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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Reference: Review of Auditor-General's reports, third and fourth quarters 1999-2000

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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Friday, 3 November 2000

Members: Mr Charles *(Chairman)*, Senators Coonan, Faulkner, Gibson, Hogg, Murray and Watson and Mr Andrews, Mr Cox, Mr Georgiou, Ms Gillard, Mr Lindsay, Mr St Clair, Mr Somlyay, Mr Tanner and Mr Kelvin Thomson

Senators and members in attendance: Senators Murray and Gibson and Mr Charles, Mr Cox and Ms Gillard

Terms of reference for the inquiry:

Review of Auditor-General's reports, third and fourth quarters 1999-2000.

WITNESSES

BLACKBURN, Air Commodore John Nicholas, Director-General, Policy and Planning, Royal Australian Air Force, Department of Defence 110

BORTHWICK, Mr David, Deputy Secretary, Department of Health and Aged Care 58

DEVINE, Air Commodore Paul Francis, Commander, Tactical Fighter Group, Royal Australian Air Force, Department of Defence 110

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Committee met at 9.41 a.m.

CHAIRMAN—I declare open today's public hearing, which is the fourth in a series of hearings to examine reports tabled by the Auditor-General in the financial year 1999-2000. This morning we will be taking evidence on three audit reports, namely Audit report No. 42: *Magnetic resonance imaging services: effectiveness and probity of the policy development processes and implementation*, Audit report No. 46: *High wealth individuals taskforce* and Audit report No. 40: *Tactical fighter operations*. The committee has received a combined submission from the Department of Health and Aged Care and the Health Insurance Commission in relation to Audit report No. 42.

I must ask participants to observe strictly a number of procedural rules. First, only members of the committee can put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I 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 directly to respond to each other.

Second, given the length of the program, statements and comments by witnesses should be relevant and succinct, please. Third, I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament. The evidence given today will be recorded in Hansard and will attract parliamentary privilege.

Finally, 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 this committee statement are available from secretariat staff. The audit report being considered in the first segment is Audit report No. 42: M*agnetic resonance imaging services: effectiveness and probity of the policy development processes and implementation*.

[9.43 a.m.]

GREENSLADE, Mr Alan, Executive Director, Australian National Audit Office

HAWLEY, Mr John, Executive Director, Australian National Audit Office

McPHEE, Mr Ian, Deputy Auditor-General, Australian National Audit Office

McVAY, Mr Peter, Senior Director, Australian National Audit Office

BORTHWICK, Mr David, Deputy Secretary, Department of Health and Aged Care

KEITH, Mr Alan, Assistant Secretary, Diagnostics and Technology Branch, Department of Health and Aged Care

MORAUTA, Dr Louise, First Assistant Secretary, Health Access and Finance Division, Department of Health and Aged Care

PAUL, Ms Lisa, Deputy Managing Director, Health Insurance Commission

WATZLAFF, Mr Ralph Harold, General Manager, Professional Review Division, Health Insurance Commission

CHAIRMAN—I welcome representatives from the Australian National Audit Office, the Department of Health and Aged Care and the Health Insurance Commission to today's hearing. We have convened this public hearing to examine the main issues raised in the Auditor-General's Audit report No. 42 on the effectiveness and probity of the policy development processes and implementation of magnetic resonance imaging services. Does Mr David Borthwick of the Department of Health and Aged Care wish to make a brief opening statement to the committee before we proceed to questions?

Mr Borthwick—Chairman and committee members, the Department of Health and Aged Care and the Health Insurance Commission have worked together to prepare this submission, although the ANAO's findings focus on responsibilities specific to each of us. The collaboration between the two agencies reflects our joint commitment to ensuring that Australians have access to cost-effective services, medicines and acute health care through Medicare. With your agreement, we propose to each make a brief introductory statement.

In considering the audit report, the department agrees that there are a number of areas where departmental processes were not as good as they should have been. As indicated in the submission, a number of initiatives and improvements have been made at departmental level to address the areas for improvement identified by the ANAO, including: formal procedures for the declaration and management of conflicts of interest, measures to improve record keeping and information management across all departmental programs and activities, and measures to increase staff awareness of the ethical and professional standards required of them.

The department and the HIC have also worked together to implement a range of strategies aimed at improving interagency relationships at both operational and broader management levels. These improvements are outlined in section 4 of our submission. There are other conclusions drawn in the audit report, which the department does not believe adequately capture what happened. First, the department believes that proper consideration was given to assessing and managing risks associated with the development and implementation of the new MRI arrangements. This was reflected in the inclusion of a range of specific measures designed to limit MRI services to where there was evidence of clinical effectiveness. That was not standard practice in terms of the operation of the MBS more generally. Moreover, specific steps were taken to address the possibility of non bona fide orders of MRI units. Because of the uncertainty of dealing with new technology and new clinical indications, the new arrangements were to be reviewed within 18 months of their introduction. In short, we would contend that, notwithstanding hindsight assessments, risks were properly addressed at the time. Secondly—

CHAIRMAN—Mr Borthwick, can I ask if this is going to continue much longer?

Mr Borthwick—A page-and-a-half.

CHAIRMAN—I do not want to be rude, but could we suggest that your written statement be included in the *Hansard* transcript? We would like to ask you questions. If you could wind up, we will adopt that procedure, if you do not mind. My colleagues have lots of questions.

Mr Borthwick—Yes—subject to the fact that we want to put on record in our own words our version of what happened, and subject to our having adequate opportunity to do that. But I am sure that it is your intention.

CHAIRMAN—You are certainly not implying that we have any reason to deny you the opportunity to put your case?

Mr Borthwick—No, I just was not expecting to be cut off in mid-stride.

CHAIRMAN—I did ask you in the opening statement to be brief. Did you wish to conclude?

Mr Borthwick—No.

CHAIRMAN—Right. Is it the wish of the committee that the remainder of the statement be incorporated in the transcript of evidence? There being no objection, it is so ordered.

The statement read as follows—

Senator MURRAY—Mr Chairman, may I make a suggestion? It may be that Mr Borthwick is concerned that, because this is a public hearing, it may be reported tomorrow before *Hansard* is out, in which case I suggest the committee allow him the latitude of distributing copies of that, if he wishes.

Mr Borthwick—That is fine.

CHAIRMAN—So be it. Does Ms Lisa Paul from the Health Insurance Commission wish to make a brief opening statement?

Ms Paul—Yes, very briefly. The Health Insurance Commission's experience with the ANAO's performance audits has always been positive. We have found these reports useful in improving the business. This report has helped us and our board to make further improvements to the way we do our work. Management of the HIC advised our board's relevant subcommittee of changes at a meeting in May this year. The focus of the changes was on investigation procedures in HIC's New South Wales office, the relationship with the Department of Health and Aged Care and the adoption of new guidelines for corporate governance, which we have covered in our submission.

CHAIRMAN—Mr McPhee?

Mr McPhee—I will be brief. Our audit report sets out our position quite clearly. The departments have responded positively to the audit report and to our findings, in the main. I point out that, recently, the Director of Public Prosecutions advised the HIC that there was insufficient evidence for a prosecution to proceed on the brief submitted by the HIC in relation to the MRI investigation. This does not alter our findings and conclusions as set out in the audit report. Consistent with the minister's request, we drew out of the audit some generic lessons for the benefit of agencies which have policy development responsibilities. We view these as important, enduring benefits of this particular audit.

CHAIRMAN—As I read the joint submission to the committee from the department and HIC dated 25 October, it occurs to me that we have a fairly significant difference of opinion. The Audit Office believes that there was insufficient consideration of risk given to the procedures in advance and ineffective risk management during the process, which undoubtedly contributed to a gigantic rush of orders at the last minute before budget night. Yet, Mr Borthwick, if I understand your statements correctly, you are saying, 'We could have done a bit better but, really, we did give very serious consideration to risk in the first place and we managed that risk pretty well.' Can you justify the differences between those two positions?

Mr Borthwick—Yes, Mr Chairman. I think the gist of my remarks was that risk was identified at each step in the process—firstly, in the initial advice that we gave to our minister and, secondly, in the design of the measure. There was a whole raft of measures involved in that. They are outlined in our submission. For example, only a specialist could make a referral for MRI; not a GP. That was unusual. The item was broken down into 160-odd specific MBS items—again, very highly unusual. There were siting requirements. There was the whole statutory declaration process to make sure that only bona fide orders were recognised. In the end, a lot more machines came into the country than we envisaged would happen. But that is not to say that we did not have a whole risk framework involved at the time. The outcome was

not exactly what we were envisaging, but that is not to say there was not proper attention to risk along the way. So I would maintain that there was proper attention to risk in the design of the measure.

CHAIRMAN—Does the Audit Office have a response?

Mr McPhee—At paragraph 34 on page 19 of our report, we make the point that we believe the department's approach to risk management was uneven. We readily acknowledge that high level risks were addressed but we felt that insufficient consideration was given to risk identification and management for some aspects of the policy development process. I refer the committee to the graph on page 88, which shows the machines on order, and ask the question: does that suggest tight risk management processes? It seems to me the answer is: we think they could have done better. So while we are not universally saying the department has not applied risk management, we are saying there is certainly scope for improvement.

CHAIRMAN—Mr Borthwick, the ANAO concluded that:

> ... the Department's management of the probity arrangements surrounding the negotiations for the MRI measure was not adequate for the circumstances. The arrangements in place lacked structure and clarity. Specifically, the Department did not seek to agree with members of the Task Force what confidentiality arrangements would apply to certain information and procedures.

Can you tell us why that happened? This is a genuine question because you were dealing with professionals who were getting ready to order, or who might actually be using, the equipment that you were negotiating about.

Mr Borthwick—In terms of that, we have said in our submission that there should have been better measures put in place for handling conflicts of interest and confidentiality requirements with the profession. There is no doubt about that. The ground rules should have been a lot clearer in terms of dealing with the profession. Having said that, I would also draw your attention to the minister's remarks in commissioning this review from the Audit Office. In his letter asking for the audit he said:

> While the negotiations were of a confidential nature, it was recognised that formal confidentiality arrangements for the college's negotiators would be inappropriate because of their need to consult the college membership more widely on aspects of the agreement.

In other words, we were expecting the college to go back and talk to all their members about the aspects of the agreement because we were expecting them to sign on the bottom line. It is quite clear there was some confusion on that point and we were not clear enough in terms of setting out those requirements.

Notwithstanding that, I want to go back to the broader question of handling risk. This MRI agreement needs to be put in the context of it being part of the overall diagnostic imaging arrangements. We were trying to strike an agreement in an area of Medicare which costs us over $1 billion. This was part of that arrangement. In terms of managing the overall risk, we have effectively got MRI services under that overall agreement at hardly any cost to the taxpayer at all. The risks that were far more important to us were managing the overall diagnostic imaging agreement, which was, as I said, worth over $1 billion, which was growing out of control—rates of growth at 10 per cent plus—and we were trying to introduce a new technology. We did that at

minimal cost to the consumer and with greatly increased access to the consumer. I think that is an important point to put in an overall context.

In terms of the rush of orders which Mr McPhee rightly pointed to, there was speculation on whether there was a possible leak. Did people have prior knowledge because of their privileged position in the negotiations? The ANAO did not find that, but they did find that there were a whole set of circumstances as to why radiologists might have presumed that that was so. They were gambling, in other words; they were taking a commercial gamble that these machines would be put on the MBS. I think, with the benefit of hindsight, that we did not fully appreciate that that is what they were doing. There has been no cost to the taxpayer in that regard. Our measure—and this is reflected in our submission—was not directed towards the number of MRI machines, and perhaps it should have been, with hindsight; it was directed to what the number of services was that could be clinically justified. It was not directed at the number of machines. The risk management was all in terms of the number of clinical services.

The Blandford report said that, if anything, we underestimated that; that there are more services that should be used with the MRI machines. It is very easy to look at what was happening at the time and say that we should have limited the number of machines. Our judgment at the time was that that was too difficult an ask in the context of negotiating the overall diagnostic imaging agreement, and that is where we were really at risk. We think, in an overall context, that those risks were well managed, but we can well understand why parliament and the community have looked at this aspect of MRI—that surge in orders raises obvious questions which need to be addressed. I think that is all I want to say on that score.

CHAIRMAN—In paragraph 6 of your summary, on page 3 of this latest joint submission to us, you state:

This submission describes how the HIC investigation and referrals to the Director of Public Prosecutions did not, in the end, result in any prosecutions, while noting that none of the units ordered after February 1998, except for three outside metropolitan areas, are Medicare eligible.

Is that true for all of the machines that were ordered from budget night until now or is that only true since retrospective changes were made? You say that none of the units ordered after February 1998 are Medicare eligible; has that been true for the entire time since budget night 1998?

Mr Borthwick—No. That is since the minister decided to backdate to, I think, 10 February 1998. That was a measure that the minister took subsequently in light of the audit report and our own suspicions that there could have been some prior knowledge, that there could have been something that was done wrong and in terms of the prima facie evidence that some of the MRI machines might not have been bona fide orders.

CHAIRMAN—Of all those ordered, how many actually got delivered and installed?

Mr Borthwick—I think there were about 47-odd machines.

Mr Watzlaff—There were 52 ordered and of those machines 25 were claiming at the highest point. The effect of the amendment to the regulations was to disqualify 21 of those and there were subsequently two others that came in under the system.

Ms GILLARD—If we can be clear about the machine numbers: as I understand it, on 12 May there were 59 machines that were operating. Is that right?

Mr Watzlaff—That is right, yes.

Ms GILLARD—Then there were four machines not operating on 12 May but that had been ordered prior to 10 February, so prior to the ministerial freeze?

Mr Watzlaff—Yes.

Ms GILLARD—Subsequently three more machines in country towns have been accorded Medicare benefits because of policy issues about their location?

Mr Watzlaff—That is correct. The regulations take a different approach to non-metropolitan as opposed to metropolitan. So the metropolitan machines that were ordered after the commencement of the negotiations and up to budget night were disqualified by the amendment to the regulations; the non-metropolitan were not. So there were three in that category.

Ms GILLARD—So we have got 59 plus four, plus three, making 66 machines currently operating that get Medicare benefits?

Mr Watzlaff—No. There are 65 machines because one of those eligible under the prior to 10 February group never actually installed a machine.

Ms GILLARD—Right. So there was one ordered prior to 10 February that for whatever reason never came on line?

Mr Watzlaff—That is right.

Ms GILLARD—Okay. So we have got 65 machines operating that get Medicare benefits?

Mr Watzlaff—And are claiming.

Ms GILLARD—And are claiming, yes. As I understand it, the number of contracts caught in the ministerial freeze—if I can use that terminology—was 55. I think you might have said another number.

Mr Watzlaff—I believe it was 52.

Ms GILLARD—Fifty-two contracts?

Mr Watzlaff—I should expand upon that. The 52 relates to the contracts that were referrable to machines that were not installed as at budget night.

Ms GILLARD—Right—52 were not installed at budget night. Is the difference of three explained by the country machines subsequently getting authorisation?

Mr Watzlaff—No, I do not think it is.

Ms GILLARD—All right. So 52 contracts were the subject of the freeze. Is that right?

Mr Watzlaff—I would not say subject to the freeze in the sense that some of them were not frozen out, if I can put it that way, because with that 52 there is obviously the group of six that escaped the freeze for two reasons. One was that they were pre 10 February and the other reason was that they were non-metropolitan.

Ms GILLARD—Okay. So, there were 52 contracts in place on budget night. Of those 52 contracts, four were ordered prior to 10 February and three were for country machines. Of that four, one of those machines did not come on line for some extraneous reason. That is right? Okay, of the 52 contracts less the six, we are down to 46 contracts genuinely caught in the freeze, is that right?

Mr Watzlaff—Yes, that is right.

Ms GILLARD—Of the 46 contracts genuinely caught in the freeze, how many of those resulted in machines coming on line and commencing to claim Medicare benefits prior to the ministerial freeze coming into effect?

Mr Watzlaff—I think there were around about 20 in that category but I would really have to check with my figures—

Ms GILLARD—All right, could you check that for us?

Mr Watzlaff—It was slightly in excess of 20, I believe.

Ms GILLARD—All right, slightly in excess of 20 were installed and operating prior to the ministerial freeze but became subject to the ministerial freeze?

Mr Watzlaff—That is right, yes.

Ms GILLARD—And you will check that specific number for us?

Mr Watzlaff—Yes.

Ms GILLARD—And are you able to advise us what quantum of Medicare benefits were claimed in respect of the operation of those machines?

Mr Watzlaff—No, I could not tell you that figure here but we do have those figures available.

Ms GILLARD—Right. Could you make that available to us please?

Mr Watzlaff—Yes. It varies. Some machines were claiming only a few services and others quite a substantial number of services. It is variable.

Ms GILLARD—I would appreciate that it would be variable but could we get the specific figure of the number of machines that commenced to operate in the freeze period and the quantum of Medicare benefits claimed as a result of the operation of those machines.

Mr Watzlaff—Yes.

Ms GILLARD—Okay, just so we are always clear about the numbers for the future, we have got 46. You say 20-odd were installed and commenced to operate in the ministerial freeze period; that leaves say 26-ish unaccounted for. Of the 26 unaccounted for, how many are still in the process of being installed and how many are the subject of cancelled contracts?

Mr Watzlaff—Sorry, how many are in the process of being installed? So far as I am aware there is only one that is eligible that has not been installed.

Ms GILLARD—I am actually asking you about the non-eligible machines now.

Mr Watzlaff—If they were non-eligible, we would not know whether they proceeded to complete the contract and install the machine. There are some examples of machines moving from one location to another. I am aware of one such incident, but I could not say how many proceeded. If they are not claiming on us, we do not have any evidence.

Ms GILLARD—I accept that. Can the department shed any light on that?

Mr Borthwick—No, we cannot.

Ms GILLARD—So the department is unable to say, of the 46 machines caught in the ministerial freeze, how many contracts were cancelled. You have no information about that.

Mr Borthwick—No.

CHAIRMAN—I will ask one more question. In paragraph 9 on page 4 of the summary you say:

> The Australian community has benefited greatly from improved access to MRI services, including in non-metropolitan areas. This has been achieved at minimal cost to the Commonwealth budget.

What is that cost?

Mr Borthwick—It is set out in our submission. It is a minimal cost; my colleagues are finding the answer. The cost was largely absorbed within the overall DI agreement and only services above a threshold were additional.

Dr Morauta—In the budget measure, the anticipated expenditure on MRI was offset by savings in the rest of the diagnostic imaging table. So the amount offset was not a draw on the public purse. There was a small wedge above that, which was unanticipated, that amounted to $9.81 million over the first two years. That is the amount that was unanticipated at the time the measure was put in place and which was drawn directly from the public purse, as opposed to what was paid for by the radiologists by taking reductions in rebates in the imaging table.

CHAIRMAN—Returning to the line of questioning that I started and Ms Gillard picked up, is it possible or likely that any of the new machines—not those that were there before budget night and were installed, operating and servicing clients and are now eligible for Medicare benefits—were installed quickly enough and were operated long enough before the freeze and thus could have earned enough money from those procedures to pay for the machines?

