appropriate priority to those matters.

I would like to report that, since the commission took responsibility for enforcement under this section of the law, there have been a number of matters taken up, including one successful criminal prosecution. There is one successful civil action as well as three enforceable undertakings that the commission has received. A further two matters

are with the DPP now waiting for criminal enforcement action.

That is only part of this story. The way in which the commission has selected those things and the outcomes that it has achieved are also very important. I would like to hand up to you copies of some press releases describing some of the actions that the commission has taken over recent months in this area.

I have one final comment on one major matter the commission took against the Woolworths retailing organisation relating to children's nightwear that failed to meet flammability standards. Rather than simply taking a criminal prosecution or even a civil prosecution, the commission has required Woolworths—and Woolworths has now complied with this by the appointment of an independent external auditor, whom we approved—to completely review its recall system, its labelling system and its training systems.

We believe that that shows evidence of all of the goals sought by the audit office. With your permission, I would like to hand up documents for committee members.

CHAIR—Thank you. We have now the Federal Bureau of Consumer Affairs.

Mr Noonan—There are three areas where I would like to update the committee on matters that have occurred since the report was produced. I turn firstly to the recommendation that product performance standards be developed using a structured risk based strategic approach.

The federal bureau for some time has been using a risk assessment nomograph in developing product safety standards and also in helping with all the other productive safety work, such as recalls, bans and warning notices. What it has not done in the past is committed that strategy to writing in a comprehensive way. It has now drafted a comprehensive risk management strategy. It has consulted with the ANAO on a draft of that document and it hopes to finalise it soon.

In the area of improving the monitoring of voluntary product recalls and the effectiveness of the recall process, the Minister for Small Business and Consumer Affairs has announced a comprehensive review of recall procedures which are used not just by the federal bureau in its area but also by some of the other regulators represented around the table because of those provisions being in the Trade Practices Act. Similar provisions also occur in a number of state and territory laws. The review aims to reduce duplication of regulation while also making the process as efficient as possible.

In the area of promoting to other Commonwealth regulators the use of the product safety powers in the Trade Practices Act, including mandatory recalls, warning notices and bans, firstly, the federal bureau has held a seminar to which all the other regulators subject of the report were invited which provided instruction on how those provisions could be

used in their particular areas.

Secondly, the bureau is currently developing a guide to regulators—it has shown other regulators a draft of that document, and it hopes to finalise it soon—which attempts to tell them what they have to do if they want to use the product safety powers under the Trade Practices Act. In most cases there are threshold tests that they have to convince the Minister for Small Business and Consumer Affairs that they have satisfied before they can use those powers.

Thirdly, we have revised our rather well-established guide to business on recall procedures with a view to making it much simpler and easier for business to understand what the processes are and know what they have to do in the event of a recall. I expect that document to be published within the next week or so.

Mr Lindenmayer—The department is very pleased with the general thrust of this report and, as the report itself indicates, has expressed its agreement with almost all of the recommendations relevant to it. It strongly supports the idea of a strategically based approach towards risk assessment through the National Injury Surveillance Unit, which it funds. Data is now being gathered and analysed for purposes of assisting in injury reduction programs.

In relation to medicinal drugs, a major initiative has been taken recently under the direction of ADRAC, the Adverse Drug Reactions Advisory Committee, which advises the Therapeutic Goods Administration, to draw together and analyse data coming from adverse drug reaction reports in order to identify areas where injury has occurred as a result of mismedication or unanticipated adverse reactions of medication used correctly. The conclusions being drawn from that data are now being fed systematically back into the system for regulation of those drug products.

The department was certainly happy to comply with the recommendation in recommendation No. 2 that the department provide leadership across agencies in relation to a coordinated approach towards risk based management. A forum was convened recently, as another speaker indicated a few moments ago, and there will be further forums.

In relation to product recalls, as the audit report indicated, TGA has been quite active in the past in the recall of products found to be defective, and is continuing with that.

In relation to the recommendation on product safety enhancement through greater information dissemination, again the department has been active. There is work being done currently through the Australian Pharmaceutical Advisory Committee and under the PHARM initiative, that is, the pharmaceutical health and rational use of medicine initiative.

