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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Reference: Review of Auditor-General's reports, second and third quarters 2000-2001

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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Wednesday, 2 May 2001

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

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

Terms of reference for the inquiry:

Review of Auditor-General's reports, second and third quarters 2000-2001.

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Committee met at 10.36 a.m.

DEANE, Mr Craig, Senior Director, IT, Australian National Audit Office

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MULLIGAN, Mr Rory, Assistant Commissioner (Internal Assurance), Australian Taxation Office

PRESTON, Dr Alan, Second Commissioner, Australian Taxation Office

SULLIVAN, Ms Glenda, Acting First Assistant Commissioner (ATO Corporate), Australian Taxation Office

CHAIRMAN—I open today's public hearing, which is the first in a series of hearings to examine reports tabled by the Auditor-General in the financial year 2000-01. This morning we will be taking evidence on two audit reports—Audit Report No. 16: *Australian Taxation Office internal fraud control arrangements*, and Audit Report No. 22: *Fraud control in Defence*. The committee has received submissions from Defence in relation to Audit Report No. 22.

We will be running today's session for each report in a roundtable format. I 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: I emphasise the word 'succinct'. 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 a contempt of parliament. The evidence given today will be recorded by 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's statement are available from secretariat staff.

The audit report being considered in this first segment is Audit Report No. 16: *Australian Taxation Office internal fraud control arrangements*. I welcome representatives from the Australian National Audit Office and the Australian Taxation Office to today's hearing. Dr Preston, do you have a brief opening statement you would like to make?

Dr Preston—Yes, I do.

CHAIRMAN—Could you make it very brief, please?

Dr Preston—Yes, I do, Mr Chairman. Thank you for the opportunity afforded the ATO to appear this morning to answer questions the committee may have on the recent ANAO report into the ATO's internal fraud control arrangements. Fraud control is an important issue because of the nature of the ATO's business. The ATO welcomes the ANAO report as providing confirmation that we are handling various aspects of this issue well while identifying some areas where we need to devote more attention.

The ANAO report notes that the ATO has developed a comprehensive fraud control environment. This environment centres around three key themes. Fraud prevention is the first theme. The report mentions many of the initiatives the ATO has introduced in recent years. For example, the ATO has developed a fraud control plan flowing from a comprehensive fraud risk assessment process. The level of change currently under way in the ATO has led to the introduction of processes to keep that plan current on an ongoing basis. The ANAO has acknowledged that the ATO's current arrangements for developing a comprehensive fraud control plan are consistent with better practice. The ATO has also developed innovative fraud and ethics training programs that are highly regarded both in Australia and overseas. These two programs focus on fraud and ethics issues and the ways open to staff to report suspected fraud for investigation. These professional programs have been well received in terms of improving

both staff understanding and the level of reporting of suspected fraud by staff. The ATO has made these products available free of charge to other organisations.

The second theme acknowledges that it is unfortunate but inevitable that in an organisation of over 20,000 people there will be some who act illegally. The ATO has established a team of skilled investigators to investigate allegations of misconduct by staff. The majority of investigators are former Australian Federal Police officers experienced in criminal investigation. ATO investigators work with the AFP if the nature of the allegation under investigation is outside their statutory powers of investigation. Allegations are investigated to the criminal standard of proof. Decisions in response to investigations are made not by investigators but by the Director of Public Prosecutions for criminal matters or by the ATO Official Conduct Team for less serious matters. Both the ANAO and the AFP have complimented the ATO on its high investigation standards. However, the ANAO also advised that there is room to improve the fraud case management system and certain file management practices.

The third theme centres upon internal controls built into ATO processes and procedures. During this audit the ANAO focused on aspects of IT security in particular. Information technology is a complex area in any organisation and particularly in the ATO. Critical elements of that are the practices, procedure and staff that look after the IT security function. In the ATO this is centralised within one area but with responsibilities related to implementation of policy sitting with all managers. The report highlighted three matters that warranted extra attention and I am confident that we are in the process of making necessary changes in the area of policy development, policy dissemination and education. These responses have been supplemented by monitoring and review processes implemented in the period since November last year with substantial progress made in addressing the ANAO's findings. At the same time the ATO's internal fraud control arrangements have not stood still since the report was tabled last November. The fraud and ethics training has continued in the current financial year. To 20 April 3,850 staff have attended the first program and 2,094 the second. Work has commenced on developing the third in this series of fraud and ethics training programs.

Our recently established Integrity Advisory Committee has been meeting quarterly to consider issues bearing on sustaining and reinforcing an integrity based ATO. A major focus has been the establishment of an integrity adviser position for the ATO. The integrity adviser would advise ATO officers and the ATO more generally on ethics and integrity issues that can arise in interactions with taxpayers, service providers to the ATO, and in a normal administration. As far as we can ascertain these types of positions are rare in Australia and we expect to fill the position shortly.

To conclude, the ANAO report has assisted the ATO to look afresh at a constantly evolving set of risks. It acknowledges where the ATO has achieved best or better practice and where we need to improve. We expect to have the majority of the ANAO's recommendations implemented by the end of this calendar year. We are now available to clarify any matter you may have in relation to the report.

Mr McPhee—The audit of fraud control arrangements in the ATO follows audits with a similar focus in the Department of Education, Training and Youth Affairs, the Department of Industry, Science and Resources, the Department of Health and Aged Care, the Department of

Defence and a survey of fraud control arrangements in more than 100 APS agencies. We also have under way fraud control audits in Centrelink, the Department of Family and Community Services and the Department of Agriculture, Fisheries and Forestry and we are planning audits in the Department of Veterans' Affairs and the Department of Foreign Affairs and Trade. At the end of this series of audits, we plan to produce a better practice guide on fraud control management, drawing on our audit work and also any views that this committee may express at the conclusion of this particular hearing.

Dr Preston has covered the ATO audit findings well, so I will not cover the ground. We made 11 recommendations to improve the ATO's administration of internal fraud control arrangements and the ATO agreed to all of the recommendations. We would be happy to respond to the committee's questioning.

CHAIRMAN—One of the things that interests me—if not the entire committee—is the fact that you report a steadily increasing number of incidents of alleged fraud. Can you tell us how many of those 373 cases in 1999-2000 were of the kind that I would call fraud—that is, accessing someone's taxation file with the intent of blackmailing them or selling the information and/or, in placing a contract for goods or services by the ATO, a purchasing officer accepting money from a supplier in order to give the contract to the supplier of goods or services?

Mr Mulligan—I am not aware of any cases in the last couple of years that fall into the categories that you have just mentioned. I have been in the branch for 2½ years, and I am not aware of any cases that fall within the description you have just given.

CHAIRMAN—What do the 373 cases largely comprise?

Mr Mulligan—About 60 per cent of our cases centre on unauthorised use of our computer systems to access taxpayer information.

CHAIRMAN—To do what with?

Mr Mulligan—Our experience is that it is browsing and curiosity and acting in breach of the secrecy provisions in the various tax laws. We have no evidence of officers selling. We have undertaken a number of investigations of staff who have been suspected of leaking information to the media for whatever purposes. But none of those inquiries have ever been able to substantiate to the required standard of proof that a particular individual committed the offence.

CHAIRMAN—Is the definition of fraud currently in place across the Commonwealth reasonably reflective of fraudulent activity? If I am an ATO officer and I decide to have a stickybeak at Kerry Packer's tax file because I wondered just out of curiosity whether or not the constant media reports that Kerry Packer does not pay any taxes are true and, if they are true, how he does that, that is obviously a case of fraud but I am just doing it for fun, for my own education. Can't we do something to get rid of those out of the definition? Wouldn't that make a lot more sense?

Dr Preston—It is probably a service-wide—

CHAIRMAN—I mean in a practical manner.

Dr Preston—Yes, it is a service-wide issue to get a standardised definition. It is clear that there is a considerable degree of variation in the definition. I think that has been acknowledged in previous debate about the measurement of fraud, which inherently and intrinsically is a difficult thing to measure accurately. But I would stress that in terms of managing it as an issue within the tax office we put a very high focus on going beyond the purely quantitative direct harm to the Commonwealth in terms of revenues or expenditures and go to issues like inappropriate use of information, the influence value of gifts, and perception surrounding conflicts of interest. They are all intangibles, but they are of fundamental importance to an integrity based organisation. We think they need very sustained and careful management, but they are very difficult to measure and you cannot devise systems to capture the scale of the problem nor necessarily quantify the nature of our management responses to them.

CHAIRMAN—What bothers me, Dr Preston, is that I would not in any way condone me as an ATO officer having a look at Kerry Packer's tax file. That is not the right thing to do. But I put that in one category of misdemeanour versus the purchasing officer who determined to buy 300 new desks, fully fitted out, and gave the order to a firm that gave him \$25,000 in cash for placing the order with them. The latter I would call fraud. The first, it seems to me, would be a serious misdemeanour and certainly to be discouraged, but I have some difficulty calling it fraud.

Dr Preston—I understand the point you are making. Where fraud transforms itself into misconduct of a different kind I think is a matter of judgment. All I can say on that is that it is not possible to set up processes and management arrangements that simply deal with a narrow definition; we have to deal with whatever we find in front of us. It is the reporting of those outcomes that becomes much more difficult.

CHAIRMAN—But one of the issues that this committee deals with and is dealing with actively all the time is trying to promote worldwide in the public sector—and hopefully that will transfer to the private sector—greater accountability, greater openness, greater transparency and reduction of fraud and criminality in dealings within the public sector and between the public and the private sector. It just seems to me that Australia has such a fantastic case to sell and we have the opportunity to help particularly our Asian neighbours who have very difficult issues to deal with concerning public corruption and fraud. When we say ATO had 373 cases of fraud last year and Indonesia, China or Malaysia have a look at that and say, 'They are just as bad as we are,' does that make sense? Do you understand what I am saying?

Dr Preston—I would not necessarily use that statistic to make that case.

CHAIRMAN—Can you imagine them using it?

Dr Preston—Only with some difficulty. I mean 373 instances in a staffing situation of 21,000 people but with millions of transactions that are potentially sources of fraud, and bearing in mind the point you have already made about how to interpret the 373, I would not regard it as an indicator of a major issue of fraud. It is an indicator that concerns us. You would like to see it down at zero but we know, given human nature, that that is pretty unlikely. We need to watch

trends in it and we have been doing that pretty actively, but I do not think I would interpret it as the source of concern in terms of our international credibility.

CHAIRMAN—I am advised that ANAO considers that your:

... fraud minimisation framework could be enhanced further by making greater use of internal publications and other awareness raising techniques to reinforce the role of the Fraud Prevention and Control (FP&C) Section and extending the compliance certification process to all ATO administrative systems.

Do we run a risk if we do a lot of talking about fraud? Bearing in mind some of the comments I have just made, do we run a risk of actually encouraging fraud by talking about it so much, or do we need to perhaps think about slightly changing the language so that we are encouraging the highest ethical standards of our employees, our contractors and our subcontractors but without constantly using this word 'fraud'?

Dr Preston—I would have a personal instinct to agree with you on that. When you look at the way the tax office has been reacting to the incidence of problems, we have increasingly turned our attention to how we can turn ourselves into an organisation that has a much more overt, higher and perceived focus on integrity as a general dimension of our performance. To that end, as I noted in my introductory comments, we will be creating an integrity adviser this year. We have created an integrity advisory committee, which is one of the first of its kind in the Public Service. We have made major steps in terms of the two videos which something like 20,000 staff have now seen over the course of the past two years. We are therefore trying to transform the culture into a general focus on integrity in the broader context of which the specific incidence of fraud is something that is dealt with—instead of just a narrow focus on the problems, a broader focus on what the behaviour, values and principles are that we require of our staff. In those terms I think we are actually agreeing with the emphasis that you would want to give to it.

Mr TANNER—In item No. 34, findings of the ANAO, Dr Preston, there is reference to the implications arising from IT outsourcing. I wonder if I could ask you a couple of questions about that. I cannot recall offhand who is the contractor. Perhaps you might want to enlighten me.

Dr Preston—It is EDS.

Mr TANNER—In item 34 it states that the risk factors have increased due to the outsourcing of many IT system functions. The ATO contractor staff have limited exposure to ATO forward prevention education and awareness material. The ATO could not provide evidence that the IT security section had monitored outsourced contractors' activity to ensure compliance with taxpayer data security provisions, et cetera. Could you tell me where de facto physical control of the total set of data rests within EDS? Where is that situated and with whom?

Mr Growder—EDS is, as you asked, our outsourced service provider, and they have been for almost the last two years. They started in June 1999. With respect to the question you have asked, the data sits in a centre in Sydney. That is the Burwood centre for EDS in Sydney. It sits on a mainframe, and access from the mainframe is specifically for our use. It is not shared in any sense with any of EDS's other business. We access it, and our ATO systems use the data

from that particular location in the country. The contract as it stands does not allow that data to leave Australia. That is a clause in the contract at some point.

Mr TANNER—Would the EDS staff who are performing work associated with that data all be people who are exclusively working on that contract, or would they in some cases be people who are working on a number of contracts?

Mr Growder—I think the answer is yes and no. The vast majority of them would actually work specifically to us, but there would be a floating population as well where they would bring in a range of people to address particular issues that may move on to other things. The vast majority of them would be associated with our contract, with the proviso that there would be some, especially at a particular technical level or otherwise, that could well be employed for a time working on an ATO issue and move on to other things.

Mr TANNER—How does the ATO respond to the ANAO finding that, in a sense, the integrity of the data and the risk of misuse has been increased as a result of the outsourcing of the IT function, and that not enough has been done to ensure that the risk is brought back to the same level it would have been at had the function not been outsourced?

Mr Growder—Going back two years to when it first started, a large number of our own staff formed the nucleus of the group that actually composed EDS. Something like 140 of our people became employees of EDS. So, certainly at that time, our feeling was that there was a fair ethic and understanding of the basis of what we would have done prior to that particular outsourcing period. Today, roughly the same number of people of the EDS total—and the total is more than that—remain. Of their efforts to undertake whatever work we ask of them, our response is that there is basically again about the same number of people.

We actually put all EDS staff through security checks. Basically, we put them through the same checks that we expect of our own people. Under the various provisions of the contract, the company is considered to be just the same as any other Commonwealth agency for things like confidentiality, security and privacy. So we have attempted to apply exactly the same conditions to them as apply to us.

Mr TANNER—Does that mean that you disagree with the ANAO finding?

Mr Growder—We do not see it in quite the same light. We have applied risks to it, but we would always want to add more to our security arrangements. So we do not deny that there is a risk, and we endeavour to ensure that we are minimising that risk. We do not see it quite in the same light all the time as the ANAO in these areas.

Mr TANNER—Has anything changed in the way you approach this matter since you were advised of the ANAO's finding?

