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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Reference: Review of Auditor-General's reports, 4th quarter 2001-2002

Roundtable

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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Friday, 20 September 2002

Members: Mr Charles *(Chairman)*, Senators Colbeck, Hogg, Moore, Murray, Scullion and Watson and Mr Ciobo, Mr Cobb, Mr Georgiou, Ms Grierson, Mr Griffin, Ms Catherine King, Mr Peter King, Ms Plibersek and Mr Somlyay

Senators and members in attendance: Senators Colbeck, Hogg, Moore, Scullion and Watson and Mr Charles, Mr Ciobo, Mr Cobb, Ms Grierson and Ms Plibersek

Terms of reference for the inquiry:

Review of Auditor-General's reports, fourth quarter 2001-02.

WITNESSES

Committee met at 10.09 a.m.

Participants

COCHRANE, Mr Warren John, Group Executive Director, Australian National Audit Office

CRONIN, Mr Colin Douglas, Executive Director, Performance Audit Services Group, Australian National Audit Office

HODGSON, Mr Alastair, General Manager, Asset Management Group, Department of Finance and Administration

HOLBERT, Ms Fran Elizabeth, Senior Director, Performance Audit Services Group, Australian National Audit Office

PAHLOW, Mr Michael John, Branch Manager, Commercial and Projects, Department of Finance and Administration

CHAIRMAN—I open today's public hearing which is the third in a series of hearings to examine reports tabled by the Auditor-General in the financial year of 2001-02. This morning we will be taking evidence on Audit report No 63: *Management of the DASFLEET Tide Contract*. In August 1999, the Joint Committee of Public Accounts and Audit commenced a review of Audit report No. 25 1998-99: *DASFLEET Sale*. The committee held a public hearing on 13 August 1999 and a further hearing on 26 August 1999. By the time of the JCPAA hearings, commercial disputes had arisen in relation to both the sale agreement and the tide contract. The committee was advised that matters were proceeding to arbitration. In light of the evidence provided by Finance and the then Office of Asset Sales and IT Outsourcing, OASITO, in relation to the disputes with Macquarie fleet, the committee resolved to delay continuation of its review of the DASFLEET sale until the arbitration was complete.

We will be running today's session 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—and I emphasise that. Third, I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as contempt of parliament. The evidence given today will be recorded 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. Mr Hodgson, do you have a brief opening statement that you would like to make?

Mr Hodgson—All I want to say is thank you for delaying the hearing. It was originally scheduled for 23 August and it would have been difficult for us to get witnesses at that time. I appreciate the fact that you have delayed it to allow us to get the appropriate staff here.

CHAIRMAN—Mr Cochrane, do you have an opening statement?

Mr Cochrane—No, Chairman, I will just take questions.

CHAIRMAN—Mr Hodgson, we are not just going to talk today about Audit report No. 63, we are going to also deal with Audit report No. 25 as we terminated our hearing into that matter at your request. By the time your arbitration was complete, we were heading towards an election so we could not get access to you to get answers to our questions. I recall that in the original audit report it said something to the effect that in the DASFLEET sale, OASITO and its business adviser Barings conducted a sales process which included the letting of a long-term contract for which DOFA had administrative responsibility. DOFA had no formal role in that process at all. Barings had prepared advice which OASITO then passed immediately through to the minister. OASITO advised ANAO that it did not accept that it stood in a reporting line between advisers engaged for sales and the minister. I would like your comments on that, Mr Hodgson.

Mr Hodgson—I am not sure I can comment. This was an issue between OASITO and the minister at the time. I am not clear what you are expecting from me.

CHAIRMAN—The question basically is do you accept that the Department of Finance and Administration has a role in advising the minister on broad issues such as the sale of an asset?

Mr Hodgson—Yes, most certainly.

CHAIRMAN—And do you accept that the department stands between any professional advice and the minister in order—as is my understanding of the public servant's role—to properly advise the minister of risks, procedure and value for money?

Mr Hodgson—I apologise. I thought you were asking me to comment on OASITO standing between the advice and the minister.

CHAIRMAN—No, I am not asking that.

Mr Hodgson—Certainly the Department of Finance and Administration has always adopted a policy of standing between advice given and the minister and of advising the minister independently if that is appropriate.

CHAIRMAN—Can you explain, then, why OASITO had a different view?

Mr Hodgson—No, I am sorry, I cannot speak for OASITO. ANAO may be able to comment if they interviewed people at the time. I am not sure.

CHAIRMAN—Mr Cochrane?

Mr Cochrane—As pointed out in paragraph 3.2, our report merely records the fact that OASITO had a much different view of their approach, which surprised us to some extent, because we thought that OASITO should have taken a bit more interest in the advice it was receiving from its advisers before passing it on to the minister.

CHAIRMAN—Mr Hodgson, one of the things that concerns this committee is that an audit report—I cannot remember which audit report or even which year—dealt with information technology leases and there was a significant dispute between the Department of Finance and Administration and ANAO regarding whether those transactions were operating leases or finance leases. That never really reached a resolution. As I recall, Dick Humphrey came in and did a report for the then minister that said it was a bit ambiguous, although DOFA still maintains that they were operating leases and ANAO maintains that they were finance leases. Is there any question in your mind that what the department, or what the minister, thought the minister was getting was an operating lease and what the minister got was a finance lease, in this instance?

