



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

**Reference: Review of Auditor-General's reports, second and third quarters
2002-03**

WEDNESDAY, 30 APRIL 2003

CANBERRA

BY AUTHORITY OF THE PARLIAMENT

INTERNET

The Proof and Official Hansard transcripts of Senate committee hearings, some House of Representatives committee hearings and some joint committee hearings are available on the Internet. Some House of Representatives committees and some joint committees make available only Official Hansard transcripts.

The Internet address is: **<http://www.aph.gov.au/hansard>**

To search the parliamentary database, go to: **<http://search.aph.gov.au>**

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Wednesday, 30 April 2003

Members: Mr Charles (*Chairman*), Senators Conroy, Humphries, Lundy, 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 Conroy and Watson and Mr Charles and Ms Plibersek

Terms of reference for the inquiry:

Review of Auditor-General's report, first and second quarters 2002-2003.

WITNESSES

BARRETT, Mr Paul, Chief Finance Officer, Aboriginal and Torres Strait Islander Commission.....	2
BENNETT, Mr Lloyd, Chief Finance Officer, Department of Defence	2
.....	37
BURGESS, Mr Trevor, Group Executive Director, Assurance Audit Services Group, Australian National Audit Office	2
.....	37
CHANDLER, Mr Jeremy Paul, Chief Finance Officer, Department of Transport and Regional Services	64
CHAPMAN, Mr Steve, First Assistant Commissioner, Australian Taxation Office	23
CLEGG, Mr Simon, Director, Aviation and Maritime Legal, Department of Transport and Regional Services	64
COCHRANE, Mr Warren John, Group Executive Director, Performance Audit Services Group, Australian National Audit Office	23
.....	64
CRONIN, Mr Colin, Executive Director, Performance Audit Services Group, Australian National Audit Office	64
CRONIN, Ms Anne, Senior Director, Performance Audit Services Group, Australian National Audit Office	23
CULHANE, Mr Michael, Branch Manager, Finance and Banking, Department of Finance and Administration	2
.....	64
DIMENT, Mr David, Assistant Commissioner, Tax Practitioner Group, Australian Taxation Office.....	23
DOBES, Mrs Alice, Assistant Secretary, Treasury and Tax Management, Department of Defence.....	2
DOLAN, Mr Martin Nicholas, First Assistant Secretary, Aviation and Airports Policy, Department of Transport and Regional Services	64
FRASER, Mr Bede, Manager, Accounting and Financial Management Unit, Department of the Treasury	64
GRANGER, Ms Jennifer, Second Commissioner, Australian Taxation Office	23
HAWLEY, Mr John, Executive Director, Assurance Audit Services Group, Australian National Audit Office	2
HICKING, Ms Anne, Chief Financial Officer, Federal Court of Australia	2

HUTSON, Mr Jonathan, Division Manager, Financial Framework, Department of Finance and Administration	2
.....	64
JARRETT, Mr Brandon Mark, Senior Executive, Australian National Audit Office	37
KAUFMANN, Mr Brett Andrew, Branch Manager, Accounting Policy, Department of Finance and Administration	37
KERWIN, Mr James Roy, Divisional Manager, Financial Reporting and Cash Management Branch, Department of Finance and Administration	37
KONZA, Mr Mark, Deputy Commissioner, Personal Tax, Australian Taxation Office.....	23
LANGTON, Mr Terry, General Manager, Comcare	2
McKEAN, Mr David, Executive Director, Australian National Audit Office	37
McPHEE, Mr Ian, General Manager, Financial Management Group, Department of Finance and Administration	37
.....	64
MOODY, Ms Donna, Chief Finance Officer, Australian Taxation Office.....	37
SODEN, Mr Warwick, Registrar and Chief Executive Officer, Federal Court of Australia.....	2
SPEEDING, Mr David, Audit Manager, Performance Audit Services Group, Australian National Audit Office.....	64
STAUN, Mr Dominic Hoeg, General Manager, Finance and e-Solutions Group, Department of Finance and Administration.....	37
.....	64
SWAILS, Mr Noel, Deputy Chief Executive Officer, Comcare	2
THOMPSON, Mr Allan, Executive Director, Australian National Audit Office.....	37
THORPE, Ms Ann, Head, Materiel Finance Division, Department of Defence.....	37
WATSON, Mr Michael, Group Executive Director, Assurance Audit Services Group, Australian National Audit Office.....	37
WEBER, Mr Graham, Assistant Secretary, Accounting Policy and Practices, Department of Defence	37
WELCH, Mrs Bernadette Tracy, Manager, Insurance Programs Unit, Financial System Division, Margets Group, Department of the Treasury	64

WELSH, Mr Gregory Frank, First Assistant Secretary, Financial Services, Department of Defence.....	2
.....	37
WHITE, Mr Peter, Executive Director, Performance Audit Services Group, Australian National Audit Office.....	2
.....	23

Committee met at 10.32 a.m.

CHAIRMAN—I open today's public hearing, which is the second in a series of hearings to examine reports tabled by the Auditor-General in the financial year 2002-03. This morning we will be taking evidence on two audit reports: Audit report No. 18, *Management of trust monies*; and Audit report No. 19, *The Australian Taxation Office's management of its relationship with tax practitioners*.

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. Firstly, only members of the committee may put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and to 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 whether it wishes to pursue the matter. It will not be possible for participants directly to respond to each other.

Secondly, given the length of the program, statements and comments by witnesses should be relevant and succinct. Thirdly, I remind witnesses that today's hearing constitutes legal proceedings of the parliament and warrants 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. Copies of the committee statement are available from the secretariat staff.

[10.33 a.m.]

BARRETT, Mr Paul, Chief Finance Officer, Aboriginal and Torres Strait Islander Commission

BENNETT, Mr Lloyd, Chief Finance Officer, Department of Defence

DOBES, Mrs Alice, Assistant Secretary, Treasury and Tax Management, Department of Defence

WELSH, Mr Gregory Frank, First Assistant Secretary, Financial Services, Department of Defence

BURGESS, Mr Trevor, Group Executive Director, Assurance Audit Services Group, Australian National Audit Office

HAWLEY, Mr John, Executive Director, Assurance Audit Services Group, Australian National Audit Office

WHITE, Mr Peter, Executive Director, Performance Audit Services Group, Australian National Audit Office

CULHANE, Mr Michael, Branch Manager, Finance and Banking, Department of Finance and Administration

HUTSON, Mr Jonathan, Division Manager, Financial Framework, Department of Finance and Administration

HICKING, Ms Anne, Chief Financial Officer, Federal Court of Australia

SODEN, Mr Warwick, Registrar and Chief Executive Officer, Federal Court of Australia

LANGTON, Mr Terry, General Manager, Comcare

SWAILS, Mr Noel, Deputy Chief Executive Officer, Comcare

CHAIRMAN—The audit report being considered in this first segment is Audit report No. 18, *Management of trust monies*. I welcome representatives from the Australian National Audit Office, the Department of Finance and Administration, the Department of Defence, the Aboriginal and Torres Strait Islander Commission, the Federal Court of Australia and Comcare to today's hearing. Thank you for coming to our hearing today. Does the lead individual for each agency wish to make a brief opening statement, or may we proceed to our questions?

Mr Swails—We wish to make a brief opening statement.

CHAIRMAN—Please make it brief—indeed, micro.

Mr Swails—The ANAO report has highlighted the need for the Safety, Rehabilitation and Compensation Act 1988 to be amended to reflect the current practice whereby Comcare makes compensation payments to agencies. To this end, Comcare has recommended to the Department of Employment and Workplace Relations that legislative change be pursued. Currently where an employee lodges a claim for compensation, Commonwealth agencies continue to pay the injured employee their leave entitlements. If Comcare accepts liability for the injury, it pays the amount of the incapacity payment to the employing agency. The agency recovers from the incapacity payment any leave which has been advanced to the employee, and continues to pay the employee through its own payroll system.

There are significant advantages to both employees and employers in maintaining the current process. For example, the employing agency continues to pay the incapacitated employee for the entire period through their existing payroll system with only one source of consolidated information for taxation payroll deductions, and employees are not disadvantaged by any disruption in payments. If Comcare were to make all compensation payments direct to employees, Comcare would be required to establish a full payroll processing system and agencies would need to recover from employees any salary advanced to them prior to the termination of the workers compensation claim. This would not be an efficient and effective use of Commonwealth resources, in our view, and would increase the possibility of disadvantage to employees.