Mr Growder—We have certainly gone back through all our vetting processes and procedures. We needed to do more of the monitoring elements, which we were not doing to the level that was there originally. One of the issues that the report referred to related to providing the evidence that we have done these things, and certainly we have now done more to show that

the monitoring is providing evidence and things of that nature. So we appreciate the advice that we are getting from the ANAO, as a third party offering us a view on what we are doing there, and we are attempting to tighten those controls.

Mr TANNER—This is difficult to express in a short time, but would you agree that a contractor has a different set of accountability patterns on a matter of this nature; when something of this nature is contracted out you have, in a sense, a different set of internal signals, which may not necessarily replicate the kinds of internal signals that you want—the incentives and disincentives for particular kinds of behaviour? Would you agree that there is a different set of internal incentives and disincentives within a contractor for particular kinds of behaviour and, therefore, the ATO's need to ensure security within the contractor is greater even than the ATO's need to ensure security within its own ranks?

Mr Growder—That is a very difficult question. I think our assessment is that we come from the point of view that we are still accountable. I am still accountable for the delivery of a range of services, even though they are provided by the contractor to the organisation. We look at the contractor as being an extension of our capabilities to the organisation itself. So, on questions of accountability, I am still accountable.

Mr TANNER—What penalty would EDS offer as the contractor under the outsourcing contract if there were a significant number of incidents of unauthorised access or fraud perpetrated by EDS employees? Is there a specific provision which provides that there is a penalty to be imposed on the contractor in those circumstances?

Mr Growder—There is a penalty regime that applies to a whole series of elements to do with the services they provide. The regime actually goes by the name of 'service credits'. It refers to the next bill that comes forward from the company.

Mr TANNER—So it is a bit like penalties on your drivers licence?

Mr Growder—Yes—points. But points can be applied in the sense that it is a fine and so much money is not provided to them in that regard. That is the general regime. In relation to security, depending on the severity of it, it could actually lead to termination of the contract. So there is a range of things in that area. I think they would have to be taken on a case by case basis. From my recollection of the contract, for various things under that service credit capability we could actually terminate the contract.

Mr TANNER—For the record, could the ANAO comment on this question?

Mr McPhee—The broad question you asked initially?

Mr TANNER—To what extent do we have an additional risk in these areas arising from outsourcing of those functions? Are you satisfied that that risk has been alleviated by the measures that are being taken by the ATO?

Mr McPhee—Certainly the risks change, and it is important for agencies to be aware of that and manage that. In this particular area, our report said that it was important that the ATO

contractor staff have the same sort of exposure to the education and awareness material as the ATO runs for its own staff, so that they equally are aware of the importance and are conscious of security of matters. We felt a little more had to be done there. Similarly, in the monitoring of contractor performance, we said that the ATO should focus on that as much as they focus on their own staff—which was the point that Mr Growder made earlier. We felt that the tax office needed to do a little more to recognise that the risks had changed and that there may be a need to be conscious, when they run these programs or do this monitoring for their own staff, that the contractors are included within that umbrella.

Mr TANNER—Do you take much cognisance of the fact that a very substantial proportion of the EDS staff are ex-ATO staff?

Mr McPhee—It is certainly a factor. But over time things change, and unless you put the regime in place initially you may not pick it up later on. I think there needs to be a consciousness that the world and the staff will change over time. So, while you may take some comfort early, I still think that you would not want to rely on that totally. The regime you put in place on the appointment of the outsourcer should obviously take account of the different risk profile.

Mr TANNER—Have you had any discussions with the tax office about subsequent processes being undertaken to respond to your concerns?

Mr White—Since the conclusion of the audit?

Mr TANNER—Yes.

Mr White—We have not been back in there doing an audit, but we are, as part of the financial statement audit, looking at some of the initiatives that the ATO will be taking and what has been implemented. So we are having a look at it as part of the financial statement audit this year.

Mr TANNER—Do you have any view to express on the ATO's response to your finding in this instance?

Mr White—Not at this stage. It is early days yet, and I do not think we have come to a formal view.

Mr COX—I am wondering why the same controls or an equivalent standard of controls to those that are placed on the mainframe have not been placed on access in the wider area network, in terms of tracking unauthorised access.

Mr Growder—Some of it has to do with the fact that the wide area network and the world of PCs and networks are far more recent to us than the mainframe in terms of maturity of technology. So it is a question of the technology that we can get hold of to help provide those forms of access controls. That is the first instance. The second is that the report has certainly concentrated on some elements, but you should not be left with the impression that the wide area network does not have a range of other controls as well. For instance, people do have

passwords. The whole network that we have in the ATO—and I think we were probably one of the first government departments to do this as far back as the late 1980s—is encrypted. So the data that passes around our network and passes interstate and things like that is all encrypted in that sense.

We also have a particular arrangement that is strange amongst government departments; that is, the PCs that all our staff access have no floppy disks, so data that must get into our organisation and into the wide area network has to come in through some very specific control points. All those sorts of elements—and there are others—tend to assist us in that regard while the technology starts to catch up with what is available in our mainframe world. We are hopeful that in the next 12 months, with the release of some new software, that gap will be reduced substantially.

Mr COX—At the moment, you would be able to track an individual's access, presumably, by some kind of datamining software if you suspected an individual of persistent fraud—using your definition of fraud, not the chairman's. If you thought that somebody was leaking information to the media about the tax affairs of celebrities or high profile individuals, you would have ways of tracking their access to that data through the WAN, wouldn't you?

Mr Growder—With the addition of some new software that we have purchased as a result of one of the recommendations being made by the ANAO, we are in a far better position to do that than we were previously. Again, it is an example of a capability that has become available. That software now is being installed to give us far more ability to do that tracking than we had originally.

Mr COX—I was very interested in the certification that you have put on various systems. There are some systems apparently that are termed 'legacy systems' that do not have it. Can you tell us a little bit more about which systems have got certification and which ones have not, and what the certification actually implies?

Mr Growder—I think I would need you to refer me to the comments being made.

Mr COX—It says here:

31. The ATO's Financial Services Section utilises a 'Certificate of Compliance' process to provide assurance that new financial systems have controls in place to prevent and detect fraudulent activity.

Mr Mulligan—I might be able to help the committee on that point. The ATO has got a process in place whereby it issues certificates of compliance in accordance with our chief executive instructions to ensure that various financial processes inside the ATO have controls in place to manage the risks inherent in those particular systems. We have had a program in place now for at least 18 months. I know it has been running longer but I cannot give you any more details beyond that period in time. We have been progressively going through all of our financial systems and giving them certificates of compliance to ensure that those risks are being identified and appropriately managed. What the audit has identified is that there are some of our what we call legacy systems, which are primarily systems for taxes which are no longer collected on a day-to-day basis because, as part of tax reform or various other legislative

amendments, the tax is no longer current. I will give you examples of, say, sales tax, PPS or something along those lines. A number of those systems have not gone through their process. If you were to ask me which particular systems we have or have not done, I cannot give you that detail now. I can give it to you later if you wish.

Mr COX—Did you say that PPS was one of them?

Mr Mulligan—No, I cannot say.

Mr COX—I am advised that withholding tax is one of them.

Mr Mulligan—Withholding tax could be a legacy system. The report does not say that all legacy systems have not been certified. It just says some of them. I cannot give you a list. I know that there was a program running for months because some of my staff is actually assisting our finance area in providing these certificates of compliance. I cannot tell you at this stage what level they are or what stage they have reached in meeting that plan.

Mr COX—Ultimately, are they all going to be subjected to a process by which they can be given a certificate of compliance?

Mr Mulligan—That is the ANAO recommendation we have agreed to.

Mr COX—Can you give us a list on notice of which of the legacy systems have got certificates of compliance and which have not?

Mr Mulligan—Yes.

Mr COX—And the time frame that you think they may all get them within?

Mr Mulligan—Yes, we can do that.

Mr COX—We are advised that there are not certificates of compliance for non-financial systems. Is the private binding ruling system a non-financial system?

Mr Mulligan—It would be a non-financial system.

Mr COX—What is our current level of assurances about fraud control in relation to private binding rulings?

Mr Mulligan—The processes for issuing both public and private rulings were treated exactly the same as other processes operating inside the ATO. They fall clearly within the ambit of the fraud control plan for the whole ATO. They were reviewed as part of that process when the latest fraud control plan was developed. With changes to legislation and the like, various processes including the private binding rulings regime have been or are being reviewed. I cannot give you the current status of that review but I am aware that it has been reviewed. The commissioner announced the Sherman report, which you have probably seen in the media, and

there are various other initiatives that we are doing as well which would require the fraud control arrangements to be reviewed yet again.

Mr COX—Can the committee have a copy of the Sherman report?

Dr Preston—In the circumstances, that would be a question you would have to discuss with the Treasurer. Let me add to the earlier response. The tax office is now going through a very protracted process of reviewing the entire private ruling process. It is looking at it end to end, rather than simply as a series of functions located in each of the tax lines, and bringing together very active management reformulated IT systems to support it and overall management of the function in our Office of the Chief Tax Counsel. That process is still under way. Until we have seen how it operates as a result of these reformulated processes we will not have much data on what the impacts have been. We are also creating a publicly accessible database as a result of the Sherman recommendation.

Mr COX—Would you ask the Treasurer if the committee can have a copy of the Sherman report?

Dr Preston—I would certainly discuss it with the commissioner in the first place.

Mr COX—The report shows a very high use of Firecall in December 1999 and January 2000 and then it trails off quite substantially. Have you had any further peaks in the use of Firecall since the data set out in the report—which I think goes to August 2000—was put together?

Mr Growder—Let me explain the use of Firecall for that period of time. The period of time in question involved our security people, approval processes and legitimate use being requested for the actual product for those particular peaks that you are addressing. The peaks involved some necessary changes to our environment. There were three instances and all of them have been investigated to ensure that there was nothing untoward in relation to them. We are satisfied that we can legitimately account for the peaks that you are looking at there. It has been suggested to us from some recent discussions with the ANAO that we had another peak earlier this year. We are in the process of investigating that, but the peak in that sense involves nowhere near the numbers that are attributed to those periods.

Mr COX—What was the reason for the peak at the beginning of this year?

Mr Growder—We have only just had that discussion with the ANAO and we are looking at that now.

Mr COX—When you say you have investigated those peaks and found that the reasons for them were justified, that implies that you have taken a sample of Firecall usages and looked at them to see what the nature of the purpose was and then made some deductions about what the whole use has been. I take it that you have not been through the whole of every single usage and checked that each usage was valid.

Mr Growder—I do not believe we could go through every single one and make a judgment, but they were all around a specific purpose at the time. For example, one of the peaks related to

a series of tests we did as a result of preparing for Y2K. We ran a Y2K scenario in advance of 2000 coming into being and then we used Firecall to validate that we got the answers that we wanted. That was a test environment in that sense.

Mr COX—But that is one use out of—

Mr Growder—That would involve hundreds or thousands of uses just to validate that test. I can give you other examples but that would be one of those contributing to those peaks.

Mr COX—On an ongoing basis, are you going to sample or are you going to review every use of Firecall?

Mr Growder—We want to get to 100 per cent. We do have the data for 100 per cent. We are logging all accesses to Firecall, but we want to get to the point where we can look at each one of those to be totally satisfied in that regard. We are certainly keeping the data around every one of them.

Mr COX—The ANAO report says:

ANAO has noted that Firecall continues to be used so frequently that effective independent review by the ATO IT security section is administratively unachievable.

What level of use of Firecall do you have to get down to before you can actually get to your target of checking every use of it?

Mr Growder—That is a judgment call I am not prepared to make for the committee at this point. We are tackling it from two points of view. We are certainly trying to reduce the number, and that increases the opportunity to be able to look at every one of these. We are also attempting to automate some of those processes as well. The more we can automate to make those checks, the better we will be able to handle the number.

Mr COX—Have you got any feel for how small the average number of Firecall uses is going to be in any month?

Mr Growder—I personally do not. I might ask my staff to assist me in that regard.

Mr Hirschfeld—I would put it in the hundreds per month—200 to 300 per month. I would also like to say that there are two different things that are reported. What is reported with 20,000 usages is every access an individual might make, or every record an individual might look at, as opposed to a usage which is somebody asking for access to Firecall to do a job, which may include looking over 100 different records. So somebody's single usage might actually involve thousands of reported incidents there.

Mr COX—The ATO report says on page 86 that in two months there were 24,911 uses of Firecall. On the opposite page it says that the contractor staff used Firecall, in January 2000 alone, 14,228 times. If they were directly comparable, it would be possible to deduce the

number of times non-contractors, that is ATO staff, had been using Firecall. Are ATO staff using Firecall or is it totally an EDS operation now?

Mr Hirschfeld—In that particular instance it was almost all EDS.

Mr COX—If it is being used to keep the system running, as a general rule, you would expect it to be EDS staff or the contractor?

Mr Hirschfeld—Yes.

Mr COX—What are the circumstances in which ATO staff are using Firecall?

Mr Hirschfeld—There are particular ATO systems that ATO staff support, so there are ATO staff on call, and if a mainframe system goes down an ATO staff member might have to come in and do emergency fixes on them.

Mr COX—Why aren't EDS staff running those systems?

Mr Collins—I think I can help here. Essentially, what we are talking about in the instances of ATO staff using Firecall are instances where production application systems have failed, aborted or broken down for whatever reason, most usually due to corrupt data, and Firecall is used with appropriate authorisation to remove the corrupt data and re-establish the production processing.

Mr COX—So there would only be a very small number of cases in which ATO staff would have access to the system using Firecall, and you could get a reasonable degree of assurance at least about your own staff?

Mr Collins—There are certainly limited numbers. They are certainly authorised on each occasion, and that is documented in the evidence that is kept within the organisation.

Mr COX—What sort of level are the officers that would do that?

Mr Collins—They range from ITO2s, typically—people who are application development programmers supporting the specific application systems that have crashed in production.

Mr COX—So they are not necessarily people who are actually running the tax system on a day-to-day basis and might have the levels of curiosity that somebody who was dealing with taxpayers' files might have.

Mr Collins—They are certainly not running the taxation systems on a day-to-day basis. They are familiar with the application systems that the production work of the office is supported by, and they will be called in to use their specific skills to fix any problems that occur. That is what they would be focusing on at the time.

Mr COX—That is things like paying refunds and doing other processing?

Mr Collins—Yes.

Mr COX—On page 27, audit recommendation No. 9 states:

The ANAO recommends that, to improve the efficiency and effectiveness of its internal fraud strategy, the:

Fraud Prevention and Control Section make further use of the Analytical Support Section to identify potential fraud-related cases and assess the further investigation of these cases against other work priorities—

What sorts of trade-offs are you presently making between fraud cases that you are investigating and ones that you are not?

Mr Mulligan—All allegations that are referred to FP&C are vetted before they go anywhere inside the section. That way, before cases are referred to the investigators, all the preliminary work has been done, and they receive a cluster of documents and background information that is relevant to that particular allegation before any fieldwork and the like commences. So the investigators use my research area which uses computer assisted audit techniques, which are comprehensive computer based data analysis programs similar to a data warehouse. They can look for data correlations, trends and abnormal connections which are very difficult to see in a mass of data but which can be detected through computer analysis.