Additional work has been done also in promoting information to patients through the consumer product information system, which now accompanies almost all medicines which go out through retail outlets. Committee members may be aware that Medicines Week was held recently and it was directed towards increasing the awareness of consumers, prescribers and dispensers to the importance of responsible use of medication.

In relation to the recommendation on legislation, TGA has been quite active in putting forward to ministers and, through them, to the parliament amendments to the legislation to improve its capacity to enforce a proper regulatory regime. There have been five different sets of amendments to the legislation to this end.

CHAIR—Mr Slater, do you want to make a statement?

Mr Slater—No.

CHAIR—Mr Barrett, would you like to respond?

Mr Barrett—We appreciate again the opportunity to give evidence to the committee on this report, the performance audit into *Risk management by Commonwealth product safety regulators*, which was tabled in November 1995. In undertaking the audit, the ANAO took into account indications that the incidence and costs of consumer product related injury were having a significant effect on health budgets, recent moves in the health sector to focus more on prevention and early intervention rather than simply on cure, the need for safety standards to be developed uniformly and consistently to address, identify and justify its safety issues and the introduction of part 5A of the Trade Practices Act which deals with product liability and the rights of redress for consumers.

As we can see around the table, the audit included regulators of consumer product safety in the areas of motor vehicles, the Federal Office of Road Safety; food, the National Food Authority; therapeutic goods, the Therapeutic Goods Administration; consumer products, not the responsibility of a particular regulator, the Federal Bureau of Consumer Affairs.

The audit also had regard to the activities of the Australian Customs Service in relation to unsafe imported goods and the activities of the Australian Quarantine and Inspection Service in relation to imported food.

The audit itself attempted to benchmark the risk management process of these agencies involving, importantly, the identification and analysis of risk, the way in which risk was actually treated, the monitoring and enforcing compliance with standards and the performance monitoring and reporting. As well, we were concerned about the cost of regulation and consequent issues of cost-effectiveness and the setting of priorities where resources are limited. We are very mindful of that for a number of these kinds of agencies.

The audit adopted a whole of agency approach to risk management. This involves adopting risk management throughout all levels of an agency in a structured fashion as part of the major process and not just in one area such as technical standards setting. It includes adopting risk management for individual projects, activities and functions and should be reflected in business plans, including priority, strategies, work programs and performance reporting, relating these back to the objective of reducing risk to the consumer. We see that as a primary focus in this particular area, rather than simply being a captive to the industry concerned, for instance.

The audit identified that risk assessment is a feature of certain activities within the agencies actually audited, and we have heard that around the table this afternoon. However, there did not appear to be a whole of agency approach to risk management as suggested in the draft risk management profile put out by MAB/MIAC.

The audit's recommendations were designed to encourage this whole of agency approach because it really then does focus primarily on two levels: one from an overall management viewpoint, and then consistently from the bottom up and within that risk management profile linked directly into their corporate planning activities.

Of the 18 recommendations in the audit report, 14 were accepted by all agencies concerned, and these recommendations encompass the essential elements of a whole of agency approach to risk management. The audit also attempted to take a whole of government approach to strategic issues relating to risk management of consumer product safety and made recommendations on how agencies might coordinate their activities better and learn from each other.

We have heard this afternoon that the Department of Health and Family Services has already chaired a forum of regulators to discuss common issues and to improve the level of cooperation and collaboration. The ANAO was very pleased to hear this has occurred, and I am sure that those concerned will be able to review its usefulness and effectiveness over time.

We do not necessarily suggest that these things should have a life of their own, but at particular points in time where there are similar products there is considerable advantage in common approaches or at least in exchanging what appears to be better practice in areas of commonality.

The ANAO is also pleased to be able to assist the Federal Bureau of Consumer Affairs with developments in the new risk management strategy. In summary, the ANAO looks upon this audit as a significant contribution to improving public administration in an area which does not receive the attention, in my view, that it really deserves. We see it when things go wrong, but we hardly see it when things are happening in the right way. Therefore, credit is not actually given commensurate with the effort that is being put in, certainly in improving public administration generally and ultimately helping to deliver

better quality of service and protection for the Australian population. Mike Lewis and Brian Boyd are the senior audit staff involved with the audit, and we would be happy to respond to any questions of the committee.