CHAIRMAN—Does the ANAO have a very brief statement?

Mr Burgess—I have an opening statement that I am happy to hand over for the record.

CHAIRMAN—Is the committee happy to incorporate that as part of the proceedings? There being no objection, it is so ordered.

The statement read as follows—

Australian National Audit Office
JCPAA REVIEW OF AUDIT REPORT 18 - 2002-2003 MANAGEMENT OF TRUST MONIES
OPENING STATEMENT

The audit of the Management of Trust Monies was conducted under the ANAO's Business Support Process audit methodology, which provides for audits of business processes that are likely to be common to all Commonwealth organisations. This particular audit assessed the agency performance against the components of the control structure, including risk assessment, control environment, control activities, information and communication, and monitoring and review.

Although the audit started out being one of the administration of trusts (that is the processes in place to ensure that monies were accounted for correctly), the scope of the audit was extended when we realised that a number of the trusts reported as such in the annual reports were in effect not trusts.

There were three main findings

Firstly, we found that organisations had not adequately ensured that trust monies were correctly identified in terms of their legal status. The effect of this was that the Commonwealth lost potential interest earnings as a result of not having at its disposal all funds available for investment.

Secondly, we found that where organisations failed to identify monies as being trust monies, the Commonwealth was exposed to a number of risks, including not acting in accordance with the terms of a legally binding trust agreement.

In coming to these conclusions, we consulted heavily with the Australian Government Solicitor (legal status of trusts), the Department of Finance and Administration (background to the changes to the Commonwealth's financial framework), and the Australian Office of Financial Management (investment of funds in the Official Public Account).

The third major finding was that the widely accepted method adopted by organisations for administering compensation payments for incapacitated employees by Comcare was not in accordance with the Safety, Rehabilitation and Compensation Act 1988 or the Finance Minister's Orders, which reflected the requirements of the Act. Rather than

seeking to change existing practices, which all agencies agreed are efficient, we suggested that the Act be changed to reflect the practices. Comcare agreed to look into this.

There were four recommendations, which were directed at all Commonwealth bodies.

We have a second audit of the topic in our draft 2003-2004 Audit Work Program, to examine whether the recommendations made in the report have been acted upon by other organisations.

CHAIRMAN—We will now proceed to questions. I have a question for ANAO. Your report concluded generally that the organisations audited were not consistently managing trust moneys in accordance with the legal and administrative requirements and better practice principles. Mr Burgess, is it serious?

Mr Burgess—I think it is serious enough for agencies to think about establishing stronger control in the first place to establish the legal status of the moneys that they hold in special accounts, in particular whether the status of those moneys is that of trust moneys or not. In that sense, it is a serious issue. Secondly, I would say that the difficulty in classifying trust moneys, whether they are or not, results in a whole range of control issues and the management of those funds.

CHAIRMAN—Is it an issue of accountability or an issue of procedure?

Mr Burgess—I think it is an issue of procedure.

CHAIRMAN—On the Comcare issue, the framework appears to have affected the classification of trust moneys. If I remember correctly, ANAO recommended not that the act be changed but that the procedure be changed. It had to do with misclassification and the business of Comcare paying out the workers and then being in violation of some rules. Could DOFA tell me whether the Financial Framework Legislation Amendment Bill is picking up amendments to clarify that?

Mr Hutson—No. The Financial Framework Legislation Amendment Bill does not pick up amendments that may or may not be proposed in respect of the Safety, Rehabilitation and Compensation Act. That is a matter that Comcare is taking up with the Department of Employment and Workplace Relations.

CHAIRMAN—Wouldn't that solve the problem? If what Comcare is doing is efficient and effective—and everybody says that it is a good idea, that it is you-beaut, modern practice and the employees are getting their money—but ANAO is telling us that we are in violation of all the rules for doing it, do we want to change the rules?

Mr Hutson—In response to that, can I say that we would certainly look at it in consultation with our colleagues in Comcare. It stretches the Financial Framework Legislation Amendment Bill a bit, in the sense that it was originally designed, as you would recall, as just a housekeeping bill. This would then stretch it into potentially a different area. But, yes, we could certainly have a look at it to see whether that is an appropriate place where an amendment might be made.

CHAIRMAN—With the greatest of respect, if the flag is wearing out and we are stitching it up, we might as well fix the halyard at the same time, don't you reckon?

Mr Hutson—I have said that we will look at it.

CHAIRMAN—Unless my colleagues have any objection to the act being amended in order to incorporate what appears to be good modern practice, it seems to me to make immense sense to—

Mr Hutson—To make an amendment on that occasion. As I said, we will look at it in consultation with our colleagues in Comcare.

Senator WATSON—With regard to definition, there does seem to be a problem. We are talking about special public money and special moneys as trust moneys. What is the difference between special moneys as such, or special accounts, vis-a-vis trust accounts? Give us some examples. I think the act itself does not help when it talks about special moneys going into trust accounts. I can understand that there are problems associated with the terminology.

Mr Culhane—It is fair to say that there is a fair bit of confusion surrounding these things. Let me take you back to what operated under the Audit Act 1901 to 1997. What we had were trust accounts formulated as part of a trust fund, and moneys were kept in these trust accounts. The moneys that were kept in trust accounts may have been trust moneys per se—that is, subject to a trust deed; perhaps somebody might bequeath the Commonwealth some money for a particular purpose. Alternatively, they might have been moneys for one of the government's businesses that it was engaged in at the time. Those moneys were not of a trust nature but they were held in what was called a trust account.

Senator WATSON—Simply because they could not go into consolidated revenue. There was nowhere else for them to go.

Mr Culhane—They could have been in consolidated revenue, but at the time appropriations lapsed on an annual basis. If you are running a business, you need that ongoing continuity. For a whole lot of reasons, the trust fund was considered the place to put them.

We then moved to the FMA Act in 1997, and they converted those components of the trust fund to what were called components of the reserve moneys fund and commercial activities fund. They operated, it is fair to say, largely as before. So the components of those two funds held both trust moneys and the more 'normal' moneys of government—perhaps funds related to commercial activities or other types of things.

In 1999 with the introduction of accrual accounting, the FMA Act was revised, and those components of the reserve moneys fund and the commercial activities fund were converted into special accounts. Those special accounts are ledgers in the CRF; they record amounts of money and they provide an appropriation for the payment of those moneys from the CRF. Again, you are in a situation where the amounts that relate to special accounts may be trust moneys, in the sense that somebody may have bequeathed them to the Commonwealth for a particular purpose and they are subject to a trust deed. Or they might be other moneys, perhaps that the Commonwealth has paid in from an appropriation such as the Federation Fund. That money is not trust money in any sense at all; it is a Commonwealth appropriation that the government put in there and is to be spent on whatever the purposes of the special account are. So that sort of explains the trust account and the special account dichotomy. As I said, you can have two types of money there: you can have trust moneys or you can have the more ordinary moneys of government.

We also talked about special public money. Special public money is a form of public money recognised under the framework where money is held by the Commonwealth but not on the account of the Commonwealth or for the benefit or use of the Commonwealth. Trust money is a form of special public money in that the money is held by the Commonwealth but it is not for the Commonwealth's use or benefit. The framework does not go into detail in terms of the management of trust money—that is, money subject to trust deeds per se—because the management of that is really governed by trust law as it exists, common law and various state statutes. So the Commonwealth's financial framework deals with the bucket of money that is public money, which is all money that is within the control of the Commonwealth. A subset of that money is within the control of the Commonwealth but is not for the Commonwealth's use or benefit, and that is money that is bequeathed to the Commonwealth or money that is given to the Commonwealth but is not for its use. Trust moneys are a subset of that.

Senator CONROY—Definitionally, there seems to be almost no difference—

Mr Culhane—Between trust money and special public money?

Senator CONROY—Yes. At one point, you described it as a subset, but definitionally, if you are writing on a piece of paper as in an act, I am trying to see where you could differentiate between the two for simplicity's sake or for clarity.

Mr Culhane—An example of special public money—

Senator CONROY—I understand the functional difference in the way that you describe it, but I am looking at how you define them separately, differently, for the purposes of interpretation.

Mr Culhane—We would define trust money as requiring a trust deed or being treated in trust at common law.

CHAIRMAN—But you still call it a special account.

Mr Culhane—It might be held in a special account but it might not be held in a special account.

Senator CONROY—How could it be held in a special account? I am struggling with that.

CHAIRMAN—That is what they told us when we were inquiring into the act.