In terms of cases deferred, obviously the most important cases get done first. As is indicated in the report, we tend to collect the less important ones for a period of time and then we might do six or eight cases in a particular region in one hit. All important cases are done as quickly as we can. In the last couple of years when any major cases have come up, I have had no problems getting extra resources from the commissioner to engage temporary extra staff to get that work done. So important cases are done immediately. When I say ‘immediately’, I mean a period of probably four to eight weeks of receipt in the area. Less ones can take anything up to six or eight months before we would start on those.

Mr COX—What sorts of cases would be deferred?

Mr Mulligan—A less important one could be something like allegations that someone is disappearing from work, abuse of leave or unauthorised use of fleet vehicles—things where the facts have already been settled and there is limited opportunity for the person to vary the facts. They are generally of lower potential monetary consideration as well.

Mr COX—The table on page 36 shows what sorts of fraud cases you are investigating. How many of them would be things where Commonwealth money was actually being misappropriated or stolen—and theft is a pretty obvious case—or there was administrative fraud? Those are things where actual Commonwealth money is at stake, I take it?

Mr Mulligan—They could be, yes.

Mr COX—We have heard that information access is not.

Mr Mulligan—No.

Mr COX—Information fraud disclosure and use?

Mr Mulligan—That would be like the media leaks I mentioned earlier.

Mr COX—So that is not. Do you have any conflicts of interest that have related to losses of Commonwealth money, or have they been more breaches of ethical standards?

Mr Mulligan—More breaches of ethical standards.

Mr COX—What about the breaches of the code of conduct?

Mr Mulligan—They are generally not monetary again.

Mr COX—That is bad behaviour towards taxpayers, bullying, overzealousness and things like that?

Mr Mulligan—Overzealous behaviour would normally be handled inside our business and service lines by managers on a day-to-day basis.

Mr COX—What sort of breaches of the code would come to you?

Mr Mulligan—Vehicle misuse and inappropriate use of Commonwealth assets.

CHAIRMAN—Road rage!

Mr COX—What about administration inquiries? What sorts of things come under that?

Mr Mulligan—That is almost like a miscellaneous category.

Mr COX—Which also includes impersonation of a public officer, bribery and damage to computer data.

Mr Mulligan—Yes. That might sound like an exaggeration but, only a fortnight ago, someone was arrested in Newcastle for impersonating a tax officer. We take that extremely seriously. As you know, the commissioner has certain powers which we insist on being used properly. We do not like posers.

Mr COX—But that is actually a form of fraud that is outside the tax office, isn't it?

Mr Mulligan—With issues like that we tend to work with the Australian Federal Police in a joint exercise.

Mr COX—How many bribery cases have you had?

Mr Mulligan—I am not aware of any. Up to three, I understand, but I am not aware of any myself.

Mr COX—Damage to computer data: is that people trying to assist others evading tax liabilities, or is that just malicious behaviour by disgruntled officers?

Mr Mulligan—I am not sure about that one, either.

CHAIRMAN—Or is that computer rage when the bloody thing isn't working?

Mr Mulligan—I am advised that officers have adjusted data to cover transactions where they might have got a benefit, for example, for travelling allowance and things like that along those lines. They are actually manipulating financial data to cover their tracks.

Mr COX—So that is administrative fraud rather than fraud related to the tax system?

Mr Mulligan—All the fraud that we deal with is internal fraud. There might be an odd case where an external fraud has internal linkages as well, but my section, this report, only focuses on internal fraud.

Mr COX—Yes. We are aware of that.

CHAIRMAN—We could keep going, but I would not want to deny our friends in Defence the opportunity to—

Mr TANNER—Could I ask one more quick question? I will be very quick.

CHAIRMAN—I want a very quick answer, then.

Mr TANNER—Can you give me an indication of what percentage of forms now are lodged electronically, what sorts of savings that might have entailed administratively, and whether that requires a different approach to fraud protection?

Dr Preston—Could I take it on notice and give you an answer in those terms? I would just be guessing the numbers. I am not sure any of us here could give you precisely accurate numbers.

Mr TANNER—I am interested to know precisely, in terms of all these issues, what difference that makes.

Dr Preston—Okay.

CHAIRMAN—Since we are taking things on notice, can you take on notice that if the committee has any further questions we will put them in writing and would appreciate your response.

Dr Preston—Sure.

CHAIRMAN—Are we all done? Thank you very much to the taxation office and ANAO.

[11.44 a..m.]

GUILFOYLE, Mr John Joseph, Director, Performance Audit Services Group, Australian National Audit Office (currently on secondment to the Health Insurance Commission)

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

MINCHIN, Mr Tony, Executive Director, Performance Audit, Australian National Audit Office

NEUMANN, Mr Claude, Inspector-General, Department of Defence

TAYLOR, Mr Martyn Fredric, Assistant Secretary, General Investigations and Review, Department of Defence

CHAIRMAN—We now come to the second audit report to be examined at this morning's public hearing. I remind witnesses that the hearings today are legal proceedings of 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. 22, *Fraud control in Defence*. I welcome representatives from the Australian National Audit Office and the Department of Defence to today's hearing. Mr Neumann, do you have a brief opening statement you would like to make?

Mr Neumann—No.

CHAIRMAN—Mr McPhee?

Mr McPhee—The objective of this audit was to establish whether Defence has developed sound fraud control arrangements consistent with better practice to fulfil its responsibilities to protect its property and revenue from fraud. The audit was one of a series of audits of fraud control arrangements in Commonwealth agencies, as I indicated in the committee's previous hearing. The level of detected fraud affecting Defence is low: some \$2.5 million in 1999-2000. Nevertheless, we felt that fraud control in Defence could be improved, particularly in corporate governance and fraud intelligence, which underpin the fraud control process. Specifically, we considered that the Defence audit committee could give more attention to monitoring and developing Defence's fraud control plans and that Defence could establish a fraud intelligence capacity. With such a capacity, Defence could identify factors that may increase the risk of fraud and enhance its fraud protection and detectionability. Our fraud intelligence capacity would also enable Defence to benchmark its fraud control work against comparable organisations, and would help in fraud risk assessment.

A limited comparison with the UK that we did suggests that fraud in or against Defence may be underestimated. Defence could also address a number of issues concerning the fraud risk assessment process. These concern the delays between assessing risks and developing fraud

control plans, the level of feedback to groups on fraud related matters and the qualifications of personnel engaged in the process. The audit report also suggests improvements that could be made relating to fraud awareness and fraud investigations.

CHAIRMAN—In the audit report we are advised that the Australian Institute of Criminology has estimated that in the public and private sectors fraud costs the community between \$3 billion and \$3.5 billion a year. They go on to say that this makes fraud the most expensive category of crime in Australia. While Defence expenditure amounts to about \$13 billion a year, the new report for 1999-2000 says there is \$2.5 million worth of fraud. Is that realistic or is it only the tip of the iceberg? I do not want to hear any perjury.

Mr Neumann—I might answer that question by going back to a report that was done in about 1993 by the UK National Audit Office. In there it asks the same question. It says:

The immediate question arises as to whether these cases—

and it is talking about procurement fraud—

represent the majority of frauds being perpetrated or whether the cases discovered are just the tip of the iceberg. Unfortunately there is no way in which this question can be answered.

It goes on to say that, nevertheless, departments—including the MOD—should take steps to ensure that fraud is actually detected and prosecuted. There is also other evidence: the odd academic has also asked the same question and come to the same conclusion.

In all cases when you are dealing with fraud the bottom line, or the floor, is the detected amount. It is the same case with the police: the crime statistics are only the reported amount. The question in my mind really is whether there is a gap between what I call the floor and the ceiling. Here it is difficult, but we have had a look at the UK figures and in terms of procurement fraud—and this goes back to 1993—they reported that in 1990 the Ministry of Defence had more than \$9 billion worth of contracts, and \$10 million dollars were under fraud investigation in 1990. That represents 0.1 per cent, and, as you will recall, we have ours at about 0.03 per cent. In 1991 it went up to \$30 million and was 0.3 per cent. Again, there is quite a big difference.

But I would emphasise there that this was fraud under investigation. This was not fraud that was actually proven, and when you look at the figures for the mid-eighties for the UK either they could not prove it or in fact no fraud was committed. So the answer to your question is: it is a floor and the gap between that and the ceiling is, I think, reasonably close, but how close I do not know.

The other issue—and I have not found an agency that actually can do it with analytical certainty—is that consistently over the last five years we have detected about the same amount within a fairly narrow band range. I would have expected by now that, if we were not detecting all that much, we would have had quite wild fluctuations. However, I would emphasise there is still the possibility that, just as the same as you get a one-in-a-100-year flood, you will still get a

one-in-a-50-year fraud, which would be quite high. In fact, if we go back to 1915, there was one of those.

CHAIRMAN—Appendix 1 in the ANAO report talks about the types and number of cases investigated—nine of purchasing fraud. We do not have against that any analysis of the outcome of investigations, so I do not know whether all nine of those were proven or none were proven, nor do I know what type of purchasing fraud was investigated.

It was my experience that, with a private sector contractor dealing with the Commonwealth and the state governments, no-one, to the best of my knowledge, would even think about trying to bribe a purchasing officer to obtain a contract, because the chances of success were about zero and the chances of being caught and hauled off to prison were very high. Can you comment on that?

Mr Taylor—I cannot give you a definitive answer on what proportion of those nine were found to be guilty but as a general rule of thumb I think we work on about 30 per cent of cases that we investigate being proven. So you are possibly looking at about three, I would think.

CHAIRMAN—None of them must have been very big, since the recovery of moneys was only \$169,000.

Mr Neumann—The recovery of moneys does not necessarily relate to the year of the fraud. Sometimes it does but it is quite rare. We had one that I can think of where we recovered the money before we got a conviction but that was the exception. The recovery of moneys can take several years. With one of the cases I can think of, we are still getting money back from about 1991 and we will still get money back in future years, so there is no direct correlation between the recovery of moneys and the amount of fraud.

CHAIRMAN—Can you do something for us, please. Take table A1.1 and all four tables: can you consolidate them so we can have against table A1.1 outcomes? Is that possible?

Mr Taylor—That might not be possible at this point in time because some cases could still be going through the courts given the length of time taken to go through the legal process.

CHAIRMAN—With the greatest of respect, ‘outcome of investigations—67’. You have got outcomes and there are only 70 cases, so it is pretty close, Mr Taylor. You may not be 100 per cent but you can certainly be close to 97, can’t you?

Mr Neumann—Yes.

CHAIRMAN—That would be helpful. The next question also relates to personal experience. One of the things that bother me a bit about the 2.5 million is that Defence is a huge establishment with assets all over the place and very tradeable commodities all over the place too. I recall working for the United States Navy in an overhaul and repair station and I can tell you—it was a long time ago; it was back in—

Mr TANNER—The First World War?

CHAIRMAN—No, it was not World War I. It was in the 1950s. Man, the controls on the gate were zip. If you wanted to walk out with tins of petrol, reams of paper, toilet tissue or whatever, the possibilities were almost unlimited. I have not seen any security at Australian bases—and I have been to quite a few—that made me think that we have a situation any different from what we had at the Norfolk Naval Air Station in the 1950s.

Mr Neumann—There are two things. First, our experience would mirror yours. We had a truck that went out with a ship's propeller—I am not actually quite sure, but I think it was a ship's propeller—which we eventually recovered after it was sold off as scrap. We eventually got hold of the scrap dealer and it was returned to us. So your point is taken. The second issue is whether it is—

CHAIRMAN—It was probably a Collins prop worth \$1 million.

Mr Neumann—No, I think it was probably something older and therefore intrinsically more valuable in terms of the metal. I cannot recall what it was made of, but I remember being quite horrified. The guard said that he saw this truck behaving suspiciously, but he did not do anything to stop it, which I thought was pretty clever! But it also becomes an issue of value for money. To track down toilet paper or pens is not value for money. When we get into higher value items we are looking at techniques to track them—so that automatic alarms would be set off with higher value items—but that again has a cost; it has to be monitored.

When you are talking about deployed assets, when you are in the field you do not actually go through an electronic barrier of any description, so it becomes harder again. When you are talking about clerical assets you can run it a bit like a library where there are those magnetic tapes. There are ways around that too—by destroying the book or the book binding for a start. But once you are out in the field with equipment it is 360 degrees, so you can go anywhere with it essentially. It is only by recording assets and making supervisors track them—by electronic, paper or whatever means—that we get controls. And we do have a strong audit program.

CHAIRMAN—Do I remember rightly that you do not yet have a complete asset register?

Mr Neumann—The asset register is not in good shape.

CHAIRMAN—Since you do not know what you have it is very difficult for you to tell us, convincingly, that you know that you still have it.

Mr Neumann—If a thing has been recorded, we can probably tell you whether we have still got it. If the thing has never been recorded, there may be no record that we ever had it. In that case, have we actually lost it? How can we prove to you that we have actually lost it? That is the question.

Mr COX—Milo Minderbinder lives on.

CHAIRMAN—I am simply pointing out to you the laxity in control.

Mr Neumann—I completely accept your comment.

CHAIRMAN—ANAO reported that on one major construction project \$37 million was paid to contractors as prepayment for materials that were neither listed in invoices nor verified before payment. How on earth did that happen, and how can you assure us that it is not going to happen again?

Mr Neumann—I would say it was a management issue in terms of prepayment. In terms of not being checked against the receipt of whatever the services or goods were, it is a supervision issue. We do have an issue in the department about that, not just in Defence Estate. The other issue, I think, is with accrual accounting. Prepayment certainly should be a thing of the past, because you can roll over.

CHAIRMAN—Do you have a problem any more with trying to get rid of money by 30 June?

Mr Neumann—There are two things: firstly, it should not have been an issue in the first place and, secondly, with accrual accounting things can be rolled over, so that should have reduced the incentive.

CHAIRMAN—It should have, but has it? You cannot say so with any certainty.

Mr Neumann—I always like to have about 10 years of evidence, being a cautious person. I do not think the evidence is in yet, because this is only the second fiscal year that proper accruals have been in.

Mr COX—At the risk of setting the chairman off on one of his favourite paths of inquiry, was the \$37 million for a construction project or a capital acquisition project?

Mr Minchin—It was for a construction project.

Ms GILLARD—I want to go back to the \$2.5 million figure. I understand that there is a difference between fraud underdetection and the actual level of fraud. Just looking at the fraud underdetection figure, you mentioned some 1993 UK stuff, but in the audit report, at 3.21 and 3.22, there is a comparison with UK stuff from 18 May 2000 and the conclusion of the Audit Office is that, if you applied the UK percentages to the fraud underdetection, then you would come out with a figure for Australia of \$15.2 million. It seems to me there are only two possibilities for that discrepancy. One is that you could conclude that the British are more susceptible to criminal activity than the Australian community—and that might not be popular with those of us who migrated from the UK. The second possible conclusion is that we are not as robust at detecting fraud as the UK defence establishment. Do you have a comment?