Mr Hodgson—I cannot put myself into the mind of the minister and know exactly what he thought, but it is clear to me, reviewing this, that we were entering into a finance lease. I understand that it is treated as a finance lease in the accounts of the Commonwealth for a whole of government approach.

CHAIRMAN—Is it not true, Mr Cochrane, that the tender documents indicated that the government expected an operating lease—that is, that the Commonwealth would be transferring risk for the operation of its vehicle fleet to the lessor rather than accepting it as the lessee?

Mr Cochrane—That was the stated intent, yes.

Ms PLIBERSEK—Mr Hodgson, you say that it is clear to you. Is it clear to you because you have seen the way the Reserve Bank subsequently treated the arrangement, rather than clear from the contract documents? Why is it clear to you?

Mr Hodgson—It is clear to me having read all of the documents. I became responsible for this area about 18 months ago—

Ms PLIBERSEK—But it is clear to you in hindsight?

Mr Hodgson—Yes, it is clear to me in hindsight.

Ms PLIBERSEK—If you had just got the original contract documents and did not know that the Commonwealth subsequently went to the Reserve Bank and argued with Macquarie Bank that it should be treated as a finance lease—if you did not know that part of the story—would it have been clear to you from the Barings advice and the original contract that was signed, or were the documents so impenetrable that, without the subsequent information, you would not have been able to tell?

Mr Hodgson—I think it is very unclear from the documents exactly what was intended or what the outcome would be.

Ms PLIBERSEK—Is the contract just badly written? Is it so much more complex than any other asset sale arrangement? Why is it so unclear in this particular instance?

Mr Hodgson—My view is that it was a very complex deal entered into.

Ms PLIBERSEK—Did it have to be that complex?

Mr Hodgson—My personal view is no, it did not have to be that complex. I am not sure why it was set up in such a complex way. I think, trying to understand what was in the mind of various people at the time, that there was a concern that the government may have been giving away some benefits in the deal and it wanted to make sure it had an opportunity to claw back those benefits. By that I mean the increase in vehicle value over time if there was any, or the increase over the intended benchmark. In an attempt to try and cover that off, I think what was ended up being negotiated was a very complex system which allowed clawback on one and allowed charging on another, which meant a very complex system to administer. So I think the intent was to make sure that Macquarie did not rip the government off, I suppose. In the process that led to a very complex contract which was very difficult to administer and difficult to interpret.

Ms PLIBERSEK—It was not just that Macquarie put all the complicated bits in for their own benefit and we did not understand it and they did a snow job on us?

Mr Hodgson—I do not know. I was not there at the time. I can only comment on the final outcome rather than what was negotiated around the table.

Senator HOGG—Where are the people who were there at the time who did the negotiations? Are they still within the department?

Mr Hodgson—As you know, OASITO has been abolished—

Senator HOGG—Yes, we understand.

Mr Hodgson—and the IT outsourcing function has been totally wound back. I think at its peak OASITO had 77 people working for it. At the moment, the asset sales branch, which is part of my responsibility within the Department of Finance and Administration, consists of about 17 people, so there has been quite a reduction. As I understand that, none of those 17 were involved in this particular deal.

Senator HOGG—So where are the people who were involved in the deal?

Mr Hodgson—I guess they work in other parts of the Commonwealth or they have left the Commonwealth. I am not sure.

Ms PLIBERSEK—They have become consultants!

Senator HOGG—That would not surprise me.

Mr Hodgson—I have not done a reconciliation of where they all are—

Senator HOGG—I just hope they have not been promoted, that is all.

Senator WATSON—I just find it difficult to understand how the risk weighting could change so significantly. It was fairly clear, and I think a reasonable person would accept that a risk rating of 10 per cent would tend to indicate where the responsibility lay. But for some reason it changed. When that risk rating changed, was there any involvement by the respective parties? That change by the Commonwealth bank from 10 to 100 completely changed the nature of the arrangement and it therefore had overtones of changing the nature of the sort of lease that it finally turned out to be. What was the involvement of the department in terms of that shift around? To me that is fundamental. As soon as the Commonwealth government changed that risk rating, the whole atmospherics of the contract changed. What enabled that to happen? That seems to be the starting point of it.

Mr Hodgson—I think it is clear from the contract that the clause entered into by the Commonwealth or by OASITO indemnified, as it were, Macquarie for changes in this risk weighting. As I understand it, this was a decision of the Reserve Bank, which the Commonwealth does not control.

Senator WATSON—That is right. It was accepted on the basis of the 10 per cent.

Mr Hodgson—Yes.

Senator WATSON—So the contract would have allowed for some minor movements, I would have thought. But to go from 10 per cent to 100 per cent completely changed the whole nature of the contract. What were the negotiations or what was the feedback arising from that dramatic change? If it was just a few percentage points, all right, that is what those contracts are all about, to enable a little bit of flexibility for interest rate movements and all that sort of thing. But this completely changed the whole nature of the contract, to go from 10 to 100 per cent.

Mr Pahlow—I think that came from the Reserve Bank's view of what Macquarie Bank, as a bank, was required to have in asset backing for the different classes of liabilities it had entered into. The Reserve Bank looked at this transaction in a different class from what it was originally indicated or assumed to be by the parties.