Mr Culhane—I will deal with your first question. An example of special public money which is not trust money might be a deposit on a purchase of something that the government is selling, perhaps. So it is not subject to trust law; it is a deposit. It is subject to the terms and conditions of the contract. If the contract does not go through, it might have to be given back. It is special public money and at this stage it is not held for the use of the Commonwealth, but it is not trust money. All trust money is part of special public money, but not all special public money is trust money.

CHAIRMAN—Special accounts are not necessarily held in a separate jam tin, are they? They are not necessarily special accounts.

Mr Culhane—That is right. I am somewhat reluctant to go too much further.

CHAIRMAN—Do forgive us ordinary individuals who are not super accountants or bean computers.

Mr Hutson—I think there is some considerable confusion created by the statute, in the sense that it uses the word ‘special’ a little too frequently.

Senator WATSON—That is the problem that I was referring to. It needs clarification by amendment, surely.

Mr Hutson—Potentially we would not disagree with you. As I said, I think the statute uses the word ‘special’ a bit too much.

Senator CONROY—I think it was ‘designated’ last time we met.

Mr Hutson—I think that was your suggestion, Senator Conroy.

Senator CONROY—We had a competition about it last time—‘pick the word’—I recollect.

CHAIRMAN—Is it also true that some of these so-called accounts are hypothecated and some are not?

Mr Hutson—All special accounts are a hypothecation, but some of them are matched by actual bank accounts. A special account is a hypothecation of the consolidated revenue fund. Some of them are represented by physical bank accounts but most are not.

CHAIRMAN—ANAO says here that some of these trust accounts—for heaven’s sake—reduced interest earnings on Commonwealth investments through moneys that should have been available for investment being excluded because they were trust moneys when they were not subject to legal trusts. In other cases where there were legal trusts we did not declare them as trusts, so that whoever the money was held in trust for did not get the interest; the Commonwealth did. Is this a big problem, Mr Burgess?

Mr Burgess—We did not look to identify across the whole public sector the extent to which trusts were trusts and the extent to which special public moneys that had a subset of trusts within them were not actually trusts, but we did do some figuring on the 19 trusts that we looked at.

Mr Hawley—We did try to do a bit of quantification, but it became more difficult because we would have had to have tracked for each account money in and money out on a day by day basis. We did say that, at the end of the receipts for that particular year, for those accounts that we thought were wrongly classified there was \$35 million in receipts on which some interest—which we did not quantify—was being forgone by the Commonwealth.

Senator CONROY—Are you saying that you were not able to follow the daily ins and outs, or would it just have been too time intensive?

Mr Hawley—That was not really the focus of the sorts of audits we do and we felt that there were enough issues around getting it right first, rather than going down a track which may have been too difficult anyhow.

Senator WATSON—For practical reporting purposes, where money is special purpose money rather than trust account money as held by the Treasury or somebody on behalf of a number of named beneficiaries, does the Audit Office have a role in ensuring that, say, the Federation Fund moneys are identified with the Federation Fund agency? As trust account moneys they would be reported in the Federation Fund main head account in the budget rather than, say, in Treasury, wouldn't they?

Mr Burgess—Yes, we would have a role in that in the scope of our financial statement auditing.

Senator WATSON—So it is still shown, whether you name it as a special account or whether you call it a trust? The tax that goes in and out should technically still be an agency responsibility and reported as such in the reports to parliament?

Mr Burgess—Correct.

Senator WATSON—So it is only the pure trust accounts that are still technically outside the agency's control that are not reported in the agency's books or reports?

Mr Burgess—To be clear on that, whilst they are outside its administrative control, the agency is still responsible for managing the trust. Those trusts are not reported in what we call the key statements of the agency but they would be disclosed in the notes to that agency's financial statements. Note disclosure is required.

Senator WATSON—There is note disclosure required but no incorporation?

Mr Burgess—For a trust, there is no incorporation into the main body.

Senator WATSON—But there is incorporation for the purposes of all other special accounts?

Mr Burgess—For special accounts other than trusts, yes—in the agency's financial statements.

Senator WATSON—And your audit did not find any cases where that was not the case? That is the big issue as far as a parliamentarian is concerned: what is a trust is a trust, and what is a special account is a special account and gets reported as such, whether by note report or—

Mr Hawley—We only truly looked at trust accounts listed as such in the notes to the financial statements. We took five agencies and looked at those trust accounts. We did not go down any other track to look at what special accounts were in or out.

Senator WATSON—But there were no problems in the reporting of those special accounts—is that right? There was just a problem about names—is that all? I am trying to get to the significance of this.

Mr Hawley—Let me make sure I understand the question. We looked at 19 trust accounts and we said that six—possibly four to six—were possibly trusts and 13 were not. We did not look at any other accounts.

Senator WATSON—Yes, but when we get to the nitty-gritty of reporting to the parliament, a trust account was reported as a trust account and a special account—as opposed to a trust account, even there are some problems with nomenclature—has been adequately and correctly identified in the reports to the parliament. There is no doubt about that?

Mr Burgess—Our response to that would be: we selected five agencies that disclosed in their financial statements that they had 19 special accounts; that could include subsets being trust accounts. We then looked at those 19 accounts and sought their legal status, and we established that only five—

Mr Hawley—It was four to six.

Mr Burgess—We established that only four to six were actually trust accounts and the other 13 to 15 were not—even though the agencies disclosed them as trust funds.

Senator CONROY—I think what Senator Watson is trying to get to in terms of accountability and reporting to parliament is this. Agencies present their books. At the moment there is a classification taking place as to what is a trust account. If there are transactions that are not trust moneys—according to the definitions that we are now pretty much agreed on—they are reported in a slightly different way and are not really consolidated into accounts. When we look at a piece of paper we would go, ‘Okay, all of that is a trust account. That is not really what affects their ongoing business of the day.’ What we are really asking is whether a lot of moneys that should have been consolidated—to use an accounting term—into that set of accounts have been consolidated, or has this classification issue meant that a substantial part of the agency’s activity has been classified in a note down at the bottom, which we have tended to ignore? And are your recommendations moving those amounts and activities back within the framework? That is what we are trying to get to in terms of accountability.

Mr Burgess—In theory, against the FMOs, the accounting framework requires those moneys that are truly trust moneys to be disclosed in just the notes. If they are special moneys that are managed and owned on behalf of the Commonwealth, they should be consolidated into the agency’s account. That is my understanding

Senator WATSON—Coming back to one practical example: were the Federation Fund moneys, which are going to be spread over a number of years, showed as a trust account and as a note to the accounts rather than incorporated in the body of the accounts?

Mr Burgess—I cannot answer that in particular, but I can answer in theory. The Federation Fund, from my understanding, would be a special account but not a trust account.

Senator CONROY—Federation probably did not fall into that classification, I would not think.

CHAIRMAN—Does anybody know the answer to the senator’s question?

Mr Hutson—Regarding the Federation Fund?

Senator WATSON—I just used that as one case to try to illustrate the problem.

Mr Hutson—There are a couple of issues which have come out of the discussion which might help the committee. The first is regarding reporting of special accounts. At the hearing that the committee had some weeks ago concerning the proposed Financial Framework Legislation Amendment Bill, we gave evidence that there is to be increased reporting of special accounts in a number of different ways: up-front in the budget papers and, if you like, at the end of the year in the consolidated financial statements—and also in the agency's annual reports. So special accounts will be receiving increased reporting over what has been seen in the past. That is one aspect.

The other aspect which the committee should be aware of is that the ANAO has indicated that it has on its program a performance audit for special accounts themselves forthcoming. I am not sure of the timetable but I know that the audit has started, so it cannot be far away regarding special accounts. The last thing on trust moneys is that, some time ago, Finance issued a circular—and I have forgotten which circular it is—regarding trust moneys in which we indicated in clear terms to departments and agencies that, in trust law, trust moneys are different to moneys which are held in trust under the trust fund that existed prior to 1997. Many issues and areas of confusion that have emerged exist because some of the terminology regarding that money has carried over since 1997. Despite the change in the financial management legislation, we have not yet completely gone through and changed all of the terminology in all of the legislation for the departments and agencies. Following this audit, which has been very useful for us, it is our intention to issue further guidance to agencies regarding trust moneys and the way in which they should classify and report them.

CHAIRMAN—Mr Burgess, if I understand your audit report correctly you are saying that, while it is important for all of this to be recorded properly—in other words, that the bureaucratic procedures are followed the way they are written down—the instances identified in the audit where trust moneys had not been properly classified were not significant; they were not material in their overall effect on financial statements. Is that true?