Mr Watzlaff—That goes to the same question that you asked previously. I will get the figures as to the amounts claimed from the machines. We have that information.

Mr Borthwick—Mr Chairman, as to your former question about the costs, that issue is addressed in paragraph 86 of our submission. The concluding point states:

> Thus, the funding arrangements negotiated for MRI have meant that the vast majority of scans have been funded at no additional cost to the taxpayer.

In other words, they were included in savings from the overall DI arrangements. Furthermore, the additional scans—which were over and above what we thought—have reflected clinical need. It is quite legitimate for the taxpayer to pay those because, as the Blandford report revealed, there are good clinical reasons for having more scans than we envisaged in 1988—largely because the technology has become more embedded and its uses have become better understood. The key point is that the taxpayer largely got this as a result of the overall agreement.

CHAIRMAN—Is that largely because specialists, not GPs, are now referring?

Mr Borthwick—No, nobody was referring before. We effectively brought in this new technology to the MBS under the umbrella of a bigger diagnostic imaging agreement. Because we did that, we were able to negotiate an arrangement with the profession whereby this new technology could come in under the overall cap.

Dr Morauta—Not quite under the cap, but funded by savings from the cap.

Mr Borthwick—It is funded by the savings from the cap.

Senator GIBSON—I am a bit confused: does it mean that, under the total DI agreement, imaging was going on before you settled the agreement that perhaps should not have been going on? Is that the implication?

Mr Borthwick—No, imaging was going on but it was not on the MBS. Patients who were not in a public hospital and getting DI were basically paying the full fee—$600 or $800 per scan.

Senator GIBSON—Sure—been there, done that myself. So the MRI machines were brought in—the last column shows six per cent in 1999—and 6.3 per cent of the imaging was done by MRI machines. Does that imply that making MRIs available means that total imaging is done more efficiently now than it was in the past?

Mr Borthwick—It is a difficult question to answer. The MRI is clearly being used when it is clinically better. I suspect that before we were using things like CT scans when MRI might have been a better bet because CT was on the MBS and MRI was not. There are very good clinical reasons why you would use the MRI, and that is why it is such a big step forward to have brought it onto the MBS so cost effectively.

Senator GIBSON—I again betray my ignorance: is CT scanning more expensive than MRI?

Dr Morauta—I think we spend more on it. We spend a lot of money on it and it is used very frequently. In a number of cases, MRI is now the superior technology for the same purpose. We expect—and we are getting some effect now—that there will be a transfer from CT to MRI. I think the reason is that in the Blandford review the committee said that it would be better if MRI were right under the cap because radiologists could then transfer from one technology to another according to the superiority and the needs of the patient, rather than because they had one type of funding or another. I think there is a transfer going on now.

Senator GIBSON—Is the basic cost of each of these alternatives approximately the same or largely different? Can I have a rough idea?

Mr Keith—The individual item level varies. Because of the complexity and the time taken, some CT scans cost more than MRI. The majority do not; the majority are cheaper. In the past, a patient would often be referred to a radiologist who might do a plain film X-ray, an ultrasound and then a CT. With the advent of MRI, it is usually decided that MRI is the appropriate technology and, if a specialist refers, they go straight to that. So the cost of the diagnostic investigation overall could be cheaper.

Senator GIBSON—Thank you.

Ms GILLARD—Returning to the discussion we had before, of the 46 machines caught in the ministerial freeze, have any of their operators threatened or commenced legal action in relation to their no longer being able to claim Medicare benefits for the operation of those machines?

Mr Watzlaff—One set of proceedings commenced. However, it was a result not of the regulation being amended but of a decision by the commission to reject a particular application. Those proceedings commenced last year and were discontinued in December. One matter that we presently have could lead to litigation, and it relates to another matter that was being investigated by the HIC. So two matters fall into the category of threatened actions against the HIC in respect of decisions taken by the HIC on the applications.

Ms GILLARD—Did the one that was discontinued result in any benefits being paid? Was it settled or was it discontinued?

Mr Watzlaff—No benefits were paid in respect of that matter.

Ms GILLARD—Is the other one still in process?

Mr Watzlaff—That is right.

Ms GILLARD—And proceedings have been issued?

Mr Watzlaff—No, they have not, but we have pended claims so we are not paying some claims until we resolve certain issues with the lodging party.

Ms GILLARD—Are you able to advise us of the quantum of the disputed claims?

Mr Watzlaff—No, I can't because there are still claims being pended, virtually on a day-to-day basis. I would have to go back and get those figures.

Ms GILLARD—Could you do that for us, please?

Mr Watzlaff—Yes.

Ms GILLARD—I would like to raise now with the department the two measures that are used to try to control this problem. One of the measures was the requirement that statutory declarations be signed by radiologists. Firstly, could we just clarify whether the decision to ask radiologists to sign statutory declarations was taken at the minister's instigation or at the department's instigation, because there are contradictory versions on the public record?

Mr Borthwick—I am not aware that there are contradictory indications. My recollection was that it was at the department's instigation.

Ms GILLARD—Right. The department advised the minister that a statutory declaration process would be a useful tool and the minister accepted that advice?

Mr Borthwick—Yes.

Ms GILLARD—Can I ask what legal advice was obtained in the drafting of those statutory declarations?

Mr Borthwick—We got advice from the Australian Government Solicitor's office.

Ms GILLARD—It seems to me that subsequently it has appeared that there is a problem with those statutory declarations. They were required of radiologists, whereas in some practices the person who was undertaking the negotiations for the purchase of new machines would not have been a radiologist but a business manager or something like that. When the radiologist signed the statutory declaration they could have done that really unaware as to its truth or falsity in respect of their particular practice. When did the department or the HIC first become aware of that problem?

Mr Watzlaff—Insofar as there were claims of backdating of contracts, we first became aware of that on 3 December 1998.

Ms GILLARD—It appears from the DPP material that the statutory declaration process has not assisted the prosecution process because it is possible that, in some cases, the statutory

declarations were not signed by the relevant person. I am asking you when you first became aware of that problem.

Mr Watzlaff—Of the DPP's advice on the issue? Is that the question?

Ms GILLARD—If the first advice to you of that problem was the DPP's advice, then that is the answer to my question or, if you became aware of it at an earlier time, I am asking you when that time was.

Dr Morauta—I am just talking around it a bit for a moment. The person who signed the Medicare form is a doctor and it is the doctor who has the direct relationship.

Ms GILLARD—I am not asking you about the Medicare forms. I am asking you about the statutory declarations and, in case I am being unclear, if you go to paragraph 86 on page 33 of the Audit Office report, the last sentence of that says:

The department advised that statutory declarations and supporting documentation controls which had been developed were sufficient to proceed with the implementation of the MRI arrangements.

Do you have that section of the report?

Dr Morauta—Yes.

Ms GILLARD—It has subsequently transpired that the statutory declarations have not been a particularly effective mechanism, and they have not been an effective mechanism because in some cases the person signing them was not the person with actual knowledge about the course of negotiations regarding purchase of a machine. Given that the department advised that that was a control mechanism and it subsequently transpired that it was a flawed control mechanism, I am asking you when you first became aware that that control mechanism was flawed or was potentially flawed.

Dr Morauta—The fact that it would not stand up in the prosecutions was only known to us when the DPP advised us of that.

Ms GILLARD—It follows from what you just said that the department was not aware that there was a potential flaw in the statutory declaration process until the DPP's advice was received. Is that right?

Dr Morauta—It was our view that referral to the DPP would lead to a prosecution, particularly in relation to the backdating side of it, and that we expected that to happen. That it did not happen meant that we had now got evidence that it did not work through the legal channels and would not proceed. But I do not think we thought before that that there was any fatal flaw in it.

Mr Borthwick—I think also it is necessary to look at the reasons why the prosecutions were not gone forward in terms of the overall reasons as well, not just that aspect.

Ms GILLARD—I am actually intending to come to some other aspects of why prosecutions did not proceed.

Mr Borthwick—What was also found was that prima facie there were contracts. Even though there was backdating on some of the contracts, the prior negotiations and prior exchange or whatever it was amounted to contracts that were entered into prior to budget night. In other words, on questions of fact it was thought that perhaps these were contracts that were entered into before budget night and hence they did meet the criteria. I think you need to be very careful in just picking out one point and not looking at all the points that have been made in that regard.

Ms GILLARD—I am not intending to pick out one point, I am going to come to the others in a second, but just to finish with this statutory declaration point, you would be aware that the minister said in parliament on 9 February 1999 that anyone who perjures themselves by signing a statutory declaration will be dealt with with the full force of the law. Are you aware of any basis on which the minister made that statement?

Mr Borthwick—He was making the statement on the basis that if anyone did not meet the regulations they would be dealt with by the full force of the law. In the event, the DPP did not find that there was a case that he was prepared to take to court.

Dr Morauta—But at that stage the reference had been made.

Mr Borthwick—It was a perfectly appropriate observation for the minister to have made.

Mr COX—It subsequently turned out to be misleading.

Mr Borthwick—No, it was not. It was made on the basis of information available at that time. He was just assuring taxpayers that if there was some malfeasance involved that he would get to the bottom of it and let the processes run their proper course.

Ms GILLARD—I think our views will have to vary on that. Can I take you to another issue in the DPP's advice. So you have the budget date, future purchases are going to be excluded, but the original budget announcement says that it applies to machines then in operation, or machines that were the subject of contracts at that time, or unconditional leases. Then there was this wording that a conditional contract would be one where there was an 'option to cancel the contract'. The DPP made some comments about that, about how it was unusual phraseology and that none of the contracts would really fit in that category. I am asking you, basically, on what advice was that wording 'option to cancel the contract' used?

Mr Borthwick—All the advice that we took on this matter came from the Australian Government Solicitor's office. It was translated into regulation legislation by the Office of Legislative Drafting.

Ms GILLARD—Okay. Are you able to tell me on what date you got advice from the AGS on that form of words?

Mr Borthwick—Not off the top of my head, but we can provide you with that.

Dr Morauta—But from the OLD it was on 17 August 1998.

Ms GILLARD—That is the office of?

Dr Morauta—Legislative drafting.

Ms GILLARD—And the date?

Dr Morauta—It was 17 August 1998, I think.

Ms GILLARD—I suppose the relevant advice really is the advice you got before the budget, given the phrase was used, 'in the budget'.

Dr Morauta—But the regulations were drafted subsequently. I think they were drafted after the budget. The broad policy intention was settled in the budget but the actual wording comes when you put the regulations in, which was later in the year.

Ms GILLARD—I understand that but presumably, if you use the terminology 'in the budget', you would have got some advice about that terminology prior to the budget. Is that right?

Dr Morauta—That was expressing policy intention but there was some legal advice prior to the budget too.

Ms GILLARD—Was that legal advice from AGS or internally from within the department?

Dr Morauta—The AGS.

Ms GILLARD—So you will be finding out for me what date you got that advice?

Dr Morauta—Yes. We will. We will take that on notice.

Ms GILLARD—And is your recollection that that advice went to the question of this phrasing, 'option to cancel the contract'?

Dr Morauta—We will take that one on notice too.

Ms GILLARD—All right. Can you advise me what that advice was?

Dr Morauta—Yes.

Ms GILLARD—The DPP obviously made some conclusions about problems that stemmed from the use of that phraseology, 'option to cancel the contract'. Prior to the receipt of the DPP's advice, did the department become aware that there was a problem with that phraseology?

Mr Borthwick—Yes. We did become aware of that prior to the DPP's advice.

Ms GILLARD—Can you tell me when and how?

Mr Borthwick—I think it was in the context of discussions with the Health Insurance Commission.

Mr Watzlaff—I believe it would have been around July this year.

Ms GILLARD—Would you be able to clarify that date for us?

Mr Watzlaff—Yes.

Ms GILLARD—Can you tell me how that discussion arose?

Mr Watzlaff—At that point we had received an advice from counsel as to concerns about the meaning of that phrase and we communicated that to the department. At that point, however, the director had not endorsed the view of counsel so in that sense we were saying at this time that it was the view of counsel who had been briefed by the DPP in the matter; it may not necessarily be the opinion of the director. So it was not a final position at that time.

Ms GILLARD—And that is the only way in which the issue has been raised prior to the DPP's advice?

Mr Watzlaff—As far as I am aware, yes.

Ms GILLARD—I will finish soon, I promise. Can I just ask you about the country machines: of machines that were ordered in this period I understand that three of them have been ticked for Medicare benefits because they are located in the country, particularly Ballarat, Wodonga and Port Macquarie. Can you explain to me why that has not been extended to machines located in places like Toowoomba and Mackay? If it is incapable of explanation, you can just say that.

Mr Watzlaff—No. I think the issue there is that those machines were in place and ordering as at the cut-off date. The ones that you refer to I do not believe had been installed at that point. So if they had been installed they would have been in the same category but as they were not they were basically excluded because of the introduction of a cut-off date.

Ms GILLARD—So you are saying the Ballarat, Wodonga and Port Macquarie machines were actually installed and—

Dr Morauta—And claiming.

Ms GILLARD—Right. At the date the decision that they would get ongoing benefits was made.

Dr Morauta—Yes.

Ms GILLARD—The date of that decision was?

Dr Morauta—It was 18 October.

Ms GILLARD—Which year?

Dr Morauta—Last year, 1999.

Ms GILLARD—It has just been such a long-running saga, you have got to keep your years straight. I found that looking at the time line. And the Toowoomba and Mackay machines you say were not installed and operating at 18 October?

Dr Morauta—They were not claiming.

Mr Keith—We do not know whether they were installed or not but they were not claiming.

Ms GILLARD—They were not claiming on 18 October 1999?

Ms Paul—The rule was put into place on 18 October 1999 but it came into effect on 1 November and they had to be claiming then.

Mr Keith—That is right.

Ms GILLARD—As I understand it—I am no expert in these matters—seven more machines are going to be authorised for Medicare benefits as part of a plan to geographically spread access to MRI. Is that right?

Mr Borthwick—That is right.

Ms GILLARD—In the selection of those seven, presumably you will mainly look at geography, if the policy is to spread geographic access to MRI machines. But I am concerned that, in extending Medicare benefits to those seven machines, we might be extending a benefit to machines that were obtained during this disputed period—perhaps even obtained as a result of backdated contracts, so that we would be conferring a government benefit on people who had done, if not something illegal, at least something highly improper. What, if any—

Mr Borthwick—That is a very strong judgment that you are making there. The HIC has taken this as far as they can, including to the DPP, and the DPP has come back and said that there are no grounds for a prosecution. I think we need to be a bit careful about the terminology.

Ms GILLARD—I accept that there are not enough grounds for a prosecution, according to the DPP. I am asking you: isn't it a fact that those seven machines could be machines owned and operated by radiologists who were involved in entering into contracts in and around this budget period in circumstances which have been subject to a high degree of public questioning?

Dr Morauta—Basically, the minister said that he accepts the position of the DPP—that that is the end of treating these different people in different ways at the time that any tender arrangements are put in place. He has asked the new Blandford committee to look at that.

Everybody is going to be treated in the same way. But that derives precisely from the process of the DPP, who has said that there is no way to distinguish between these people before the law.

CHAIRMAN—I want to get this point clear in my mind: is it true that the decision about these additional seven machines has been made not on the basis of when somebody brought the machines into the country or did not, but rather on the basis of the needs of the patients in those communities?

Mr Borthwick—That is exactly right.

Dr Morauta—And those are the criteria that will be used to advance that process.

CHAIRMAN—Thank you.

Ms GILLARD—So there will be a tender process and you say it is the minister's view that it will be ground zero and there will not be regard for these past events in terms of selecting the radiologists that end up using those seven machines. You say that that arises from the DPP stuff. The DPP stuff dealt with the criminal matter. As I understand it, there are eight radiologists who are going to be subject to some form of civil action. What about those radiologists? Will they be able to tender for these seven machines?

Mr Watzlaff—In terms of our earlier report, we said that we were looking at several matters that may become civil actions. When we further examined those matters, we found that two of them were matters that we thought were similar to the matters that we had identified as being suitable for referral to the DPP. So in that sense two of the matters became criminal matters. We decided not to proceed with the other matters because when we investigated them further we found there were no grounds. So we have sent those matters to our legal advisers. The view that we have received is that there are no grounds for taking action on one of those matters, and we have accepted that advice. In respect of the other matter, that is still undergoing legal review at the moment. So there is one matter of those several mentioned that is outstanding at this point.

Ms GILLARD—In respect of that one, you would not be able to say whether that radiologist would be permitted to tender, if that matter is still under investigation?

Mr Watzlaff—I cannot even say at this point whether or not we will reject the claims for benefits. Obviously, that is the preliminary point before we need to take the second point. I think it is worth mentioning, however, that the scheme we have is not a participatory scheme in the sense that we exclude some practitioners for incorrect behaviour, either in terms of excessive servicing or criminal conduct or whatever. It is an exclusionary scheme, it is not an inclusionary scheme, if I can put it that way. It is not participatory in the sense that people who are providers are applying to us for registration and recognition in an accepted sense. As for the exclusion of individuals, unless there are some of the established cases of overservicing or criminal conduct or something of that kind, there is no gateway by which we could reject an application from a radiologist.

Ms GILLARD—Yes, I accept that is true in respect of your processing of claims. What I am talking about is a government policy generated decision about who will be permitted to tender in a round, which is really a little bit different from your processes once people are out there

claiming. I accept that. I have two more questions and then one for the Audit Office. I will be very quick.

CHAIRMAN—Thank you. Other people want to ask some questions as well.

Ms GILLARD—In that tender process for the additional seven machines, will public hospitals be able to bid?

Mr Borthwick—Yes, they will.

Ms GILLARD—I understood, and I may have got this wrong, that the government had decided that the additional seven machines would all be existing privately owned machines and that there had been no new MRI machines in public hospitals. Is that incorrect?

Mr Borthwick—That is incorrect.

Ms GILLARD—So a public hospital could bid and if it was successful get an MRI machine?

Mr Borthwick—Yes.

Ms GILLARD—When was that decision taken?

Mr Borthwick—It has always been envisaged thus.

Ms GILLARD—Since time immemorial—good. If I could ask one last question to the Audit Office before everybody runs out of patience with me: in terms of the statutory declaration process which I discussed with the department earlier, clearly that statutory declaration process ended up being a flawed process. I would be interested in the Audit Office view about what mechanisms should have been used to ensure that the accuracy of claims made could be tested and people backdating orders could be successfully prosecuted.

Mr Borthwick—I want to place on the record that we do not accept that it was a flawed process.

Ms GILLARD—All right. ‘Flawed process’ is my terminology and not the department’s terminology, I accept that.

Mr COX—We will note that the department is in denial!

Ms GILLARD—The Audit Office is entitled to say I am wrong too, but given that the statutory declarations have not successfully formed the foundation of legal action which could have corrected some of these problems, I would be interested in the Audit Office advice about what other mechanism could have been used which would have been more successful in founding legal action.

CHAIRMAN—Are you asking ANAO to second-guess the DPP?