CHAIR—I think we will proceed to specific recommendations. There are a number related. Recommendations 2, 3 and 8 relate to the department of health's provision of leadership and coordination necessary to achieve and implement the national goals. Recommendation 15 is that all regulators improve their approach to enforcement by setting targets, et cetera. Recommendation 18 is that all regulators and Health improve their performance reporting by reporting of priorities, strategies, targets and achievements against targets. I ask each agency in turn: do you support the Auditor-General's recommendation that Health take a leadership and coordination role in the field of consumer product safety? Why, or why not?

Mr Makeham—Can I clarify that we are talking about recommendation 18?

CHAIR—Yes.

Mr Makeham—FORS agrees that the improvements mentioned in the recommendation are desirable but notes that there are difficulties in achieving the outcome sought. The absence of a straightforward, objectively measured cause and effect relationship between the multitude of factors affecting road safety was a primary reason these indicators have not been available. This does not, however, preclude the search for improvement and the development of better indicators of performance. It is something we have put a lot of effort into, but I am saying that there are difficulties.

Mr GRIFFIN—What about the general question of Health as a department taking a leadership and coordination role in the field of consumer product safety—that particular aspect which goes beyond recommendation 18?

Mr Makeham—We have supported that and we have cooperated with our colleagues in Health in terms of a forum to coordinate with, and we have met with them. We intend to meet with them every six months, I think. In our own particular field with the Department of Health, as well as this broader coordination recommended by the ANAO we have quite extensive coordination arrangements through the advisory committee on road trauma, which is a committee made up jointly of health and transport people. It advises both the Minister for Health and the Minister for Transport on road trauma issues. That is serviced jointly by the Federal Office of Road Safety and the Department of Human Services and Health. Through that we have developed quite a significant link on a day-to-day basis.

CHAIR—The summary of recommendations on page xxiii of the Auditor-General's report stated that your agency did not agree, but you seem to be agreeing now.

Mr Makeham—It says that we agree in principle, and we certainly do. We have been cooperating with our colleagues in Health. I think what we have not supported and probably continue to not support—and I don't believe other agencies support this—is an elaborate bureaucratic apparatus. We are more into the substance than the process, if you like. But we agree in principle. That is how we have been recorded.

Mr GEORGIOU—Can you spell out a little bit more what is meant by coordination and leadership? I think there may be a diversity of internal definitions amongst the various authorities.

Mr Barrett—In essence, the only agency that has a common responsibility in this area is the department in one way or another. I think it was looking for a focus in the first instance. It seemed that the department was the logical one to provide that focus, particularly in its emphasis on better health, et cetera. That was the issue about providing, in the first instance, the identification of who should get that ball rolling.

Secondly, clearly there is a range of common issues. We have heard that already today in the regulatory environment and the approaches that are taken by the agencies concerned. In a sense, as in many other areas of federal government activity, you do not want to go and reinvent the wheel. In essence, it was observed that a lot of the agencies concerned were in fact grappling with similar kinds of problems but not necessarily talking to each other. In that sense, someone has to take a leadership role in the issues that are of common interest. We thought it was appropriate that the department do that.

That course does not suggest necessarily that the responsibility is removed from the particular agencies concerned—far from it. I appreciate the notion of a forum for discussion to ensure that the obvious efficiencies that can arise from this coordination approach are actually realised.

Mr Lewis—We did not envisage that the department would become a super regulator in that sense but that it would take a strategic view of issues and problems that faced consumer product regulators, as the Auditor-General has said. There are a number of portfolios involved in protecting different areas of consumer product safety. However, a lot of them are within the department of health portfolio. Ultimately, any failures to protect consumers will impact on the health budget. That is why we saw the department of health being an appropriate coordinator in that sense.

Mr BEDDALL—I want to raise a more practical example to get some idea of how it would be coordinated. The area I have the greatest and increasing concern about is food in this country. I think that is a concern expressed by the broader community. There have been two cases in relation to Garibaldi and also contamination of peanuts from Kingaroy in Queensland. In the case of Garibaldi, there was an unfortunate death of a child and, in the case of the peanuts, people have suffered serious illness. Certainly, in case of the peanuts, there is also the question of importation. As far as I am aware, we are still not

sure that all the product was domestic because Kingaroy peanuts do import and mix their product.