Mr Neumann—There are a couple of issues. The first is that comparisons are problematic because there are different systems. I think the UK Audit Office made that quite clear in 1993 when it said, of comparisons with the private sector::

Many commercial organisations, such as banks, are reluctant to reveal the extent of fraud ...

because of reputation issues. It then went on to say:

... few if any organisations in the UK purchase such large quantities of manufactured products. Moreover, public sector organisations abroad work within such different legal frameworks and procurement arrangements that make it difficult to draw conclusions.

So one of the issues is whether we are actually comparing like with like. My colleague here has done some slightly different calculations.

Mr Taylor—Yes. You can look at the figures that are included in the report in a slightly different way. For example, if you take the £17 million in paragraph 3.22 and then look at paragraph 3.21, where it says that that represents 75 per cent value of frauds investigated by the ministry, that would give you a figure of approximately \$23 million worth of investigated fraud. If you then go back to the end of paragraph 3.13 for the total defence budget of \$23 billion, that gives you a fraud level of approximately 0.1 per cent, which gives you quite a different impression from the way it has been interpreted there.

Mr Neumann—I went to a data mining conference only last Friday. A comment was made there by a fairly small organisation, but a worldwide one, that their estimate was that about 0.1 per cent of whatever population you are looking at for statistics could be characterised as fraud, including theft. So, to the extent that we have got any figure, the figure of about 0.1 seems to be about right, but with all the caveats about international comparisons, different jurisdictions and different definitions of fraud, which is another issue we come up with—different jurisdictions have different definitions.

Ms GILLARD—Okay. I might get the Audit Office to respond to that a little later. Moving to the question of total fraud and the gap between detected and total, I understand Defence have come to Senate estimates over the last couple of years and, under questioning, have indicated that their monitoring of loss and theft of Defence assets is basically limited to computers and weapons. Is that true or false, or have you moved on from that stage? If so, how?

Mr Neumann—In terms of risk, you do the high value and in our case probably more dangerous things we hold in greater detail. Certainly the risk of losing a personal firearm is much higher, (1) because it is smaller to conceal, (2) it is more attractive and (3) it is easier to get away with than a bomb or a missile. But they are also tracked. If you are asking what level of tracking do you want and how much are we prepared to pay for it, we do not track, for example, pens, paper, toilet paper—those sorts of things.

Ms GILLARD—Uniforms?

Mr Neumann—Uniforms are tracked in bulk, but not individually. We have just done an audit which suggests very strongly that units are holding far too many uniforms. This is where we start to get into a grey area. With fraud you have to prove intent, particularly to get a

conviction. In the US they use the term 'waste and abuse'. What our auditors are finding is that the bulk of it, in terms of actual alleged theft, if you like, is not managing the asset most efficiently. But, again, if you go back to the UK, their National Audit Office made it quite clear that a lot of people will give contractors and others the benefit of the doubt. They regard it as sharp practice rather than automatically assuming that people are being fraudulent or thieving. Therefore, they may not report something because they think it is sharp commercial practice rather than an intent to deceive. But proving intent to deceive is actually quite difficult.

Ms GILLARD—I accept that. At the end of the day, I do not have a problem if Defence has gone through area by area and, having made rational judgments about what likely losses there are and what the cost of detection is, has said that it is more cost effective not to do the detection mechanisms. I understand that. I used to be a partner in a law firm and we did not track stationery, for example, because, if the secretary or one of the lawyers flogged off with 20 pens, everybody would live. So you do make those management decisions. I understand that. But it seems to me there is a difference between that process and not doing it just because you do not do it or you have not done it historically. I am not getting a clear view, outside of weapons and computers, as to whether you have made an asset by asset decision about that detection.

Mr Neumann—In terms of assets, we are still moving from the historical to what we regard as good management practice. There is no doubt about that. So we are still on that curve. The very fact that for the last three fiscal years we have had quite large amounts of assets first found shows that the asset registers are not complete. If you then ask whether it is by commission or omission, I would say it is by omission. I cannot prove to you that it has been deliberately done in order to gain an advantage by deceit, which would be fraud, including theft. So there is a way to go yet and I think Mr McPhee would agree with that—at least I hope so.

Mr COX—When do you think these asset registers are going to be in shape? This is a saga that is longer than *Blue Hills*.

Mr Neumann—Given that it has taken us the best part of a century not to get there, I think progress has been reasonably swift in the last few years. But whether we will ever get to it being 100 per cent is the question, because we have so many areas that actually buy things and, if they are not put on the register—going back to the chair's question—when they are bought, they are not recorded. Therefore, even if, at the end of the day, the investigators come around, for whatever reason, and say, 'We think the person's actually stolen this,' to prove it is going to be almost impossible in a court of law. So we need the registers for two reasons. So we need them primarily for good management—and this gets to the efficient and effective use of resources under the Financial Management and Accountability Act—and, secondly, if we have a problem, in order to get a conviction Defence needs to be able to prove that we actually are the legal owners of the assets.

Ms GILLARD—To get the assets into a serviceable shape—rather than a perfect shape—what is the time period?

Mr Neumann—I think the chief financial officer is hoping that it will be within a year.

Ms GILLARD—Within a year from where we are now?

Mr Neumann—Yes.

Ms GILLARD—We will probably end up talking to you about that in a year's time. We will see how we go.

Mr Neumann—To the chief financial officer, anyway.

Ms GILLARD—Moving to the table that the chairman was referring to, which was on page 61, I have a couple of questions. One question is about the division between what you do and what the military police does and the availability of aggregate figures, as I understood that the Audit Office said to us earlier that about 85 per cent of fraud, theft style things, is investigated by military police, and any outcomes from that are not included in this figure. I know the chairman has asked you for further clarification of this table, but can we get total figures, including what the military police do? And can we get guidance from you about what is the dividing line between what military police would do and what you would do?

Mr Taylor—I will answer the second part of the question first. The general approach is that we take the more serious matters or the more sensitive matters. Things that might fall into the more sensitive category would be cases involving senior officers, for example. In terms of determining what is more serious fraud, we have a guideline that, where the military police are investigating something which looks as if it will involve \$5,000 or more, then they are to consult with us and we have discussion as to who investigates it and also under which jurisdiction we do that investigation. That generally works quite well. There will be occasions where the Inspector-General Division will get a case which is below \$5,000 which we think would be more appropriately done by military police and we will refer it to them.

With regard to the second part of your question, yes, we can certainly provide you with some information from the military police investigations but, unfortunately, they cannot break it down into specific types of fraud as we have done here.

Ms GILLARD—Why is that?

Mr Taylor—Either because they do not have the information or they did not, at the time, have an information system that allowed them to do that. We have recently introduced a new case management system for all investigative services in Defence. Previously, we had four separate systems. We have introduced a new system and that was rolled out at the end of last year. So, in the future, that will enable us to give a response for the whole of Defence.

Ms GILLARD—So that is going to be online from now on?

Mr Taylor—Yes, that is online now and we are finetuning it and we would expect that, from this year on, we would be able to give that sort of information.

Mr Neumann—That is with the exception of Army, where we have a few difficulties in terms of our local area networks being able to handle the additional information.

Ms GILLARD—Until we can get to a stage where we can see it all displayed, you have got to worry about the robustness of the data really, haven't you? You have got 85 per cent of it in the military police and you are dealing with 15 per cent of it.

Mr Taylor—We make annual returns to the Attorney-General's Department which are not of this detail but which do give the picture for the whole of Defence. That will include the investigations from the service police—not broken down into this amount of detail, but certainly giving an organisational picture of what is happening.

Mr COX—That is the Commonwealth Law Enforcement Board, is it?

Mr Taylor—Yes.

Ms GILLARD—Moving on to instances of fraud and looking at that table again, my attention has been drawn to a report in the *Sydney Morning Herald* on 24 April this year which mentioned cases of fraud uncovered, including in the Commonwealth Department of Defence, noting that:

... staff problems led one employee to assume two roles, allowing creation of false vendor information in a financial management system, defrauding the department of nearly \$200,000.

Can you tell me whether that case appears somewhere in the statistics that have been given to us?

Mr Taylor—It certainly will not be included in these statistics, because it is obviously a current case. I would have to say that I am not aware of that case. Do you know whether that was a recent case?

Ms GILLARD—I am relying on the *Sydney Morning Herald*. Hopefully, they know their business.

CHAIRMAN—Well, that is an authoritative source!

Ms GILLARD—Absolutely—full of authority! It was 24 April this year, so I would not have thought that they were knocking the mould off it if they were reporting it then.

Mr Neumann—We have had some where they have redone fairly old cases. What you are talking about is a separation of duties, and that is an issue not only from the point of view of fraud but also from the point of view of good management. Someone who actually proposes and approves something should not also be the person who pays. Essentially, from what you have read out, they have been able to do exactly that: both raise it and pay it—presumably either to their own account or to accounts set up under their control.

Ms GILLARD—What I am really getting at is the accuracy of this data. It is of concern because it is not the complete picture—we know that because it has not got the military police stuff in it—and it is not clear to me. I accept an explanation might be that the *Sydney Morning*

Herald is harking back to something that happened two, three or four years ago, but if you are getting us some further information on this data—

Mr Taylor—I will pick up a copy of the *Sydney Morning Herald*.

Ms GILLARD—I am happy to give you a copy of the article. I am concerned that the \$2.5 million is underdone in terms of what should be under detection. I am concerned that the total volume of fraud may be higher, and I am concerned about the robustness of the data that is before us.

Mr Neumann—The \$2.5 million is our estimate of the losses. It is quite clearly a floor; it is not a ceiling. The question, as I said before, relates to the gap. From what we have seen elsewhere, the gap could be reasonably large, or reasonably small, depending on how you calculate the UK figures, and depending on whether the comparison with the UK is a reasonable one.

Ms GILLARD—In terms of estimating losses, I refer to the next page of the audit report—page 62, table A1.3, ‘Estimated value of cases at commencement of investigation’. When you look through that, the greatest number, 32, is in the ‘unknown’ column. I accept that at the commencement of a fraud investigation it might be difficult to estimate the value of the case. You probably have to get into the investigation a bit before you can adequately do that. What is the number of an unknown value at the conclusion of the investigation? It seems to me that that is the relevant statistic.

Mr Taylor—The \$2.5 million figure is aggregated by taking the value of those cases that go to court and the amount that is mentioned in court or in a Defence Force magistrate hearing. We have had instances where we look at a case which might involve \$12,000. We go to the DPP and they say, ‘We feel very comfortable with proving it for \$10,000, but not for the additional \$2,000.’ We would then use that \$10,000 figure, and that is the figure which we would use towards that total of \$2.5 million. Where it does not go to court, we are reliant upon the best estimation of the investigator who has undertaken the case.

Mr Neumann—This may include audit. We will use computer aided audit techniques if necessary to try to find out, for example, on travel frauds, how much is there. We will use this in terms of trying to secure a recovery through court action. These are only estimates. Even using computer aided audit techniques, it only pulls out the ones that appear suspect for some reason. It does not pull out the ones that may have been done elsewhere, under a different name, for example, or ones where the data does not appear to be suspect, or in fact have been approved. Then we try to get a restitution order from a court. That may in fact be less again. In one of the cases I can think of, we did not actually get the amount that we asked for; we got less. The court awarded us less than the amount that we asked for.

Ms GILLARD—Of the \$2.5 million, what percentage of that figure involves court generated figures in cases?

Mr Taylor—I do not have that information.

Mr Neumann—We will have to get that for you.

Ms GILLARD—Can I refer you to the Defence Annual Report 1999-2000. In that annual report, at page 63, there is a reference to the Defence audit and program evaluation committee addressing fraud, theft and loss information. Can you tell me what that included and what input this has had regarding the fraud management staff training that Defence does now?

Mr Neumann—Since December, we have had three or four meetings of the audit committee. Fraud control planning has been on the agenda at each meeting. The comparison, going back a couple of years now, is where the previous committee at best took the issues twice a year. The best expression is that it certainly brought it into more prominence. There is also a follow-up now. The chair of the audit committee now briefs the defence committee on issues. On the last occasion, I know he was very forthright in his comments about fraud control planning and the failure of one group to do it on time.

Ms GILLARD—So the outcome of the Defence audit and program evaluation committee addressing fraud, theft and loss information was a determination to focus on it more heavily?

Mr Neumann—It is not only that but also the reports done by the Australian National Audit Office. The committee is now named the Defence Audit Committee. We have dropped the other bits—just to make the acronyms different for this year! I think there are a range of issues—I do not think it was just that one issue—because the Australian National Audit Office have observers on the audit committee, both the current and the previous one, and they have raised issues, as the chair was raising, about record-keeping. An audit of the Management Audit Branch was done, I think, around April last year. So it is all this information feeding in together that has given people a greater appreciation of what role they are supposed to be performing.

Ms GILLARD—As you know, the departmental secretary or CEO is responsible for fraud control policy and, as I understand it, they then delegate that to the Defence Audit Committee. How many times would that committee have met over, say, the last two years, and how many times would it have formally reported to the Minister for Defence on these issues?

Mr Neumann—The audit committee now tends to meet about eight times a year. It used to meet about four. I think this year we might even be getting to 10.

Ms GILLARD—So it would have last met within the last month or so?

Mr Neumann—It met on 12 April, and it will meet again on 14 May.

Ms GILLARD—And in terms of briefing the minister on these issues?

Mr Neumann—I am not sure there has been any direct briefing of the minister in that sense. The chair briefs the secretary and I do not know what the secretary briefs on. I also know that the financial auditors—not the performance auditors—have briefed ministers over the years on financial issues. One of them, certainly in the last briefing, would have covered fraud control planning.

Ms GILLARD—In the last briefing to the departmental secretary?

Mr Neumann—I think there was also probably a briefing done by the Australian National Audit Office. The financial auditors, which form a different group—and Mr McPhee might want to comment on this—would have taken these issues up.

Ms GILLARD—How recently would that have happened?

Mr McPhee—I could give you the date later.

Ms GILLARD—I am trying to get a handle on what has been generated in terms of the management of fraud issues by that committee and what, if anything, has been generated by that committee in terms of asset registration questions. From what you are saying, what has been generated on fraud issues is a brief upwards, if I can put it like that, to the—

Mr Neumann—I should also say that action has been taken, because the Defence committee is now going to make people report on the more significant outstanding issues. The way it is written, I think, includes only the ANAO, but it will turn out the internal audit issues as well—the more significant audit issues, both internal and external. Let me put this a bit more bluntly: it will focus managers' attention on the fact that they cannot just simply agree to a recommendation from either the Australian National Audit Office or management audit and then not follow through with it. That is probably as bluntly as I can put it—

Ms GILLARD—So that committee has got some oversight in improving the processes as suggested by the Audit Office?