Ms GILLARD—No, I am not asking them to second-guess the DPP, I am asking them if there is an entirely different way it could have been done, a better way that it could have been done.

Mr Greenslade—Perhaps I could answer that without second-guessing the DPP. It goes back to our comments about the overall approach to risk management. I refer you back to page 33. You earlier referred to paragraph 86 and the department's advice. I draw your attention to the following paragraph. One of the gaps that we would see that was there which might address your point is that the briefing about statutory declarations and so on that went up on 7 August 1998 did not identify risks of continuing with machines on order policy or look at alternative options available. In other words, it did not explore some of those issues, whether there was any risk to the statutory declaration approach and so on. It goes back to the broader issue of risk management.

Ms GILLARD—Thank you.

Senator MURRAY—Mr McPhee, in a broad sense, the allegation concerning this matter relates to insider trading, to persons who have confidential information making improper use of that information. In terms of your remit for your audit, there is no insider trading legislation concerning government instrumentalities to which you could make reference as a framework in reviewing any such broad allegation, is there?

Mr McPhee—Not that I am aware of.

Senator MURRAY—So there is nothing similar to what is available regarding financial markets?

Mr McPhee—No, not that I am aware of.

Senator MURRAY—Is the lack of that a limitation in terms of viewing matters such as these?

Mr McPhee—It is not something we specifically considered. I think our report really suggested it was the responsibility of the department and the task force radiologists to have a clear understanding of what the working arrangements were. As Mr Borthwick has said, an important element of this process was that it was intended to be open so that the radiologist could refer back to their members the negotiations that were going on.

I think the issue was: did the department have a clear idea as to what was not to be entertained in discussions or negotiations and what could be? While the process is a bit unclear, because of the lack of documentation, I guess our conclusion that people either became aware of or deduced what the measure would be suggests, at least to us, that the lack of clarity about the discussions that occurred during the process of the negotiation may have led to the risk that people who were present picked up on information which gave them a privileged position, if you like. Senator Murray, we have not explored this particular issue that you raise; rather, we have really said that it is up to Commonwealth agencies, Commonwealth departments, to have a clear understanding about what is to be the subject of discussions and negotiation and what is off limits.

Senator MURRAY—I will continue to use the phrase because we all understand it in popular parlance. The characteristics that identify insider trading are two things: firstly, that a profit is made, or somebody profits by it; and, secondly, there is a type of behaviour that accompanies it. Therefore, Ms Gillard's line of questioning becomes of real note because she has identified in the questioning 26 units which were ordered in the disputed period but which were not installed by the time the minister withdrew eligibility. If those 26 units were subsequently cancelled in terms of the contract, it might indicate, might it not, as one supposition, as one thesis, that because those persons could no longer profit, as they had assumed they could, they had decided to withdraw their contracts? Therefore, the implicit question put by Ms Gillard, which I am now putting explicitly, is this: do you consider there is a prima facie case for further investigation of those 26 if a majority of them, or sufficient numbers of them, are subsequently cancelled, which would indicate a particular behaviour?

Mr McPhee—It is a very difficult one. I guess there are a number of conclusions you may draw from the fact that someone has cancelled a contract. It may be a perfectly rational response for reasons which I would not be aware of.

Senator MURRAY—I accept that.

Mr McPhee—I think it is a very difficult area and we are not privy to sufficient information to help you draw a conclusion there. The other thing I would say is that, even with insider trading legislation in the commercial arena, it is very rarely successful—only a handful of prosecutions, from memory, have been successful in this area, and these have been in very recent times. So I think it is a very difficult area to try to use. I guess I would prefer to put the emphasis on the preventative approach to avoid the situation occurring, rather than trying to recover downstream.

Senator MURRAY—Yes, I make no inference automatically, obviously, because there could be other reasons. However, the circumstantial evidence would certainly cause some raised eyebrows, and I am certain that there will be efforts made by the parliament to establish just what has happened to those 26 contracts.

Mr McPhee—Yes, and the question of how direct the linkage is between the individuals who have made those decisions and cancelled and their role in this whole process. Our emphasis was very much on departmental and HIC administration, and we did not look to extend the focus of our work, because of our particular audit mandate, much beyond the immediate people involved in the negotiations.

Senator MURRAY—Thank you, Mr McPhee. My next question is to the HIC. If I understand it correctly, the DPP considered these matters in criminal terms, in which case his proof of evidence would have been 'beyond reasonable doubt' not the lower bar of 'the balance of probabilities'. The question, of course, is whether he might have had a different view if he had had to meet the balance of probabilities argument. We will never know. However, as I understand it, and I might misunderstand it so I would like your response, the HIC was caught up in this matter and therefore was a participant. Yet, as I understand it, the HIC provided the brief to the DPP.

Ms Paul—The HIC's role in this matter was to undertake the investigations. It is our normal activity under our act and so on, if it is relevant, to refer to the DPP.

Senator MURRAY—So you were not at any stage part of the accused, shall we call it, from the departmental side of things.

Ms Paul—No, we have a statutory role in terms of investigation and preparing briefs.

Senator MURRAY—Thank you, that clarifies that for me. I think both the DHAC and the HIC might want to answer this. As I understand it, the Blandford review found that the current MBS fees for service arrangements could mean the Commonwealth paying the capital component of the MRI scanner several times since there is no way to separate MBS payments for capital costs from recurrent costs. Is that so?

Dr Morauta—That is the nature of the MBS right across the schedule. We pay a single fee for service which encompasses within it a notional component for capital as well as recurrent costs. When you have a GP consultation and you have a rebate related to that it covers premises and so on as well as anything else. It is an all in thing.

Senator MURRAY—With regard to those seven projected contracts that might be awarded, if some of those seven had in fact ordered in the disputed period, it obviously would not matter if the payment was relevant to operating or recurrent costs because that is current, if you like, but the payment does in fact relate to capital costs as well.

Dr Morauta—It is a flat fee.

Senator MURRAY—So they would get their return.

Dr Morauta—The conditions for the tender have not yet been developed. Obviously, the new Blandford committee will be looking into that, and the terms and conditions of the tender.

CHAIRMAN—Could I just follow up with the Health Insurance Commission. I think it is appropriate, although perhaps it is for the department, I am not sure. One of the lines of questioning that Senator Murray undertook relates to machines that might subsequently have been cancelled once they found out that they were not going to be able to be players. Am I correct in assuming it would be very difficult to use one of these machines in competition—that is, a privately owned and privately operated machine, which was not subsidised under the Medicare Benefits Scheme—with another machine somewhere in the reasonable vicinity?

Mr Borthwick—You are right in that.

CHAIRMAN—Commercially you would have to say, 'Cease and desist.'

Mr Borthwick—It would be difficult. Some are operating. They are either billing for services that are not covered by the MBS but private services, and there is quite a range of those, or they might be billing just a small amount—in other words, not what they would otherwise wish to bill because there might be a free MRI service. These people gambled that

these machines were going to be subject to the MBS, but they have not been. It would be a logical thing for them to cancel the contract if they had an opportunity in terms of the contractual arrangements to do so.

Senator MURRAY—That is if you accept the supposition that they were gambling. That is the key thing we have to decide on. I do not think the auditors accepted that.

Mr Borthwick—I do not know if it is a matter for the Audit Office. The Audit Office pointed out in their report that there were strong commercial incentives for them to put an MRI machine in place against the possibility that it might be subject to the MBS. The Audit Office commented on these things and, in effect, 'gambling' is not their word but that is the gist of what they found.

Ms GILLARD—The Audit Office said they were unable to conclude whether they were 'gambling', to use your terminology, or actually became aware. I think you will find that is the auditor's term, though Mr McPhee might want to correct me.

CHAIRMAN—The Audit Office is very conservative.

Mr McPhee—Yes, Mr Chairman. We used the words 'may have deduced or actually became aware'.

Ms GILLARD—I apologise.

Mr Borthwick—To be fair, the Audit Office also listed quite a range of reasons why it would have made good sense for the radiologists to order the machines, in other words, and they are listed in the report as well.

Dr Morauta—There is still some private market for MRI because of the narrow indications that are on the MBS and because of public hospital in-patient services, and some of those are also in the market.

CHAIRMAN—Mr Cox has two pages of questions and we are running out of time.

Ms GILLARD—Just referring back to these 26 machines and 26 contracts, do you know how many of them are actually operating?

Mr Borthwick—No. There is no reason for us to know because—

Ms GILLARD—Because they are not claiming.

Mr Borthwick—they are not claiming and they are not in the MBS system.

Ms GILLARD—They do not know that either. We would like to know but no-one seems to know.

CHAIRMAN—Can I turn to a different topic which does concern me? The auditor has told us that the radiologists kept much better records of meetings and agreements, or potential agreements, than did the department. I would like to know how on earth that could occur when it is generally perceived by the private sector that the public sector, being bureaucratic in nature, would be much better in this area than the private sector?

Mr Borthwick—You are right. Our processes were not up to the mark. Everything the Audit Office says about that reflects deficiencies in that process by the department.

CHAIRMAN—Your statement is refreshing. Have you acted in order to rectify the situation for the future?

Mr Borthwick—Yes, we have, in spades, in terms of not just this particular area of the department but at a departmental wide level in terms of making it very clear what responsibilities are of officers for record keeping, filing and all those basic bureaucratic skills.

CHAIRMAN—Thank you.

Ms GILLARD—Would you have said your standard of record keeping on this occasion was the same as usual?

Mr Borthwick—No. I do not think it was usual.

Ms GILLARD—It was a more unsatisfactory standard.

Mr Borthwick—It was an unsatisfactory standard.

CHAIRMAN—It was appalling.

Ms GILLARD—This is a question I asked the auditor before but, as I understand it, when the Audit Office comes in and there is an unsatisfactory documentary record, are you able to say whether or not any documents were removed or destroyed?

Mr Borthwick—To the best of my knowledge, there were no documents that were deliberately removed or destroyed. However, I think the Audit Office might be able to comment on it. I think some officers' personal records, such as notes, went missing, but they were personal notebooks, time had moved on and the issues were no longer relevant. I might leave it to the Audit Office to respond to that question.

Mr Greenslade—We found no evidence that documents were deliberately destroyed to hide evidence.

Ms GILLARD—So you found no direct evidence that documents were deliberately destroyed, but it is a possibility, isn't it, when there is such an unsatisfactory record? Either they were not kept or they were subsequently removed—there are two possibilities.

Mr Greenslade—Yes.

CHAIRMAN—Wouldn't it be highly unlikely in a department for documents to be purposely destroyed?

Mr Borthwick—The point is that it is highly unlikely and the nature of this audit commission, where they had unfettered access to all of our staff and interviewed them under oath, if need be, would have revealed whether there had been some action to destroy documents. There was no such action.

Ms GILLARD—I accept there is no direct finding of that by the Audit Office.

CHAIRMAN—Even I, who have never been, as a private sector person, a great fan of the bureaucracy, increasingly become enamoured of the Public Service, quite frankly. They do a better job than previously I had thought. In any case, I could not imagine that it was standard procedure for the Public Service to go around shredding documents.

Mr Borthwick—It certainly is not.

CHAIRMAN—And I would have thought somebody would know and somebody would blow the whistle.

Mr Borthwick—Exactly.

CHAIRMAN—Is that reasonable to assume?

Mr Borthwick—Absolutely.

Senator MURRAY—Mr Chairman, just for the record, I would like to return to the gambling remarks. The Auditor has returned several times to his graph or table—I do not know how you would describe it—at page 88. For the record, I remind Mr Borthwick that this gambling that you refer to was so extraordinary in terms of past practice, and it occurred over five days. Frankly, commercial decisions which are all synchronised on that basis have raised an alarm. You can see why there is a view by others that the gambling supposition does not necessarily hold water.

Mr Borthwick—No, I agree very much. That is why the minister initiated this wide audit inquiry and agreed that the Audit Office could extend its normal powers to get right to the heart of the matter, because we, too, were concerned by that rush of orders. My only point is that the Audit Office goes to some lengths to also say there are some commercial reasons which can explain why that happened as well as the insider trading possibility that you were trying to draw out.

Senator MURRAY—Thank you, Mr Borthwick.

CHAIRMAN—Okay, are we all done?

Ms GILLARD—I have one more question for the Audit Office, just to get this on the record. Has any new information come to the Audit Office since the conclusion of its report that is relevant to its inquiries?

Mr Greenslade—There is no information that has happened since the audit was tabled that changes any of our findings or conclusions.

Ms GILLARD—So you have not had any new information?

Mr Greenslade—No.

CHAIRMAN—Mr Borthwick and Ms Paul, if we have further questions and we put them to you in writing, you would not mind responding with respect to this issue?

Ms Paul—That is fine, thank you.

Mr Borthwick—Do we have a choice, Mr Chairman? We would be happy to respond.

CHAIRMAN—That would be very nice of you, Mr Borthwick and Ms Paul. Thank you very much. Mr Borthwick, just to clear the air, do you believe now that you have been fairly heard?

Mr Borthwick—Yes, Mr Chairman.

CHAIRMAN—Do you believe you have been able to put your case as you wanted to put it?

Mr Borthwick—Yes.

Mr COX—Would you like to come back for another couple of hours at a future hearing?

Ms GILLARD—Would you prefer it if I were not here?

CHAIRMAN—I thank the participants. We will close this part of the hearing and have morning tea; then we will have a private meeting with the Audit Office before we proceed with the next inquiry. I thank everyone who participated.

Proceedings suspended from 11.04 a.m. to 11.47 a.m.

[11.47 a.m.]

GRIMMOND, Mr Norman John, Director, Performance Audit Services Group, Australian National Audit Office

McPHEE, Mr Ian, Deputy Auditor-General, Australian National Audit Office

ROE, Mr Lindsay, Senior Director, Australian National Audit Office

WHITE, Mr Peter, Executive Director, Australian National Audit Office

FITZPATRICK, Mr Kevin, First Assistant Commissioner, Australian Taxation Office

TUCKER, Mr Michael, Acting Assistant Commissioner, High Wealth Individuals Taskforce, Australian Taxation Office

CHAIRMAN—We now come to the second audit report to be examined in this morning's public hearing. I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. Evidence given today will be recorded by Hansard and will attract parliamentary privilege.

I now welcome representatives from the Australian National Audit Office and the Australian Taxation Office. We have convened this public hearing to examine the main issues raised in the Auditor-General's report No. 46 entitled *High Wealth Individuals Taskforce*. Mr Fitzpatrick, would you by any chance have a brief opening statement, and I wish to emphasise the word 'brief'?

Mr Fitzpatrick—I did not plan an opening statement, Mr Chairman. I could say that the Australian Taxation Office is pleased with the Auditor-General's report on the operations of the task force. We have agreed with the recommendations made, as you would have noted, and we are implementing them.

Mr McPhee—I do have a statement but I would be happy for it to be tabled. It essentially summarises the audit findings.

CHAIRMAN—Is it the wish of the committee that Mr McPhee's opening statement be incorporated in the transcript of evidence? There being no objection, it is so ordered.

The statement read as follows—

CHAIRMAN—We will now go to questions. Mr Fitzpatrick, on Audit Office recommendation No. 2, can you tell us how you are going about implementing that? I should tell you that, as an individual MP in an electorate, I not infrequently have letters and/or email correspondence from individuals concerned that some Australians, particularly high wealth individuals—for example, over and over again I get Kerry Packer—pay little or no income tax. I am really interested in how you go about doing this advertising and how you get some of these people off my back.

Mr Fitzpatrick—Essentially, our major reporting of the High Wealth Individuals Taskforce work is through the commissioner's annual report. The commissioner's last annual report was tabled this week in parliament. In that report we have outlined the results of the ATO's work in respect of high wealth individuals compliance in revenue terms. We have outlined the tax planning techniques or arrangements used whereby some high wealth individuals do minimise tax—some certainly legally. In essence, our implementation of that recommendation, like recommendation 1, which is reporting consistently on revenue outcomes, is through the commissioner's annual report.

There are other opportunities which might become, and do become, available at different times about the work of the task force. We certainly take whatever opportunities are available to indicate to the community our approaches, our strategies and what has been achieved. Mainly it is through the commissioner's annual report each year.

CHAIRMAN—We will be interested in examining your annual report, because all the annual reports of all the departments are of great interest to the JCPAA, as you know. Isn't there more you can do? Really, can't you figure out some publicity strategy in terms of press releases or press conferences in order to try to get the message out to the Australian public that there are programs in place that examine the affairs of high wealth individuals, that you believe, generally speaking, you are getting a fair share of revenue and that where there are leaks in the system that you have made recommendations to have those leaks fixed?

Mr Fitzpatrick—There have been press releases over the period at which we have looked at high wealth individuals in the last four years or so. We have commented on particular issues. Sometimes there are press releases which show the aggressive tax planning techniques or practices used by high wealth individuals. We are certainly open to continually looking for ways in which we can communicate widely to the community what has been achieved here and what is happening. We clearly give advice to government, of course, on the outcomes of our work and where we believe there is a need to consider legislative change. The purpose of that advice, of course, is for the government to decide what it wishes to do. The government may well in its decisions announce changes to the law which might come about as a result of work done by the ATO in respect of high wealth individuals planning practices. Various changes have happened over the period of time we have been looking in close focus at this area of the population. As I said, we are open to looking for different ways in which we can communicate to the public what is happening and what has been achieved.

Mr COX—For the public record, I want to go over some of the things with the Audit Office that we discussed in the private briefing about the range of the audit. Did the Audit Office make an independent assessment of the revenue being lost or at risk from the activities of high wealth individuals?

Mr White—No, we did not.

Mr COX—Did you look at the advice to the previous government about the $800 million and did you find any reason to dispute that advice?

Mr Roe—Yes, we looked at the advice that was provided, and no, there was not anything to suggest that it was different from the way we reported.

Mr COX—Did the Audit Office look at the specific advice that the task force had given to the government in relation to the need for tax reform and legislative changes?

Mr Roe—We looked at a number of submissions that were made by the task force which were then coordinated through the tax office to Treasury. We did not itemise those and check them against changes that were made. But, yes, we saw evidence of advice that was being provided on an as-you-go basis.

Mr COX—And it was a very substantial volume of advice?

Mr Roe—It was.

Mr COX—Did the ANAO evaluate in any quantitative way the success of the task force's litigation program? Did it, for example, evaluate how much tax was being deferred by the length of litigation proceedings? Did it examine in any quantitative way the decisions that had been made to settle vis-a-vis taking cases to court?

Mr Roe—In terms of the litigation, we did not look at the monetary value that was being either held up or fought. There were only four cases of litigation that had been completed at the time and I think two of those were more to do with access to documentation rather than any challenge on tax affairs. No, we did not look at the quantum of money involved in the other litigation. We examined the procedures that led to settlement to ensure that they actually met with the general tax office guidelines. Again, we did not pursue the correctness or otherwise of the monetary values that were being determined.

CHAIRMAN—You gave those procedures a tick?

Mr Roe—We did.

Mr COX—You were not able to make a judgment about whether, if more legal resources were available to the tax office, they could collect more revenue?