How is that handled by these agencies that are involved here? Who coordinates it or do we just simply say, as in the case of Garibaldi, that that is an issue for the particular state and it is not an issue that we address? I think one of the things Australians in the past have valued most is the fact that if you buy a food product in a supermarket you were guaranteed that it was safe. It seems to me that in the risk management approach we are taking now, that is at risk.

I heard some comments before in relation to importation. I have great concern about importation because I think we put are own manufacturers under more stringent scrutiny than we do manufacturers of imported product. A number of incidents have been brought to my attention. How would we handle the situation in these agencies such as the problem that we had with peanut paste? Perhaps Health could tell us how they would coordinate it.

Mr Lindenmayer—I think it would be appropriate if Dr Burch addressed the specific issue of food in the first instance.

Dr Burch—This is obviously a very big topic that you have raised and I guess there are several aspects of it that we need to deal with. The first is: what are the responsibilities of the Australia New Zealand Food Authority—that is, what is the Commonwealth's responsibility compared with state and territory responsibility? Under the arrangements of the agreement with the states and territories, the Commonwealth has the responsibility through the Food Authority and its Act to set standards which are then adopted by reference into state and territory food law. They have their own individual Food Acts. They are the responsible agencies in terms of application, implementation and enforcement and monitoring of whether those standards are being complied with.

In terms of the other arm of regulation that I have spoken about a moment ago, that is, hygiene regulation—and here I guess I am talking about the principal aspects of safety of food—in the past and as of today that is the responsibility of the state and territory governments. They have their own hygiene regulations. In some instances these are reviewed on a regular three- to five-year cycle. In one case in Victoria at the moment regulations have expired and they have brought new provisions into their Food Act and they are travelling without regulations.

Since the authority was set up in 1991, one of the aspects that the authority was asked to look at as a matter of priority was to develop consistency in hygiene regulation. More or less as of this moment the authority has been through an extensive period of preparing consumer discussion documents for consideration by industry, governments and consumers, and a formal proposal is about to be launched which sets out a completely reformed agenda for food hygiene regulation in Australia. It is based on the principles of a

preventative approach to food safety. It is also, as I mentioned earlier, taking the premise or the stance of a national approach to food safety, which extends its application from paddock to plate.

If you take the example of peanuts that you have just mentioned, if there is a break down in the safety of the food at the farm level which is not in some way remedied or rectified throughout the processing and distribution chain, then clearly the system is going to unwind. That is a difficult aspect in the sense of that there are different Commonwealth portfolios with responsibility for the production side and, indeed, you have quite separate legislation at the Commonwealth, state and territory level for things like meat, which you are probably aware of, as distinct from the arrangement that I have talked about today which is the setting of standards within the food standards code.

Under the proposed reform agenda, there will be a standard for hygiene and that will set the safety standards for food in Australia and again our process will lead to this standard being adopted without variation into every state and territory around Australia after appropriate public consultation and agreement by the ministerial council responsible for food. By that mechanism there will then be uniformity of approach to food hygiene in particular. That will then encompass the majority of aspects of safety.

That is not to say that within the Food Standards Code there are already matters of composition and labelling and indeed some standards, microbiological standards, that apply to safety. We have had to, because of the Garibaldi outbreak, move ahead of our proposed reform agenda to bring in the sort of comparable requirements, preventative requirements, into the Food Standards Code for the production of fermented comminuted meat products—that is, the salami style products.

Mr BEDDALL—What is the time span? It is five years from establishment already.

Dr Burch—The time span is that there will be a staged introduction of the new reform agenda and part of it is our responsibility in terms of setting up a standard. Part of it is a reform agenda within the states and territories because governing state and territory food law is what is called the Model Food Act. To actually enable the new provisions to be introduced there have to be changes brought about in state and territory law. That can only be brought about by revision to the Model Food Act and then an undertaking which was given by state and territory health ministers on 5 July that they will, as a matter of urgency, introduce those changes.

So, between now and about 12 months from now, there will be the process of consultation and the establishment of the food standards within the Food Standards Code for Australia and New Zealand. In that period, the states and territories will also introduce changes to their own food law. Twelve months from now, there will be a phased-in period of two-yearly cycles on the basis of risk. The high risk sectors of the food industry will be

introduced first, over a two-year period, and then a rolling cycle until the entire food industry is performing under the new arrangements.

Mr BEDDALL—In the year 3000?