Mr Burgess—I think that is true.

CHAIRMAN—Are we nitpicking? Are you nitpicking? It is a fair question.

Mr Hawley—It is a fair question. This is a business support process audit and I think it has been useful for all parties involved.

Mr Burgess—That is correct. The whole basis of these audits is not to focus on the numbers; it is to focus on the support and control framework surrounding the business process. This audit has unravelled the fact that, as my colleague from Finance has suggested, the control framework surrounding the management of trusts within the public sector is not as good as it could be.

CHAIRMAN—But you are not saying that this hearing is likely to be the lead article in tomorrow's *Financial Review* or *Australian*?

Mr Burgess—From the perspective of significance of numbers, and from the samples we took, no.

CHAIRMAN—I just thought I would ask.

Senator CONROY—That was a very leading question. Mr Burgess, I appreciate that you decided to look at the framework rather than the actual movements because you want to get the framework right first. Given that, there seems to be a substantial need to change the framework. In the private sector the auditor or ASIC says, ‘That’s been wrongly classified; there’s a restatement of the accounts.’ Will you be requiring a restatement of accounts once everybody gets their house in order in terms of the right classifications?

Senator WATSON—Past accounts or future accounts?

Senator CONROY—Past and future. Future accounts would obviously be incorporated if they got the reclassification, but I am interested in whether you will be getting a restatement of previous accounts.

Mr Burgess—There are two ways to answer that. First of all, if it were material there would be an expectation that there should be a reclassification. But under the current accounting standards that reclassification would be going forward; it would not be going back.

Senator CONROY—But you could recommend it.

Mr Burgess—We could certainly recommend it.

Senator CONROY—Have you recommended a reclassification where it is material? I accept that you would not where they are relatively small amounts.

Mr Burgess—We have not yet established whether it is material across the board.

Senator CONROY—But there must be some large amounts. You have identified some large amounts of money that have possibly—at this stage—just been misclassified.

Mr Burgess—From the audit, no. But we would like to think that, as a result of this audit, agencies will review the moneys they hold as either trust moneys or in special accounts and establish their true legal status and will then look to reclassify. The Audit Office would expect that reclassification to occur if the amount were significant or material.

Senator CONROY—That is going forward, but I am talking about what has happened since this devolvement took place. We have talked about it on previous occasions. Where matters are material, are you requesting, directing or requiring a restatement of accounts by various agencies?

Mr Burgess—To me that is somewhat hypothetical because we do not know what is in the past in the sense of what is material. But, in theory, I would say that, if material adjustments are required because of a misclassification of trust moneys, we would expect that reclassification to be done going forward.

CHAIRMAN—Have anybody's financial statements been qualified because they have been misappropriated, misallocated or misstated?

Senator CONROY—I think 'misclassified' is the word.

Mr Burgess—To my knowledge, no, not recently. That is to the best of my knowledge.

Senator CONROY—The key here is that no-one has actually put up their hand subsequent to your report and said, 'We're one of those agencies that have had this possible material misclassification and we're going to do something about it.' No-one is game to put up their hand and admit that unless you make them. Frankly, I thought that was your job. Where they are misclassified you have to tell them to go and do it again and get it right.

Mr Burgess—We would do that as part of our audits of the financial statements. Where agencies have significant holdings of funds and trust moneys, if the results of the audit are significant we factor them into our audits of financial statements as part of our planning—as we normally do with any audit we undertake, whether it be a performance audit or a business support process audit. We would then expect agencies to take on board the recommendations coming out of this report, one of the issues being that agencies should reconsider their reports.

Senator CONROY—Yes, but asking them to reconsider is not the same as requiring a restatement. We would hope that they would take a suggestion like that from you.

Mr Burgess—Certainly we would recommend to them that they establish the legal status. To the extent that they have misclassified, under our accounting and auditing framework if it were material we would then say to them that we expected them to reclassify.

Senator CONROY—It is just that I have always found them very shy.

Mr Burgess—I am speaking from an accounting framework. That is what we would expect them to do.

Mr Hutson—Senator, earlier in your comments you said that there had been recommendations of alterations to the framework. I do not think that that is quite the way in which we would characterise that.

Senator CONROY—I was not trying to be misleading there. I appreciate the point you are making. I should have said 'misclassification' rather than the framework itself. But within the existing framework there has been a misclassification, and we do not know how big that is. All I want to do is make sure that, for the purposes of parliament, the Auditor-General is saying to those people who have a material misclassification, 'We expect you to restate your past accounts, not just your future accounts.'

Mr Burgess—Under the accounting framework we would expect them to reclassify from the point in time that they identify, which is the particular year. As a result of this audit there would be an expectation by us that reclassifications would occur from this financial year, 2002-03, onwards.

Senator CONROY—I understand the onwards, but I am just trying to—

Mr Burgess—Under the accounting framework we would not ask them to revisit previous years accounts—to bring those accounts out of the woodwork and readjust them.

Senator CONROY—But what I am trying to say to you is that I think parliament does. Parliament would like to know accurately what the state of the accounts was, not just what it will be on an ongoing basis. I would have thought that the auditor's job would be to tell them to go and do it. Companies in the private sector are frequently told to restate their accounts; ASIC regularly says, 'Restate your accounts and reissue them.' I just naturally assumed that that is what you would be saying to the relevant agencies. You are aware that that is a common practice that ASIC undertakes?

Mr Burgess—They would do that under the accounting framework. My understanding is that, when they say, 'Restate the accounts,' they restate the accounts from the year in which they are doing the accounts, as opposed to pulling out previous sets of accounts and restating them. But, of course, the disclosure of that restatement is very bold within that set of accounts that they are looking to do a major restatement of. There is one other thing I would mention, though, and I think our auditing standards require this. If the restatement is so significant to the accounts that it would render those previous accounts misleading or they would mislead the user to the extent of their decision making—in the sense that they cannot be relied on in total, as opposed to as individual items—my memory is that the auditing standards would then require us to readjust previous sets of accounts. But the likelihood of that, in both the private and the public sector, is less probable than probable.

Ms PLIBERSEK—I have a question for the department of finance. Do you have any indication of whether other agencies have approached the Australian Government Solicitor for advice in this area?

Mr Culhane—I cannot say whether any agencies have approached the AGS in relation to advice in this area, but we have had a few approaches from several agencies. The audit has raised the profile of appropriate classifications and moneys in this area, and a few agencies have approached us and consulted us on that matter.

Ms PLIBERSEK—How many agencies?

Mr Culhane—Four or five.

Senator WATSON—If it were the case that all these problems emanated from the changes to the FMA Act in 1997, what instructions were sent out by the Department of Finance and Administration, together with examples, to ensure compliance with the new act as opposed to the act it was superseding?

Mr Hutson—I will answer that question in two parts. The first is that you have suggested that many of the issues identified in this report came out following the changes to the financial legislation in 1997. I am not sure that is correct. I am not sure that previously trust money which was not trust money was part of the trust fund. If we were doing this audit five or six years ago, we might have identified much the same issues and perhaps even greater confusion. But there is an undue use of the word 'trust' rather than the current use of the word 'special'. So I am not sure that that is right.

Senator WATSON—Could you give us copies of the instructions that were sent out to all the agencies to make sure that their understanding of the processes and procedures required under the FMA Act were consistent across the board? That would have been your responsibility.

Mr Hutson—Sure. Following that, some Finance circulars were issued and we would be happy to provide those Finance circulars to the committee.

Senator WATSON—So you did send them out?

Mr Hutson—Yes.

Senator WATSON—This report came out last year. What instructions have you sent out since then to clarify and to ensure consistency across all departments as a result of issues raised by this audit?

Mr Culhane—Following the tabling of the audit, I wrote to all CFOs in all departments in all FMA agencies drawing their attention to the findings of the report and to the key points coming out of that report and providing them with links to copies of the report should they wish to look at it. At the moment, as Jonathan indicated, we are working on revised guidance in this area.

Senator CONROY—Could you detail what the new guidelines are? I think they are subject to disallowance by the Senate, so they are certainly going to be looked at there too.

Mr Culhane—Just to correct you: guidance is not subject to disallowance by the Senate; it is just departmental guidance on government policy.

Senator CONROY—We might be talking about two different things, but that is my fault, not yours.