Mr Roe—We observed that the tax office at times hired expertise to provide them with support in terms of their argument. We were satisfied, in the cases that we observed, that that seemed to fit the bill.

Mr COX—The tax office provided a substantial amount of advice to the government and it is set out on pages 56, 57 and 58 of the Auditor-General's report on the need for tax reform and

legislation in various areas. Would the tax office be willing to provide the committee with copies of that advice?

Mr Fitzpatrick—Our advice to government is provided in the normal way. It is up to the government to decide what it wants to do with that advice in the sense of policy change. With respect to the approach we have taken in this area of our work in more recent times, we certainly provided advice to the Ralph review of business tax reform to assist that review to formulate its recommendations to government. Before that, we had provided advice to government on the findings of the task force and our recommendations on what some high wealth individuals were doing to minimise tax. But it is not normal for the ATO to provide advice that it gives to government to anybody else.

Mr COX—Thank you. On top of page 58, the auditor says:

On the basis of evidence gathered by the taskforce to date, the taskforce considers that the most significant systemic generators of tax planning by HWIs are the use of trusts and related party or intragroup transactions. The ATO expects that the Government's proposed business tax reforms, including the taxation of trusts through the new entity tax system, will address major deficiencies in the current tax system.

Can you confirm that that is the ATO's view?

Mr Fitzpatrick—The ATO expects that some of the tax planning arrangements of some high wealth individuals will be addressed by the proposed reforms to the taxation of trusts and also by the proposed reforms—or, in some cases, already enacted reforms—to intragroup arrangements involving losses. The parliament has already enacted some measures concerning the creation and duplication of losses. In our view, those so-called integrity measures will have an impact on some of the arrangements entered into by taxpayers, including some high wealth individuals. The proposed consolidation regime is another foreshadowed reform which, in our view, will have some impact on the tax planning arrangements we have identified.

Mr COX—But the new entity tax system has not been legislated yet, has it?

Mr Fitzpatrick—No, that is correct. I think the draft legislation is presently out for consultation, and the government has announced the proposed reform of the taxation of trusts from 1 July next year.

Mr COX—I do not expect you to comment on this, but we have known about the need to change the tax treatment of trusts since the problems with high wealth individuals were raised in 1996 by the previous government. Another issue I want to get to is on page 55 of the report. It talks about your having a memorandum of understanding with the Department of Finance and Administration, which seems to be a resource agreement. Is this the only area where the tax office has a specific resource agreement with DOFA to fund a particular area of tax administration?

Mr Fitzpatrick—My understanding of that memorandum of understanding is that the government decided, I think in the 1996-97 budget, to allocate additional funding to the ATO of around $9 million or so per annum, which was subsequently extended for a further two years. So it was a four-year additional funding allocation to the ATO from government. The memorandum of understanding referred to was in relation to the additional funding for that

period of time: we would report to the Department of Finance and Administration on the use of that funding and the revenue outcomes that had been achieved as a result of the additional funding.

Mr COX—Is that the total funding available to the task force or do you have other resources as well?

Mr Fitzpatrick—We have other resources, which have been used from what I would call the ATO base funding. Presently, the task force, which is continuing to operate, is funded from the ATO base funding. As I said, that additional funding from government was for a period of four years. It established the task force and it continues as part of the ATO's resource funding. As is always the case, we allocate resources based on the assessment of risks. We have maintained our view that we need to continue to monitor closely this segment of the population and we have allocated funding accordingly.

Mr COX—What total quantum of resources does the task force expend each year?

Mr Fitzpatrick—I cannot give you exact figures on how much the task force expends each year. However, apart from the task force, other ATO resources are allocated to work in respect of some high wealth individuals' compliance. For example, we call in experts from our tax counsel network and our international tax division within the ATO. Other areas, particularly the large business area of the ATO, are working on some high wealth individual cases. So it is not just the task force itself—although that is certainly our clear focus.

Mr Tucker—Our current staffing is 120. Our salary budget is about $8 million and I think our administrative funds this year are about $500,000. But other areas of the ATO work with us and we have other resources beyond the 120 who are working on high wealth individual related tax matters.

Mr Fitzpatrick—We also use some of our funding to bring in—as I think has been noted already—some external expertise to assist us. That has happened over the time that the task force has been operating.

Mr White—Picking up on what Kevin said, on page 26 of the report we attempt to give parliament an idea of the overall funding. For 1999-2000, we are talking about approximately $15 million, of which around $9.5 million was made up of additional funding.

Mr Fitzpatrick—In that funding, we also like to engage counsel to assist us with advice in litigation cases. I expect that will certainly continue as more cases come before the courts.

Mr COX—Are you finding an increasing need to litigate?

Mr Fitzpatrick—In some cases. We do not have control over whether a taxpayer wants to litigate an issue: it is the taxpayer's decision whether he, she or it wishes to litigate. There are certainly cases before the courts at present awaiting hearing or a decision. Some taxpayers in this area have settled cases, as I think the report mentions. It depends: it is a case-by-case approach as to whether cases get litigated. As I said, it is up to the taxpayer.

Mr COX—Do a lot of taxpayers decide to litigate cases to defer paying the tax?

Mr Fitzpatrick—I do not know whether they do. I assume that some taxpayers litigate cases because they believe the ATO view is incorrect and they do not want to concede the ATO view. Tax is not always deferred in full because a case is before the courts. Some taxpayers agree to pay part of the tax in dispute whilst the matter is before the courts or the Administrative Appeals Tribunal.

Mr COX—But some taxpayers do not and it may be a technique for deferring tax.

Mr Fitzpatrick—If the tax is not paid, a general interest charge continues to accrue and, in some people's minds, that is a fairly significant amount. But the parliament has enacted laws that require that tax that is assessed is due and payable and, if it is not paid on time, a general interest charge accrues. That becomes quite significant over a period of time.

Mr COX—But some taxpayers do not pay their tax until the matter is either litigated or settled.

Mr Fitzpatrick—That is certainly correct: some people do not pay their tax in full until the matter is resolved.

Mr COX—Are you finding increasing numbers of cases where people are disputing your assessments and it may have been easier for the tax office, and more certain for the taxpayer, if legislation had been passed to cover the areas in dispute?

Mr Fitzpatrick—In the areas we are talking about, in high wealth individual cases, a lot of the transactions which are disputed and a lot of the issues which are disputed are quite complex. The arrangements and transactions themselves are complex, as I am sure you would appreciate. There are some large private company groups. The application of the law to those facts often is unclear. It is uncertain because of the complexity of the transactions. It would not always be fixed by an amendment of the law. The law contains general principles as to whether deductions are allowable and when income is derived. Those principles are applied and sometimes it is difficult to agree on the application of the law to the particular facts of the case. In my view, there is not always a need to amend the law to resolve those complex disputed cases. The courts have a role to play, of course, as we all know, in helping to clarify the application of the law to particular arrangements, transactions and facts of cases.

Mr COX—How often do you have litigation with high wealth individuals and have to use the general antiavoidance provisions?

Mr Fitzpatrick—We have used the general antiavoidance provisions in a number of cases, not all of which have proceeded to litigation. As has already been noted, some cases have been resolved by settlement or by the taxpayers conceding. But in position papers we would have put to some taxpayers, we would have raised the application of the antiavoidance provisions in some of those cases.

Mr COX—In some of those cases have the activities that those taxpayers been engaged in been the subject of advice to government which suggested legislative changes?

Mr Fitzpatrick—We have advised the government, as is noted in the report and in our annual report, on areas of the law where we believe that people are able to minimise tax—some quite legally, certainly. We have attempted to identify the systemic drivers of tax planning, looking for systemic approaches to addressing some of those practices through legislative change—not piecemeal, ad hoc changes to the law. That is not, in my view, the way to go in order to develop a more certain tax code which is more understandable for taxpayers generally. We have looked at the tax planning practices over the period of time and, as the Auditor-General's report notes, at the systemic areas of weaknesses in the law and provided advice accordingly. It is for government and the parliament to decide whether it wishes to change the law to remedy what we see as areas where taxpayers are able to minimise tax—as I said, some quite legally.

Mr COX—At the moment there are a number of outstanding areas where you have submitted advice to government and it has not been acted on yet?

Mr Fitzpatrick—We have provided advice to government over a period of time. Government has announced changes to law and the parliament has passed changes to law in respect of some of that advice. It has foreshadowed reforms arising out of the Ralph review of business tax. Some of those measures have been enacted. I mentioned before those loss integrity measures in particular. Others have been foreshadowed by government.

Mr COX—Or deferred.

CHAIRMAN—Has it ever been any different from that?

Mr Fitzpatrick—In general terms, no.

Mr COX—The issue is whether there is a significant volume of advice going from the tax office to the government that the government is choosing not to pursue, and whether a substantial amount of revenue is being put at risk or remains in jeopardy because of that lack of action.

CHAIRMAN—May I suggest that you ask the Treasurer that?

Mr COX—I will get around to that. There is an assessment on page 61 of the report, which states:

> The identification and risk profiling of HWIs is on-going. The list of HWIs has grown to more than 500. As reported at paragraph 2.44, the taskforce has concluded that, on the basis of its risk analysis activities, a significant proportion (approximately 50 per cent) of HWIs examined require on-going monitoring by the taskforce.

If the number of HWIs is growing substantially, what sort of increase in your resources do you need to make sure that they are all given proper risk-weighted attention?

Mr Fitzpatrick—I am not sure that I would necessarily agree that the list of HWIs has grown to more than 500. I will explain. We look at an area of the population that we call 'high wealth individuals'. What does 'high wealth individuals' mean? Three or four years ago when this task force was established, we looked at people who, based on our evidence, controlled wealth of

around $30 million or more. We do not have expert evidence on everybody's wealth but we base it on that sort of risk management approach. The list was about 500 four years ago. As time goes on, some people are no longer wealthy and others emerge and become wealthy. Some people die.

Mr KELVIN THOMSON—Are any of these things due to the activities of the task force?

Mr Fitzpatrick—I cannot answer that, Mr Thomson. One of the areas we continue to look at is the emerging wealthy: people who have become, or who we think have become, wealthy in recent times. What are some of those people doing as far as tax compliance is concerned? We look at that population, which is about 500, at a particular time. As is normal within the tax office, we generally take a risk management approach to which cases should be looked at more fully. We have gone through a fairly comprehensive process over the last four years, including questionnaires and requiring expanded taxation returns to examine the risks, and we make assessments of risk. Some taxpayers are looked at very closely. There are comprehensive audits of the whole group's affairs. Others are monitored by way of more detailed information and tax returns each year. In other cases, we might do some audit work on a specific issue. So the range of our activities varies across the population.

Mr COX—On page 35, paragraph 2.44, the auditor says that you have looked at 300 HWIs over the first three years. Would it not be reasonable for us to assume that, if you have identified 500 HWIs and half of them require ongoing monitoring, it is likely that the job is growing and that more resources will be needed?

Mr Fitzpatrick—I do not think it necessarily follows that the job is growing. Like any area of the population, the tax office makes assessments of risk and allocates its resources based on those assessments. Resources are not never ending: we know that we have an allocated budget that we work within. We are comfortable with the resources that we are allocated to look at this area of the population. As I said, it is not just the task force of 120 people within the tax office at this point of time; there are others whom we can call on to assist us in that work.

Mr COX—I think it is a legitimate concern for this committee that such a substantial part of the funding in this area is determined by a resource agreement with the department of finance.

Mr Fitzpatrick—No, I do not think that is correct. There is no resource agreement with the department of finance. Perhaps I did not answer your previous question correctly—or at least clearly. That Department of Finance memorandum of understanding related to the additional funding provided by government for four years. We have no agreement with the department of finance specifically on resources allocated to the task force at this point in time.

CHAIRMAN—You did say before—and I made a note of it—that this area of your responsibility, like every other area, is now just part of your budget.

Mr Fitzpatrick—That is correct.

Mr COX—But what the audit report says about the MOU—

CHAIRMAN—It had finished.

Mr COX—is that you were receiving money and expected to report certain revenue outcomes on the basis of that.

Mr Fitzpatrick—Of that additional funding provided over that period of time by government. But that funding ceased at June 2000. That additional funding which the government provided in, I think, the 1996-97 budget for a period of two years was extended for a further period of two years, as a task force was established and undertook its comprehensive look at this area of the population. As I indicated before, we went through a very comprehensive approach to questionnaires and other information to determine what was happening, where the risks were and how we would address those.

Mr COX—But that MOU effectively determined how much activity there had been in this area, didn't it?

Mr Fitzpatrick—No, it did not. As I said, it was not just the task force and that additional funding provided by government which we used to look at high wealth individuals. There were other resources from the ATO's base funding which were also used to look at high wealth individual cases. So the department of finance memorandum of understanding did not determine how much the ATO allocated to this area of the population.

Mr COX—Were you involved in negotiating the MOU?

Mr Fitzpatrick—I was involved in the development of the memorandum of understanding; that is correct. But it was a reporting mechanism more than anything else, because of the additional funding provided by government. I would not have seen it as a negotiation.

Mr COX—It seems a pretty explicit MOU. I have been involved in negotiations with the tax commissioner about the ATO's running costs and how much extra money he would like to have—never to the point of a written, formalised MOU requiring certain outcomes from a specific area. It seems a concern to me that, far from being a device to assist the tax office in the proper conduct of its duties, it might have been a device to confine the amount of activity that was done in that area.

Mr Fitzpatrick—That is not correct, Mr Cox. I would regard the memorandum of understanding as a reporting by the tax office to the Department of Finance and Administration on the allocation of that additional funding and what was being achieved with that additional funding. It did not determine how many resources were put into looking at high wealth individuals in the tax office.

Mr COX—But the money was given to you for the High Wealth Individuals Taskforce.

Mr Fitzpatrick—That is correct, and we use that money for that purpose— as well as using other base funding resourcing for that purpose.

Mr KELVIN THOMSON—My first question is to the tax office, through Mr Fitzpatrick. The Audit Office's report to us, in terms of this discrepancy between the $800 million a year that was initially said to be at risk in relation to high wealth individuals and the $100 million a year which has subsequently been accounted for and collected, suggested that the $800 million

was seen as potential revenue at risk of being lost if no legislative action was taken against the range of tax planning and minimisation practices employed by some high wealth individuals. It goes on to say that advice by the task force to government has resulted in some legislative initiatives. Can you itemise the pieces of legislation that we are talking about that occurred as a result of that advice?

Mr Fitzpatrick—In the Auditor-General's report at page 57 it said:

In recent years the Government has introduced a number of legislative measures to remove tax minimisation opportunities formerly available to HWIs (and other taxpayers)

Not all of those measures came about as a result of advice from the High Wealth Individuals Taskforce; some of them may have come about partly as a result of that and partly from other areas of the organisation or Treasury. Some of them, R&D syndication, would have been before the task force was established.

I mentioned earlier, Mr Thomson, that the loss integrity measures which came out of the Ralph review on business tax have been enacted. That was referred to by Mr Cox in the report here as an area which we believed was being utilised by some high wealth individuals and other taxpayers as a means to minimise tax, and that has been addressed by legislative means.

Mr KELVIN THOMSON—Does the tax office have some feel or estimate for revenue which has been either collected or saved as a result of the measures to which you have referred?

Mr Fitzpatrick—I have got no estimate of the revenue impact of those measures.

Mr KELVIN THOMSON—It is a highly relevant question as to what has become of the $800 million and the $700 million gap between what was said at the start of 1996 and what was subsequently reported as to whether the measures that are outlined here and to which you have referred have been able to generate or save the $700 million. So my query is: do you have some feel for that?

Mr Fitzpatrick—Certainly the measures outlined here, and I have referred to previously, will have an impact on the revenue which we estimated to be at risk in respect of some high wealth individuals arrangements. From our experience it is clear that some of those taxpayers will look for other opportunities on an ongoing basis. We need to be alert to those as best we can to address whatever new opportunities arise, and that is certainly a clear focus of our intention at the moment.

Mr KELVIN THOMSON—It is not particularly satisfying to me for you to respond that it will have an impact and for me or others not to be able to get any feel for the quantum of the impact, the dimension of it, whether it goes to the $700 million gap or it does not. I might direct the same question to Mr White from the ANAO in terms of the Audit Office investigation of this area, whether you then get from this some suggestion as to whether these legislative measures have been effective in recovering the $800 million or whether they have not.

Mr White—Our report in discussing the $800 million makes it clear from the information we saw from the tax office that the $800 million is an order of magnitude estimate of revenue that

could be gained from both audit activity but also from various legislative changes if they were to occur. What we did as part of—

Mr COX—Whether it occurred in the last five years, yes.

Mr White—What we did as part of the audit was to specifically look at the direct and indirect revenue measures that the government required for the additional funding, the outcomes, and we reported back on that. We commented in the audit report that the task force had contributed to various legislative changes. We were unable to quantify a financial amount in terms of the legislative changes, the impact thereof. I think it would be a fairly difficult thing to do.

Mr KELVIN THOMSON—Nevertheless, one of considerable public interest as to whether the $800 million has been addressed or whether it has disappeared and the high wealth individuals are still not paying their fair share of tax. In the legislative changes which are proposed here, there is the reference to entity taxation and, as David Cox mentioned, this legislation has not yet been passed. It stands to reason, doesn't it, that the delay in entity taxation must be costing the revenue money, given that it is identified as a way of addressing tax avoidance by high wealth individuals?

Mr Fitzpatrick—To the extent to which high wealth individuals or other taxpayers use trusts to minimise tax, that would be correct.

Mr KELVIN THOMSON—It has been suggested here that this is quite a major way in which high wealth individuals avoid paying tax.

Mr Fitzpatrick—Certainly some high wealth individuals, yes.

Mr KELVIN THOMSON—Therefore, the delay in the passage of that entity taxation legislation is costing the revenue money and, indeed, has been for every year since this matter was first reported.

Mr Fitzpatrick—I should also add that some measures relating to trusts have been enacted. Trust losses, which received considerable debate within the community and parliament at the time, a few years ago, have had some impact as well in this area. My colleague Mr Tucker reminded me that, in talking about revenue, it is not just the revenue from legislative change; it is not just the revenue from what we call audit results. Our annual report and the Auditor-General's report also referred to the indirect revenue, which, essentially, is the impact in our estimate of the ATO's actions in examining some high wealth individuals. I would call it improvements in voluntary compliance. That is referred to in the Auditor-General's report, and it is referred to in the commissioner's annual report. We should not lose sight of that aspect of improved compliance as well when we are talking about revenue in more general terms.

Mr KELVIN THOMSON—I do not want to lose sight of it, but I just cannot get any quantification of it.

Mr Fitzpatrick—In the annual report of the commissioner, there is a quantification of our estimate of the improved compliance which we call the indirect revenue impact, as well as the direct revenue through audit results.

Mr KELVIN THOMSON—You have referred to the area of trust losses and legislation that has been enacted there. To go back to my earlier question, do you have some kind of feel or estimate for the revenue that is saved as a result of the enactment of that legislation?