Dr Burch—It is a very complex subject. I am trying to summarise the essential elements of the reform process.

Mr BEDDALL—I thought what we were having here was a lead role by the department of health to try to make this happen. I can remember, from experience, with the national building code of Australia, where the exemptions were bigger than the building code because each state had different requirements. Is there any movement by the Commonwealth to say, 'This is what we require,' and to put pressure on the states to adopt that national approach? If you are going to wait for the problem area to arise, as in Garibaldi, you are going to have a reactive approach rather than a pro-active approach.

Dr Burch—What I have tried to outline is that Australia—if I can use a vernacular term—is travelling on a command and control system. It is a system that is in most countries in the world as of today, but much of the world is in transition at this point in time.

The command and control system says you set a regulation, you send inspectors out to inspect, you catch someone out, then you enforce and prosecute. What we are trying to do is say—and this has been agreed internationally—that that is not an appropriate way to bring about an improvement in food safety and better consumer protection. You have to build food safety into food products by a preventive approach. Whereas our current regulatory system is set up on end product standards—in other words 'Here is what you have to do. If you do not meet that standard, then we will take you to court and prosecute you'—what we are introducing is processing standards where we provide them with what is called a hazard analysis critic control point approach. All food companies hopefully, whether they be at the farm level or at the advanced processing level, will be following the same sort of analytical framework for analysing their own risk, giving them the tools and the training to do that, and then introducing safety measures in their production process.

This is absolutely sweeping aside the current regulatory system as we know it today. It should be introduced in a manner in which we will not get companies off side to the point where they react negatively and it bounces back on the parliamentarians. We will have total chaos. We want a managed process, and that is why I am saying it is not something you do overnight.

At the moment the costs of training—this is an important aspect—are being borne by failure. In other words, Garibaldi fails at enormous cost to the health community, enormous cost to the sale and distribution of all products in that sector and, of course, the company goes to the wall. Those costs are quite substantial.

The costs of implementing the new system are going to be significant, but by implementing it we transfer the costs in failure to prevention. Of course, there will be industry reaction to that. Therefore, we have to have industry understand that that is the outcome. They have to realise that the benefits are going to be provided by that.

Mr BEDDALL—Will they be policed?

Dr Burch—Yes. There will still be in place all of the enforcement mechanisms. In addition, it will be consistent with what is being done elsewhere, such as in the meat sector, primarily—

Mr BEDDALL—The meat sector is not a good example. We keep closing abattoirs because they do not meet standards.

Dr Burch—Yes. A reform agenda within the primary industries and energy portfolio has been in place for several years now. There has been the introduction of audit requirements as well. There is no requirement on auditing for safety within the food sector as it stands today.

Mr BEDDALL—Find a better example. We keep closing export abattoirs because this process is not working. I do not want to prolong it, but if your example is the meat industry, then we have a real problem.

Dr Burch—My example is not relying on the meat industry. I used the meat industry as one sector that is of a high risk component. In our reform process, we have to make certain that the high risk sectors of the food industry are dealt with in a seamless manner.

Mr GEORGIOU—Do you regard Health as being a leader and coordinator of your activities?

Dr Burch—The National Food Authority has the principal responsibility, but we work in very close coordination with the health department.

Mr GEORGIOU—Do you want me to ask that question a different way, because the short answer seems to be no?

Dr Burch—The authority has been set up by the—

Mr GEORGIOU—I am not arguing about it. I am just asking: do you perceive the department of health as being a coordinator and leader?

Dr Burch—Yes, I definitely perceive that. The health department took the initiative back in the late 1980s and early 1990s to recognise that the old system of

committees setting food standards based on the command and control system I have spoken about was failing. It took the lead and developed a very strong Act and, in a sense, put in place all of the mechanisms.

It is recognised—I believe worldwide—that this authority is probably the most advanced in achieving world best practice compared to many other agencies elsewhere in the world. In fact, Canada has taken our model for a complete reform process of their own, modelled on what has been achieved by the health department in Australia.

Mr Barrett—I just want to make a quick clarification. In answer to Mr Georgiou's question about how we saw leadership and coordination, we saw that as being at a high level—in the sense of establishing the framework where there are national goals and strategies that can be agreed and targets set. In that sense, we would hope that, where there is that commonality of view, the discipline would be accepted within that framework. I think you are now talking about whether that forum could be a coordinating mechanism to deal with specific instances.