Senator WATSON—This is fundamental. The Commonwealth bank must have been misled, because they did their risk weighting on 10 per cent originally.

Mr Pahlow—The Commonwealth bank or Macquarie Bank?

Senator WATSON—Macquarie Bank.

Mr Pahlow—My understanding—I was not there at the time either so I am relying on information that I have heard since—

Senator HOGG—You were lucky!

Mr Pahlow—I was very lucky; I agree with that 100 per cent!

CHAIRMAN—You were both lucky.

Senator HOGG—That is why you have smiles on your faces. *Hansard* cannot record smiles!

Senator WATSON—The point I am making is that the nature of the lease is quite academic because the whole nature of the contractual arrangements change fundamentally as soon as there is an acceptance of this movement from 10 to 100 per cent.

Mr Pahlow—I think that is where the argument came forward that the finance lease view of the world is based on exactly that sort of scenario.

Senator WATSON—What did Barings say in relation to that fundamental change? They were the ones that were monitoring these arrangements and giving advice as a consequence of that change. Somebody must have commented because it suddenly changed the whole risk profile.

Ms PLIBERSEK—That begs the question: Barings were not monitoring; they gave initial advice and then they took their money and ran, didn't they?

Mr Hodgson—My understanding is that they just advised on the initial deal.

Senator WATSON—Based on 10 per cent?

Mr Hodgson—Yes. I think the mistake was that essentially the Commonwealth was taking the risk of that variation without really understanding what potential there was for that variation to move so dramatically.

Senator WATSON—The point is that when you provide for variation clauses, it is always at the margin to account for interest rate movements. There is nothing to indicate there is a completely changed profile, which changes the whole nature of the contractual arrangement.

Mr Pahlow—What was indicated as a result of that change in the potential capital adequacy ratio was that if it were to be an operating lease, then it would be—

Senator WATSON—No, forget about the terminology and whether it is an operating lease or not. The whole question is where the risk lay. Stay with these terms. Originally, there was a 10 per cent benefit, which meant the risk was of a minor nature with the Commonwealth. But, suddenly the whole nature of that arrangement changed for some reason. Who were the parties that gave the tick-off to this new arrangement which changed the whole nature of the leasing?

Mr Pahlow—The new arrangement you are talking about was already built into the contract. The contract had provisions which said that if the capital adequacy ratio changed, then there was a mechanism by which the Commonwealth and Macquarie had to agree an alternate costing structure, which ultimately delivered the same outcome, or as similar an outcome as possible. In the end, the capital adequacy ratio did not change; it remained at 10 per cent, and later on in fact

dropped to zero. It never went up to 100 per cent; that was a debate that the Commonwealth and Macquarie had with the Reserve Bank over interpretations of asset classifications.

Senator WATSON—Therefore in hindsight, would it have been better off going with the alternative? There was nothing much in it, in terms of the initial tender process.

Mr Pahlow—The alternative?

Ms PLIBERSEK—The LeasePlan.

Senator WATSON—LeasePlan.

Mr Pahlow—My understanding is that at the time there was about a $6 million net present value difference between the two bids on price but there were substantially different bids in terms of what we were getting for the deal. But I have to confess to not knowing the detail of the—

Senator WATSON—But in terms of the final outcome, we have to benchmark it somehow—the success of this program.

Ms PLIBERSEK—Why don't we ask the ANAO?

Senator WATSON—Okay. What is the alternative?

Mr Cronin—LeasePlan were actually offering a genuine operating lease. That explains the large difference in the funding margin. If you take that out, LeasePlan had significantly cheaper components in terms of the vehicle operatings.

Senator WATSON—Therefore at the end of the day, other things being equal, in hindsight—

Mr Cronin—You have the risk return trade-off.

Senator WATSON—Would we have been better off with the LeasePlan arrangements?

Mr Cronin—That is what you have ended up with.

Ms PLIBERSEK—That is what we have anyway. Macquarie farmed it out to LeasePlan.

Senator HOGG—Yes, I was about to say—

Ms PLIBERSEK—That is what we have, isn't it?

Mr Cronin—That is what you have ended up with. LeasePlan now runs it.

Senator HOGG—That is what I thought was the case.

Senator WATSON—But we paid the extra costs.

Ms PLIBERSEK—Yes, exactly.

CHAIRMAN—The question has to be asked: has anyone ever analysed this whole business from beginning to end to determine whether or not the Commonwealth got value for money? Or did we do our dough?

Ms PLIBERSEK—I think we did our dough.

Mr Pahlow—In the context of LeasePlan versus Macquarie Bank, no, we have not undertaken that transaction.

CHAIRMAN—I am sorry, let me rephrase it so that I make myself clear. Are we better off now with what we have, considering all the costs, the sale price, the money that has come in and whatever interest we have been able to earn from that money in the capital market, than we would have been if we had retained ownership of the fleet?

Ms PLIBERSEK—The fleet was making a profit every year, wasn't it? Take that into account.

CHAIRMAN—If they were, that is included in the question.

Mr Pahlow—I cannot answer your question with a firm yes or no because I do not know. All I can do is refer back to comments made by OASITO at the time. Their calculations at the time had indicated a $70 million or $80 million benefit to the Commonwealth in the disposal of DASFLEET.