Mr Culhane—We could be. The guidance we are issuing will focus largely on special public money and trust money and the difference between the two. It will pick up on a lot of the things raised in the ANAO report such as the considerations to take into account when, as a Commonwealth official, you are deciding whether or not to accept trust money—how you should handle that money, the appropriate banking of the money, the appropriate record keeping of the money, what the responsibilities of a trustee are and how that differs from how you should handle special public money, and how the responsibilities of a trustee interface with the Commonwealth financial framework and where that leaves you at the end of the day in what you should be doing.

Senator WATSON—Will they be ready for this year's annual accounts, to ensure that there is uniformity?

Mr Hutson—They will not be ready for this year's annual financial accounts. It is a fairly complex matter on which we need to seek legal advice from AGS. How you should handle trust moneys is perhaps not more well known, but how the trust law interfaces with the Financial Management and Accountability Act is not an area that has been subject to detailed consideration.

Senator WATSON—It seems to be a priority at the moment. Are you treating it as a priority?

Senator CONROY—I would hope so.

Mr Culhane—We are treating it as a priority, Senator. The other thing that we usually do when we issue this sort of guidance is to consult agencies fairly extensively to ensure that the guidance we issue is useful and relevant to the agencies, and that is another thing that takes time.

The guidance we will be issuing will not really go to the issue of financial reporting per se; it will go more to the issue of classification, management and ongoing good practice. The guidance that is out there in relation to classification of moneys as either trust or not trust is correct. So it is not so much that the guidance that is out there is incorrect; it is just that the guidance in relation to the management and handling of the moneys could be enhanced. I guess what I am trying to say is that agencies could follow the existing—

Senator WATSON—So there is not a problem per se?

Mr Hutson—Agencies could follow the existing guidance and, on the basis of that, they could classify their moneys correctly and report them correctly in their financial statements.

Senator WATSON—But they are not reporting it correctly.

Mr Culhane—That is right.

Senator CONROY—They could enhance the reporting of it, Senator Watson.

Senator WATSON—What does that mean? The auditors have just told us that they are not reporting it correctly and you are saying that they are reporting it correctly but they could enhance their reporting.

Mr Hutson—I think what Mr Culhane said was that the guidance which is on issue, which we have put out, is correct but, following the audit report which indicated, as Senator Conroy said, that there had been some misclassification within the existing framework, some additional assistance for agencies in classifying and managing these moneys would probably be helpful, and that is what we have decided to do.

Senator WATSON—To me, that means that you say that what you have put out is correct but the agencies' understanding of what you have said seems to be a problem. Is that correct?

Mr Hutson—I think that is what the audit report said.

Mr Burgess—We would agree, notwithstanding that there is going to be further guidance to help agencies understand. Our audit goes to the application of the framework—that is, how agencies are actually applying the existing framework.

Senator CONROY—I am not quite sure that you can get completely off the hook, Mr Hutson. I think even you admitted that, if we went back and audited when DOFA had sole control over this, we would find that some of the classification issues that exist now probably existed then. So I am not sure even your guidance to yourself previously would have been as completely enhanced as we would have hoped.

Mr Hutson—Senator Watson said that these issues were new following the act, and I said that I was not sure that the issues were new. I do not know how much work we have done in the past regarding the interaction of the previous financial framework and trust law. Certainly this audit has raised the issue, so we need to address it.

CHAIRMAN—We could try the Dead Sea scrolls.

Senator WATSON—Could we have a response from the agencies? The Department of Finance and Administration say that their instructions are quite clear. How is it that you have had trouble interpreting them?

Mr Bennett—We have had our legal service looking at this since May 2002, and we expect them to complete their interpretations and guidance by September this year. That perhaps could give you some sense of the complexities of this and that might be a guide. The ANAO have also organised for us to have discussions with the AGS to make sure that their understanding of the issues are clear at the start of that process. Perhaps I could also put a quantification on this. We estimate that the potential misstatement is in the order of \$18,000.

Senator CONROY—For Defence?

Mr Bennett—Yes. So it would never be a significant error in our accounts and it would never require a restatement of our accounts.

CHAIRMAN—Could the Federal Court say the same thing?

Mr Soden—Senator, I am—

CHAIRMAN—I am not a senator, thanks very much. The people elected me, not the parties.

Mr Soden—I am hesitant to say anything at the risk of complicating the issue. We have applied what we have always thought were the guidelines. That is probably why we are here. There is a large amount of money that the court has at any one time which, on the face of it, looks like it is trust money. But, as a result of this exercise, I think it has been reasonably—I will not say ‘absolutely’—concluded that it is not trust money in the normal sense; it is money paid in pursuant to orders of the court. It is held by the court—not for the Commonwealth and not for the court—sometimes until it is found out who the money is owned by. So it is not held in trust. That is not classified by us as trust money; it is classified as a note to our financial statements as special account money. I think that is why we were included in this exercise. The year before last there was about \$14-odd million at any particular time in that year, which comprised a collection of money paid in. It is called the litigants fund or the special investment fund.

Senator CONROY—I defer to the obvious legal expertise of the Federal Court and officers of the Federal Court. I don’t understand why you don’t classify that particular litigants fund as a trust. That just seems a classic trust fund.

Ms PLIBERSEK—It is money held in trust, but it is not a trust fund; is that right?

Mr Soden—That is a good way of describing it, yes. There is a pure legal explanation, but I wouldn't want to bore the committee with that.

Senator WATSON—But there is nothing wrong with the classification of people's understanding. It is money on your behalf for somebody else's ultimate benefit, rather than incorporated in terms of the ongoing expenses of the department.

Mr Soden—That is true.

Senator WATSON—So, in a sense, there has been no statement of accounts in terms of its potential to mislead people as to the purpose for which the various moneys are held or expended.

Mr Soden—I think in our note to our financial statements we tried to make it as clear as we could. The legal authority for it is by virtue of an order of the court which enables the establishment of a special fund—either a litigants fund or special investment accounts. So we have added it as a note to try to explain why it is a special account and not a trust fund.

Senator WATSON—The Attorney-General's Department have not given any misleading statement in terms of their annual accounts, whether by note or incorporation into the main body of the accounts as such; so how do you regard this whole exercise then, as one of just semantics of getting it correct?

Mr Soden—From our perspective, this is a valuable exercise in terms of clarifying what is trust and what is not trust and making sure that what is Commonwealth money on trust is properly managed. We think that that is a valuable exercise. If there is some uncertainty and there needs to be some clearer guidelines, that is a good thing.

Senator WATSON—In terms of the management of the money, that might change, as I understand it?

Mr Soden—In our situation, we have some very, very tight and onerous procedures arising from orders of the court for the management of the money; there are extensive checklists. None of the money is paid out unless there is a further order of the court. So it is quite a comprehensively managed process so far as we are concerned.

Senator WATSON—Where is the big problem with Attorney-General's Department? The moneys are being managed in accordance with the orders of the court. They are being held in a manner consistent with the orders of the court. Where is the problem?

Mr Soden—From our perspective the exercise was really to have a look at whether there might be a problem. I think it has been identified, in respect of our court and that money, that there is not a problem.

Senator WATSON—There is not a problem. Well, why are we here if there is not a problem?

Mr Hawley—That is one out of five. There are other issues here. We are trying to resolve quite a lot of accounts called trust accounts. Are they or are they not? I do not know—that is what this audit was trying to show you.

Senator WATSON—But if there is adequate description for the purpose of those moneys and they are shown separate from the ordinary activities, the day-to-day activities of the Attorney-General's Department, I cannot see the big play or the big problem.

Senator CONROY—I think this is just one of the five they picked; there were trusts involved, so they just picked them for that reason.

Mr Soden—Senator, I would not want this committee to be left with the suggestion that we would be saying that this exercise should not have been conducted. I would say that it was a valuable exercise because, on the face of it, there was some uncertainty. The law of trusts is a very complex area. What on the face of it might look like a trust will at law not be a trust. Certain obligations may or may not arise. I think this exercise has been valuable in clarifying certain circumstances. It has certainly helped us make sure, as a result of this exercise, that we are doing everything we should be doing.

Senator WATSON—But whether or not moneys are held in trust, they are held for somebody else's benefit. Although technically not a legal document or meeting all the requirements of the trust, they meet the purposes of the court in terms of a distribution being required to go for some named beneficiary. If you are showing those separately, I cannot see how you are not discharging your responsibilities correctly to the court, to Attorney-General's and to the parliament.

Mr Soden—I would say that we are, and this exercise has established that.