We did not necessarily envisage that, but I think it would be a test of the maturity of that arrangement as to whether people saw the value of using that forum to coordinate activities when, in fact, there are similar interests. It would not necessarily mean that everyone in the forum would be involved in a specific area. But there may be two or three of the particular authorities who would see advantage in coming together, under a coordinated arrangement, with the Department of Health to resolve particular issues. I personally would see that coming out of the maturity of the arrangement, in the first place, where there was confidence established within that group, and that they would commit to a set of national strategies—and I am talking about higher level ones—not pre-empting state rights but, in fact, making sure that there is a complementary relationship between the activities that are carried out in the state and local government arenas and the Commonwealth arenas.

But it is absolutely essential that the Commonwealth get its act together so that, when it establishes the framework, everyone knows what they are expected to do, they know what the ultimate objectives are and the strategies that are being pursued at that higher level by the responsible agencies. It does not pre-empt in any way the functional responsibilities or the statutory responsibilities of the agencies concerned. But what it makes transparent to them and everyone else is that there is such a framework and these are its major component parts.

CHAIR—Thank you, Mr Barrett. I will jump forward to recommendation 17 because I think Mr Asher has to catch a plane to Perth. In this recommendation, the Auditor-General recommended greater use of legislative remedies to enforce consumer product safety—in particular, the remedies available under the Trade Practices Act. Recommendation 17 sees your agency playing an important role in educating other regulators, consumers and lawyers on this appropriate use of the product liability

provisions of the Trade Practices Act. How do you propose to implement this recommendation?

Mr Asher—The commission has gone a long way to implementing this recommendation. We produce guidelines. Also, in relation to the product liability provisions of the act, part 5A, the commission has spoken at 17 or 18 different industry conferences explaining to manufacturers, producers, their lawyers and other government agencies just what the law is and how it works. Indeed, over the next few weeks I will be speaking at three producer conferences in the peanut producing areas to describe to them the operation of the product liability provisions of the Trade Practices Act.

In addition to that, we have fairly regular contact with other regulators both at the Commonwealth level and at the international level. In addition, of course, where we do take enforcement action, we make sure that we publicise very widely those actions, so that we can draw to the attention of other manufacturers, consumers and regulators the activities that we plan. So I would suggest that the commission is very active in pursuit of recommendation 17.

CHAIR—Recommendation No. 11:

5.49 The ANAO recommends the TPC request Customs to include banned products in the Prohibited Imports Regulations . . .

The FBCA is said to be the appropriate agency to negotiate with Customs on this issue. Customs disagreed because of the significant resource implications. Do you want to comment on that?

Mr Asher—I would comment just to say that our role as an enforcement agency really does not include dealing with governments on those policy issues. However, that is not to say that we do not think it is a good idea. It is that the federal bureau, which is the policy agency, is the one that is responsible for fixing those sorts of administrative issues. Perhaps Mr Noonan would be best placed to deal with that.

Mr Noonan—At the small business summit, in fact, the Minister for Industry, Science and Tourism announced a review of the relevant parts of those regulations which we are carrying out at the moment. The regulations are a mixed bag. Some of them date back to the 1920s. In fact, you would probably want to remove a number of things out of the regulations because they are rather outdated and prescriptive. But there are certainly a number of issues in there, such as toys made incorporating lead—and you would certainly want to see that covered. The question would arise whether some of the matters that are currently covered by the product safety standards that the bureau administers should also be carried over into the regulations. The standards themselves are also under review under the ministerial council for consumer affairs.

I would expect those two reviews to come together probably late this year. At that stage, to the extent it is appropriate, there would be a correlation between the imported regulations and the safety standards where that would see the regulations better enforced.

CHAIR—Recommendation 12 relates to Mr Asher. Since assuming responsibility for enforcement of product liability provisions of the Trade Practices Act 12 months ago, what action have you taken to identify high risk areas for consumer product safety? How is the TPC adopting a risk based approach to enforcement?