Mr Fitzpatrick—Offhand, I do not have an estimate of that amount. There would have been estimates made at the time the legislation was introduced into the parliament of the impact of that particular measure across all taxpayers, not just high wealth individuals. As is usually the case, as I am sure you appreciate, there is an estimate made of any legislative amendment of the revenue impact. There has been no attempt, to my knowledge, to estimate the impact on high wealth individuals and other taxpayers. I do not think that is possible.

Mr KELVIN THOMSON—Somewhere we got the $800 million figure and it is germane to whether the $800 million is being collected, saved or not. When you identify the area of trust losses as being significant and say that action is taken in that area, it is interesting to me and, I am sure, to the broader public to get a feel for what kind of revenue is addressed as a result of that mechanism. Does it deal with 50 per cent of the problem, 10 per cent of the problem or something else? That is the sort of thing that does interest me about the legislative steps that you have referred to.

I have a couple of further questions on the issue of resources to the Audit Office to Mr White. In the light of your examination of this high wealth individuals area, is it your view, or that of the Audit Office, that extra resources would lead to higher revenue?

Mr White—From looking at the area and, as you probably know, when we are doing our performance audits, we do look at resource applications but, at the end of the day, those resourcing decisions are made by the tax commissioner.

Probably as close as we came to discussing the adequacy of the resources to the task force relates to that recommendation 3 of our report. We had seen the additional funding occur and it ended in June this year and what we were saying there was that we believed from what we saw that the tax office had a group of people—around 120 to 130—who had developed expertise in looking at a particularly complex area of tax administration, tax law, that relating to high wealth individuals. We believed that expertise was certainly worth keeping, and hence our recommendation 3 was along the lines that, even though the specific funding might be ending and that while it would be a risk management decision for the commissioner, we thought that it was well worth while continuing the work of the task force.

Mr KELVIN THOMSON—Mr Fitzpatrick said that budgets, or resources, are finite, but it is my impression—I do not know whether or not others agree—that in fact resources in this area do not cost money, they make money; that they generate additional revenue as a result of the application of extra resources. I do not know whether you are in a position to comment on that, but it is certainly my impression that, if you put more resources into this area, it is not going to cost revenue, that it actually ends up making money.

Mr COX—A dollar would get you $10 when I used to negotiate with the tax commissioner.

Mr McPhee—Over the years the tax office has received a range of funding for new policy initiatives. My prior position was in the department of finance, and one of my areas of responsibility was to look after tax office resources. You will not be surprised to know that the finance view—which was pretty basic at the time; I am sure it is more refined these days—of what the tax office was saying often was that, as David Cox has said, one dollar would make you $10. So the finance line was always, 'You can reallocate resources from within your existing budget from low revenue earning areas to high revenue earning areas, so you do not need to go to government for new funding.'

That is a very basic, even crude, perspective, because it does not recognise the important work the tax office does in education and in encouraging greater compliance. But in response to your question, it is never easy for government to handle that particular issue. As Mr Fitzpatrick has mentioned, the tax office uses a risk profiling approach to determine the allocation of resources. I think it is pretty hard to argue conceptually with that, although there is always the view that, if you can continue to make $2 for every $1 you put into the tax office, why doesn't the government pump in another $500 million to make more?

Senator MURRAY—It is the marginal cost argument.

Mr McPhee—Yes. These are very difficult decisions for government, and they get made in the budget context.

CHAIRMAN—We look forward to your announcement of something like $500 million extra spending on the tax office were you to win government at the next election!

Mr KELVIN THOMSON—I just want to stop those constituents coming to your office, Bob, complaining about high wealth individuals getting away with it. I think you have identified a problem there, and I support you absolutely. Can I just close my questions on that issue by raising the question of the actual extent of resourcing to be provided into the future. I suppose this is a question for the tax office. What ongoing or continuing resourcing for the high wealth individuals task force is intended?

Mr Fitzpatrick—My colleague, Mr Tucker, mentioned before some figures. There are about 120 people, with additional administrative costs and legal costs associated with that for this current year. It is certainly a clear decision of ours that we will continue with this task force approach of looking at high wealth individuals. Each year we make assessments of risk, as we have already discussed, as to where to allocate our resources. Obviously, the tax office, as I am sure you appreciate, has a major job at the moment in implementing tax reform. A lot of our resources go towards that. We have other risk areas, the cash economy, for example. We allocate those resources, as has already been discussed, on a risk management approach each year, but clearly we have made a conscious decision to continue with this area of our work.

Senator MURRAY—Mr Fitzpatrick, it seems to me that it works like this. In your work you identify in due course tax loopholes which are significant enough that you think they should be closed. So you make a recommendation to government and you put up an estimate of what you think the revenue effects of closing that loophole would be, and probably make other judgments

as well. If the government accepts your argument then the question is simply the one Mr Thomson was alluding to as to whether they act speedily enough. However, if they do not accept your judgment, having been apprised of the tax loophole, it would mean that they therefore think there is a benefit to that tax situation and it therefore, in my view, moves from being a tax loophole to a tax concession, because if you know about it and you do not consider it a loophole it is a concession. So for me, tax loopholes that are known and deliberately not closed effectively become tax concessions, and therefore to me it means that they should be measured. The advice which you have put to government and which government have rejected, which you consider loopholes, would therefore be concessions. Surely, the cost of those concessions should be known to the parliament and to the public; otherwise we have got no means of identifying it.

Mr Fitzpatrick—And you want me to respond to that, Senator Murray?

Senator MURRAY—Your argument was absolutely proper. You said, ‘When we give policy advice to the government we cannot release it.’ That is so throughout the whole of government. However, when you have given policy advice to the government on a tax issue and government decides not to follow your policy, only you and they know—assuming we have not found it out through other means—that this exists. And on the logical approach that I have taken, the government of the day would have taken the view that they want to keep the tax loophole because they think it is beneficial, in which case I say to you it is a tax concession, not a loophole, and I want to know how much it is. Don’t you think, in those circumstances, you should be releasing that information in your annual reports?

Mr Fitzpatrick—To the extent to which it is reasonably measurable, I can understand the logic of your argument, Senator. But it depends on what information is available. If the government of the day decides that a particular concession continues to be available, or there is no need in its view to change a particular area of the law which the tax office might believe enables people to minimise, as distinct from avoid or evade taxes, we do not necessarily then continue to look at that particular area so we can properly measure what is going on. The decision has been made. This is a legally available way of reducing one’s tax. We are not going to devote significant resources to see what is then happening. There might be some exceptions to monitoring over a period of time. Some of the areas where we would advise government over periods of time would relate to specific concessions in the law, like the R&D concession, which the government a few years ago decided to change because of what we saw as being the rorting of the syndication arrangements. To some extent those concessions in the law are estimated by Treasury, and reported.

Senator MURRAY—Yes, but the point I am making is that where an R&D policy in that instance had been devised by government, they had in fact costed what they regard as a concession, so it was publicly available. I am making the reverse point. You identify a loophole. We do not know about it. If the government of the day says, ‘We are happy with that loophole,’ the rest of the parliament, who might not agree with the government, do not know about it. I will leave it at that. I just put it as an issue, that you know things that we do not find out.

CHAIRMAN—Mr Fitzpatrick, in answering that, isn’t it true that a loophole in the eye of one beholder may not be one in another? Isn’t it true that the Treasurer, in considering

legislation in this area, or the Assistant Treasurer, will take advice from the tax office, from their own department, from their own resources and from the community?

Mr Fitzpatrick—I would say that you are correct.

CHAIRMAN—I recall very strongly that, when this committee examined the TLIP bills, to rewrite the tax laws in plain English—and I chaired the sessions on capital gains tax rewrite—in the industry itself, the tax office, Treasury or anywhere else there was not absolute uniform agreement on anything, nevertheless everything.

Mr Fitzpatrick—I think it is fair to say that the tax profession does not always agree with the tax office on whether a particular area of the law is a loophole or not. There is a lot of debate on whether a particular piece of law is appropriate, whether it is tax avoidance or not tax avoidance, whether it is being exploited or otherwise. Certainly, you are correct that the government takes advice from others beside the tax office, of course, and Treasury is clearly an area and a department where they do take advice on tax policy.

Senator MURRAY—Let me cut you short because I want to carry on with my line of questioning, if I may. My simple point to you is this: I do not think it is proper for the tax office and the government to be the only people knowing that there is a revenue consequence in terms of what you have identified to be a loophole, and that is not then publicly known if the government decides to do nothing about it. I will leave it at that because I can see this could end up as a debate. That really was Mr Thomson’s point.

The other question I want to ask you relates to lags. As you know, when announcements are made by the Treasurer as to what he will do, that can constitute the date from which a tax event will occur. At other times, it is the date of assent. At other times, it is the date of the transitional provision. So consequently there are lags in the effect of changes. You have given the ANAO, which they have reproduced at page 51, a medium-term picture of the change in net tax paid by HWI companies and other private companies over five years, and that reflects a favourable picture. Wearing other hats, I read a great deal of economic material and they pack their analyses with charts and graphs and all that sort of thing. In terms of the measurement issue that Mr Thomson and the chair were identifying, which is the community are demanding we and you do something about this problem, we need to be able to go back to them and say, ‘The result of this measure has been that.’ We also need to identify to them the lagged effect. In other words, we might take a measure today but it might only actually take effect in 2003 or 2004, and in the next three years they are still moaning about it even though we have done something about it. My question to you is: are you properly charting, recording, graphing and analysing for good reporting on what is an extremely sensitive community area the leads and lags—it is principally lags—in terms of legislative and other policy changes in this area?

Mr Fitzpatrick—I do not think that we could say that could give the parliament an estimate of the revenue resulting from the lag effect—and that is your term, Senator—between announcement and the particular enactment of the change of law. We certainly do monitor what the taxpayers are doing in that period of time and, as you said, some of the measures do have transitional provisions. In the area of the taxation of trusts, as I recall, there was an announcement that early in 1999 certain activities involving discretionary trusts would be impacted if taxpayers ordered their affairs in a way to prepare for the change of taxation of

trusts at a later period. In other areas, there is no transition provision—I would certainly have to look at it—but I do not think we would be in a position to give you reasonable estimates of the revenue. Many of the measures from that—

Senator MURRAY—You make projections. Every time we receive a bill—for instance, the trust losses bill—there is a financial estimate. We want to know two things as legislators: firstly, when the real effect of that comes in—and it is, generally speaking, following a financial year, but sometimes it is not; sometimes it is relative to the company's financial year, not our audited financial year—and; secondly, if the effect of the measure is equivalent to the projection, which is very important. I think that quantifiability and the time series effects of these things really do need to be identified. If there is a shortcoming in this entire report, for me, it is that.

There is no forward projection; there is no time event analysis; there is, as has been outlined earlier, a very useful kind of checklist on page 56, paragraph 3.39, of all the areas the Audit Office think should be examined. But this is an extremely sensitive area. Every parliamentarian in this country gets those letters which say that somebody very large and very powerful is not paying their fair share and people then say, 'Why am I?' We need to react to it, and you need to react to it. So I think the points have been made before, and I just want to reinforce them.

Mr COX—Andrew, can I reinforce your point by just asking the ANAO to confirm a couple of things about the first chapter of this report?

Mr Fitzpatrick—Mr Cox, before you do, could I just mention one point in relation to Senator Murray's point about 3.39? Those areas or planning techniques are not necessarily areas we have advised the government to do something about in the law.

Senator MURRAY—I understand that, but they include some of them, though.

Mr Fitzpatrick—The names of some of them, but some of those are obviously areas which a number of taxpayers, including some high wealth individuals, use to minimise their tax quite legitimately. It does not necessarily follow that, in our view, the law should be changed to address all of those.

Senator MURRAY—In that case, it is a deliberate tax concession.

Mr Fitzpatrick—Tax deductible gifts are a deliberate concession, quite clearly. We are not saying the law should be changed to deny deductible gifts, for example. I just was not quite sure whether it was a misunderstanding, that is all.

Senator MURRAY—No, I do not misunderstand it.

Mr COX—I think some of us are concerned by the line of questioning that we have pursued about the amount of effort that the government is putting into this area, whether it is legislation or whether it is resources. I just refer the ANAO officers to page 20 of their report, where they discuss the $800 million and describe it as revenue potentially at risk. You might like to confirm that the reason that that is in italics and indented is that those are actually the Treasurer's words, aren't they?

Mr Fitzpatrick—Yes.

Mr COX—You refer in your report on page 24 to outcomes that the government was required to achieve—the outcomes are listed on page 47—which was the $100 million in additional revenue in each of 1997-98, 1998-99 and 1999-2000. So they were outcomes that the government required the task force to achieve. They were not an assessment of the revenue at risk. For the benefit of history, I will just read one paragraph from the former Treasurer's press release when he advised the Australian community in 1996 that there was $800 million outstanding. He said:

By January 19, 1996, the ATO and Treasury were able to advise that on the basis of the work undertaken to date in respect of 100 wealthy individuals alone, appropriate measures to deal with a range of specific tax minimisation techniques using trusts would produce additional revenue of at least $500 million. Later, at a meeting on January 23, 1996, Treasury gave me verbal advice raising that estimate to $800 million. Some amount could be forthcoming in 1996-97, but the first full year effect would be in 1997-98.

Nothing has been said that indicates that that is not the potential.

Senator MURRAY—My last question is just on an observation, if I can get it from you, Mr Fitzpatrick. The principal means of arranging tax affairs is to maximise the use of law, if you like, within particular structures or entities. We tend, in these discussions, to focus on tax law, but other law changes have major effects on structures and entities and on the general economic configuration. I am thinking of Corporations Law, which has had two major changes in the last four or five years, and finance law—all the things to do with the way in which those markets are affected. Are you able to tell the committee whether those law changes in other areas at all affect how the high wealth individuals are structuring? In other words, you have seen effects that you did not expect to arise from, say, changes to mergers or capital gains incentives—all those sorts of things—so are we looking here at some historical data which might change in the future because of changes to other laws?

Mr Fitzpatrick—We certainly take note of other changes which might impact on a person's tax affairs in the sense of their tax compliance. I am not able to say today whether we have seen any significant change as a result of changes in other areas, such as in Corporations Law, to the way people organise their affairs from a tax compliance point of view. Certainly, they would be impacted. You mentioned capital gains, which are obviously part of the tax law, and there is no doubt that people will be looking to maximise their advantage through changes in the capital gains tax area of recent times. We expect to organise, or structure, the groups to take advantage of that. That is something which we need to be, and are trying to be, alert to in a real time sense; to see what effect those changes, whether they be tax laws or other laws, are having on structures and how that impacts on tax compliance.

CHAIRMAN—Could you tell the committee whether the task force met its revenue outcome for 1999-2000?

Mr Fitzpatrick—Yes, it did. The commission's annual report referred—

CHAIRMAN—We have not read the annual report yet.

Mr Fitzpatrick—Okay. I will refer to it, if I may.

CHAIRMAN—Certainly.

Mr Fitzpatrick—Following on from the Auditor-General's recommendations, we have attempted to report on revenue outcomes in a consistent way. This year we have certainly outlined in the Commissioner's report both what we call the direct revenue, which is the result of audit activities, and our estimate of the indirect revenue, which, as I discussed before, was our best measurement of the voluntary improvement in compliance. Certainly, you will see from that report—when you get a chance to look at it—that, if the target was $100 million per year, the revenue figures suggest that that has been met over the period of time.

CHAIRMAN—Thank you.

Ms GILLARD—In paragraph 2.34 on page 32 of the audit report there is a description about the number of entities associated with high wealth individuals. In the first dot point it discusses the number of discretionary trusts, fixed trusts, et cetera. The Ralph integrity measures, as I understand, recommended that trusts be taxed as companies, whereas the entities exposure draft has limited that to discretionary trusts; is that right?

Mr Fitzpatrick—Yes; that is my understanding.

Ms GILLARD—Following the line of questioning from Senator Murray, we will never really know the costs to revenue of the decision to exempt fixed trusts, unit trusts, from the Ralph integrity measures and having their tax rates equalised with the company tax rate, will we?

CHAIRMAN—Neither will we know of the cost—because you never did anything about trusts, ever.

Mr Fitzpatrick—It is certainly our experience, not just with high wealth individuals, but focusing on that area of the population, that the minimisation of tax has occurred through the use of discretionary trusts, essentially.

Ms GILLARD—That is not true in the employee benefit arrangement area, particularly share schemes that are reliant on fixed trusts?

Mr Fitzpatrick—I do not think many high wealth individuals have used employee benefit schemes to minimise their tax, to my knowledge—there probably are exceptions.

Ms GILLARD—There are probably a few people who became of high wealth as a result of those arrangements.

Mr Fitzpatrick—My understanding of that is that discretionary trusts are used there, for some of the schemes we have identified. The extent to which high wealth individuals or others use fixed trusts in the future is an unanswered question in the sense of tax minimisation. Clearly, we would be looking to see what happens there, if the law passed by the parliament is, as you have indicated, as in the exposure draft. In summing up and trying to answer your question, it is the area of discretionary trusts which has in the existing law enabled people to minimise tax more than fixed trusts have.

Ms GILLARD—I accept that, in the high wealth area, that is right.

Mr Fitzpatrick—But more generally that is the case too. It is not just high wealth individuals.

Senator MURRAY—It is low wealth ones as well.

Ms GILLARD—I accept that. But, to the extent that we are aware that there are some tax avoidance arrangements that rely on fixed trusts, there is a problem. Senator Murray's point that if government decides—something like the Ralph integrity measures—to take fixed trusts out of that pool, we will never know in current processes what the cost to revenue of that decision was.

Mr Fitzpatrick—It may depend on what people do to arrange their affairs, responding to whatever reforms are passed by the parliament. As I indicated to Senator Murray, clearly our role has to include monitoring the emergence of new arrangements which we expect some will try to enter into as a result of whatever reforms are passed by the parliament.

Ms GILLARD—So you could see a movement from discretionary trust arrangements to fixed trust arrangements because they are not in this legislation.

Mr Fitzpatrick—I do not know to what extent. It depends on what is finally passed by the parliament in the area of taxation of trusts.

Mr COX—In the work of the high wealth individuals task force you are generally dealing with areas that are not related to private binding rulings, aren't you?

Mr Fitzpatrick—Very few high wealth individuals and their advisers have sought private binding rulings. There have been some, but not many.

Mr COX—With respect to reporting of the revenue and the activities, I have not looked at the annual report, but would it be possible for the reporting of payments by high wealth individuals independent of the task force action to be reported separately but together with the revenue that resulted from task force action, so that people could see the full extent of what high wealth individuals were paying and how much of it was the result of enhanced enforcement activities?

Mr Fitzpatrick—I am not sure I quite follow you. Are you saying to in the future report separately?

Mr COX—You have 500 people here you have identified as high wealth individuals.

CHAIRMAN—Are you asking how much tax those 500 people pay?

Mr COX—Collectively, yes.

CHAIRMAN—That is his question: how much tax the 500 people are paying and how much of that is due to specific activity by the task force.

Mr Fitzpatrick—We are trying to report what we see as the increase of revenue in the population of high wealth individuals, both directly through audit activities in the ATO, including some activities outside our task force, and what we see as improvements in voluntary compliance. That is the best estimate we can provide, which we call the indirect revenue impact. In our terms, that provides the measurement of the increased revenue from the high wealth individual area of the population—

Mr COX—As a result of your activity?