CHAIRMAN—That is fine but that was before we paid out extra money to Macquarie Bank as a result of arbitration. Mr Cochrane, has ANAO done any analysis?

Mr Cochrane—As you know, we have to accept government policy so we have not actually done an analysis between the old policy and the new policy. We have just accepted the new policy and checked to see in the first report whether the sale objectives were achieved.

Senator HOGG—The sale objective, though, surely was the profit that was promised. Has that profit been delivered? That is the question, isn't it?

Mr Cochrane—Given that one of the original sale objectives was to transfer the risk from the Commonwealth to the new owner, that in the first instance did not occur. We did not meet that objective.

Senator HOGG—So one objective down. What about the profits?

CHAIRMAN—But we do now.

Mr Cochrane—We do now.

CHAIRMAN—Thank you.

Senator HOGG—Yes, we do now. One objective down initially. What about the profit? Was the profit there?

Mr Pahlow—My understanding from reading previous transcripts of evidence given is that Mr Hutchinson from OASITO estimated that to be approximately $88 million better off in present value terms. We have not done the analysis but my gut feeling is that we have not eaten into $88 million in terms of amounts either received from or paid to Macquarie Bank.

Senator HOGG—Is it a major exercise to find out what is left out of the $88 million by way of profit?

Mr Pahlow—We estimate settlement and all amounts paid—adjustments to sale proceeds, both disputed and non-disputed—to be less than $50 million. But it is a reasonable exercise to determine what those amounts are, in detail anyway.

Senator HOGG—All right. Take a gut feeling then—you are saying that it is about $38 million better off. Is that the way to read it?

Mr Pahlow—On the basis of the information provided by OASITO, yes.

Ms PLIBERSEK—And we respect their advice. You say 'about $38 million better off', but that is offset by the fact that DASFLEET was making $10 million a year, so within four years there is no net benefit. Is that right?

Mr Pahlow—I have no idea of what their profit levels or projected levels were, I am sorry.

Ms PLIBERSEK—Does the ANAO know the answer to that question?

Mr Cochrane—Yes. One way of tackling the question might be to say what we have said in our report, which is that certainly the contract entered into meant that the Commonwealth had engaged itself in an expensive form of finance and that it would have been cheaper to have self-financed. That is the position we came to.

Ms Holbert—Returning to the question about what DASFLEET owned, paragraph 1.1 of Audit report No. 63 points out that, in their last year of Commonwealth ownership, the net operating profit was about $23 million. But that is not the dividend to the government; that is the net operating profit of the business.

Ms PLIBERSEK—How much of the net operating profit would be a dividend to the government and where would the rest of the money go?

Ms Holbert—I am sorry, I do not have that information.

Ms PLIBERSEK—Where would the rest of the money go if it were not coming back to the government? If it is still profit, how is it disbursed?

Ms Holbert—Some of that is needed for the business.

Mr Cochrane—Some of it is retained earnings for the business.

CHAIRMAN—Does anybody know whether OASITO, in that estimate of $88 million, took into account the net operating profit over the four years of the contract?

Mr Hodgson—That is a good question; we do not know. We have not gone back to investigate what happened pre and what happened post.

CHAIRMAN—Could you?

Mr Hodgson—We could try digging out records.

CHAIRMAN—Would you?

Mr Hodgson—If you insist, Mr Chairman, we would.

CHAIRMAN—We are asking you to.

Mr Hodgson—Yes, we can do that.

CHAIRMAN—Thank you.

Senator SCULLION—Mr Hodgson, I have to confess that, at this stage, I am still pretty confused about the process but it sounds as though this is historical, and lucky for you. Did you apprise yourself of the advice that Barings gave at the time? You said that, when you arrived in the seat, you looked over all the documents. Did you have a look at the written advice that Barings gave the minister at that time?

Mr Hodgson—The simple answer to your question is no. When I took responsibility for this area it was for the management of the current contract that the Commonwealth had entered into. Although at that stage we were heavily in dispute, I availed myself of what most of the issues in the dispute were rather than going back to see what advice had been given at the time. Quite extensive work has been done by various teams that have looked at what the intent was at the time, what was agreed and what was thought to be agreed. This all came through in the process of arbitration when we tried to settle the dispute through arbitration. We had to fully establish what was in each other's mind at the time.

Senator SCULLION—I am basically trying to get an appraisal of the quality of that advice in view of the circumstances at the time of the advice. I would appreciate it if ANAO could add something if Mr Hodgson has not actually read that. Mr Cochrane, would you be able to add anything?

Mr Cochrane—Only in the sense of what we raised before about lessons learned—that maybe one of the lessons learned is to improve procedures to ensure you get a better job from the consultants. But, having said that, we are not saying in this instance that we have actually audited the advice that was given by Barings.

Mr Cronin—One distinguishing feature of this sale was that there was no tender evaluation committee. It is quite common in many of the activities when you are getting tenders in that you construct an evaluation committee. They review it and pass it on to the relevant department, which then puts the advice. That was not applicable in this case. As a standard rule, our office supports this concept of having this evaluation, because you would have had people in from the then Department of Administrative Services who had had a lot of experience in running and managing the fleet, you would have had people in from the then Office of Asset Sales and you would have had advisers, and together you would go through the tender in a systematic way and work out whether in fact the Commonwealth got advice. They did not have a tender evaluation committee in place for this one so the information went, as they say, straight from the adviser through to the minister.