Mr Asher—There are a number of responses. They are included on the schedule that I handed out, the product survey assessment. We have been through all of the products where there are mandatory standards, we have made an objective assessment of their likely risk and we have established a monitoring process. There is another schedule I have handed up that shows for all of those standards what steps we are taking to make sure that those products, given their relative risk and likely harm to consumers, conform with those standards. In the year I mentioned, there have been five legal actions taken already to enforce those standards. We are doing a lot more work with industries to explain how they can better meet their obligations under the Trade Practices Act.

CHAIR—Thank you. I think we have pretty well covered it all. Mr Barrett, would you like to make a final comment on the position of the Auditor-General regarding that report?

Mr Barrett—I think the committee could be very encouraged by what they have heard today and the initiatives that have been taken by the various authorities sitting around this table. It is an area, as we have mentioned on many previous occasions to the committee, where there is risk management and the Commonwealth Public Service is still learning in trying to set priorities and establish risk profiles. We will not get it right from day one but I am sure that, when we are operating in similar areas, we can learn from each other in these respects. I hope the forum that has been established would produce that outcome for the agencies concerned. Certainly, we anticipate that the final draft of that MAB-MIAC report on risk management should be available in the near future.

I say to the authorities that we will be continuously interested in their experiences in applying the risk management framework in their own areas. They are involved in many aspects of public service that are common, where there is a propensity to have aligned interests, where the costs of regulation can get out of hand and where the overall objectives of the functions can get lost sometimes in the detail. Focussing on high-level strategies makes sure that we are meeting the objectives that are set by the parliament of the day and that we understand exactly what we are focussing on when we put these organisational arrangements in place. On that basis, I think we should be encouraged by what we have heard today.

Mr Lindenmayer—I might say one or two things about what has been raised,

including Mr Barrett's closing comment. The process that led to this report generally was a very good one, to the extent that there was interaction between the agencies—in particular of the department and the ANAO—that involved a good deal of mutual learning.

At an early stage in the process, there was a suggestion that a body be created that was referred to as a RIO. For the moment, I cannot recall what that acronym stands for—risk identification office or something along those lines. We perceived a RIO as a regulator to regulate the regulators. We saw it as being unlikely to be able to do that in a way that made effective use of resources. To the considerable credit of ANAO, they took the points that we were making that, without very substantial duplication of the high-level technical skills that reside in the various regulatory bodies around the table, it would not be possible for the RIO to effectively come to judgments that needed to be made in order to direct the regulators on how to regulate.

We do not see the forum as a directive forum. We believe that would not only cut across the quite separate and different statutory responsibilities of the various regulatory bodies that are involved, it would also have the forum doing things that it simply would not in general have the skills to do. We see it more as a facilitative mechanism that assists in the exchange of information and insights, and which I hope will lead to the development of better practice across all the participants.

As to whether the forum should constitute a mechanism for responses to things such as the Garibaldi case or the peanut butter salmonella case, I believe that the forum would be unduly unwieldy for that sort of purpose. There are—and it has not been mentioned this afternoon—many coordinative mechanisms either in place on a standing basis or which come into effect when needed. With the mad cow disease scare not very long ago, AQIS, DPIE, the National Food Authority and the public health area of the department came together very quickly and met on a very regular basis in order to ensure that a whole of government response occurred quickly. I do not believe that it would have been helpful to have involved colleagues from FORS in that. Apart from occasionally getting in the way of cars, mad cows really are not a road safety issue.

CHAIR—Unless you drive into a McDonald's.

Mr Lindenmayer—Yes. Mr Chairman, we are seeing the forum as something that will develop functions as it goes along. Where it tries things and they work, I would see them being perpetuated. Where it tries things and they don't work, I would expect it to abandon them.

Mr Noonan—Mr Chairman, I just endorse some of those remarks about the forum, because I do not see it as a directory body. I do not see the forum sitting around telling me how to make a safety standard about bicycles, nor would I try to tell anybody how to make a food standard.

There are issues that are common to regulators. For instance, one issue that we are dealing with at the moment is lead in venetian blinds. You may have noticed the press controversy there. It is a consumer issue, but we cannot evaluate it without input from expert health professionals about how lead comes into the environment, how much is dangerous and so forth. The health department has been very helpful to us in evaluating that situation.

More generally, the collection of data is an important area. A theme of the report is that we have to take an organised approach to safety. In order to do that, we have to collect data from all sources. The data that is accessible to the department of health will be much more comprehensive than any one of us can gather. For instance, all hospital admission data can be used to identify a problem area and target it before it might become critical. That is another area where I see the forum playing a very useful role.