Mr Fitzpatrick—As a result, in our estimate, of the ATO's activities, which improves compliance with the law at the time. I am not sure that I have—

Mr Tucker—I would like to make a comment, Mr Cox. One issue might be that the wealth of many high wealth individuals is represented through their shareholding in public companies, for example. Those public companies pay tax. There are a lot of issues in trying to get the best measure of the tax that is paid by that individual. We are looking at ways to try and enhance our reporting, but there are many issues. There are family groups, for example, where it is difficult to say which individual actually has the wealth and so on, but we are looking to try and improve those reporting areas.

Mr COX—Thanks. That is very helpful. My final question relates to page 41 where you go through the process of negotiation with a high wealth individual or entity group. The second dash point says that you develop a position paper, including a record of the task force's view as to the amount of tax payable—then you begin your negotiation with them. That view is not an assessment of the tax payable, is it? So if you negotiate a lower figure and settle, does that become the assessment?

Mr Fitzpatrick—That is often the case. Let me explain what does happen there. This applies more generally to beyond high wealth individuals. This is the tax office's approach to particularly the large business end, including high wealth individuals. When we do an audit, we look at the issues obviously and come to a view based on the facts available as to how we see the law applying. We then issue what we call a position paper, which outlines the facts as we understand them and our view of how the law operates or applies to those facts; and we would generally propose to amend assessments in accordance with that view. We enable taxpayers and their advisers to respond to that and tell us where we have got it wrong, on either the facts or our view of the law. As you have indicated, that is generally done before any amended assessments are issued.

Sometimes the taxpayers or their advisers come back to us and we accept that we got the facts or the law wrong and an assessment might be issued for what would be a lesser amount than otherwise would have been the case pursuant to our position paper. Sometimes there is a settlement discussion of what should be the right tax outcome. Sometimes there is no agreement and assessments are issued and there may well be litigation or subsequent discussions at a later stage which resolve a case. That is the process by which we operate. Has that answered your question?

Mr COX—That is clear about how you operate it, yes.

CHAIRMAN—Thank you very much.

Ms GILLARD—Will the tax office model the revenue effect of not applying company tax rates to unit trusts if the exposure draft ends up being the draft for the bill?

Mr Fitzpatrick—That is probably a question you should direct to the Treasury, I would have thought.

Ms GILLARD—So the ATO would not model that?

Mr Fitzpatrick—Not necessarily. We would need to look at whether there would be a risk to the revenue through the use of fixed trusts. We would need to make some judgments about that. I have got no view about that at the moment. As I said earlier—

CHAIRMAN—That is a policy issue for Treasury, isn't it?

Mr Fitzpatrick—It is a policy issue—that is right. On our experience to date, our view is that the use of discretionary trusts is much more prevalent for minimising, as distinct from avoiding or evading, taxation.

Senator MURRAY—But the question is whether you or Treasury actually have a model capable of saying, 'If we did this as Ralph recommended to both discretionary and fixed trusts, this would be the revenue effect. If we only did it to discretionary trusts, this would be the effect.' My judgment is that neither you nor Treasury have that modelling capacity. I might be wrong, but that is what lies behind the question.

Mr Fitzpatrick—I cannot answer the question, Senator. There may well be within the Treasury a model which can do that, I just do not know.

CHAIRMAN—Thank you, ladies and gentlemen. We will suspend the hearing until about 2.30 p.m., but we will reassemble at 2.00 p.m. to talk to our friends from ANAO about the F/A-18 Hornets.

Proceedings suspended from 1.10 p.m. to 2.28 p.m.

[2.28 p.m.]

BLACKBURN, Air Commodore John Nicholas, Director-General, Policy and Planning, Royal Australian Air Force, Department of Defence

DEVINE, Air Commodore Paul Francis, Commander, Tactical Fighter Group, Royal Australian Air Force, Department of Defence

KOPP, Dr Carlo, Defence Analyst

McPHEE, Mr Ian, Deputy Auditor-General, Australian National Audit Office

MULLER, Mr Anton, Audit Manager, Australian National Audit Office

CHAIRMAN—We now come to the final audit report to be examined in today's public hearing. I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will be recorded by *Hansard* and will attract parliamentary privilege.

The audit report being considered in this session is Audit report No. 40: *Tactical fighter operations*. Tactical fighter operations form the basis of Australia's current military capability to ensure air superiority. Air superiority over the Australian territory and maritime approaches is an essential element in Australia's defence strategy. Matters dealt with in Audit report No. 40 examine issues that are essential to Australia's regional security. The committee places a high priority on matters relating to Australia's defence. We have previously examined the Jindalee Operational Radar Network and Collins class submarines. Australia's air defence strategy is no less important.

To begin the public hearing I will hand over to Dr Carlo Kopp, a defence analyst from Monash University, who will provide a presentation on air superiority, regional competitiveness and tactical fighter operations. Could I remind everybody that, come 4 o'clock, we are going to turn into pumpkins, so we want to be as concise as possible, thank you.

Dr Kopp—In Audit report No. 40, section 5.22 raises the issue of competitiveness of the F/A-18 against regional capabilities. This short submission will cover two principal areas. The first is that of the regional proliferation of late generation Russian combat aircraft and missiles. The second is a short analysis of the competitiveness of the F/A-18 in comparison with developing regional capabilities and related issues of force structure.

Overhead transparencies were then shown—

Dr Kopp—The best starting point is to place the role of the F/A-18 into its proper context. This aircraft is Australia's air superiority fighter. Air superiority is domination in the air whereby the effects of enemy air power are defeated or nullified on the ground and in the air. Without air superiority, enemy aircraft can attack RAAF aircraft on the ground and in the air,

frustrating the RAAF's ability to strike at hostile land and maritime targets and preventing the RAAF from performing maritime patrol reconnaissance, antisubmarine warfare, aerial refuelling and airlift operations. Without air superiority, enemy aircraft can attack RAN surface warships, submarines and commercial shipping lanes. Army land forces can be attacked, as can the nation's economic infrastructure, ports, airports and population centres. Every nation which lost air superiority during the 20th century suffered grievous losses and most often lost the war in question.

The necessary ingredients for achieving air superiority are: superior fighters, superior radar, missiles, pilots, tactics, doctrine, superior airborne early warning and control, superior surveillance, ample aerial refuelling, superior electronic combat capabilities and the ability to destroy as many of the opponent's aircraft on the ground as possible. In short, air superiority is the product of a complex mix of systems and skills.

The ability to achieve air superiority will become increasingly important for the ADF as broader regional capabilities continue to build up in the coming decade. The dramatic growth in regional air power and missile capabilities over the last decade is a direct consequence of the break-up of the Soviet Union. Russia is bankrupt and, as a result, is dumping the very best weapons it can produce into Asia in very large numbers.

The Sukhoi Su-27 and Su-30 fighters are the Russian equivalent to the Boeing F-15, which is the finest Western air superiority fighter in operational service. With advanced aerodynamics, large internal fuel load and range, powerful engines, a large radar and potent missiles, the Sukhoi fighters are a direct challenge to the F-15 supremacy and more than a match for many lightweight fighters such as the F-16 and F/A-18. India has standing orders for up to 200 of these fighters, while China is pursuing an ambitious program to field up to 350. To place this in perspective, the United States air force fielded around 400 F-15Es. Malaysia has been negotiating for the Su-30, while Indonesia had to cancel its order for several Su-30s due to the economic collapse. One of the effects that we have seen is also that Korea is now looking at purchasing F-15s to offset the gains that they expect from China fielding the Su-30. The latest Su-30 models incorporate advanced technology such as phased array radar and thrust vectoring engines, which are yet to be introduced in operational Western fighters.

Missiles carried by the Sukhoi fighters are no less formidable. The active radar guided R-77 or AA-12 Adder is a direct equivalent to the US AMRAAM missile being introduced on the RAAF F/A-18s. The R-77 missile is credited with greater range and agility than operational models of the US missile. That is the missile at the top of the picture. A long range Ramjet powered variant of the R-77, know as the R-77M, is in development and it is expected to become operational well before the European Meteor Ramjet missile, the nearest Western equivalent. The heat-seeking R-73, or AA-11 Archer missile, set the standard for modern dogfighting missiles. It can be aimed by a sight on the pilot's helmet. It is vastly superior to the Sidewinder missile currently in service on the RAAF F/A-18.

While the Su-27 and Su-30 will decisively alter the regional balance of power over the next decade, a no less important development over the last 12 months is the proliferation of the supersonic Tupolev Backfire strategic bomber. This Cold War era aircraft is a 130-tonne equivalent to the F-111 flown by the RAAF, and it has about 2½ times greater range. It can use any runway which is suitable for a 767-300 airliner and it can deliver various cruise missiles

and bombs. India is in the process of leasing four Backfires. China was denied this aircraft in 1993, but it is likely to now acquire it, given that the Indians have set a precedent.

The Tupolev Bear is a Cold War equivalent to the B-52, used mostly as a cruise missile carrier by the Russians—or then Soviets—but also adapted to maritime patrol. In the latter configuration it is equivalent to a much larger and faster P-3C Orion. India is upgrading and expanding its fleet of maritime Bears, possibly up to 20 aircraft. It is more likely 14, but there are disagreements on the numbers. Indian sources claim the Bears will be armed with Russian cruise missiles. Given the colourful history of Soviet Bears as cruise missile carriers, this adaptation would be cheap, yet yield a potent power projection weapon with an operating radius of 8,300 kilometres, without aerial refuelling.

While the Backfire lease has stolen the limelight in the region, an equally important development is the proliferation of Russian cruise missiles over the last 12 months. India is soon to take delivery of its first Kilo class submarine, which has been armed with a potent Russian 3M-54E1 Alpha, or SS-N-27 cruise missile.

The 3M-54 family of cruise missiles—they are the three missiles on this slide—most closely resemble the US Tomahawk—that is the Tomahawk at the top—and can be launched from submarine torpedo tubes, warships, maritime aircraft and fighters. It is available in antishipping and land attack models, while the Mach 2.9 supersonic variant is in advanced development. The arrival of the Backfire brings its standard weapon, the Kh-22 Burya cruise missile, into this region—that is the missile at the bottom here. This missile carries a one-tonne warhead at speeds of up to Mach 3 to a range of up to 270 nautical miles. It is available in antishipping, antiradar and land attack versions—a very widely used missile. It is very difficult to engage.

Russia’s A-50 airborne early warning and control, or AWACS, aircraft is most likely the next major purchase of both the Indian and Chinese air forces. China was denied earlier this year the A-50I AWACS with an Israeli radar which is very similar to the system bid for the ADF Wedgetail program. China is now evaluating the third generation Russian A-50E model, while India has leased two Russian A-50s for evaluation while negotiating with Israel for the Israeli A-50I model.

Possession of airborne early warning and control aircraft provides not only a potent battle management capability but also the nucleus of an air expeditionary force. Both China and India have a stated intent to acquire aerial refuelling tankers, most likely the Ilyushin 78 Mainstay based on the same airframe as the A-50. It looks pretty much the same, without the radar dish on the back.

This October, India signed a deal with Russia to acquire the last of the 40,000 tonne Kiev class carriers at the cost of a refit. The deal is to include an air wing of 46 navalised MiG-29 fighters similar to the 76 MiG-29 aircraft flown by India and the 18 aircraft flown by Malaysia. The MiG-29 is similar in size and weight to the F/A-18, but it is generally considered to be more agile. The air wing will include airborne early warning and control and antisubmarine helicopters.

An interview published in Russia this July proposed that the Oscar II class cruise missile carrier submarine should be exported to China. These nuclear-powered boats displace 18,000

tonnes, not unlike a small aircraft carrier. They can launch up to 24 supersonic P700 granite cruise missiles. These cruise missiles have a range of around 500 kilometres. The Oscar II was designed to deliver a saturation cruise missile strike against a convoy or carrier battle group, a role which is now irrelevant in Russia's current strategic circumstances. It is likely to be attractive to China as a deterrent to the US 7th Fleet. Russia has 10 of these boats in service—this is in fact the same type of submarine as the *Kursk*, which sank recently.

The regional proliferation of top-tier Russian weapons raises the capability benchmarks across the region. Indeed, the deployment of strategic power projection assets such as cruise missile armed Backfires, Bears and submarines significantly changes Australia's relative strategic position in the region. Hitherto, any attacker would have to secure Indonesian territory to reach Australia's north—that is, with combat aircraft.

This is no longer true. The yellow and red contours which cover the arc between the Gascoyne and Northern Territory, which are these curves here, show the coverage footprint of the Backfire bomber flown from forward bases off the Asian continent. For all practical purposes Indonesia can be bypassed by cruise missile firing strategic bombers and submarines, thereby diminishing its importance as a buffer territory. Moreover, should the Sukhoi fighters be based in Java, they have the range to deliver cruise missiles against the Pilbara and Kimberley. That white curve there is the footprint of the Sukhoi fighters, and I have also put in footprints here for the Sukhoi fighters into South-East Asia with and without aerial refuelling.

I think it is fair to say that most of the strategic assumptions that were held about the region are beginning to slowly dissolve. Why does this interest us strategically? The North West Shelf venture in the Pilbara and the North Australia gas venture in the Timor Sea will become important long-term sources of export revenue as well as providing large volumes of natural gas for other domestic industries. Therefore, both will become critical economic assets which will contribute many billions annually. Any situation which could cause them to be shut down could be very expensive. If any serious damage to these facilities arise, it could produce also a major environmental disaster in the north.

The yellow, red and orange plots on this map show the distances at which cruise missiles with 300, 200 and 160 nautical mile ranges, which is typical of types now being sold in the region, can be launched at the North West Shelf and Timor Sea gas and oil installations. The little red and green stars here are basically gas wells and oil wells, and these are the distances to which an arbitrary aircraft or submarine would need to get to in order to let loose with a missile attack. These curves on the map are distances from the RAAF bases, which are Learmonth, Curtin, Darwin and Tindal.

To engage an aircraft delivering such cruise missiles or engage submarine launch cruise missiles, RAAF fighters will need to operate at distances of up to 500 nautical miles from Learmonth, Curtin and Tindal. This brings us to the central question of whether there is any point in extending the life of the F/A-18 fleet beyond the planned 2012 to 2015 life of type. Life extension can only be justified if the F/A-18 remains competitive in its combat capability.

This slide compares the size of the Sukhoi Su-30, the F/A-18 and the F-111 as operated by the RAAF. The F/A-18 has about 60 per cent of the empty weight, 50 per cent of the internal fuel, 60 per cent of the wing area and about 50 per cent of the installed thrust of the Russian fighter.

The Russian fighter is almost twice as large, with all of the advantages that that confers. We can compare three fundamental parameters in air combat capability. Clean combat radius determines the distance at which a fighter can engage an opponent or, ultimately, is a measure of spare fuel to be expended in high energy combat manoeuvres. The Sukhoi has around three times the radius of the F/A-18. In clean configuration with external missiles and 50 per cent of internal fuel, the F/A-18 matches older Sukhoi 27s in the ratio of engine thrust to aircraft weight, which is a measure of the aircraft's agility. But the F/A-18 falls short of later Su-30s. What is important is that the difference is above the vital one-to-one thrust to weight ratio—a Hornet comes out in this configuration at around one to one. Finally, on the size of the radar antenna, a measure of the radar's ability to engage a distant target or a small target like a cruise missile is compared. The F/A-18 has about 40 per cent of the radar aperture size of the Sukhoi. These three parameters are fundamental to a fighter's basic design and they cannot be substantially altered by any upgrade. The F/A-18 is outclassed on all three.

It is worth comparing the gains produced by the Hornet upgrade program and the AIR 5400 missile program against the Su-30. In close-in combat the new ASRAAM missile provides a significant capability advantage over the Russian R-73 missile. Given the superior agility of the Su-30 in closer combat, this is vital to the Hornet's ability to survive in such a close-in engagement. In beyond visual range combat, which is long range missile combat, the gains provided by the Hornet upgrade and the new active radar AMRAAM missile are less dramatic against the larger Russian R-77 missile. The Russian missile has a slight range advantage over the AMRAAM. In this slide we have the figure for the AMRAAM, and this is a fairly approximate figure, and the figure for the Russian missile—again with the caveat that the figures are order of magnitude rather than absolutely exact.

Of much greater concern is the impending deployment of the Russian Ramjet Adder, the R-77M which, together with the new phased array radar, provides the Su-30 with about twice the engagement range of the Hornet, with the APG-73 radar being fitted under the Hornet upgrade program, and the new AMRAAM missile. The ramjet R-77M will be deployed by about the middle of the decade or possibly earlier, upon which the F/A-18 will be decisively outgunned. The small radar antenna on the F/A-18 precludes the effective use of a Ramjet missile to its full potential.

CHAIRMAN—Dr Kopp, I do not want to be rude but are you getting close to finishing?

Dr Kopp—Yes. I have got a few more slides to go.

CHAIRMAN—Then very quickly, please.

Dr Kopp—Yes. For the F/A-18 fleet to have genuine combat credibility over the last decade of its operational life, it will require supporting Wedgetail airborne early warning aircraft and adequate aerial refuelling support. The Wedgetail aircraft has been the major part of a large program by Defence. At this point in time we do not know what its future will be, since cabinet is still trying to decide whether we have it or not—or at least that is as much as we can gather from the press.

Defence have asked for six to seven aircraft, which is a minimal credible number. To provide the required fighter patrol endurance in defence of the Pilbara, Timor Sea and Northern

Territory, should the need arise, the RAAF will need a robust fleet of operational aerial refuelling tankers. The four existing Boeing 707-338C tankers cannot refuel the F-111, use thirsty and noisy 1960s engines and lack the performance to use most available runways. Defence initiated the AIR 5402 project to evaluate available alternatives. One of these alternatives is the KC-135R, which is available from the United States, refurbished. We could require anything up to 30 aircraft, depending on what fleet-sizing assumptions we make. The other alternative we might like to look at is the KC-25 or KC-747, which is a rebuilt commercial airliner. These airliners are very cheap; therefore we could get a very respectable amount of capability for a very modest amount of expenditure. This aircraft is also very useful as an airlifter. We would probably get by with between 12 and 15 aircraft.

In terms of fighter alternatives, if we intend to have a fighter aircraft which is competitive against the type of aircraft we are seeing deployed throughout the region, the only choices are really to go for an aircraft with sufficient size, internal fuel load, performance and radar to be credible. The choices that are available in this respect are basically the F-15, which is old technology, or the other alternative is the F-22, which is new technology. The F-22 uses supersonic cruise engines; it can typically do the job of two or more F-15s; so we could probably get by with a smaller number.

If the Ramjet missiles proliferate earlier than anticipated, one way of being credible is to use support jamming aircraft. These are capable of blinding an opposing airborne early warning aircraft, opposing fighters and disrupting opposing communications. This was very widely used over Iraq in 1991 and Serbia in 1999. The choices that the RAAF would have, should we wish to pursue this, would be to refurbish F-111 aircraft from the United States or put such jamming equipment onto airborne tankers.