Senator CONROY—Page 9 of report No. 18 says:

Trust money held by the Commonwealth is 'special public money' for the purposes of the *Financial Management and Accountability Act 1997* (FMA Act). Special public money is defined in section 16(4) of the FMA Act as public money that is not held on account of the Commonwealth or for the use or benefit of the Commonwealth. The Commonwealth reported almost \$500 million as being held in trust as at 30 June 2001.

Can I confirm that this special public money as defined under section 16 amounted to \$500 million?

Mr Hawley—I will go through how we dealt with the \$500 million. We actually looked through the financial statements of all agencies.

Senator CONROY—I was going to ask how you derived the \$500 million.

Mr Hawley—We calculated that as \$500 million. We did include HIC in that as well, although it is not an FMA body, because we were doing some auditing of them. So that came to, roughly, the \$500 million that we are talking about. Of course, who knows if it is \$500 million, quite honestly, because we have already discussed here that some that was shown as trust was not trust.

Senator CONROY—I am trying to look at the definition you used to come up with the \$500 million. You took it out of the agency financial statements?

Mr Hawley—Yes, the notes of.

Senator CONROY—I appreciate the classification issue that we have now talked about.

Senator WATSON—That includes, say, Attorney-General's, which we have now said is not a problem.

Mr Hawley—The Federal Court, not Attorney-General's—there is a difference.

Senator CONROY—I wanted to ask about special public moneys on page 147 of the consolidated financial statements. The table shows that, at the end of 2001, total special public moneys as held by the Commonwealth amounted to \$170 million. I know we have had some discussion and I hesitate, Mr Culhane, to go back to the discussion and the difference between 'special public moneys' as defined in this CFS. Would you like to add to your earlier answers as to how special public moneys are defined or are you happy with what you said earlier? I know we did cover it and we ran away from it as it got really complicated.

Mr Culhane—I think I am happy with what I said earlier. It is very much a quote from section 16.

Senator CONROY—Sure. Are they defined as they were in the ANAO report—according to section 16? Again, I am trying to get to the definitional issue and the difference between the \$170 million and the \$500 million. I am trying to get to an understanding of where those classification differences are.

Mr Hawley—From our perspective, the \$500 million is derived as I explained it. I know the department of finance in answer to a question on notice explained where the \$330 million difference was.

Senator CONROY—It is just that both figures seem to be working off the same set of agencies' statements.

Mr Hutson—No, they are different.

Senator CONROY—How are they different?

Mr Hutson—This question was raised in the Senate Finance and Public and Administration Legislation Committee, and a written answer was provided in response to that question. The answer is that the money in the consolidated financial statements reflects special public money that was held outside the official public account by various FMA Act agencies and CAC agencies, and it does not include special public money held inside the official public account, which is the vast bulk of the money that was included in the \$500 million that the ANAO was reporting on.

Senator CONROY—You used the word 'inside'. Could I get clarification on the other \$330 million, being the difference between the two amounts. Where are you defining that that is actually being held? You used the word 'inside'.

Mr Hutson—The \$170 million in note 41 reflects special public money held outside the OPA. It does not include special public money held inside the OPA.

Senator CONROY—So the discrepancy between the \$500 million and the \$170 million is inside the OPA?

Mr Hutson—There is certainly a difference, because the fundamental basis of the creation of those two numbers is different.

Senator WATSON—Could you give us a definition of what you say is ‘inside’ the agency. When you say that it is inside the agency, does that mean it is incorporated into the accounts or is it inside it by way of notes to the accounts? What is the meaning of it being ‘inside’ the agency; what does it refer to?

Mr Hutson—It is the official public account.

Senator WATSON—The official public account also includes the notes to the accounts which have the special purpose moneys. What does your terminology of it being ‘inside’ the account mean? Is it in the consolidated account? You were referring to the notes to the accounts. Does ‘inside’ refer to the whole lot, the amalgam?

Mr Hutson—The \$170 million that—

Senator WATSON—Just refer to that terminology: when you said ‘inside’ the agency, what did that mean?

Mr Hutson—I will give an example in respect of one particular agency that the ANAO audited, which is the Health Insurance Commission. The Health Insurance Commission would have been included in the \$170 million, and it would have been included in the work that the ANAO did. As it is a CAC Act agency, the funds are held outside the official public account, whereas the money that the Federal Court has is inside the official public account because it is an FMA Act agency.

Senator WATSON—So, in relation to the first case, it would not even have been shown as a note to the account.

Mr Hutson—The HIC moneys were shown in the consolidated financial statements in note 41.

Senator CONROY—So we agree that the \$330 million is represented within the OPA?

Mr Hutson—I do not think that you can look at the 500 number and the 170 number and say that the 170 number is a component of the 500 number, because the bases upon which those two numbers were calculated are fundamentally different. They started from completely different bases.

Senator CONROY—You can argue that, but I am going to play on. I am not sure whether the Audit Office agrees with you.

Mr Hutson—Does the Audit Office agree?

Mr Hawley—All I can talk about are the numbers that we did.

Senator CONROY—They are both based on the same—

Mr Hawley—With the 500 number we were trying to give an indicative figure of what we are talking about.

Senator CONROY—I accept that it is an indicative figure, but you are both working off the same basis—albeit Mr Hutson is defining it with a different interpretation of how you got there. I accept that. I am saying that I am more comfortable initially with the ANAO's interpretation. Hopefully you can argue me to a point where your definition is the one that should have been adopted by the ANAO. I do not know if you will get there; I might offer you the opportunity on another day, perhaps.

The ANAO report notes that the OPA funds are invested with the Reserve Bank and that the Commonwealth earns interest on those funds. You have concluded that in some cases interest was earned on trust moneys included in the OPA but was not returned to the trust accounts. I am trying to get to an understanding of that. Could you take us through that in a little more detail. Did you do an estimate on the amount of lost interest?

Mr Hawley—We did not do an estimate on the amount of lost interest. By the way, the accounts which the money could have gone back into for the trustees rather depended upon whether we were right or wrong and whether the account was a trust account. Two of the ones we were talking about were possibly trust accounts. They had some big numbers in them, but there were only receipts. I could tell you the balance, but we only looked at the receipts in and out to find out how much money went through those accounts for that year.

Senator WATSON—Surely who gets the benefit from the interest goes back to the deed itself? It does not automatically go back to the trust itself.

Mr Hawley—Exactly right.

Senator CONROY—It is a nice little earner.

Senator WATSON—One needs to establish in the first case what the deed says and who is going to get the benefit—whether the Commonwealth, the trust or the Reserve Bank is going to get the benefit of it.

Mr Hawley—That is correct.

Senator CONROY—I am just trying to find out who got the interest.

Mr Hawley—I think that perhaps Defence might be able to help with some of those questions, because—

Senator WATSON—Who got the interest would be determined by the trust deed.

Mr Hawley—That is exactly the point.

Mr Burgess—That is exactly right. But they would not in actual fact be trusts.

Senator WATSON—Did you go back to the trust deed? What did that say?

Mr Hawley—We did not do that.

Senator WATSON—You should have. If you did not go back to the trust deed, how can you say that it was incorrectly appropriated or classified? The trust deed would have determined how that money should have been properly classified.

Mr Hutson—Could I correct the record a little in regard to the definition. I was not disagreeing with the ANAO's definition of how they did it; I was merely reporting what I think they did, and I think that they have agreed that my report was a fair one.

Senator CONROY—I have one last question. I understand that the Department of Finance and Administration agreed with the recommendation from a framework perspective. Is it something that you are adopting or not? The recommendation concerns 'uncertainty regarding the legal status of moneys reported as trust' and says that organisations should obtain legal advice to ensure that these moneys are classified. It also says that, if you can report it, report it accurately. Are you adopting that recommendation?

Mr Culhane—We were not an auditee. Accordingly, we cannot agree to the recommendations in respect of our own agency.

Senator CONROY—Can you adopt this as best practice? Do you agree with it, and can you just adopt it?

Mr Culhane—Yes, you can.

Senator CONROY—Are you adopting it?

Mr Culhane—Yes, I think we will, Senator.

CHAIRMAN—Thank you for your participation, ladies and gentlemen. If we have any further questions, we will put them to you in writing rather than ask you to come back again.

[11.41 a.m.]