Mr Makeham—I wanted to also support the view in relation to the forum. As I indicated in my earlier comments, we do support coordination with health. We have a high degree of integration. We have been recorded in the report as not supporting recommendations 2 and 3 in relation to risk identification. That was because our perception was that the proposals were a process that was really a surrogate RIO—risk identification office.

We do support coordination, and we do so at the strategic level identified by the Auditor-General. Transport Ministers and Health Ministers have agreed on a range of strategic items in terms of road safety which I believe meet the spirit and the intent of that. I just make that clarification. We have put together some comments which might assist the committee, and I am happy to table them if that would help you.

Mr BEDDALL—In terms of the Federal Office of Road Safety, if it became apparent that there was a major flaw in an automobile manufactured either overseas or domestically, do you have the power to order a mandatory recall? If you do not, do you think you should have?

Mr Makeham—The power does not reside with the Federal Office of Road Safety. We have the power to cease the compliance plate approval under which vehicles can be supplied to the market. So we could stop the supply to the market. In terms of recall, the arrangements are that the minister would advise the Attorney-General or the Minister for Consumer Affairs who could order a recall. There is a cross linkage between our act and the Trade Practices Act, but the formal power in relation to compelling a recall is done through the consumer protection provisions of the Trade Practices Act by the minister responsible for that act, not our minister.

Mr BEDDALL—But the power is there.

Mr Makeham—The power is there, but it is not exercised by us.

Dr Burch—I wish to make a minor comment in terms of detail. There are very strong relationships between the Food Authority and areas within health that are important to us. The two main areas are in communicable diseases reporting. The health department takes the leadership in running a communicable diseases network within Australia and New Zealand, and that is one of the principal mechanisms of early warning. To some extent, that network was the basis by which early detection of the Garibaldi outbreak occurred, as well as some of the early warning signs of the salmonella outbreak in peanut butter.

I should just add that, with regard to the peanut butter, there has been no previous case of food borne illness being carried by peanut butter anywhere in the world. It is a most unusual circumstance. In response to the question as to whether the source has been fully identified, I can say that it has been. It is not due to imported nuts; it is entirely due to contamination at the processing plant. That has been clarified in its entirety.

Within the health portfolio, we also work very closely with the National Health and Medical Research Council. In fact they are conducting a working party at the moment on food borne illness which we are participating in. Part of that exercise is to work out costs, benefits and control of food borne illnesses.

We also work very closely with the department on data collection, and we are establishing what is going to be known as the Australian Food Safety Information Network. That uses computer facilities and networks established by the department with health portfolios around the nation. It is to be extended down to the local government area so that we have real time reporting of the problems and compliance associated with food borne illness.

Finally, in the area of public health and nutrition—another area where there is shared responsibilities between the department and ourselves—we also enjoy coordinating arrangements there. Our standing committee, which is an advisory committee to the authority, includes membership of the Commonwealth departments of health and primary industries and energy, with AQIS representing that portfolio.

CHAIR—I want to thank everybody who has participated today. This was a final session in a totally new format in considering Auditor-General's reports. I think we finish on a very positive note. We are quite impressed with the responses to the Auditor-General's reports. On this committee, we are not used to dealing with good news. As politicians we do not receive many phone calls from people to tell us that they have no problems. On this occasion, it was quite pleasant. I thank you all for attending.

Resolved (on motion by Mr Griffin):

That the following documents be accepted as evidence and included in the records of the Auditor-General's sectional committee as exhibits to the review of the 1995-96 reports of the Auditor-General—from the Australian Competition and Consumer Commission media releases of 15 February 1996, 4 July 1996 and 18 July 1996. The documents are entitled 'Threshold assessment

work sheet', 'Product survey assessment' and 'Regional office surveys of consumer products covered by safety standards'.

Resolved (on motion by Mr Griffin):

That the following submissions be accepted as evidence of the Auditor-General's sectional committee review of 1995-96 reports of the Auditor-General and be authorised for publication:

The Australian Competition and Consumer Commission submission on Audit Report No. 12.

The Federal Office of Road Safety submission on Audit Report No. 12.

Resolved (on motion by Mr Griffin):

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

Committee adjourned at 4.30 p.m.