Mr Neumann—and I think one of the auditors here was generous enough to make that comment at another hearing. So all of the things that the department has agreed to in this report now appear on a database, and I am the responsible officer in this case—I am just taking this report because it happens to reflect my responsibilities. That will now be followed up, and a report will be produced for the audit committee—and I think that will end up being monthly now—that says which are overdue. People will then be called upon to explain why they are overdue rather than just leaving things for months that are overdue or not updated on the recording system. So there is a follow-up mechanism. That was put in place, to a limited extent, over three years ago.

We have also included the Joint Committee of Public Accounts and Audit because you make recommendations that the department agrees to, and the follow-up on that is part of the process. By the end of the financial year, I am hoping it will cover internal audit, Joint Committee of Public Accounts and Audit and Australian National Audit Office, both the financial and the performance audits; at the moment the financial audits reside in another group. The intention is to consolidate the whole lot. I wrote to the secretary recently and gave him a picture of how many outstanding ones we had.

Ms GILLARD—So, if we want to complete the trifecta, we are saying we will have a serviceable asset register in about 12 months time, that, in terms of the IT that has been fixed,

henceforth Defence should be able to generate statistics for fraud which include what the military police are doing—

Mr Neumann—Automatically as opposed to manually.

Ms GILLARD—Yes. So, to complete the trifecta, if you were a betting man, when would you say that the audit recommendations that have been agreed will be addressed, out of this new system?

Mr Neumann—The first thing I should say is that I do not bet. It would be totally inappropriate from my position. The second one is that it depends on the attention given to them by responsible managers. In terms of this one, I am responsible as the manager and in my view I have to set the example, so I will be giving it full and due attention. The audit committee, and now the defence committee, secretary and CDF, are bringing managers' attention to the fact that it is part of their responsibilities and they actually have to do it. It is no good just agreeing to something and then not implementing it. The first one there about reviewing instructions is in progress at the moment. We have agreed to it, and anyway we do not have any option because that is a straight compliance issue, in my view. I hope Mr McPhee agrees with me on that one.

Ms GILLARD—Are we talking a year, two years, 10 years, the second Centenary of Federation?

Mr Neumann—We set time frames for the internal audit ones. We set it with managers and we get managers to agree to them. For example, on fraud control, the chief executive instructions actually set up July 2001. That is 1a. 1b will have to be a continuing one because every iteration we go through we will have to keep up to date with that. 1c compliance, July—

Ms GILLARD—This year?

Mr Neumann—Yes, 2001. We did not agree with 2, so it does not appear. 3a is July 2001. 3b, which is the risk assessment, is March 2001, and we are doing that at the moment; it has already started.

Ms GILLARD—Are these the start dates or the finish dates?

Mr Neumann—The date for implementation, but that one actually says receive appropriate advice and assist in full risk assessments. We have provided the training. 3c is January 2002. They are different authorities to do them. All the rest, except 6b, are July 2001. 6b is January 2002.

Ms GILLARD—Hansard has got that for posterity.

Mr Neumann—Why don't we just provide you with a consolidated list? That is probably the best way to do it.

Ms GILLARD—That is terrific.

Mr Neumann—So we need to provide the list.

Mr COX—When you are doing that, can you also address when you are going to deal with the recommendations of ANAO *Department of Defence procedures for dealing with fraud on the Commonwealth*, a 1991 report, in which the ANAO recommended that Defence continue to develop analytical techniques and audit tests designed to detect the existence of fraudulent transactions. Apparently you accepted that recommendation and, according to the 2000 audit, you have done nothing about it.

Mr Neumann—We have a different view here.

Mr TANNER—It takes time.

Mr Neumann—I explained before that we actually do use computer aided audit techniques. We have a full-time team of three personnel who use it on a daily basis. They look for what we were talking about with respect to inefficiency and ineffectiveness as well as fraud, as well as abuse, if you like. Some of the things we use it for are debtor management, fringe benefits tax, leave processing, travel payments, which is one of our high areas, and determining the extent of fraud, which is that, when we find someone has committed some fraud, we then track all the records back to try and see how much it is and make an estimate to go to court with and also to initiate recovery action. That is one.

An expert from Canada who works in my counterpart organisation there, dealing essentially with, I suppose, other analytical techniques, came out here and gave our staff a review. He has written a few papers on things like ratio analysis as an assistance to computer aided audit techniques. That is where you try to compare different things over different years to see whether there is anything that jumps out at you. As I mentioned, last Friday we went on a data mining course, trying to find useful patterns in the information presented and trying to analyse why there was a change. Sometimes it does not actually work all that well. We used Benford's law—a statistical thing which says that different numbers will have different probabilities of arising. We thought we had come across a huge fraud, but it was rather disappointing to the computer aided auditor because, in fact, it was a round \$40 for a travel payment. Unfortunately, that happens to be exactly the daily allowance now. So there was nothing fraudulent in it; it was just an aberration.

Ms GILLARD—Does the Australian National Audit Office want to say anything about the comparison with the UK statistics, in view of what has been said by the Department of Defence? Does the office want to say anything about the methodology of quantifying detected fraud figures in part of court figures? I do not know whether it is the former lawyer in me, but I have a real concern about that. It seems to me, just as a matter of logic, that there is always a difference between what is going to be able to be proved beyond reasonable doubt in a criminal proceeding or even beyond the balance of probabilities in a civil proceeding as opposed to what has actually been detected. If our police decide that someone is probably engaged in blackmail, a conspiracy and a fraud, but they get advice from the DPP that says, 'Only go on the blackmail charge and don't worry about the conspiracy and the fraud because we do not think we can get them up,' three serious matters have been detected and one was capable of proof beyond

reasonable doubt. So I worry that we are narrowing the scope down too much by looking at court figures. But I would be interested in your comments on that.

Mr McPhee—I will make some initial comments and ask Mr Guilfoyle to follow up. Mr Neumann makes some fair points about definitional issues and even measurement issues—the sorts of matters you are raising. The one recommendation we could not get Defence over the hurdle on—to continue the racing analogy—was the one about fraud intelligence capacity. Mr Neumann, I think, fairly represented the state of the systems and the asset recording, and our reports over the years have raised a range of issues dealing with administration. We think that Defence is higher up on the risk curve than they hope to be and obviously are working towards getting themselves lower and getting the systems and the environment much better controlled. But, at this point in time, we think there is value in Defence seriously considering a greater intelligence capacity.

Clearly the issues Mr Neumann mentioned about the analytical techniques and the data mining are part of that, but we are talking at a more strategic level, having regard, for instance, to what may be happening overseas and what may be appropriate benchmarks. Mr Neumann mentioned point 1. I have seen figures significantly higher than point 1 being the level of reported fraud, and I would not want to take comfort in that figure. It is interesting that the tax office—which the committee looked at just previously—have a section that they call the Fraud Prevention and Control Section. So they have a whole section. We are not suggesting that, but we are suggesting some more strategic capacity within the department to have regard to fraud, given the environment that is facing the department. I will ask Mr Minchin or Mr Guilfoyle to add to that in terms of some of the more detailed issues that you raise.

Mr Minchin—The reference to the \$15 million at paragraph 3.23 was not meant to suggest there is that totality of fraud in Defence here. It was simply meant to be a prompt to Defence here to do the kind of benchmarking we have been talking about, and it was leading up to our recommendation that there be a fraud intelligence capacity. It must be seen too in the context of our discussion of the Defence environment. Defence does not have good financial systems. The previous minister has been quite blunt about that and the present Secretary to the Department of Defence has said that too, and those comments are summarised at page 35. So any benchmarking must be done in the context of Defence's own systems.

Senator GIBSON—Actually, Ian has just answered the main question I had to ask, which was about recommendation No. 2, the response from Defence and your comments. So you have actually answered that. One relatively minor one back on page 34—the standard Defence supply system recorded 3,863 fixed asset groups of 50c each, and the ANAO estimate the understatement at \$350 million. What are we talking about—items in assets groups of 50c each? I am just a bit intrigued.

Mr Neumann—People have entered at 50c items which are clearly not worth 50c. That is the short answer.

Senator GIBSON—What sorts of things? What are you talking about?

Mr Neumann—I think these are actually parts.

Senator GIBSON—Does this imply these are obsolete or something?

Mr Neumann—No, not necessarily. It is the way that people have actually used it to get around the NATO standard number. I think they have used it, essentially, as a way of just recording the asset because they could not find it easily on the catalogue. So they have given it a nominal value, if you like, of 50c, but clearly that is not the amount. I think that the \$350 million was actually done in conjunction with my Management Audit Branch, where we worked out a formula—how many of that proportion. With regard to the standard Defence supply system, remedial action has been under way for about three years and I do not think we are there yet.

Mr COX—What were they? Were they aircraft engines?

Mr Neumann—No, they were probably parts for things. One of the issues that comes up when an aircraft engine goes into maintenance is which system it is on. There are things like that. Is it still part of the aircraft and recorded as part of the aircraft, or is it recorded as a part of the spares system? Basic issues like that were worked out—and are still being worked out, I think, in some of the inventory systems—because, when you have a cash budgeting system, you do not actually account, measure, or whatever all your inventory. And the thing about accruals is that you have got to count everything, starting from the land upwards and across-ways, and I think this is part of the system—having built up assets, however you describe them, over 80 or 90 years. Until the last decade or so, there was no penalty, in fact, for storing obsolete items, and there was no penalty in the UK either or in other agencies.

CHAIRMAN—So what you are saying, Mr Neumann, is that you put parts in store, probably at the purchase price of the part at any price. I am not talking about the 50c items; I am just talking about the ones that are recorded. The ones that are recorded would have gone into store at the purchase price, not at a standard cost.

Mr Neumann—The bulk of them probably would have been, but there are also other items—and I think this is the same system my internal auditors were looking at. There are some very peculiar valuations altogether.

CHAIRMAN—Okay. The Secretary to the Department of Defence stated that systems ‘give us different answers to the same question’. A Defence Estate Organisation internal document conceded that its financial data is never absolutely accurate and that it is not uncommon for the two systems to vary by several million dollars. If it is so bad, how on earth can you be sure there is no fraud if you do not even know the value of stuff?

Mr Neumann—But you cannot—if the thing is not recorded on the system or is misrecorded on the system, you will never know.

CHAIRMAN—That is really helpful. We will be happy to comment on that.

Mr Neumann—If it is not recorded on a system, you would never actually know you have got that asset, right?

CHAIRMAN—Yes.

Mr Neumann—So you will find it afterwards by either an internal audit—

CHAIRMAN—I just wanted to hear you say it. You have rejected in essence ANAO's recommendation that you should do more about establishing some procedures for what you call minor fraud, irregularities, petty theft or whatever. You say it is not value if it does not represent value for money. But you did talk about the Australian Federal Police. What intelligence capacity does the AFP give you in terms of Defence fraud?

Mr Taylor—The AFP does have an intelligence unit and we do provide them with intelligence. They provide us with periodic assessments on threats to Defence.

CHAIRMAN—For the last question, the ANAO reported that the 'vast majority of performance indicators in the fraud control plans do not allow for regular assessment of their achievement. Examples of this include particular actions that are to be completed within timetables defined as *continuing*, *ongoing* and *as required*.' How do report your fraud control plans when you cannot measure the performance indicators?

Mr Neumann—I think there are two parts to this. Some of them clearly do have continuing on it. For example, this was one from Defence Estate on the commercial support program which has now been centralised but, at the time of the third fraud control plan, was not. It said, 'Ensure staff have access to the commercial support program manual and provide guidance or training in their roles and responsibilities in a range of Defence fraud and ethics workshops.'

The timetable on that was continuing because obviously it is a continuous task and has to be updated all the time. But there are others in here—and I am not sure I can find one—and there are some like 'Allowances: civilians' to take account of the findings of the Financial Management Act and ensure measures to combat fraud in accordance with the processing of allowances for civilians. That was given to an officer in December 1998. The position no longer exists. There are actually ones that you can measure. But there are others here—and I cannot actually find one—which we should have put a date on and which we did not. So there are a range of things. Some of them I think are appropriately continuing. Some of them are continuing which we actually should have put a date on because they are one-offs. If there is something to be done, it is finite. But where you are providing training, assessments or access, I believe there are continuing tasks. We will look at it in terms of the fourth plan and maybe the way to do it is to set an initial implementation date and then have it continuing all the way through. But I would not want to set a date which people then take as an end date so they would train people up to that date and say, 'Oh, we've started it. We've trained two people and then we stop,' because it is not that; it is every new member of staff that comes on that requires the training.

Mr Taylor—Perhaps I could just add a couple of additional comments to that answer. Every group is required to report on every action that is there. Even the continuing actions we expect them to report back to us. That is in fact what happened.

CHAIRMAN—We will now suspend the hearings which will resume at 2 o'clock although we will have a private briefing by ANAO at 1.30 p.m. Thank you very much.

Proceedings suspended from 12.44 p.m. to 2.06 p.m.

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

MINCHIN, Mr Tony, Executive Director, Performance Audit, Australian National Audit Office

THATCHER, Ms Nicola Patricia, Performance Audit Service Group, Australian National Audit Office

BAIN, Mr Ross, Assistant Secretary, Property Management, Infrastructure Division, Corporate Services and Infrastructure Group, Department of Defence

COREY, Mr Rod, Head, Infrastructure Division, Corporate Services and Infrastructure Group, Department of Defence

HAMMOND, Mr Owen, Director, Estate Operations Section, Infrastructure Division, Corporate Services and Infrastructure Group, Department of Defence

LANE, Mr Brian, Assistant Secretary, Estate Operations, Infrastructure Division, Corporate Services and Infrastructure Group, Department of Defence

CHAIRMAN—We now come to the third 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 the 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. 26, *Defence estate facilities operations*. I welcome representatives from the Australian National Audit Office and the Department of Defence to today's hearing. Does anyone from the Department of Defence have an opening statement they want to make?

Mr Corey—No, thank you.

CHAIRMAN—Do you have an opening statement, Mr McPhee?

Mr McPhee—I have a brief statement.

The objective of the audit was to assess the Defence Estate Organisation's facilities operations. The DEO, in our view, has developed a good framework for the delivery of maintenance work through the facilities program. Initiatives such as the comprehensive maintenance contract offer efficiencies that earlier methods lacked. The introduction of the total estate management system will also provide improved data on the condition of the Defence estate, which is needed for maintenance funding bids.

Audit findings indicate that there is scope for improvement, particularly in relation to management of contracts and resources. Significant staff reductions in recent years have decreased the knowledge base and skills available within the organisation. Not all contract management staff have the skills needed to maintain—or manage, if you like—the complex new maintenance contracts now in use. This is a general issue that this committee has raised more widely.