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

CRONIN, Ms Anne, Senior Director, Performance Audit Services Group, Australian National Audit Office

WHITE, Mr Peter, Executive Director, Performance Audit Services Group, Australian National Audit Office

CHAPMAN, Mr Steve, First Assistant Commissioner, Australian Taxation Office

DIMENT, Mr David, Assistant Commissioner, Tax Practitioner Group, Australian Taxation Office

GRANGER, Ms Jennifer, Second Commissioner, Australian Taxation Office

KONZA, Mr Mark, Deputy Commissioner, Personal Tax, Australian Taxation Office

CHAIRMAN—We now come to the second audit report to be examined in this morning's public hearing. I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. 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. 19 2003-2003: *The Australian Taxation Office's management of relationships with tax practitioners*. I welcome representatives from ANAO and the Australian Taxation Office. Does Taxation have a brief—like a few seconds—opening statement?

Ms Granger—No, we would just like to table our submission, which I believe you already have a copy of.

CHAIRMAN—What about the ANAO?

Mr Cochrane—We are happy to incorporate our opening statement.

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

The document read as follows—

JCPAA REVIEW OF AUDITOR-GENERAL'S REPORTS 30 APRIL 2003 AUDIT REPORT NO. 19 THE AUSTRALIAN TAXATION OFFICE'S MANAGEMENT OF ITS RELATIONSHIP WITH TAX PRACTITIONERS
OPENING STATEMENT MR WARREN COCHRANE, GROUP EXECUTIVE DIRECTOR

Thank you, Mr Chairman.

The audit examined the ATO's management of its relationship with tax practitioners (professional intermediaries who assist taxpayers to deal with their taxation responsibilities, such as tax agents; bookkeepers lodging Business Activity

Statements; and lawyers and accountants working in the taxation area). Our main focus was the ATO's management of its relationship with tax agents because they are the core element of the tax practitioner grouping, and their role is fundamental to the effective operation of the tax system.

The audit sought to assess how well the ATO manages its relationship with tax practitioners. We looked at:

- the ATO's relationship with tax agents and other tax practitioners as stakeholders;
- the ATO's service relationship with tax agents;
- the regulatory arrangements for tax agents.
- Broadly, we found:
 - managing the relationship well was an ongoing and challenging task;
 - aspects of the relationship had not been well-managed in the past:
 - tax agents did not feel confident in the information and advice the ATO was providing to them;
 - the ATO had problems with its telephone support services for tax agents—including in provision of access to correct, specific client information, protocols for call handling, and staff skilling;
 - the limited capacity and complexity of some of the ATO's technological and administrative systems—phones, mail and return processing—had led to variable levels of ATO service;
 - at the time of the audit, the relationship was strained and tense:
 - both the ATO and tax agents had dissatisfaction and negative perceptions (the ATO saw that some tax agents were not embracing technology and the electronic systems that might assist them; tax agents did not feel confident in the information and advice that ATO was providing);
 - much of the strain on tax agents and on the ATO's operational systems was said to come from the implementation of tax reform.

The ANAO made ten audit recommendations. In particular, we saw the need for the ATO to:

- enhance its strategic framework for the relationship, including with an integrated statement of the dimensions of its relationship with tax agents and the objectives of its relationship with tax practitioners;
- prepare a clear statement about the roles and responsibilities of tax agents and the ATO in the tax system; and
- gather and publish performance information on its telephone support services for tax agents.

The ATO agreed with all recommendations, and noted that, during the audit, it had taken a series of initiatives, as agreed with the tax and accounting professional associations, to address its relationship with tax agents with improved tax agent services and support.

With me today are two ANAO officers who were involved in the audit—Peter White and Anne Cronin. We would welcome your questions.

CHAIRMAN—This feisty—according to the Audit report and our personal knowledge—relationship between the tax office and practitioners out there in the real world goes back a long way, doesn't it?

Ms Granger—We have certainly had tax practitioners in the system for many years, and they have a growing role. There are natural tensions in that relationship but, as the audit report recorded, the relationship was at a very tense period during this audit. There are still tensions in that relationship, and we are working to improve that. We are certainly having a lot of signals from the profession that they recognise that, as we have made improvements to our systems.

CHAIRMAN—Ms Granger, you are surely familiar with taxation agencies and regimes in other countries. Do you know whether their relationship with their equivalents who are tax agents is of a similar nature?

Ms Granger—I am not aware of any tracking research. I will just check with my colleagues.

Mr Konza—Most of the other countries do not have such a close relationship with a regulated group of tax agents. In my experience, it is not directly comparable.

CHAIRMAN—For whatever it is worth, I came from another country, I do not know how many years ago—

Ms PLIBERSEK—It is definitely in the hundreds.

CHAIRMAN—Thank you; it was 34 years ago. My recollection is that the tax agency was not hated to the degree that the ATO in Australia is. Do you have any comment?

Senator WATSON—But if we go back 30 years ago in relation to Australia, that problem did not exist even here. The only problem has been in the last three or four years where there has been resource pressures on the Australian Taxation Office and there has been overwhelming changes in terms of the requirements by the legislature on (a) the tax office, because of the nature of the changes, and (b) practitioners and the taxpayers themselves.

CHAIRMAN—That is your comment, but—

Senator WATSON—I think we have to put it in perspective.

CHAIRMAN—No, I am asking them a question.

Ms Granger—As Senator Watson has said, we have generally had a good relationship with the profession. There are, and always will be, tensions in it because tax agents represent their clients and, naturally enough, that has a different perspective from ours. Our tracking research—because we do monitor—shows that our relationships were quite good. There have been additional tensions as we have gone through the process of introducing the new tax system and making major changes to our systems. As I said, we would certainly not say that it is without tensions—it will never be without tensions—but we believe there have been additional pressures on it and we have been moving to address those.

CHAIRMAN—Without denying that there have been increasing pressures—which I agree with—Mr Cochrane, is it however symptomatic of a long-term culture that has developed or is it inherent in the relationship between the ATO and tax advisers and practitioners?

Mr Cochrane—As I told the tax colleagues this morning, 20 years ago when I was working in the chartered firms there was tension in the relationship then. I think the core part of the relationship has not changed; it is just that the intensity and the strain on the relationship, as Senator Watson was saying, has been so much more present over the last few years with all the tax changes. I think, basically, there should be some tension between the ATO and the agents, because there can be good, creative tension in getting improvement in tax administration.

CHAIRMAN—Ms Granger, do you have any view on the recent procedural changes which will leave most of the legislative burden of tax reform to Treasury and allow you to get on with the job of protecting the Commonwealth purse and collecting the revenue that we need to run the place? Do you think that that shift in procedures will have any effect on this overall longstanding culture?

Ms Granger—It is certainly true that it will more strongly focus us in relation to the administration of the tax laws and our administration engagement. No doubt you will have heard that we have in fact announced a significant change program that will, in effect, support making it easier to interact with us.

In relation to whether that will change the tensions, we believe that it will and is in relation to the interactions with the system in the administrative sense. We believe there is a natural and creative tension in relation to the fact that we are the law interpreters and we are also the ones

who do the checking of compliance, if you like. That means we are checking the books of tax practitioners' clients, and that will always be a natural tension between us. We think we can make that a positive and professional one, but there is always going to be a level of tension around that.

CHAIRMAN—I hear what you say, but I am an individual member who does get lobbied by his constituents, and significantly in the last two or three years with respect to schemes such as the Budplan and, recently, so-called employee share plans. Would you agree that Taxation has exacerbated the problem by its use of language, which in turn has also resulted in the use of extreme language by constituents who have been caught in the web of tax promotion schemes?

Ms Granger—I think we can always learn about how to better express our concerns. Interestingly enough, a concern right now—and you may well be aware of it in relation to the whole area of planning where we have concerns—is how we describe those who are involved in the promotion and marketing of those schemes. Various formulations have been tossed around: whether 'promoter' is an appropriate word or whether it is 'designer' et cetera. A difficulty for us always is how to express, to make our concerns clear, in language that does not offend but clearly gets the point across. The problem is, if you make it too general, people are not clear about what the concerns are, and then of course we are criticised for not being clear and for not giving those warnings. This is a perennial challenge for us and, yes, there are times when we learn, through reaction, that we could have expressed ourselves better.

Senator WATSON—At the same time we are faced with very aggressive tax planning operators, whether you call them promoters, accountants or whatever name they might come under, who have made your life much more difficult—people who are really pushing the margin so strongly. This is a new development in terms of what you have had to cope with. But I turn to the extraordinary aggressive tax planning arrangements, where people are going to unusual lengths to achieve a tax outcome. I think we have to set that aside from the sorts of day-to-day dealings with small practitioners, where I hear of particular problems—for example, people from Tasmania who are directed by phone to South Australia, but who do not have a standard call rate to go there, are charged at the penalty rate because it is an interstate call. These are the sorts of things that I have problems with.