Ms GRIERSON—Because we are dealing with people who were not there through the whole process, we have some difficulties in achieving the best outcome. In my view, the best outcome would be for someone to wear this pretty considerably, because the losses are huge. We would very much want to know that skills reside in DOFA in areas such as risk assessment processes and the preparation of contracts. What is the normal procedure now when you prepare a contract for the sale of an organisation or asset on behalf of the Commonwealth? What is your involvement in the preparation of tender documents or the information memorandum? How does that process operate? If you answer that question I will move on from there.

Mr Hodgson—The Department of Finance and Administration has quite rigorous processes to handle the letting and evaluation of tenders and the awarding of contracts. Those processes involve independent probity advice. They involve a tender evaluation committee. They always involve independent legal advice. That legal advice can be drawn from a panel of three legal advisers which Finance has, or it could be an independent contract for legal advice on a particular tender. We use quite thorough processes at the moment. All of them have stood the test of ANAO audit and internal audit to ensure that those processes are robust.

Ms GRIERSON—Because of this situation, have other existing contracts been reviewed to make sure that there are no further difficulties in terms of the risk to the Commonwealth? There are quite a few.

Mr Hodgson—Yes. We asked our internal audit function to carry out a review of all contracts entered into to make sure that we did not have another of these sleeping. That review was taken out and any issues that were identified were addressed. It was clear from very early on that this contract was difficult. There were differences of view as to what the contract meant. It was not a sleeper: it did not creep up on the people involved; it was clear from very early on that it was difficult to administer.

Ms PLIBERSEK—I guess that would have been clear as soon as Macquarie Bank started asking for more money.

Mr Hodgson—There were issues around the provision of information, the quality of information given and the accuracy of invoicing—a whole range of things early on which meant that it was a very difficult contract to administer.

Ms GRIERSON—How reliant are you currently on external advice, and what is the balance between the external advice that you have to gain and your internal competencies?

Mr Hodgson—We have no internal legal services. We have a panel.

Ms GRIERSON—So there is just this panel. Is it retained permanently?

Mr Hodgson—Yes.

Ms GRIERSON—Is it reviewed regularly?

Mr Hodgson—Yes. The AGS are on that panel, as well as Minters, Phillips Fox and Blake Dawson Waldron. We are very happy with the quality of legal advice that we get. We can go outside that panel if we want specific advice in a specific area. We are quite comfortable with the quality of the advice. Given that there has been this large culling of staff out of what was OASITO, I have personally been very impressed with the quality of staff that I have—the 17 who are left. They have been through a number of audits and have understood what ANAO require. It is now standard procedure in an asset sale to draw up a matrix of all of ANAO's previous recommendations on asset sales and to address that matrix: are we complying? If we are not complying, for whatever reason, why are we not complying, and is it appropriate not to comply? That is reviewed at a very high level in the department. In fact, I review it to make sure that we are fully following the advice.

Ms GRIERSON—Are tender evaluation committees now standard practice?

Mr Hodgson—Yes, it is standard practice.

Ms GRIERSON—And you have a probity auditor on that as well?

Mr Hodgson—Yes, we have a probity auditor.

Ms GRIERSON—Who is the probity auditor?

Mr Hodgson—It depends on the individual sale. It could be Finance's own internal auditor for a small sale; for a major sale, it goes out to contract and someone is appointed with the appropriate skills.

Ms GRIERSON—In our previous experience that we were dealing with today, was there a probity auditor—an independent probity auditor or an internal probity auditor?

Mr Hodgson—My understanding is that there was not.

Ms GRIERSON—Can you find out for me?

Mr Hodgson—I am pretty certain there was no—

Ms GRIERSON—I am sorry, for the Audit Office, there was no probity auditor.

Mr Cronin—No.

CHAIRMAN—Let us go back again to Audit report No. 25. DOFA advised ANAO that it had initiated an external review by Oxley Corporate Finance which was to be a comprehensive assessment of the tied contract dynamics and downstream liabilities, if any. The review was scheduled for completion by late December 1998. Did that ever get completed?

Mr Pahlow—We received, as I understand it, a final draft of the report, but by the time it was completed we were well and truly into dispute and we had other commercial and legal advisers identifying the impacts for us of what the issues in dispute were. I do not think the report was ever formally finalised. There were other risk assessments being undertaken at the time as well.

Ms GRIERSON—Have you changed your arrangements? The advice from Barings is something we are fairly interested in. What are your contractual arrangements with advisers now? If you were to contract for independent advice in that way, what terms and conditions would you place on that? Is it possible to place on that terms and conditions that test it or deal with risk or failure of that advice and cost to the government? Or is that indemnified in some way?

Mr Hodgson—We do not give indemnities to advisers for bad advice. If they give us bad advice, we have the right to pursue them for the consequences of that bad advice.

Ms GRIERSON—Is that contractual?

Mr Hodgson—That is contractual. That is the way we approach our contracting of advisers.

Senator HOGG—How many have you pursued?

Mr Hodgson—I am not aware of any but that does not mean to say they have not been.

Senator HOGG—How many of them have given you bad advice?

Mr Hodgson—I am not aware. I was not involved in Barings.

Senator HOGG—But in the broader sense.