This brings me to the conclusions. When the F/A-18 became operational during the early 1980s, it was the most capable fighter in this region. The arrival of the F-15 class Su-27 swung the capability balance against the F/A-18. With the Hornet upgrade program, AMRAAM/ASRAAM, and the intended deployment of the Wedgetail airborne early warning and control aircraft and improved aerial refuelling tankers, the advantages of early model Su-27 fighters could be largely offset. More recent developments—such as the planned deployment of phased array radars and Ramjet missiles on Su-30 fighters, supported by A-50 AWAC and Ilyushin-78 tankers—largely nullify any gains produced by the Hornet upgrade and the AIR5400 programs.

Defence against cruise missiles would present another challenge for which the F/A-18 is not well suited to by basic design. It follows that a new technology fighter may be required as early as 2010. A larger fighter in the size class of the Su-27/30 would be preferable. Finally, a substantial investment into aerial refuelling tanker aircraft and Wedgetail AEW and sea aircraft would be required.

CHAIRMAN—Thank you, Dr Kopp. Do any of the Air Force representatives have an opening statement to make about ANAO report No. 40?

Air Cdre Blackburn—No. We have no opening statement. We have had responses back to the individual recommendations, and we are prepared to discuss any of those you wish.

CHAIRMAN—Mr McPhee, would you like to make an opening statement?

Mr McPhee—I have an opening statement which essentially summarises the audit report.

CHAIRMAN—Is it the wish of the committee that the opening statement of Mr McPhee, dated 3 November 2000, be incorporated in the transcript of evidence? There being no objection, it is so ordered.

The opening statement read as follows—

CHAIRMAN—One of the things that I guess we have some difficulty in understanding is that ANAO has stated that the Tactical Fighter Group has never met its internal goals for a number of serviceable aircraft and fully trained aircrews and has not developed a formal long-term strategic goal system. The ANAO also stated that it would be preferable to develop more realistic longer term goals that are directly linked to Defence's strategic planning. Would you care to comment on that?

Air Cdre Devine—TFG developed internal goals in the light of earlier, less than precise, guidance. We have a concept of operations based on reasonable expectations of the employment of the force in the defence of Australia's environment. We based that on three operational Hornet squadrons, backed up by the Operational Training Unit, to conduct operations, say, in the northern Australian environment in maybe two locations, and that is for defence activities

We based our concept on that premise and on a certain number of pilots per squadron. We run a training scheme to develop capabilities, to provide both air-to-air and air-to-surface capability. As we have been short of aircrew for a number of years and there have been some maintenance issues, we have not met our own stringent goals. However, having said that, the process we run of categorisation training of the aircrew and so forth gives us a strong basis for a wide capability to meet various contingencies. Now the fact that we do not meet that does not mean that we are failing to provide a spread of capabilities, should the government need to use them.

CHAIRMAN—I think the committee would remain to be convinced. The audit report says that in 1994, for example:

Tactical fighter group lost over 20 per cent of its pilots.

Then it goes on:

However, it was difficult for ANAO to contain continuous figures on Hornet pilot wastage rates.

I have asked our friends from the ANAO why they could not get separate information on Hornet pilots wastage. It seems a simple thing: you have an employment contract and either you are flying F/A-18s or you are not. But the answer I got—and tell me if I am wrong, Mr Muller—was that they could not discern the difference between pilots who were flying F111s and F/A-18s. I would have thought that was fairly fundamental. They seem to think there is no real problem with pilots for the F111s: is that because they are more fun to fly?

Air Cdre Blackburn—No, Mr Chairman, we have a problem with the number of fast jet aircrew in totality. So we have the same problem existing with the F111s. The reason is that, when we have a certain input to a pilot's course—we aim to graduate in the order of 57 pilots a year—we found that the percentage of those pilots who have the skill sets and abilities to fly fast jets has not met the number we actually need to send to the F118 and the F111. That has been a problem that has been there for a few years. As a result, with recent high resignation rates, we have not been able to maintain the number of people in the squadrons that we need. We have had recovery programs over the past seven or eight years. In the past, we have actually looked at the elements rather than at the totality of the system. We are approaching it differently in about the last 12 months.

We have addressed some of that in our responses to the Audit Office in that—rather than just saying we have a retention problem or a recruiting problem, we are trying to look at it end to end. That is to say, how do we attract interest in joining the Air Force in the first case? How do we better recruit people? That was done poorly in that we had not centralised the recruitment of aircrew. That is now being done that way. How do we test these people to see if they have the right aptitude and the skills? Some of the test processes we had were not giving us good enough indicators at the start of pilot training to say what the pass rates would be. We have a new system for that in place now. And how do we actually progress those people through to the cockpit? That is half of the problem.

The other half of the problem is how we retain them. Accepting there are market forces that change, depending upon the economy, we are now trying to address the retention far more holistically: not just looking at throwing a bonus at somebody to stay in the service, but really looking at what it is that encourages them to leave: the lifestyle, the remuneration, their career opportunities, vocational stability, spousal issues. We have a strategic aircrew management cell now that looks at it from one end to the other of the system. It is going to take a few years to see if those changes we have made in these elements are effective. What we do not want to do is continually react as we did in the past when we see a blip or a problem without having seen if one change we have made is going to be effective overall. This is going to take five to eight years to try and recover, if we can get all of those pieces of the puzzle together.

CHAIRMAN—I accept that, after the Vietnam War, and with the pay rates for commercial air pilots improving dramatically, there was a big wastage. That has been the case for a long time now and I would have thought the Air Force would have been able to address it. Dr Kopp is talking about some very sophisticated platforms that Defence might consider for the future and some very complex military problems that this committee is not necessarily competent to deal with. Basic to all of this is that, if we have got problems with the platform itself, it does not make much difference if we do not have anybody to fly the planes.

Air Cdre Blackburn—When you say problems with the platform itself, the Hornet upgrade program over the next five to six years is going to provide significant increases in that platform's capability. We are satisfied that those upgrade programs will provide the level of capability that is needed for our defence purposes. With the number of aeroplanes we have got and the current crew shortages, we cannot maximise the combat capability as a nation. That is why we are putting a lot of focus into recruiting and retaining the right type of people. It is not just a matter of throwing a lot of dollars at it. There is a remuneration problem because the airlines do pay significantly greater rates. We do not think we are ever going to be at a stage when we could argue for paying the same rate as an airline pilot.

It is more than just a dollar issue; it is a lifestyle issue. One of the problems nowadays is societal trends and people's expectations. The type of lifestyle that a military pilot leads—the mobility—causes quite a few problems. We are also trying to address this to see whether there is a different way of doing this to give people and their families a greater level of stability. In the past we have been a bit simplistic in just throwing dollars at it and that did not work.

CHAIRMAN—A year and a half ago, I went to sea on a Collins class sub, the Dechaineux, for about 2½ days. Everybody in the crew from the commanding officer down to the chef, from the chief to the able seamen, was free to sit down and tell me about his problems. I would have

thought the career path in this service was not dissimilar to Air Force pilots. It is a very specialised sort of job, going under for weeks on end. I brought their concerns back as a private member and turned them over to the minister. My advice is that a lot of those problems have been fixed. It is not 100 per cent but there has been a huge turnaround in terms of the number of people who are staying and the reduction in the problems. I wonder why it has taken five to seven years to solve these problems of flying sophisticated aircraft?

Air Cdre Blackburn—If you look at the problems across Defence, there are significant difficulties in our retention rates across the three services. In the past, resignation rates have been in the order of eight or nine per cent on average. We have in the order of 13 to 14 per cent loss rates right now. On the recruiting side, Army and Navy are in the region of mid-80 per cent of achieving recruiting goals—and I understand Navy is down to 55 or 60 per cent. This is not a problem that just exists in the fighter force or in a single area.

As a defence force, we have significant challenges in recruiting and retention rates, which we are trying to address. That has been addressed over a broader level across Defence by the department. In this case, we are looking specifically at the aircrew and what we can do to address their lifestyle issues and problems. Perhaps Commander TFG can talk about the current concern of aircrew operating in his area.

CHAIRMAN—I just point out that, if we cannot man the subs, the Hornets and the F111, we have not got a lot of strategic capability left, have we?

Air Cdre Blackburn—If we continue with our current loss and retention rates, it is going to be a growing problem.

CHAIRMAN—Do you have any comments, Mr McPhee?

Mr McPhee—We as an audit office are starting a project on work force planning, because it is an issue not only for the forces but also for many public sector agencies. Recruitment and retention is not just a matter of dollars. The strategies outlined by the Air Force sound pretty good to me on the basis of the work that we have done at the moment in this preliminary stage of the work force planning project. It is pretty tough but it does get into lifestyle and career management for the people that you have. It is a very important area now for all organisations and particularly important in these critical areas.

CHAIRMAN—Dr Kopp, in terms of your experience internationally, are these problems unique to Australia or are they somewhat similar to those of other defence forces around the world?

Dr Kopp—I think the problem is very similar to what we have seen in the United States. In fact, the Americans are having significant difficulty also with overcommitment of reservists. The result of this is that they very frequently come home, after being sent overseas on a deployment that might last many months, and find out that the wife has left them, the job has gone and the dog does not know them. The Serbian air war resulted in a huge wave of resignations. This is proving to be a significant problem, particularly since they are losing people at the lieutenant colonel and major levels, which is basically equivalent to our squadron leaders and wing commanders. These are particularly guys at the section leader level, which is

talking about pilots that have 2,000 or more hours of time, and therefore they are the guys that usually are the repository of corporate knowledge within a particular unit or a group. So we are talking about a difficult problem.

With regard to the difficulties the RAAF has had with recruiting applicants into pilot training, I would have to say that they parallel what experience I have had in academia, in hard sciences disciplines, where, again, there is a general shortage of what I would consider to be highly talented applicants—guys who would follow through to the level of a postgraduate research degree, which is probably a similar level of intellectual ability and discipline as is required to be a high quality or top calibre fighter pilot, which is really what we are looking at here. I am not sure whether this is the result of a broader demographic trend—I am no expert on this; certainly I see, at least in terms of an empirical observation, a bigger and broader problem. It may well be that we need to come up with a more comprehensive, systemic solution towards dealing with the recruiting problem.

CHAIRMAN—We have discussed some of Australia’s problems. We have discussed some of the problems in other democracies with whom we deal regularly. But in your presentation you were talking about India and China, and I have forgotten who else, in terms of very large purchasers of very sophisticated modern military hardware and platforms. Are they going to be able to man the fighters, the bombers and the subs and adequately maintain both the platforms and the weaponry?

Dr Kopp—That is an excellent question and it is a very good point. The Chinese to date have had considerable difficulty getting the systems up to the level of serviceability and also up to the level of flying proficiency that we typically see in Western air forces, but the general consensus of most observers is that they are slowly improving. The Indians are significantly more competent, although they have also had some difficulties with underbudgeting flying hours and, as a result, having accidents. The big issue is the fact that both of these countries have population bases of the order of a billion, so when they eventually do learn how to properly train pilots to the kind of standard that we expect them, or that one would expect, and certainly providing that they can generate a sufficient uptake at the recruiting end, I think it is reasonable to assume that they will be able to meet the needs. One of the difficulties we have is that we have a small population base, in comparative terms.

CHAIRMAN—Whoopee! I think we know that. What kind of time span are we looking at? You do not want our compare our 19 million to China’s 1.3 billion, do you?

Dr Kopp—It is very difficult to put a figure on this. We have conflicting reports that come out of particularly China on the operational status. I have seen reports in US journals that say they are going to be credible and be capable of threatening US interests in the Far East by 2010. Then there are other reports out there that say they will not be able to do it ever. So one finds a considerable spectrum of opinion on this. The fact that it ends up devolving to opinion rather than hard fact would suggest to me that a lot of people actually do not know. I would not go as far as to put a figure on the point in time at which we can say the PRC or India or, in fact, any lesser regional nations will be able to put together an air force with the operational competence level that we expect from a modern Western air force like the RAAF, the RAF or the United States Air Force. I think we will only learn this over the next decade.

CHAIRMAN—I should not dominate this, but I have one more question I have to ask. Could Air Force tell us your view of the importance of the Wedgetail and refuelling?

Air Cdre Devine—The Wedgetail is a part of the triangle with the tactical fighter and airborne radar. Without going into a long technical discussion, the capability of Wedgetail gives us that radar coverage over a large area that ground based microwave radars do not. The over-the-horizon radar capability that we have is supplemented by the Wedgetail capability. The Wedgetail gives us that more precise surveillance after the over-the-horizon radars have detected the general threat, to put it simplistically. It is, from my perspective, a critical aspect of our air defence, of our general management capability and protection of our fleet units at sea and of our land based operations, wherever they may occur, if we are going to control the air.

On the need for air-to-air refuelling, the F/A-18 particularly does not have the range of some of the larger, more modern fighters, which also need air to air refuelling. However, to maintain that presence in the areas where we would have to operate at reasonable range, air-to-air refuelling is critical, whether we are in a defensive posture or whether we are in an offensive posture, to carry a task to an area for a strike or for protection of a land based or sea based operation at some distance from our airfields.

CHAIRMAN—We are conducting a major inquiry into Coastwatch. You would be familiar with Coastwatch assets and intelligence information. To what degree do you believe that Wedgetail will assist Coastwatch?

Air Cdre Devine—From previous experience, I think Wedgetail will greatly enhance our capacity to protect our coastline, our littoral, from the various things we are attempting to protect it from. Depending on the number of assets we have, the time on station that we can provide to support the various government agencies that have those tasks, I think it is going to greatly enhance how we control who comes into this country and what comes into this country.

Mr COX—On the Wedgetail issue, why did Air Force decide to pick a 737 as a platform for it?

Air Cdre Blackburn—The answer to that is the subject of what we did in the tender evaluation processes. The reasons behind that are beyond what we are here able to answer today. We could get an answer back to you in writing to explain why the 737 was chosen out of the options that were available. It is not just the aeroplane, the aeroplane is a convenient truck. What we are talking about is a system on board it and what it is capable of doing, not only today but its development capacity. If that same system had been offered on another platform, then it may have had a different outcome. But we could take that on notice, if you wish, and get a response back to you.

Mr COX—I would be interested, given that we have this Coastwatch inquiry going, to know what would have been the advantages and disadvantages in terms of coverage if we had had a smaller, cheaper airframe and more of them, whether we would have got better coverage.

Air Cdre Blackburn—We can certainly give you that answer. The issue with AEW&C is that the airframe itself is not the expensive issue. The cost in this aeroplane is the systems on board and the development associated with it—the smart part of the system. So whether you get

a small number or a large number of aeroplanes, the cost is not the number of aeroplanes, it is the actual cost of the system. Therefore, if you want a capacity to surveil effectively, not only for Coastwatch purposes but in combat—and that needs quite a different capacity—it is the system. So a smaller platform and more of them will cost you a hell of a lot of money. It is really what the optimum number is, depending on what the operational job is, and it has the ability, as OTHR does, to support our peacetime operations for national surveillance purposes.

CHAIRMAN—Isn't it the phased array radar that makes the big difference and you cannot effectively locate that on a much smaller platform?

Air Cdre Blackburn—One of the things with the phased array radar, in particular, is that if you take the older AWAC platforms, the antennae rotate once every 13 or 14 seconds. If you have the phased array radar, you can control that antenna instantaneously. As you are tracking something, and say it is looking over there and you see a hit, whilst it continues to track you can actually come back and revisit that and start to discriminate the targets. In the older technology, you have got to wait till that radar comes around every 13 seconds. It can take two or three rotations before I can establish a track. If these targets start manoeuvring, you have immediately lost the identification that I have five or six tracks over here. With the phased array radar, it is a totally different approach. If there are a lot of aircraft in one area, you can revisit them perhaps every second whilst still surveying the whole airspace. The performance increase, the knowledge increase, you get out of that is just phenomenal.

Mr COX—What sorts of radars do the US navy use on the AWAC aircraft that are deployed on their aircraft carriers?

Air Cdre Blackburn—The E2C now has extended rotating antennae.

Mr COX—Did you want to add anything to that, Dr Kopp?

Dr Kopp—I would basically agree with everything Air Commodore Blackburn has said. I would say that the Defence Force chose very wisely in going for the particular system they did; that is, the Wedgetail project. The particular radar—on the strength of everything that I have seen published and I have some research background related to phased array theory—was a very capable radar, particularly in its ability to detect fleeting and small targets. That is relevant in the combat situation, when you are trying to nab a low flying fighter or a cruise missile or a fighter at a long distance, but it is also relevant if you are trying to catch somebody in a general aviation aircraft who is trying to sneak in and fly in a zigzagging track to try to break the Doppler gate. With the kind of the radar that you have in the Wedgetail, I doubt frankly that they would get away.

I do very strongly agree with the point here that it is the radar on the system that is the big driver. We could put it on a 707 or a 767. There is some lower limit in terms of size because of the weight of the radar. I do not have the exact figures for the Wedgetail, but it is several tonnes. If you put it on an airframe any smaller than the 737, you are apt to lose so much aerodynamic performance that it will be a problem to fly around with it. There will be certain issues in what I would call critical mass of capability in this area. If you go for a smaller radar than what you have on the Wedgetail, you will start losing detection range, angular resolution or peak power output, which makes it more vulnerable to jamming in a combat situation. There are whole piles

of technical issues in here that really go beyond the scope of this level of discussion. In my opinion I am satisfied that the Defence Force chose extremely well. I also concur with the Defence Force's assessment that we needed six to seven aircraft.

Mr COX—What proportion of our northern approaches would six to seven aircraft adequately cover? I think Dr Kopp talked about going from Darwin around to the Pilbara.

Air Cdre Blackburn—I am happy to take that on notice and report back on that from the AWAC office, who are the best ones prepared to answer the question. That information is contained in the proposals to government, explaining the difference between six and seven and what they could actually deliver.

Mr COX—What sort of force multiplier do you see the AWAC as providing?

Air Cdre Blackburn—For fighters?

Mr COX—Yes.

Air Cdre Blackburn—I could give you an analogy. If you came into a room with a laser pointer in the dark and tried to find a fly, that is what it is like in a fighter aeroplane—and we have both been in that situation. You have a 3.3-degree beam with radar—that is all that there actually is in a fighter. You are moving a 3.3-degree beam, trying to scan. So if you came in here and tried to find a fly in the dark, I would suggest it would be a reasonable challenge with a laser pointer. But if you came in here with a huge searchlight and ran it around once every second, the chances are you would find the fly. So you can have a lot of fighters running around up there with a lot of firepower on board, but it is like having one eye and a hand tied behind your back. Airborne radar and, more importantly, the command and control part of that system are perhaps what turns a bunch of very enthusiastic people on steroids running around there with weapons into an intelligent fighting capability. It is that significant.

Mr COX—Are you a little frustrated at the moment that the project has been put on hold?

Air Cdre Blackburn—Certainly not; I am full of anticipation.