The DEO has sought to deliver estate services on a priority basis, by region rather than by individual establishment. In practice, this has not always been the case, with variations in regional procedures resulting in a lack of transparency in decision making, and with funding not always being applied to identified priorities. Estate management could be improved, if better information were available to target scarce maintenance resources to best effect. This would include information on actual costs for attribution to defence outputs and on the contribution each asset makes to defence capability. ADF input is essential here, to ensure the estate management decisions are justified under defence priority and cost effectiveness grounds.

CHAIRMAN—Thank you very much, Mr McPhee. We understand that you have a difficult job to do and we understand that because we still do not have a proper total asset register, so we do not know entirely what we have and what it is worth, either on a first-in first-out basis or a cost or standard cost or cost to replace basis. We understand from this audit that there are some strategic maintenance issues on some of our assets which are becoming if not critical certainly important because parts and Defence assets stored therein could be at risk. We also understand from Defence this morning, in discussing fraud, that there are a lot of assets that we own that we do not know what they are. I would think that that creates a few problems for you. One of the things I would like to know at the beginning is: why does your strategic plan, which is approved by the executive, conclude that repairs and maintenance are a lower order business issue and therefore a soft target in the battle for resources?

Mr Corey—I think that is taken out of context. You must remember that the strategic plan was written to be read in a total context, not for people to take areas of it in isolation—that was in justifying some of the decisions we were making in the way we were managing the estate. Much of the argument within the strategic plan was to convince members of the defence committee to adopt the approach that we will be putting forward. So many of the arguments put forward were arguments raised by us in saying that over the years the facilities operations and maintenance side of the estate had not been funded to the level it probably should have been. I guess that was the context of that statement in the strategic plan.

CHAIRMAN—But our understanding is that, until you came along, each base commander was responsible for his own maintenance. Is that right?

Mr Corey—In part. It was still managed in a central way by each of the three services. The Army, the Navy and the Air Force each managed their own facilities operations and under the guidance of a central organisation, but then they had sub-budgets down to bases and many of the decisions were at the discretion of the base commander, but they were still managed within a single service environment.

CHAIRMAN—Is the budget for repairs and maintenance at such a dangerously low level that major assets and/or substantial value of parts could be at risk?

Mr Corey—Again, anecdotally you could suggest that, Chairman, but within Defence in the wider defence budgetary context we have been under pressure for probably 10 years to establish relative priorities for capability versus support. Within the Defence estate we have established priorities not to maintain to the level that might be acceptable in a public arena some of the assets that do not have a medium- or a long-term life in the sense that where we are going to re-build a base in the short to medium term or where we might adopt a different strategy for how we provide living-in accommodation for personnel, we have chosen not to invest in repairs of those assets. That is a risk we think we can manage without much difficulty. You may find instances where there are warehouses and storehouses, again because the base has not yet been redeveloped, where some of those assets may pose a risk to the items that are stored in them, but I would suggest to you that they would be only very isolated instances because we have taken the fire prevention measures and others to make sure that we can protect the assets that are inside those buildings to the extent that they need to be protected.

CHAIRMAN—So we do not need to worry that we would have a substantial part of the F111 or FA18 fleet housed such that the planes that are not being flown would be subject to deterioration because of weather?

Mr Corey—I would suggest that that is the case. They are inside a hangar that is fire protected. There are no instances that I am aware of where any major asset of that nature would be at risk.

Mr COX—There has not been any loss of assets due to fire since the Nowra fire.

Mr Corey—Not since the Trackers, which was a long time ago.

CHAIRMAN—There is one question I would like to ask before we run out of time. We have had a long-running issue with the Department of Defence about giving the Auditor access to contractor records and contractor premises. I am advised that recent contracts from your organisation still do not provide for access to contractor records, and I wondered if you would tell us why.

Mr Hammond—We currently have access clauses in the contracts to allow us to view contractor records. The proviso is that access is based on whether we are going to renew the contract—so we are reviewing contractor performance. During the audit, we felt that those contract clauses were adequate for the ANAO to have access; they said that it was not. So we agreed with the ANAO that we would change the clauses in the contract to allow full access.

CHAIRMAN—You did agree to that.

Mr Hammond—We have agreed that we will do that.

Mr COX—Are you going to do it?

Mr Hammond—All we need to do is change the contract clauses when we let the contracts.

CHAIRMAN—Paragraph 3.63 of the audit report says:

Regardless of ANAO and subsequent Joint Committee of Public Accounts and Audit recommendations, none of the facilities maintenance contracts, including recent contracts reviewed in the present audit, provided for suitable Defence or ANAO access.

Mr Hammond—We agreed that there were clauses in there to allow access. I am sure that the ANAO would be prepared to acknowledge that the clauses are there, but they felt that the clauses were not strong enough for what they wanted and asked us to change them.

CHAIRMAN—Mr McPhee, do you have a comment on that?

Mr McPhee—It is good news. I am very pleased to hear that the department is taking steps in this area. Our point is fundamentally that we would like access in our own right rather than rely on the department agreeing to that. We have said in many other places that it would be rare for us to believe that we would need to have access ourselves, because we can generally rely on the department getting the right sort of information to be able to manage the contracts. But, as a point of principle—and as this committee has said—the Auditor-General should have independent access, if necessary, through these contracts.

CHAIRMAN—We have been advised by the Minister for Finance and Administration that that is being fixed to our satisfaction. Unfortunately, he has been ill, and we have received no further advice since he went to hospital.

Mr TANNER—The shadow minister for finance is committed to it.

CHAIRMAN—That is really irrelevant!

Mr TANNER—In other words, it will happen under a Labor government.

CHAIRMAN—You have to win first!

Ms GILLARD—You would be aware of Audit Report No. 37 *Defence estate project delivery*, which was from the 1999-2000 financial year. The primary finding of that report was that there had been some prepayments or movements of money prior to the end of the financial year, amounting to \$57 million. As a result, there was an ANAO recommendation which said:

... Defence reinforce the Chief Executive's Instructions against expending excess funds at the end of the year without commensurate advantage to the Commonwealth, by re-assessing budgetary incentives (internal and external) and clearly articulating better practice in this area so that Defence's staff fully understand their responsibility for acting in the Commonwealth's interest.

Defence agreed with that recommendation. Can you tell what, if any, steps were taken to implement that?

Mr Corey—We used the instructions to that effect—the intent of the audit recommendation.

Ms GILLARD—In light of the issued instructions, can you explain to me how the financial expenditure pattern that is recorded in figure 8 on page 74 of this audit report occurred?

Mr Corey—The first report relates to the capital expenditure, to investment in new facilities, as distinct from this one. The expenditure pattern in this is totally different. It is structured differently because it is a totally different way of contracting for work. That is the first part of the answer. Why the pattern is the way it is is due to historical reasons as much as anything. This cultural organisation was reluctant to get on and start placing orders and fill up its program of work prior to the commencement of the financial year. That was in part caused by the way monies were appropriated and the culture of the people within the organisation.

Under the new regime which we have now, with the comprehensive maintenance contracts in place throughout the country, we expect that that pattern will go away. The comprehensive maintenance contractors and our focus on planning and managing the contractor rather than actually managing the work will mean that we will be planning our work much more in advance than we did previously, so expenditure will occur in a much more stable pattern across the year. There will probably still be some elements of trending up expenditure as the year progresses, just because of the nature of the way the orders are placed. We are fighting that, and it is something we have been fighting for as long as I have been around the organisation. With the new contracts and the new emphasis on planning, we anticipate that we will win that battle.

Ms GILLARD—Regarding the instructions that were given in response to this report, surely you would say, through those instructions, that it would be inappropriate to prepay or to rush jobs at the end of the financial year, whether they be of a capital nature or of a recurrent nature.

Mr Corey—What I am suggesting to you is that the prepayments—we can talk a little about that if you like—were, in part, aimed at having supplies on the ground in Darwin, in one case prior to the wet because the contractor was telling us that he could not guarantee materials to works through the wet unless he had them on the ground prior to that time of the year. In the event, we agreed to him buying materials in advance. As it happened, the materials did not arrive before the end of the financial year and the moneys were paid in advance anyway, but that is another story. We have corrected that.

With the maintenance activities, because the orders are placed progressively throughout the year, there is no attempt to waste money. What happens is that a lot of the work does not get placed until after the first quarter—even the second quarter—and all of the work is being conducted around the country in the third and fourth quarters. While it looks like you are rushing around and spending money for the sake of spending money at the end of the financial year, that is not the case, because the facilities operations budget is underfunded by about a third in our estimation. We have no intention of wasting money. With the new accounting arrangements, the accrual budgeting arrangements, the incentive to achieve your cash budget is not as great as it was previously. Under the previous regime, Defence was penalised significantly because of the way our budget was structured—if we did not achieve our cash expenditure. The following year's budget was based on our achievement in cash terms the previous year. If we did not achieve it, we were penalised. We were doubly penalised: we did not spend it in the year in which we had it and we did not get it the next year as well.

Mr TANNER—It is strange to be talking about ‘achieving’ spending money.

Mr Corey—Achieving spending money, in our terms, in facilities means achieving maintenance on buildings or building new buildings. The two things are synonymous.

Mr TANNER—Presumably, one of the possible reasons for not achieving might have been that it was not necessary, that the amount budgeted ended up being—

Mr Corey—I can assure you that we were about a third underfunded in facilities operations, which the audit report confirms. It is essential that we achieve the maintenance on building. It is not as if we do not want to do it. There will have been instances, particularly prior to the Defence estate being set up, when people spent money on things that probably did have a lower priority at the end of the financial year because of the culture and their feeling that if they did not spend their money they would not get it for essential things in the next financial year. That is a cat chasing its tail exercise.

Ms GILLARD—I understand what you say in terms of the move to accrual accounting, that there is not the same incentive that there used to be for government departments to fully expend—

Mr Corey—Except the government still operates on a cash basis.

Ms GILLARD—Is an explanation for this graph in figure 8 that within Defence Estate, down at the subregion level, people have been allocated funds and it is perceived that if they do not spend them by the end of the financial year the excess will be returned to central office, to HQ, if you like, for reallocation; there is an incentive for them to get a hurry-on towards the end of the financial year?

Mr Corey—That was the previous culture that existed in the organisation. It has flowed over because we do not place sufficient emphasis on doing the planning to make sure that the orders are raised and they are placed before the commencement of the financial year so that expenditure occurs in a more stable pattern throughout the financial year. We have still got people out there who are reluctant to actually place an order on a contractor before 1 July. But we are working our way through that and we hope that the comprehensive maintenance contract that is in place and our emphasis on planning will overcome it.

Ms GILLARD—So in your view if we are looking two or three years out from this year we will not see a curve pattern like that.

Mr Corey—I am sure you will not.

Mr Hammond—Can I add something on that? It is very difficult to remove that J-curve completely when you have to design, document and tender before you can actually commit the money. If the program is approved and you cannot spend before 1 July, you have to go through design, documentation and tender before you can actually go and spend the money, so there will be a J-curve. However, we have advanced approval of the program to February-March of the preceding financial year to allow some documentation to be done. But, again, design cannot be

fully committed until the new financial year. That means we will get a slight J-curve but the gradient should improve over that.

Mr TANNER—Is that because you are lacking specific approval for a particular project or because the degree of uncertainty about the total amount of money that you will get for that financial year is so great?

Mr Hammond—We are trying to work on 70 per cent being a guaranteed amount. We are telling our regional staff to go away and document up to 70 per cent. But we could have incidences, such as a Timor or a cyclone hitting Learmonth, where halfway through a financial year we have got unforecast works that we have to go and deliver. So, in each financial year that I have been in this game, we would get to March and something would happen, like a cyclone or a flood, that we had not predicted or forecast that adjusted our program.

Mr TANNER—What would be the typical lag time between the start and finish of the process? You identified the problem of getting paperwork together and placing tenders and whatever. What would be a typical lag time?

Mr Hammond—It depends on the complexities. Some of the projects we deal with are multimillion-dollar projects, such as a wharf refurbishment at *Stirling* or dredging of Trinity Inlet at Cairns. Those sort of jobs take a longer lead time for development of the paperwork than a small job, such as a repaint of a building or a room like this, which we can go and document quite quickly.

Mr TANNER—Would the bigger jobs be about six months? Would that be a typical time?

Mr Hammond—We believe that some of them take over 12 months to deliver and we have to go into an outstanding liability at the end of the financial year to do it. So we have got a separate program for works above \$250,000 that we dedicate some special resources to to advance the approval on those. Then we will run them perhaps over two years.

Mr TANNER—So does that mean that until now when the clock ticks over to 1 July you get this floodgates effect, where things have been sitting waiting to go and suddenly the initial stage of the process starts and the bigger ones tend to peak towards the end of the financial year? Is that essentially what you are saying?

Mr Corey—That is right. And there is one other factor in 1999-2000. Early in the year, because Defence was having budgetary problems across the portfolio, the Defence Estate Organisation was required to reduce our facilities operations by \$30 million. Subsequently, we were handed back \$20 million towards the end of the year and that contributed significantly to the peak in the last two months of 1999-2000. There has always traditionally been a peak, but this one was accentuated by the \$20 million that was handed back to us late.

Ms GILLARD—In relation to the former report, in our discussion with Defence before lunch it appeared that there is a Defence Audit Committee to which people report in terms of their progress on meeting ANAO recommendations. Is that right?

Mr Corey—Yes, that is right.

Ms GILLARD—Could you send us a copy of whatever you have furnished in terms of progress for these recommendations from the No. 37 report

Mr Corey—Yes, we can do that.

Ms GILLARD—From more a specific point of view than those questions, I am aware from my own electorate that there are tenants on Defence bases that are not military or Defence entities. For example, at the Point Cook base there are various lessees that have got parts of that base under lease or licence arrangements. I was reading through this report and it mentioned a structure where you have works priorities committees in order to get some client input about what the maintenance and minor work schedule should be for the following year. Is that kind of tenant on a Defence estate represented in that process at all? How does that work?

Mr Corey—I think not. I think they would be represented by the regional staff.

Ms GILLARD—The regional staff of DEO?

Mr Corey—Yes, the regional staff of DEO. Point Cook is an example where we have quite a number of tenants, as you are aware. I am not sure that their needs would be represented by anyone other than the DEO.

Mr Hammond—No, they were not represented specifically. I am trying to take it a little broader. Perhaps you could look at Bandiana where we have a major contractor who is also a tenant in our assets. They are doing work on behalf of Defence and they would be represented through perhaps the support command representative.

Mr Corey—Yes, but the other people are people who have nothing to do with Defence—they are contractors who work for Defence. I think your point was about people who have no association with Defence, like the film studio.

Ms GILLARD—Yes, and RMIT. I do not want to go through the material about the runway lights again. The Senate committee has gone up hill and down dale about the difference between the \$50,000 quote and the \$2,500 that it was ultimately fixed for. Leaving that aside, it seems to me that part of the problem—

Mr Corey—You did read the answer on that, I presume.