Mr Hodgson—I have been very happy with the quality of advice that I have received in the time that I have been responsible for it. I have not had big issues about the quality of the advice. We have not had any need to pursue anybody, I guess, in my limited experience.

Mr Pahlow—Quite often, too, if the advice provided does not meet our needs, we go back to them and say, 'Please meet our needs.' So it does not get to the situation where you have to take recourse such as legal action.

Senator HOGG—But obviously sometimes bad advice does not become evident immediately. It takes time. What time have you got in which to pursue them if the advice is bad?

Mr Pahlow—My understanding is that the normal statute of limitations would apply, but I am not a lawyer, so I would have to seek confirmation.

Senator HOGG—I highly commend you on that.

Senator WATSON—Given the initial very wide risk ratings between the two close participants for the contract and given the fact that, in the Macquarie Bank case, they were given the option of changing the risk rating quite significantly, why was it that neither OASITO nor Barings approached the Reserve Bank to assess its views on changes to risk weighting to be assigned to the tied contract?

Ms PLIBERSEK—They did not even get initial advice about what the risk weighting would be, did they?

Mr Pahlow—I have to confess that I am not sure. I assume that—

Senator WATSON—There was a fundamental weakness.

Mr Pahlow—when you say 'risk weighting' you mean capital adequacy ratios.

Senator WATSON—No, there is 10 per cent to 100 per cent—such a big gulf between the two. On the other hand, the Macquarie Bank had this contract for flexibility built into it, which went from 10 per cent to 100 per cent et cetera. Why was it, do you think, that neither OASITO nor Barings, the adviser, bothered to approach the Reserve Bank to get its views on the likely risk weighting to be assigned to their tied contract before they advised the minister?

Mr Pahlow—I am afraid I do not know, Senator.

Senator WATSON—Would you have done it?

Mr Pahlow—At the time, if I had any questions or concern over the information that I had available to me, yes, I would have. But if I were doing it then, I would have looked at the rules and regulations surrounding that and applied them. If there were any questions about that then, yes, you would have either sought more advice from your advisers or gone to the—

Senator WATSON—But there was just such a big gap. On the other hand, despite the fact that there was a big gap, one party did have the option of changing and having it built it into the contract. I would have thought that somebody, either OASITO or the business adviser Barings, should have approached the Reserve Bank about the consequences.

Mr Pahlow—I am not clear, senators, whether they did or they did not talk to the Reserve Bank.

Mr Cronin—They did not talk to the Reserve Bank.

Senator WATSON—They did not.

Mr Cronin—In May 1997, before the Commonwealth agreed to select Macquarie, Barings, OASITO and Macquarie met and discussed the question of the risk weighting. Macquarie got it inserted into the tied contract schedule 10, which provided the mechanism for the movement. Barings, in their advice to OASITO, which was passed through to the minister on 30 June 1997, advised that, in fact, the margins could move. As to your question about why someone did not go to the RBA and ask how they would rate it, if you actually add in the margin for 100 per cent weighting, it brings both funding margins up in the order of 180 basis points. What you normally expect in a market is that there will be equality in terms of funding, because we are dealing with very large financiers. Why would somebody have such incredibly different rates in a functioning market?

Senator WATSON—Absolutely. That is not the question.

Mr Cronin—We could never work that out because it had to relate back to how it was treated on the party's books. If Macquarie did not have it on their books then they did not have to claim much of a margin in terms of their capital adequacy. If LeasePlan were carrying it on its books, which it expected to, it had to fully fund that. That is the heart of the problem, and it goes right through to the selection: did we actually select the best candidate in terms of a risk return trade-off to us? That process of not knowing what the RBA was doing and not knowing the deal then set in train all the other events.

Senator WATSON—Maybe we should be sending a letter to Barings.

CHAIRMAN—Did DOFA, on behalf of the Commonwealth, ever go back and attempt to recover from Barings?

Mr Hodgson—No.

CHAIRMAN—On the basis of that advice—am I entitled to ask why?

Mr Hodgson—Of course; you are entitled to ask anything you like.

CHAIRMAN—I am going to ask why.

Senator HOGG—That is a very good response.

CHAIRMAN—Thank you. I must admit that I criticised a bloke at a public hearing recently when he said, 'My question to you is,' and I said that we do not answer questions, we ask them. Very good.

Mr Hodgson—Yes, I got the message. My understanding is that there was a serious look at whether we could sue Barings for bad advice. There was legal advice sought as to whether that was a course of action which would be productive. The advice we received said it would be difficult to succeed in such a case. The main reason it would be difficult to succeed was that it would be difficult to identify exactly the loss incurred by the Commonwealth as a result of the bad advice and, therefore, difficult to assess what you would actually sue them for and how the court could assess what damage had been done to the Commonwealth as a result of bad advice.

Senator HOGG—Do we still use Barings?

Mr Hodgson—I have not used Barings.

Ms GRIERSON—Has the loss been calculated?

Mr Pahlow—That is the point: it is very difficult. I am not involved in that area.

Ms GRIERSON—But you have a responsibility to try to estimate what that loss has been. I would be interested for you to quantify that.