Mr COX—Regarding the retention problem, we were having a discussion with ANAO before you came in about the degree of planning for build-up for warning time and things like that. I was looking at table No. 1 in the Audit Office report, which shows the price of Defence output 14 to the tactical fighter operation. It shows operating costs of about $784.9 million and a capital charge of another $504.8 million. If you were to get the sorts of enlistments in terms of both number and quality to train—to meet your targets—how much would those costs increase by, given that you would presumably be doing more flying, supporting more aircraft, and using more airframe hours?

Air Cdre Devine—I cannot give you a dollar figure here. I can take it on notice. At the present time, we are flying a certain number of Hornet flying hours per year with the number of aircrew we have, and we have been increasing our pilot numbers steadily for a number of years. At the end of this calendar year, early next year, we will be—for a six-month period—reasonably close to the peacetime figure that we have set as a goal. That will decrease for various reasons over the next year or so. The increase in dollars would not be significant, I

over the next year or so. The increase in dollars would not be significant, I believe. Once again, I would like to take it on notice to give you the precise figures, or the order of magnitude figures. We would be looking at in the order of another 1,000 to 1,500 Hornet hours per year at the outside.

Mr COX—Have you got a meaningful set of plans for expansion, given various warning time scenarios?

Air Cdre Devine—For aircrew?

Mr COX—Yes.

Air Cdre Devine—We do not, in a direct sense, because of the warning times that we consider are inside the aircrew training time. The aircrew training cycle is from two to three years. If you take the selection process pre joining, you would probably be looking at almost a four-year cycle from finding a person to getting them into a squadron and then it may even be a little longer to get him to an operational standard. Our warning times are well inside that; we would operate with the operational squadrons in being. We would supplement from our training units. We have a Hornet training unit and we have two Macchi/Hawk training units plus some other staff in the flying training schools. So we would supplement the operational squadrons from those sources to meet the warning times that we are tasked with at the present time.

Air Cdre Blackburn—If we are talking about a longer term and how we maximise the combat capability that we have here, it is not just the aircrew issue. There are a few things we look at there. What is the thickness of the pipeline we have got and how can we maximise that? There is certainly a capacity to grow that with the number of training assets we have got, because we operate the aeroplanes certainly not 24 hours a day, so we can grow that pipeline somewhat. The other issue we are also now exploring is: what is the capacity of the defence industry in this country to provide that training surge? We have already outsourced quite large parts of our training pipeline. For example, at Tamworth, BAe Systems provide part of our initial pilot training. We are discussing with various industry reps the possibility down line of having a surge capacity to our training, should that be needed, to ramp up to a higher level of operations should we have a warning time of, say, six or seven years. So we have looked at those options and we believe we can ramp up.

The issue, however, is not the pilot numbers, because as critical to flying an F18 is the ground crew, in particular the armourers and the logistics tail to that. So when we start to look at ramping up on that side there is that issue of the ability to ramp up the support part of it. We are getting quite concerned, not from the military sense but in looking at the civilian infrastructure as it relates to aircraft maintenance—for example, LAMEs, engineers. There is a concern amongst the civil industry about the ability for Australia to generate sufficient civil personnel to maintain the current industry in this country, let alone support a growth in military operations. So, from the demographic perspective on where we are going as a nation, we do have concerns. We have looked at a degree of ramp-up but, nationally, we have a much broader problem.

Mr COX—The other issue is the number of people who have been through the RAAF system and are out there either as commercial pilots or as LAMEs. Have you begun to reconsider the use of reserve forces for such an expansion?

Air Cdre Blackburn—We have had a look at what capacity we could generate with the platforms and said, 'How many reserves, and how could we recruit to qualify people?' The figures of our authorised work force now are 13,555. We have had a look at what is needed to maximise the combat platforms and use them to their full capacity. We would need in service in the order of 18,500 to 19,000 people at wartime if we wanted to maximise everything. In addition, there would be additional contractor support. So the contractor support base we have now, which is large—bearing in mind that we have come from 23,000 down to 13,500 people in the last decade, with a lot of that shortfall being replaced by contractors—would have to be increased, and we would have to grow that extra 5,000 or so people. We cannot physically recruit those people through the door and train them in the sort of time we are talking about. We believe we will need to grow our reserve forces in the order of 3,500 people, from our current active reserves of the order of 1,200 or 1,300, to be able to maximise that.

So in our work force plans beyond the current FYDP planning, we are saying, given budget availability, what we think we need to do with our reserve force in particular to give us an economic yet robust expansion capability. We are going to have to grow our reserves, as I said, from about 1,200 to 3,500 and, in doing that, there is a small overhead that will be in the permanent force as well. When we look at those overheads and what we need, we have our plans in place and we are making a case through the department that, over the next decade, to maximise capability we think we need to grow our Air Force to these figures.

Mr COX—Are you looking at anything at the moment that contemplates the use of reserves as fast jet pilots?

Air Cdre Blackburn—We have had a look at that over the years, and there has been a familiarisation scheme for the F111s as reserves. With the number of flying hours available, which are not only generated by budget but by the people in the service, the issue is: how safe is it and how effective is it to keep someone supposedly current on a fast jet? We do that in the training on the Macchi aeroplanes and we will do that on the Hawk. To keep someone safe and effective on an F18, flying a limited number of hours, is an issue I will let the Commander, TFG, come in on.

Air Cdre Devine—As Air Commodore Blackburn has said, we certainly employ reservists, mainly airline pilots, in the Macchi squadrons and they will be employed in the Hawk squadrons. We have found it relatively easy to keep them current and they are very interested in that type of work. For the actual operational aircraft, the F18, finding the time for the reservists to keep current and to devote the time to the more complex platform has been difficult. We have had various attempts and, to date, all the people have fallen by the wayside because of the pressure of their primary job working for an airline and their fairly busy home requirements have meant that maintaining the commitment to the F18s has just been too difficult.

Just a short time ago we started an officer who retired from the permanent Air Force, and we are running a trial with him. He is prepared to give it a go, but he is just one in a fairly large bucket. It has not been a success simply from the point of view of the complexity of the task and the time that people have available to put into that task at the tactical fighter level.

Mr COX—In 1991, when the previous government set up the Ready Reserves, we had a discussion about this with the then chief of the air staff, Ray Fennel. He was talking about the

possibility of getting back people who had moved out of fast jets into the airlines, basically giving them a few hours of activity a year to keep them in touch. It did not seem to me to be much of a capability at the time, but do you see any value in those sorts of arrangements?

Air Cdre Devine—In fact, Air Commodore Blackburn did touch on that. We have a scheme where we bring in airline pilots who are interested and run a three- or four-day refresher type course where we brief them on the latest tactics, developments, modifications to the aircraft, threats, et cetera, and run some simulator profiles with them. But it is a very short course. It is more to keep them in touch in case they have an interest in coming back some time in the future. Although, once people leave the system and are out of it for a number of years, the cost of bringing them back is a thing we have to consider. You are looking at the cost effectiveness of getting somebody back in in a time frame, et cetera, depending on whether you are looking at a long lead time in years or a shorter lead time for a contingency.

Most people, once they have been gone for several years, are interested, but I think the prospect of bringing them back—unless they are in active, tactical flying—is quite a difficult one. We do bring people back from overseas. Quite a number of our pilots have been employed by contractors overseas in the training environment, flying Hawks in various Middle East countries and so forth. If they have indicated a wish to come back into our environment after they have finished in that environment, we have always considered that favourably. We have had a number of returnees, but they have come back after having been actively flying in a single-place or two-place training aircraft in a similar sort of environment so they fit back in pretty well.

Mr COX—The Americans use a lot of reserve pilots for transport activities and things like that. Is the quality of the people who are permanently flying RAAF transport aircraft and Orions and things like that so far off the pace in terms of fast jets that it would not be possible to replace some of them with reserves and use the permanent RAAF pilots for fast jets?

Air Cdre Blackburn—It is not a quality issue. What you are talking about is a skill set and an ability to do it, particularly spatial awareness. It does take a particular type of person to be able to do a fast jet preparation. So, yes, we do have reservists operating in the transport area there, but we found that, by taking people from the transport or maritime areas, the success rate in coming across to fighters has not been very good. It is because their skill sets and capabilities are well suited to that particular job they are doing. So, unfortunately, because you have a set of wings on a chest does not mean you can fly any of the types, and the cost, as pointed out in the report, of putting people through the system is fairly high. It just does not work, basically.

CHAIRMAN—You say that it is hard to put a Greyhound bus driver to driving a 500cc motorcycle.

Air Cdre Blackburn—Yes, but I would not suggest that the Greyhound bus driver's ability is of a lower quality, because my life depends upon him as well.

CHAIRMAN—No, and neither did my question imply that.

Senator MURRAY—I liked that exchange. I thought the better comparison was maybe with Formula One and 500cc. You cannot easily switch between those either. Dr Kopp, are there any sophisticated air forces in the world that have an excess of fast jet fighter pilots?

Dr Kopp—Not that I am aware of. The retention issue to my knowledge has been a problem everywhere. What frequently happens is the guys start approaching 30 or 35 years of age. A lot of them get married and they frequently come under domestic pressure to basically bring in more bucks. A number of my friends have left the employ of the RAAF for various related reasons.

Senator MURRAY—How about Russia or east Europe—all those places?

Dr Kopp—The problem with Russia primarily is that the proficiency level of most of the nominal fast jet pilots is so low now that it is in the same high risk accident domain that Air Commodore Devine commented on with regard to reservists who simply cannot put in enough time.

Senator MURRAY—Going to recruitment, are there any sophisticated air forces who reject people through their recruitment systems—maybe the Americans—who we would actually accept? I mean, do people have different forms or different standards of recruitment; are we at the highest level or what?

Dr Kopp—I am not sure that I am able to give you a proper answer to that question simply because it is not a problem that I have looked at.

Senator MURRAY—What I am suggesting is that flying these planes is just a job. It needs a particular skill set. But, throughout this country, we fill jobs with migrants from all over the world. If you need a chief executive officer, a chairman of a committee or a member of a committee, we have people who come from all over the world. I just do not see what the difference is with the Air Force. Why can't we recruit overseas in countries that are suitable? You might decide that English is a criterion, but it seems to me that we are looking at this through very Australian eyes and I just wonder if we—

Air Cdre Blackburn—In fact, Senator, for many years we have had a clearly focused lateral recruitment program. We have recruited people from the UK, Canada, USA, New Zealand and Singapore. So, yes, we do have that, and we have not looked at a purely Australian focus. When you fly a high performance aeroplane such as this, fundamental to safe and effective operations is culture, airmanship. You could put some people in this aeroplane and cause an incredible amount of havoc—because of the firepower that is on board these aircraft and also because of the way they are operated. It is critical that the airmanship of those people is compatible and meets our standards.

In the countries I have mentioned, there is no question about our airmanship standards and training systems being similar. We all maintain very high quality levels. I would perhaps suggest that this job is not just a job. You can hire someone to do a job, but we actually want people to approach this job as a profession. They have to put their necks on the line. That is essentially what we want them to do. We want to get young folk into our organisation, train them at a very high standard and drive them extremely hard. We want them to go out there and

actually die for the country if necessary, which is something we do not tend to emphasise publicly. This is not a job. This is a vocation. It is a profession. We do not want to go and just hire somebody who is on the floating job market.

Senator MURRAY—Yes, but the fact is that this country has got migrants from 192 countries in it. That is a massive number. When Eritrea come and play football, suddenly we discover that the country has got 6,000 Eritreans in it. Who would have thought such a thing? In other words, Australia is made up of people from other countries as well as indigenous people. Nothing you have said indicates to me that it is not possible to find migrants who meet whatever criteria you establish for this job. It has the same special characteristics as running a company, a university science lab, or whatever.

There are many jobs in this country that have particular skill sets that sometimes need people to be brought in from overseas. I am not denying this has special characteristics. You can get killed doing it, but there are other jobs where that happens. If the defence capability of this country in an extremely sophisticated and important area such as you are describing requires people, and you have got difficulty holding them at the back end—retention—you have got to pay as much attention as you can to the front end.

If you have not got the capability in Australia, then we have to look outside to a greater degree. In this report, we have not really looked at whether the foreign recruitment possibilities are being developed or explored as fully as they might be. They might be, but I do not know. I am actually putting a proposition to you in asking for the response. Do we send a recruitment team and plonk them down in Great Britain and say, 'Come over to our place and get killed. It is nicer to be killed in Australia rather than in the UK'?

Air Cdre Blackburn—It is nice and sunny. You will die with a smile on your face. We have had recruitment teams overseas. What we have been primarily targeting there in the past are people who have been trained by someone else, particularly of a compatible airforce. It certainly saves us a lot of those initial funds. We have recruited people straight off the street from New Zealand, and they have just come across to join our organisation. We have not really gone beyond that to try to recruit other nationalities from the street.

Senator MURRAY—Why not? Every company in this country, every government department, every university, every walk of life goes overseas, if they are short of people, to recruit them, either on lease or contract or as permanent migrants. How else do you develop a country without the migrant bodies? We have got two of them on this committee.

Ms GILLARD—Four.

Senator MURRAY—Four. My apologies.

Air Cdre Blackburn—A couple over here as well.

Senator MURRAY—Then you know exactly what I am saying.

Air Cdre Blackburn—I know what you are saying there. Culturally I would be somewhat inhibited, as a personal response, in trying to actually get someone purely for a job application

when we are talking about the defence of the country. I have no problem with the whole migrant issue. What we are carrying through the front door is not someone to do a job. We are trying to get someone who is coming in to be able to defend the country and, therefore, the citizenship issues and the belief in the country. If we change this to an advertisement in any country saying ‘Come and do a job’ I think we are going to lose something fundamental in what we have in our defence forces today. We do not ourselves view this as a job. We view this as far more, as I am sure members of parliament view your positions in certain ways. It is something else. It is not just a job issue.

Senator MURRAY—I have been deliberately provocative by describing it in such a way, because I want to make you think laterally. Now I want to make you think historically. Do you know how many young Australians went to fight in World War I and II who loathed England and the English—the Poms as they were called? They absolutely loathed them. They did not have a test, but by golly they did a wonderful job and they lost their lives doing it. The point I make is that you can overdo the kind of idea that people will not go and do a wonderful, brave and committed vocational job simply because they are not of your culture.

Air Cdre Blackburn—No, but in that example I would suggest the motivation, from my reading of history, was one of Australian mateship: going along with your mates from here to go off and fight together, and there was the adventure of that time. Their motivation when they got there was not necessarily fighting for the country but fighting for their mates alongside them. In our case here, what we are trying to breed in our country and our Defence Force is that issue but also fighting for the country and a belief in the country. Whilst I do not argue that we do need to look laterally at recruiting solutions, what we are concerned about within the force is to make sure of the motivation of the individual in there. What they are in it to do is a very important part of why they are there. We are verging on the edge of mercenary issues, and I agree we need to look outside to see a recruiting source. Personally, and I am not speaking for the department, I have some concerns about taking a mercenary path but I accept that we are going to have to look laterally for alternatives.

Senator MURRAY—But ‘mercenaries’ is a pejorative word. I do not regard the head of BHP as a mercenary. I know you do not like the analogy. One of the finest fighting men in the Rhodesian Selous Scouts was Lieutenant John Murphy, who was a former Green Beret, an American. If you are short of people to fly these fighters and if it could give you that extra 10 or 20 per cent of people capacity, I would think you should look at it seriously. By all means come to a judgment once you have looked at it seriously, but in your responses I am getting a cultural response, not an objective analytical response. I do not mean that rudely. You have been very honest in your responses, but I have tried to provoke you deliberately to see how you would react.

Air Cdre Blackburn—I agree with you, Senator. There is a cultural phrase, as I mentioned in my first response. As a personal response from a cultural perspective I do agree that we have to look at broader recruiting options. We have not looked at that particular option you mentioned there, beyond recruiting to compatible air forces at this stage.

CHAIRMAN—We are going to have to fly—literally! There are a couple of things my secretariat would be furious at me if I didn’t ask. The Hornets are planned to undergo a complete and expensive series of upgrades over the next eight years to improve their capability.

The ANAO in their report stated that some of the acquisition projects related to these upgrades have already suffered from ‘project management deficiency’. That is on page 92. I can tell you that if there are major project management deficiencies, this committee will indeed be upset, as I am sure the minister will. Can you give us some assurance that this upgrade will be on track? No?

Air Cdre Blackburn—I can again give you some response from the DMO organisation, who are the people responsible for addressing those issues. I understand that the changes that have been instigated at the minister’s direction in DMO recognise our past deficiencies and put in place measures to manage risk better and certainly manage projects better. It would be more appropriate, however, for a response to that to come from the head of the Defence Materiel Organisation—and, again, we can provide that.

CHAIRMAN—I will ask the secretariat to write a question to Defence Command on that, because this goes to the heart of the issue. It has been a long time since we invested in new capability. We did not look at the Anzac frigates but we have looked in depth at both JORN and Collins class, and we have also looked at the tanks that were sent up to the Northern Territory without airconditioning—which was a bit of a problem. We constantly revisit Defence procurement, contract management and systems engineering difficulties, about which we continue to comment. I simply make the point for the record that this committee will be interested to know how that issue is progressing.

The final question is this. On page 33 of the report, ANAO comment that Air Force should monitor the military vulnerability of the aircraft and remedy any identified shortcomings, particularly those relating to levels of technology. I do not know to what degree—depending on national security interests—you wish to comment on that recommendation.

Air Cdre Devine—We have measures in place to asses our environment and to assess our capability versus the potential areas we have to operate in and be aware of our deficiencies and capabilities. It is an ongoing process. I think you have to be very careful about making knee-jerk reactions against this. The information that Dr Kopp has put up before for us with reference to India and China is the sort of thing we would look at in our intelligence summaries and assessments. We would then assess whether the ownership of those systems indicated a capability—or, as we discussed, when that would be a capability and, when that ownership became a capability, whether that nation had intent to use them in our environment—and therefore whether we might expect to have to react against them. That would give us a lead time for upgrades, changes and so forth. That is the type of process that goes on fairly continuously. It is a long process. There are times, of course, when things can occur at fairly short notice—and that is where we rely on our intelligence summaries and so forth. But, once again, our capacity to modify aircraft or obtain other capability in the short term is a major issue, as you are aware.

CHAIRMAN—Dr Kopp, do you have any final brief comment you would like to make?

Dr Kopp—Most of the pertinent issues have been covered quite well. On the issue of addressing aircraft capabilities, we will have a much better picture of what is happening in Asia in probably the next two or three years—because we will have an idea of more exact timelines for new platforms. There are some uncertainties at the moment: not so much uncertainties about what platforms who is going to buy, but rather when they become operational and, as the Air

Commodore has properly commented, when you can class them as credible capabilities. I think we will have a much clearer picture of this in the next year or next two years.

CHAIRMAN—As no-one else wishes to comment, I thank everyone who has come today to listen and participate. I thank Hansard, my colleagues and the secretariat.

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

That, pursuant to the power conferred by section 2(2) of the Parliamentary Papers Act 1908, this committee authorises publication, including publication on the parliamentary database, of the proof transcript of the evidence given before it at public hearing this day.

Committee adjourned at 3.55 p.m.