Ms GILLARD—I did read the answer on that, though the answer made me think about why one would not inquire of the tenant, before getting the quote, what standard of repair they required. That might have circumvented the difference between the \$50,000 and the \$2,500. Looking at it from a systems point of view, part of the problem for tenants in that situation is that you have KFPW running around as the sort of agent, you have the local DEO people running around as the local DEO people, you have the base commander running around as the base commander, and all of them relate upwards to some other part of the DEO structure. When

someone there needs something fixed, like a few light bulbs changed on the runway, instead of there being a clear port of call and things getting fixed, it seems to end up in this vortex.

Mr Corey—I am not sure that Point Cook is a good example.

Ms GILLARD—I suspect it is not.

Mr Corey—You are aware of the history of Point Cook as well as I am. What you are saying is exactly what happens around the country. If it were not for a number of mainly political factors, we would not have anything. We would have only part of Point Cook if we had any of Point Cook, and that problem would be resolved. We are hoping that in the next couple of months we will get a strategy agreed that will resolve Point Cook and then those sorts of instances that you are talking about will not happen. But Point Cook is not an example of the sorts of business that we do around the country.

Ms GILLARD—At the risk of trying your patience, can I give one more Point Cook example before we move on? I am interested to see how this fits in with the broad arrangements that you have for maintenance and minor works. At Point Cook there is a not-for-profit organisation called the Point Cook Flying Club that was granted access to a disused building at Point Cook in 1997 and permitted, with its own time and labour, to refurbish that as a club room. These are hobbyist flyers. They had working bees and fundraising dinners—whatever one does as a volunteer organisation—to put together these club rooms, which now comprise a small bar and social area, for people who have gone flying for the day. It has come to my attention that the DEO, through their agents—KFPW—are now saying to the Point Cook Flying Club that it retrospectively owes rent of \$7,500 per annum for each year that it has occupied that building and that, in their generosity, what they are prepared to do is charge that rent in the future and net off the back rent from 1997 against the refurbishments that were done with the volunteer labour. That would seem—

Mr Corey—It sounds like a biased view to me, which I would have to take advice on.

Ms GILLARD—I have with me the most—

Mr Corey—It sounds like a one-sided story.

Ms GILLARD—With respect, they are your agent's letters. I have a copy of a letter from Jarrod Frazer of KFPW Pty Ltd, which says:

Upon the valuers inspection of the premises and analysis of current market levels, a rate of \$7,500 per annum has been recommended. It is our intention to offset the improvements made by the Point Cook Flying Club valued at \$27,200 and agreed to by yourself in a fax dated 28/8/00 with the arrears rent owed as at the Point Cook Flying Club occupation date (8/3/97).

Mr Corey—That sounds quite reasonable to me.

Mr COX—It sounds like a grab for the flying club's assets.

Mr Corey—They have been getting a free ride, by the sounds of it.

Mr TANNER—Three and a half times $7\frac{1}{2}$ would be roughly 27.

Mr Corey—That sounds about right to me.

Ms GILLARD—As I understand it, there is a dispute about whether rent was ever agreed, with the club denying it and DEO—or Defence, because I understand all of this relates to a time prior to the existence of DEO; I think it was the Australian Property Group or something at that stage—

Mr Corey—There are lots of arrangements at Point Cook, that we are either not aware of or are aware of and do not agree with, that have been going on probably since 1908 rather than 1997.

Ms GILLARD—I would have thought, though—with my former lawyer's hat on—that if a client came to me and said that someone was suggesting that they owed \$7,500 a year retrospectively for a number of years and the party that was claiming that debt was unable to produce a document upon which that debt was based, like a lease, a licence or a contract, I would be pretty tempted to advise my client not to pay it.

Mr Corey—Even on the old boys club handshake basis?

Ms GILLARD—I do not think you are even able to name who shook hands with whom, let alone—

Mr Corey—You are probably right.

Ms GILLARD—I would be interested in Mr Bain's clarification of this example, which I am sure will be completely rational when Mr Bain explains it.

Mr Bain—I am aware of the issue you have raised. I have spoken to the president of the club—is it a Mr Harrison?—and our agents, KFPW, have been negotiating with them for some time. During those negotiations, the issues which you have raised did come up and I am informed that at no stage was there any concern expressed about what was being discussed. However, in the last month, through the local media—and I was aware that you were familiar with the story—the issue has come up. I have said to Mr Harrison that I am happy to revisit it personally with him and we will find a solution to it.

Ms GILLARD—I am glad that there is a solution being found, but I would have thought that when KFPW got their lawyers' letter of 19 April, which I think you will find is prior to any local publicity about the matter, there might have been some concern expressed at that time.

Mr Bain—I thought it was around the same time. I was checking to see when I first heard of it; I thought it was about three weeks ago. It is about the same time; you are right. I have given him an undertaking to sort it out, and I think it is based on some prior agreements. There is nothing in writing and that is what we have got to sort out. Those agreements probably were not proper, and we are trying to put something in place that protects both sides.

CHAIRMAN—The chair has been terribly lenient, but it is time for us to get back to the topic at hand.

Mr COX—Mr Corey, does the Defence Estate Organisation manage office buildings for the Defence organisation?

Mr Corey—We manage all of the estate, yes.

Mr COX—Have you been on a program of sale of office buildings, particularly ones around Canberra and the capital cities, and entering into lease-back arrangements?

Mr Corey—Yes, we have. We have been selling some of them, and others will be sold by the Department of Finance and Administration on a sale and lease-back arrangement.

Mr COX—Has Defence been getting the proceeds of those sales?

Mr Corey—No.

Mr COX—Can you tell us whether the lease-back arrangements represent value for money relative to the Commonwealth continuing to own those assets itself? Was there any evaluation of that?

Mr Corey—There were evaluations done that we provided to the Department of Finance and Administration and to the Expenditure Review Committee of cabinet, either in part or in whole, when the decisions were made. The government made a judgment that the sale and lease-back of those properties was in the best interests of the government.

Mr COX—You have said that they made a judgment that they were in the best interests of government, but they did not make a judgment as to whether they were value for money.

Mr Corey—I am not sure whether they made that judgment or not. From where we sat in Defence we felt that some were marginal cases and others were less marginal. In a whole of government context, there may have been a different perspective put on it.

Mr COX—So in some of those would you say that a lease-back arrangement was definitely not value for money?

Mr Corey—From some of the work we had done, and on the basis that Defence would be occupying the building for perhaps 50 years, we thought that it did not make a great deal of economic sense from a Defence perspective to sell them and lease them back.

Mr COX—I suspect that, if it did not make a great deal of sense from a Defence perspective in terms of value for money, it probably did not make sense in terms of value of money.

Mr Corey—To offset that, the government have agreed to supplement us for the costs of the lease-back of the ones that we felt did not make sense from a Defence perspective; in other instances, they have not.

Mr COX—So the taxpayer is paying the difference.

Mr Corey—I am not sure in a whole of government context as to what it works out as.

Mr COX—I am sure that, if the taxpayer is not subsidising it, nobody else is. Can you give us any indication of what proceeds have been obtained from the sale of those buildings thus far?

Mr Corey—No, there has been nothing to date, although the hydrographic office in Wollongong was sold and leased back. I think the sale has been executed; maybe it has not been settled yet. They are all in the process of being sold. Some will slip until next year because of other considerations, but some of them will be sold during this financial year.

Mr COX—The two new buildings in Blamey Square are being sold?

Mr Corey—The Russell complex, except for the security elements of it, is being offered for sale. They were to be sold this year, but because we are looking at perhaps utilising one of them for extra security reasons, that sale has been deferred until next year.

Mr COX—So the DSD building and—

Mr Corey—The DIO building and the ASIO buildings are not for sale, but the other buildings—the two new buildings and the refurbished buildings—are all for sale.

Mr COX—Has Campbell Park been sold?

Mr Corey—No, it is not being sold this year.

Mr COX—But it is slated for sale?

Mr Corey—Campbell Park is being looked at in the context of potential sale and lease-back next year.

Mr COX—What are Defence's future requirements for Campbell Park? Is it likely to be required for Defence organisation purposes?

Mr Corey—On the basis that Defence stays at its present size—and there are indications that elements of Defence will be growing—Campbell Park will be necessary for as long as we can see into the future.

Mr TANNER—You are no doubt aware that a week or two ago there was a leaked document from somewhere in the Prime Minister's department to the Prime Minister, which made reference to a proposed change from the minister with respect to arrangements regarding

Defence retaining a percentage of the proceeds of property sales. I wonder if you could describe to me what current arrangements apply in that area?

Mr Corey—When the Department of Administrative Services became untied from them in about 1989 or 1990, there was an agreement of cabinet at that time that we could, to give Defence an incentive to dispose and rationalise some of its properties, retain up to one per cent of the net revenue from disposal of Defence properties—that is, one per cent of Defence outlay. In today's terms, that is probably some \$150 million or \$160 million a year. That was in place until last year.

Mr TANNER—Was that capped?

Mr Corey—It was capped at one per cent of net revenue in any one year.

Mr TANNER—But there was no aggregate cap?

Mr Corey—No, there was no overall cap.

Mr TANNER—It was a just a percentage point.

Mr Corey—There was no overall cap. It was just one per cent, and above one per cent we shared the proceeds fifty-fifty with the broader budget. If we achieved revenue of more than one per cent of Defence outlay, and say Defence outlay was \$15 billion so it would be \$150 million, then if we achieved \$200 million we would retain \$150 million and beyond that we would share fifty-fifty with the broader budget.

Mr TANNER—I am sorry, I am getting confused now—you had better run me through it again. The one per cent is a percentage of what?

Mr Corey—Defence outlay, in cash terms. The Defence budget at the time of the agreement with cabinet was about \$11 billion, which meant that the amount Defence could retain from revenue from disposal of properties was \$110 million, which was one per cent of defence outlays.

Mr TANNER—In other words, the percentage has no reference to the value of properties?

Mr Corey—None whatsoever—it was tied to Defence outlay.

Mr TANNER—So where is the incentive to sell anything?

Mr Corey—We would retain the revenue. It was added on to Defence budget funding; it was not part of Defence budget funding. The Defence budget was \$11 billion, plus any revenue from return of sales, up to one per cent.

Mr TANNER—I am still a bit confused about this. What do you have to do to get that one per cent of your total budget?

Mr Corey—We had to sell sufficient properties and get revenue back from the sale of those properties up to that one per cent. So if we sold properties worth \$100 million, we would retain \$100 million.

CHAIRMAN—If they sold properties worth \$200 million, they got \$100 million.

Mr Corey—\$155 million.

CHAIRMAN—That is today, but then?

Mr Corey—No, then—anything above one per cent, we shared fifty-fifty.

CHAIRMAN—You did not tell us that.

Mr Corey—Yes I did.

Mr TANNER—He did, but the preliminary explanation was a bit opaque. I now understand that. What change occurred last year?

Mr Corey—Last year there were specific properties identified where the return would go direct to the budget. The one per cent still applied for Defence, but there were specific properties identified that we did not retain any revenue from—it was returned directly to the budget. That was \$500 million worth of property sales identified in last year's budget.

Mr TANNER—Without trying to pin you down too precisely, what has been the typical pattern over that decade or so? Has Defence achieve that one per cent?

Mr Corey—Never.

Mr TANNER—So you have never got to the stage of having that fifty-fifty split?

Mr Corey—No, and the Department of Finance and Administration have a view that we do that deliberately, but we do not. It takes a long time to get properties at that value onto the market, because they are all zoned as defence special purposes and to maximise the revenue you have to take them through a zoning process.

Mr TANNER—Does this mean that 0.9 per cent would be a pretty common outcome?

Mr Corey—This year we are forecasting for the first time to achieve in excess of one per cent.

Mr COX—But something unfortunate might happen and you might not get there?

Mr Corey—That could happen, but not deliberately.

Mr TANNER—In relation to the change last year, were these decisions essentially one-off decisions that said, ‘Property X will not be subject to this system’?

Mr Corey—That is right.

Mr TANNER—In other words, it does not necessarily predetermine anything that might happen?

Mr Corey—No. In the Expenditure Review Committee of cabinet last year and in the budget it was determined that the revenue from disposal of properties would be determined in the annual review of the Defence budget. In any one year the government left itself the flexibility either to let us retain the one per cent or to direct it to the general budget.

Mr TANNER—Is that decision made before or after the sale?

Mr Corey—The decision is made before the sale.

Mr TANNER—So, effectively, we are now in a regime where the government will decide annually, saying, ‘Okay, we are proposing to sell this list of half a dozen properties this year,’ and making a one-off decision that you can have none of the money, all of the money or some of the money. That is the new regime?

Mr Corey—That is the new regime.

Mr COX—Will you tell us what the regime is in the budget?

Mr Corey—In this budget?

Mr COX—Yes. I do not mean that you tell us now, but when this budget is announced will it be made public?

Mr Corey—I presume it will be quite clearly identifiable in the budget papers.

Mr TANNER—If there is a change to the regime?

Mr Corey—Yes. You will be able to identify it from the budget papers.

Mr TANNER—Can you give me a justification, other than that you need every dollar you can get your hands on, as to why, from a broader point of view of government, Defence should get any money at all from the sale of these assets?

Mr Corey—The original reason was the incentive. Prior to 1989—

Mr TANNER—Why do we need an incentive to sell them?

Mr Corey—It was the incentive to get the culture changed. Within the Defence organisation, properties that the Army were on were Army properties and properties that the Navy were on were Navy properties, and they were not going to move for any reason.

Mr TANNER—I see them as taxpayer properties, actually.

Mr Corey—They are, and they are quite clearly identified now. We have come a long way since then in overall Defence budgeting. Everyone within Defence understands that they have to make maximum use of the resources, whether those resources are in terms of property or whatever. We have moved from 500 plus properties in 1991 to 380 now and there is a further 100 for disposal. Prior to 1990, we would probably have been lucky to dispose of 10 properties in the history of Defence.

Mr TANNER—Given that this pattern of property sales is pretty well universal across the public sector, are you aware of any other departments or agencies that have had this sort of arrangement?

Mr Corey—Yes. The CSIRO retain the proceeds of their sales. Anybody with big property portfolios has retained them—for example, Telstra, which is now not a Commonwealth agency but it was and, similarly, Australia Post.

Mr TANNER—Retain them, but with what constraints?

Mr Corey—They had no constraints. They did not have the constraints we had—they retained all revenue.

Mr TANNER—Does that not tend to suggest that they are not talking about surplus to requirement property?

Mr Corey—Any property that you can eventually dispose of is surplus to requirements. The only reason Defence—

Mr TANNER—Shifting your investment from one property asset to another does not mean that it is surplus to requirements; it means you are changing the pattern of your asset allocation.

Mr Corey—In the Defence context, once we rationalise a property or function and move it and co-locate it with another one, the property does become surplus.