Mr Hodgson—We have tried. The problem is that the contract had a number of problems with it, not just this one which came about as a result of perhaps bad advice by Barings. Consequently, there was a dispute. The dispute led to claim and counterclaim. It led to us withholding payments, which were arguably due under the contract, and then it ultimately led to a whole-of-dispute of settlement, which said, 'Okay. We'll agree to these sums of money, provided the contracts are signed and provided these problems are addressed,' and so on. It is difficult within that whole-of-dispute settlement to clearly say, 'This bit of it relates to any settlement of the issue related specifically to any questionable advice by Barings.' That is the difficulty.

Ms GRIERSON—Has the Audit Office attempted to quantify that loss to the Commonwealth?

Mr Cochrane—The main information we had in the report was to detail the settlement and the amounts that were paid as a result of the different contractual disputes in the tied contract. If the question goes wider to whether the deal had been done one way against the other way, I do not think we will ever know that answer because we never went down the other route to be able to compare it in a concrete manner and to determine an actual dollar loss.

CHAIRMAN—Our understanding is that, had the Commonwealth accepted the arbitrator's draft ruling, we would have been some millions of dollars worse off than the final settlement. Is that correct?

Mr Hodgson—Correct.

CHAIRMAN—How did you manage to achieve that?

Mr Hodgson—A lot of hard work, I would have to say, mainly by my colleague here. It was a bit of a body blow when the draft settlement came out because we thought, on the assessment of the evidence and from our position, that we were in a stronger position than the draft ruling indicated. We rallied and then went back and were just bloody-minded with them and said, 'Look, we're going to go to a full arbitration; we're going to go to court, if this doesn't get settled.' I think to be fair to Macquarie, they did want a settlement, although they obviously wanted a higher one than we wanted to give, and we arrived at a settlement through a process of persistence. One of the benefits that came out of the arbitration was the discovery process where various documents were tabled. We were able to look at the other side of the fence, as it were, and see their documents and their thoughts. It allowed us to pick holes in various areas and,

eventually, through a process of just wearing each other down, we got to a point where we agreed to settlement.

CHAIRMAN—Could I just point out to you that a couple of years ago in a public hearing in Brisbane into contract management, an organisation—the name of which I cannot remember now—told us that, when it came to construction contracts, they had for a number of years established a procedure where they required the tenderers to produce to them their full initial costing sheets in less than 24 hours after the tenders closed.

In other words, they took the lowest tender and then they said, 'We want your complete tender documentation.' If they were discounting their tender, and they had all sorts of sneaky bits in, it was easily disclosed. They found out that they were paying a little bit more for the original contract and that they were achieving ultrafast completion times and there were almost no variations on contract and a good relationship between the client and the contractor because they had full disclosure at the time. Have you ever considered implementing any of that? We did discuss it in the report on contract management.

Mr Hodgson—It is standard practice at the moment in the tendering process we have just been through on the Medibank Private scoping study. The standard process is to ask for detailed breakdown of the costs—in other words, not just a borderline bid—so we can understand and appreciate what costs they have put into the tender and what they are expecting and the time they are expecting to take to do it, the personnel they are expecting to use on it and the quality of the personnel, the number of hours they are going to put to the task, and so on. That forms part of the tender. It is probably not totally to the extent that you are saying, but some way.

CHAIRMAN—Do they disclose the expected profit margin?

Mr Hodgson—No.

CHAIRMAN—Do they disclose the amount they expect to make on the variations?

Mr Hodgson—No.

CHAIRMAN—May I recommend that to you?

Mr Hodgson—Certainly.

Senator WATSON—The information is very limited in terms of the tender documents that were given to the Commonwealth.

Mr Hodgson—On this particular matter?

Senator WATSON—Yes.

Mr Hodgson—I am sorry, I do not know. I was not involved.

Senator WATSON—You were saying that subsequently you were able to get behind and look at some of the problems arising from the fact that the tender documents were then subsequently put on the table.

Mr Hodgson—I am sorry, do you mean in the dispute? It was not so much the tender documents; it was more the work that they had done.

Mr Pahlow—A lot of it was background information as to why they had a particular view on something, or did not have the same view that we had.

Senator WATSON—Was there a lack of transparency in their tender documents about what they were bidding on and how they were arriving at their costs?

Mr Pahlow—I am sorry, I could not tell you. We were more concerned with focusing on the management of the contract and making sure that we could ensure that the contract was being managed appropriately and that Macquarie were providing what they should provide. In a dispute context, we were making sure that we could defend the Commonwealth's interests.

Senator WATSON—Perhaps we should ask the auditors. Was there transparency to the Commonwealth in terms of the tender documents that were lodged with the Commonwealth?

Mr Cronin—There was an evaluation.

Senator WATSON—Was there transparency? For an ordinary person—

Mr Cronin—We could not understand them. We could not understand, and we tried for months to work out what the standard Commodore or Ford vehicle price was that was being bid. We had extensive discussions with the Department of Finance and Administration monitoring—

Senator WATSON—Because it was not obvious from the tender documents?

Mr Cronin—No. We could not relate material from the tender into the contract in respect of what was being charged.

Senator WATSON—I see.

Senator MOORE—I have two questions—one follows on from Ms Grierson's questions about the current practice. I know it is a tough one, but do you feel pretty confident, Mr Hodgson, that given this experience this thing could not happen again?

Mr Hodgson—Yes, I am confident given that our current processes stay in place and are followed, and they are at the moment.

Senator MOORE—So the lesson is learnt?

Mr Hodgson—The lesson is learnt. I should say that the audit was very accurate. The audit was very thorough and it identified very clearly the lessons learnt. It was a good piece of work. We have no dispute with its findings. We agree.

Senator HOGG—Is that 100 per cent confident or 10 per cent confident? I am just trying to work it out.

Senator MOORE—My second question relates to the question we asked earlier about trying to quantify the cost of this whole exercise. What if it had not happened? I know that is a very difficult thing to cost, but Mr Pahlow went into detail talking about how much effort you had to make to then question the arbiter's decision and all that work. I would like that kind of costing to be included in any kind of comparison so it is not just the specific and immediate cost but all the extra costs that have gone in subsequently to try to overcome it. I do not know how you do that but I do think that any kind of costing exercise needs to take into account, as much as possible, all the costs that have taken place in this process.

Mr Pahlow—The difficulty is that it would cost us an inordinate amount of money to do that. We can come back with, as the Chairman indicated, an estimate or a gut feel. But to get to that level, we have already spent millions of dollars on the dispute. I do not know how much it cost to do the evaluation initially, but to go back and repeat all of that again at this late stage would be very difficult.

Senator MOORE—But in terms of a line item?

Mr Hodgson—We do have an estimate of the hours that we spent on the dispute and in-house costs.

Senator MOORE—That is what I want. I do not want that missing from the final exercise in terms of the cost of the process. I am not asking for a line by line account but, in terms of this is what happened and this is how much it cost, you have to take into account the exercise that your department has gone into to try to make it work.

Mr Pahlow—Yes, we can do that.

Senator COLBECK—Returning to the investigation that you undertook into potential action against Barings, you have said that there were other factors involved in problems with the contract that made it difficult to assess what you might claim for. Are you essentially saying that Barings were giving you advice on the acceptance of the tender and there were other elements involved in the preparation of the contract by other parties that confused the capacity to determine that amount?

Mr Pahlow—I have to confess that I am not familiar with the details about the action against Barings. I am more familiar with what was going on with the dispute. One of the problems we had with the dispute was that there were an enormous number of very complex issues, not only in dispute but bearing upon issues in dispute. To try to neatly excise one component of the issues that we had with both the sale agreement and the tied contract was not an easy job to do. There was so much interrelation both between the sale agreement and the tied contract and the operations of the tied contract. What Mr Hodgson was trying to say was that the advice we got

from our legal advisers was that it is very difficult to then try to pull one component of that out and specifically say, 'The damage suffered was this.' The other side would have a field day chopping that to pieces and putting sufficient ambiguity around it so that we would have a lot of difficulty winning that case. Correct me if I am wrong, but that is my understanding of the essence of the legal advice that we got from senior counsel.

Ms GRIERSON—Does the Audit Office have an opinion on whether loss recovery should have been pursued in this case?

Mr Cochrane—No, we have not sought advice on that question.

Ms GRIERSON—Are you satisfied that the risk assessment processes now in place in DOFA are satisfactory or have been altered to avoid further risk?

Mr Cochrane—We have not carried out any asset sales so we cannot give you an assurance.

CHAIRMAN—Would you re-employ Mr Hutchinson?

Mr Hodgson—I do not know Mr Hutchinson that well. He has a good reputation for ability and so on. Given that I think he is now working as a consultant, I probably could not afford him.

CHAIRMAN—I note that Audit report No. 63, which we theoretically were going to examine, makes no recommendations. Are you happy that your operating lease with LeasePlan is now providing value for money for the Commonwealth?

Mr Hodgson—Absolutely.

CHAIRMAN—Could you tell me why the resolution of the disputes with Macquarie Fleet Leasing took so much longer to achieve than either DOFA or OASITO officials forecast when they appeared before the committee in August 1999?

Mr Hodgson—That is not an easy question to answer. The fact that we got an unfavourable interim ruling—certainly in our view it was unfavourable—meant that we really did not want to just accept that and pay that money; we wanted to pursue it further. So that took longer than would have been the case. When we got into the issues—and I cannot, obviously, say what was in the mind of officials when they gave that original assessment—they were more complex, the views on either side were more entrenched than was originally thought and there was more interrelationship between the issues. We could not just knock one off and leave it; if you agreed with one, you had to end up agreeing with the others as well.

CHAIRMAN—Could you pass on to the department secretary that this committee was at the time quite frustrated because it felt that Audit report No. 25 was an important issue. This committee believes that this committee plays a very important role in terms of the accountability of the public sector of the Commonwealth to the parliament. We are convinced that that is so. We were quite frustrated at the time in not being able to pursue our inquiries. Now, of course, the personnel that were involved are gone, which disappoints us, so we are having some difficulty coming to grips with why some of these things happened. I think I speak

fairly for other committee members, particularly those who were here at the time, when I say that we feel some degree of frustration. We would like not to see this sort of exercise repeated.

Mr Hodgson—I will pass that message on to the secretary.

CHAIRMAN—Thank you very much. If we have further questions, I assume that you will not mind if we put them to you in writing, to save you coming back and appearing before this committee again.

Mr Hodgson—No problem.

CHAIRMAN—I thank you very much.

Resolved (on motion by **Senator Hogg**):

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 11.12 a.m.