Mr TANNER—Does this arrangement apply in circumstances where you might have a pretty much equal arrangement where you sell property A and buy property B and in each case they are used for the same function?

Mr Corey—Very rarely, but there will be cases where that will happen—for example, when we moved the School of Artillery. The School of Artillery was probably not a good example, because we moved it to Puckapunyal. We moved 10 Terminal Regiment from Middle Head in

Sydney to Townsville. We purchased land in Townsville and built a new base for 10 Terminal Regiment.

Mr TANNER—For the purposes of that one per cent arrangement, would the proceeds of the sale of the property in Sydney have been factored in on a gross basis or a net basis? Would you have deducted the costs—

Mr Corey—It would not have been factored in at all except in the business case. It would have been factored in on a net basis on the business case of actually relocating that function. It was relocated principally on capability ground, but the business case also supported it on economic grounds. In a Defence context, we budget and plan five years in advance. The revenue that is projected from sales will be programmed into that total budget but it will not be identified against a particular project.

Mr TANNER—I will rephrase my previous question to you. Are you aware of any other departments that have a similar arrangement with respect to the sale of property as opposed to GBEs?

Mr Corey—The CSIRO is the only one, but it is a GBE. Most other departments would not have anything like the estate portfolio we have. Most of them were managed previously by the Department of Administrative Services and now they are managed by the Department of Finance and Administration which has just recently been outsourced to PricewaterhouseCoopers and a consortium.

CHAIRMAN—The old Department of Social Security had an awful lot of assets at one time.

Mr Corey—But I think they were managed by either DAS or the Department of Finance and Administration.

CHAIRMAN—It was DAS.

Mr Corey—They were not administered by themselves. Once we took over from DAS in 1989 or thereabouts, we have always administered our own properties.

Mr TANNER—Presumably, you think that should continue.

Mr Corey—We have had more reviews than Ben Hur of that function, and most of those have suggested that yes it should continue. We are not prepared to fight those reviews. We are quite happy to go along with the proposition. It makes sense. From a Defence point of view, it is much easier to make things happen inside the tent than from outside. It is a very strong culture within Defence, and you really need to be in there mixing it with them to actually make decisions about things like getting out of some of these properties.

Mr TANNER—I thought that taking orders was part of the culture, but obviously I was mistaken.

Mr Corey—It all depends who is giving them.

Mr TANNER—I see!

CHAIRMAN—I want to get back to some of the maintenance stuff, which is what the inquiry is all about. What data is collected to assist FACOPS to decide maintenance priorities and asset protection given that the strategic plan states that reliable data on asset value, condition, function and utilisation is essential for total asset management purposes?

Mr Corey—I will pass that to one of my colleagues, Mr Chairman. But just in a general context, since that has been written—a strategic plan for the Defence estate—we have set up a Defence estate management system, which is the basic vehicle by which we collect the data.

Mr Hammond—I am happy to answer this; I just have to find it. I anticipated a question like this, and I have got it written down.

CHAIRMAN—Do you want me to come back to you when you find the answer?

Mr Hammond—Yes.

CHAIRMAN—Given that backup funding has been cut substantially in real terms, what pressure has this placed on the prioritising of maintenance needs?

Mr Corey—We have been prioritising maintenance needs ever since we took over the function from the Department of Administrative Services. There has never been sufficient funding to satisfy all the needs for maintaining buildings. So we have established a planning process where we have a bottom-up and a-top down process that come together at a reasonable level and a central level and where we involve all of the players in the game, apart from private lessees. We make judgments based on capability needs in the first instance and occupational health and safety in the second.

CHAIRMAN—Recommendation 1 from ANAO is that individual facilities' costs be directly linked to the relevant outputs and sub-outputs so that FACOPS program costs can be appropriately attributed to Defence outputs. You agreed in principle, where it is practical and cost effective to do so. What progress have you made in that respect?

Mr Corey—Again, the Defence estate management system, with the comprehensive maintenance contracts in place, will allow us to identify costs down to building level on a basis which will allow us to attribute directly the costs of maintaining all of the assets of the estate.

CHAIRMAN—Can you comment on ANAO's finding that DEO analysis indicates that the 2000-01 budget for facilities operation is less than the industry benchmark by about \$100 million and that repairs are being deferred?

Mr Corey—I think I answered that earlier, Mr Chairman. That is correct. The repairs that are being deferred are repairs on either non-essential assets that we do not see as having a long-term

future or on assets that perform a function where the function may change and be satisfied by a different means in the near future.

CHAIRMAN—Can you assure us that this deferral is not creating a depreciation situation to the point that major assets are at risk?

Mr Corey—The assets that are depreciating are probably ones that we will demolish and we will not spend any money on them at all.

CHAIRMAN—To what extent is the Defence estate being maintained in accordance with sensible business practices, especially when property may be earmarked for disposal?

Mr Corey—I would hate to think there were examples of our spending money on something that is being disposed of, but I am sure there probably are out there. The planning system we have in place should ensure that that does not happen.

CHAIRMAN—Are you using the planning system, or are repairs done on an ad hoc basis?

Mr Corey—They are done principally on a planning basis. We have part of the repair facilities operations devoted to ‘urgent minor maintenance’. About 20 per cent is ‘urgent minor maintenance’, which you could describe as ad hoc. We would describe it as ‘urgent minor maintenance’. It is probably less ad hoc than it is. The rest of it is planned maintenance.

CHAIRMAN—In your submission you stated that you have almost implemented recommendation 4. Can you tell us the outcome, particularly in the regions?

Mr Corey—Recommendation 4 was?

CHAIRMAN—It was:

ANAO recommends that, to promote efficient and transparent decision-making by RECs—

that is me—

and EOP Branch in the relocation of scarce FACOPS funds, and better relationships with clients, DEO develop:

- a) clear directions ...
- b) an objective and comprehensive set of criteria ...
- c) a single, consistently applied format for the Facilities Executive Summary ...
- d) clear and consistent definitions ...
- e) procedures to provide clients with clear, consistent and assessable information ...

Mr Corey—I would suggest that that is pretty much in place across the board. When the audit was done of FACOPS by the ANAO we were in a transition phase. We were still

continuing some of the practices of the past and the new contracting arrangements had not come into being. I would suggest that, if you went back and reviewed it now, we have pretty much got that under control.

CHAIRMAN—What about staff training?

Mr Corey—Staff training is a difficult one in that we have been progressively relocating the staff that do not have the skills, that are no longer necessary. We are doing business differently. With respect to people that are not capable of being retrained, we are placing them in other positions or giving them the option of finding themselves something else to do. We are progressively implementing a system of recruitment and retention of people. You have got to understand that the sort of skills that we give the people that manage the facilities operations activity and our capital investment program are in high demand outside, and we cannot compete with the private sector. We train them—

CHAIRMAN—I have heard that said before.

Mr Corey—and they poach them. It is a sad fact of life but it is something that we have to live with.

CHAIRMAN—To what extent are your regional staff aware of CEO instructions?

Mr Corey—Probably not as aware as they should be. We conduct a series of workshops annually for the senior staff and expect them to make sure that their more junior staff are aware of those instructions. We have made a concentrated effort, particularly since the ANAO has highlighted some of the deficiencies in the awareness of our staff, and we intend to continue that.

CHAIRMAN—To what extent have you put in place any risk management strategy to assess contractor performance?

Mr Hammond—Would you like me to answer the other question from 10 minutes ago first?

CHAIRMAN—Go ahead.

Mr Hammond—It runs into it, so it is a good way of doing it. We have a strategic facilities appraisal model which has been published in the audit findings. It talks about the capability contribution of the asset and grading it. There is an expectation that the ADF will give us input into what the capability contribution of each asset is. Then we will look at the condition of each asset, which is fairly simple for the industry to take on board, and look from that at the capability impact of not doing the work inside a restricted budget. That also has to be done in consultation with the Australian Defence Force.

What we recognise from that inside our current budget limits is that we are going to highlight or identify works that are not being done and we have to apply a risk management profile to those. We are embracing Australian standard 4360. We have got a beta test at the moment for

environmental works. We are applying the AS4360 matrix against those. We are going to migrate that across the entire estate so that we can look at occupational health and safety aspects, the risk of deterioration of the asset, and profile the risks that are being carried by the department. In this way we believe we will be able to identify to the executive what risks they are carrying and not just say, 'The model says two per cent of the gross replacement value is what we should spend on maintenance,' because that really does not tell us what a risk management profile would tell us. That is what we aim to do.

CHAIRMAN—Does ANAO have any comments on that whole series of questions and answers?

Mr McPhee—No, Chairman, I think it all sounded fairly positive.

Mr COX—The only other thing I wanted to ask was whether all of the \$14.8 billion, in gross replacement value terms, in assets appear on the Defence asset register.

Mr Corey—I do not know. I am assuming they do. They are in the Defence report.

Mr Lane—I believe that we are in a much better position now to understand exactly what we have in the estate in comparison to what was the case a few years ago. When we look at the property asset register, one of the activities that we have developed, as part of the creation of the Defence Estate Organisation, is to identify all of the properties and assets. I believe that we are in a much better position now than we were before.

Mr Corey—I have had some advice that the \$14.8 billion is derived from the Defence asset register.

Mr COX—Does that necessarily mean that everything is on it?

Mr Corey—We are fairly confident that everything is on it. We went through a period of having assets first found, and they came from assets under construction which we did not necessarily identify. Defence as a whole, for about 12 or 18 months, has gone through a process of recognising what were assets and what were not. We had some accounting regimes in place that did not necessarily conform with what the Audit Office and other organisations had in place. Once something was issued from us, for example—not from the DEO but from Defence—it was no longer an asset, even though that could come out at billions of dollars. So we have changed the way we do some of our accounting.

CHAIRMAN—When do you think you will have a full asset register in place?

Mr Corey—We think we have got a full asset register for Defence estate in place now.

CHAIRMAN—What makes sure that it stays up to date?

Mr Corey—The estate management system records everything that happens to the estate and it gets fed back into the asset system.

CHAIRMAN—Is that foolproof?

Mr Corey—It should be foolproof.

Mr Hammond—We have got a fairly powerful motivator—that is, our contractors get paid based on what work they identify that they are doing. So if they identify an asset or we ask them to do work on it and it is not in our contract, they are going to very quickly identify it so that they can get paid. In this way, we have identified a significant increase in our asset database since we have let the comprehensive maintenance contracts.

CHAIRMAN—Mr Corey just said that you already have a 100 per cent accurate asset base.

Mr Corey—I said I was fairly confident that we had a 100 per cent accurate asset base.

CHAIRMAN—How then is it possible that the contractors are still identifying assets that are out there?

Mr Corey—The other thing that will help us is that all of the actions that happen to an asset come through the accounting system as well, which is linked. So the asset register and the accounting system are now linked.

CHAIRMAN—Even though it comes through a register, who is to say that a single asset does not get described in two, three or four ways?

Mr Lane—That was the case before in terms of a lot of the properties. They were recorded by an address and by a property ID number. As part of the purification of our database, we made sure that we identified all of those properties. By doing that we are now quite confident that we have got the properties right and that we are down to the facility identification, so that we do know what the extent of our estate is. By way of example, we have something like 25,000 individual buildings in the estate.

Also, from the point of view of a lot of the individual equipment systems in our establishments or facilities, we have had them all bar coded. That is one way that we are having our contractors keep track of what has occurred on individual systems. If there has been a replacement, or if it has been moved from one area to another, it has been recorded back onto our DEM system. So we do have the ability to track that information in a much more comprehensive way than we ever did before.

CHAIRMAN—It sounds good, but I think I slightly prefer Mr Hammond's answer to Mr Corey's answer.

Mr Corey—He knows more about it than I do.

CHAIRMAN—Mr Corey is telling me that it is 100 per cent, while Mr Hammond says, 'Where we have a problem, we are identifying it and fixing it.' Being a practical engineering type, I think I prefer Mr Hammond's answer.

Mr Corey—He is a practical engineering type as well, so that probably explains it.

Ms GILLARD—With respect to the strategic plan for the Defence estate, which we have talked about during this discussion, it says that it—and I quote:

... was endorsed by the Defence Executive in December 1998 and is awaiting consideration by Government.

What is the explanation for that delay? Is it in the ‘in’ basket and has never been taken out, or it is likely to be changed in view of the white paper?

Mr Corey—That is part of it. Initially, the previous Minister for Defence was a little reluctant to take it to cabinet at the time because he felt that it contained a couple of proposals that needed a bit more consideration before it got floated before cabinet. Then the white paper came along and now we have revised the strategic plan, so we have got an amended one that will go forward to the defence committee later this year, and it will come forward to government once that has been endorsed. The strategic plan projects which bases have a long-term future, which ones have a medium-term future and which ones have no future. In doing that, there were some implications that the minister felt we needed to do some more work on before we put it to the government.

Mr COX—Can you tell us which ones have no future?

Mr Corey—From where I sit or from where the government sits?

Ms GILLARD—It is a bit of a problem, though, if your central strategic document—

Mr Corey—It is a problem—

Ms GILLARD—I am not suggesting it is your fault, by the way.

Mr Corey—but we still work within those constraints. We can still work on rationalising our bases and doing some of those things. We are effectively taking individual rationalisation proposals of the government. Instead of them giving us a level of endorsement of the strategic plan—which no government is likely to do, I suggest—they may endorse it in principle but still want us to come forward with individual rationalisations, base closures and those sorts of things on a case by case basis. I do not have a problem with that.

CHAIRMAN—On behalf of the committee, I thank you for your candid answers. I am impressed that you seem to be trying hard. I accept the fact that you have come from what we would call a very low base, and I understand the reasons for it—I understand the culture and how it all occurred. If you are getting that close to having an asset register, then you can make strategic plans, do risk analysis on the assets and incorporate the contractors in your overall plan and make it work reasonably well. So it sounds like you are headed in the right direction.

Mr COX—Mr Corey, I have one last question. You said that you have got 25,000 buildings. Are there a proportion of those that are absolutely useless? I can remember having a discussion with a former Chief Defence Scientist who was amazed to discover that out at Salisbury he had

a whole lot of buildings which were basically left over from when the place was a munitions factory in the Second World War. Every year his organisation was required to certify that they had been maintained to a decent standard. What he really felt that he should do was hold a raffle every week and give the winner the right to press the plunger on a detonator and blow one of them up so that they would no longer be a liability.

Mr Corey—We adopted that strategy in part, but we do not use the plunger and run the raffle. You would be aware that some of them are heritage buildings that we cannot do that with, but in cases where they are not heritage buildings—

Mr COX—I was not suggesting Victoria Barracks.

Mr Corey—Some of the buildings at Salisbury that were left over from World War II are heritage listed.

CHAIRMAN—I inherited a manufacturing plant and half the store was held over from World War I, and it was all at standard cost.

Mr Corey—We have probably got a couple of those.

CHAIRMAN—Thank you again to all of you.

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

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

Committee adjourned at 3.13 p.m.