Mr Chapman—Senator, I have some broad comments.

Senator WATSON—What progress are we making on that so that everybody in Australia has local call access to the tax office?

Mr Chapman—In fact, quite complete progress. If I could just go back—

Senator WATSON—Is it universal now?

Mr Chapman—The 1300 numbers that we are using are at the cost of a local call from wherever you call the ATO. We would bear the cost of any transfers within the system across Australia. In fact, it goes further.

Senator WATSON—So everybody is on a 1300 number?

Mr Chapman—Yes, a 1300 number. Even if a tax agent wants to contact one of our field staff who has a mobile phone number, that practitioner can phone the tax office on the 1300 number and we will then route the call through to the field officer, therefore covering the cost of it. I will pick up the context of your broader comments. If we look at the tensions with tax practitioners at the moment, it is useful to look at them at two levels. One is the broader tax planning—interpretation, auditing sorts of activities. That has been continuing for many years in what we might call a creative way, but it is a natural part of the system.

Over more recent years, the amount of change that has occurred as part of the broader reform processes has led to a whole new range of interactions between practitioners and the ATO. This is particularly apparent for the smaller practitioners you have referred to. The challenge we have faced over the last couple of years is keeping the ATO systems and responsiveness to a level which meets the needs of those practitioners. That is where we come to the telephone issue that you raised. If I were to venture a statistic, 80 to 85 per cent of telephone contacts by tax agents to the tax office are generally around administrative sorts of matters—they want access to a client's account; how much is owing. We send them a new form, and they update the record. Streamlining those processes and those interactions is important to us. We have had very significant turnaround with our telephone performance. The most recent surveys we did showed that there was an exceptional level of approval by practitioners—84 per cent. It demonstrates that ATO is looking to be responsive. It has changed the system, and that has been recognised.

Senator WATSON—Taking it to another level, outside the tax practitioners to the public, the greatest call on us at the moment appears to be in relation to the superannuation guarantee, where employers have not been putting in the money or the correct money. People ring up, and they say, 'It is under investigation'—and it is under investigation for two years—'but for privacy reasons we cannot give you any information.' It is very frustrating when it goes on year after year and then, at the end of the day, to suddenly find out that the man has gone bankrupt or the company has gone into liquidation and there is no collection. The tax office is reluctant—even though people have individual moneys there—to fund a court case to try and get it back so the superannuation guarantee money can be paid.

This is an area of great concern—not as far as the agents are concerned but so far as we are concerned as politicians, because we cannot get answers. It is taking too long to get the employers' money that should have been paid into the superannuation guarantee account. Nobody can get any answers, except that, 'The matter is progressing.' That is a standard response. It is quite unsatisfactory. While you are very good at collecting money owed to the Commonwealth, collecting people through the superannuation guarantee does leave a bit to be desired.

Mr Chapman—You have raised several levels of issues. One is the communication process that we take into this territory, privacy regarding what we can communicate. The second issue is our level of efficiency in collecting debts. I am not briefed today to be able to offer a view on just where we are at with that.

Ms Granger—I was seeing if I had some more information for you. I think we would need to respond to you in more detail on that one, Senator Watson.

Senator WATSON—It might even take a law change, because people are obviously hiding under the protection of privacy.

Ms Granger—There are two sets of issues, as Mr Chapman has said, in relation to what we call ‘employee notifications’, which is the first issue that you raised with us. We do have difficulties about communication and how far we can go in relation to that because it is the affairs of another taxpayer.

Senator WATSON—But even the taxpayer himself cannot get the information—and it is his money!

Ms Granger—Because it involves the affairs of another taxpayer. I know that they were looking in the superannuation area. In fact, I know because you asked this question at Senate estimates and they responded to you. They were looking at the issue of whether there was more that we could supply in a general sense to indicate progress because, naturally enough, we would like to, but we are very conscious of our legal requirements there.

A couple of initiatives are going on in relation to the superannuation guarantee itself and what we can do to follow up on employee notifications. Some of that involves data-matching around payment summaries against surcharge data that we have as well, to see if we can follow up more in that area. We are also investigating more cases of employee notifications. As you probably were aware, the tax office did get a funding injection last year, and that is allowing us to do more work, and hopefully earlier. We have an ongoing education activity in the super area to try and encourage that. But it is one of our more difficult areas—how to do more.

Senator WATSON—Why is there reluctance from the tax office to fund a court case to recover money from a delinquent employer or company or director where that director or employer has funds but the particular branch operation, or whatever it might be, has gone into insolvency or bankruptcy? The liquidator says that he is not interested because he does not get paid and he does not have any money to fund the case. So because of the time delay of the tax office in pursuing this thing, everybody has missed out. It seems to me that if the law cannot be administered properly it comes into disrepute.

Ms Granger—I am not aware of any reluctance. None of us here today are from the superannuation area specifically. I am not sure if that is based on some particular view that has been expressed to you, but I am not aware of any particular reluctance.

Senator WATSON—It has been expressed to us that we get good cooperation from the relevant section, but their hands seem to be tied. It is very frustrating for our constituents, who keep ringing us up every three months and asking, ‘What progress have you made?’ You say, ‘It is in progress,’ and they just about pull their hair out.

Ms PLIBERSEK—In the audit, you mention some information about the characteristics highlighting possible risks of noncompliance. We were asking the Audit Office about this before you came in, and they suggested that this was particularly Mr Chapman’s new area—developing a way, I guess, of profiling where the risks lie. Can you tell us a bit about that?

Mr Chapman—I have to say up-front that the reference to the audit report is not immediately coming to mind.

Mr Cochrane—It is more around recommendation 5 and the profiling of the tax agents.

Mr Chapman—I can provide the committee with some information in that area. The broad driver to this was when the professional associations met with the Commissioner of Taxation in September last year. There was an agreement that the ATO would pursue further research called ‘The World of the Tax Agent’ to better assist our understanding of the broader pressures that tax practitioners were facing and specific issues in their dealings with the ATO. We have worked with the professional associations to have some research undertaken in that area. As part of a broader range of research that we undertake, we do regular research about our levels of telephone service, the use of technology by tax practitioners, and the use of the ATO portal, which is a recent initiative for tax practitioners to get a better understanding of how agents are developing in picking up these issues. In terms of the research into what we are calling ‘The World of the Tax Practitioner’, we have been through a fairly intensive process on that and we will be sharing more broadly with professional associations some of that research—in fact, later this week.

What the research is showing is the moving feast of the industry. For instance, it is giving us some broad demographic information. The average age of tax agents is pretty well reflective of the baby boomer age profile within this country—it is in the late forties. That would suggest to us that, through normal retirement and looking for other things, a number of practitioners will depart from the profession over the next few years. The research is telling us that our young graduates are not necessarily looking to public practices as attractive career paths, so we are talking to the professional associations and saying, ‘Are there ways we can work with you to better present the accounting profession to potential entrants to that industry?’ It is telling us about the success of a public practice—and Senator Watson might have views on this himself. Some of the indicators of the business success of a public practice are around whether those practices are improving their internal business practices in going forward; how they structure the operations of their firm; the strong correlation between the profitability of a practice and the success of the practice; and the take-up and use of technology, with computerisation and online accessing of the ATO.

The research is telling us that the broad compliance work that tax agents do is still a significant issue for them. Interestingly—and it is probably something we would expect—many practitioners get personal fulfilment from their role of working with their clients and seeing them become successful in their own right; that is, input into business growth and into the small business economy, which I think is very important. One of the frustrations they are seeing at the moment is that too much of their time is being spent on regulatory Tax work when they would like to spend more time on business planning and giving business advice to their client. That suggests the need to improve the level of technology, streamline operations or even improve the level of services we provide. That was interesting for us.

One survey undertaken by the NTAA, as I recall, suggested that when we improved our telephone service accountants found they had an extra four hours a week available to them to do other work. It was not in the sense that they had been wasting four hours because of the difficulties of the past. It was quite positive in the sense of moving forward because they have that time available. So that is broad information about the world of the practitioner.

Ms PLIBERSEK—What about identifying specific risks? Are you picking up that some types of businesses are more likely to lodge incomplete or wrong returns? Are you picking up the sorts of risks that would alert you to where you should look more closely when returns are being lodged?

Mr Chapman—That is very much an underlying theme to our work and activity. To be honest with you, our focus to date has been on what things we can do to improve the level of service we provide to tax practitioners to eliminate some of the irritants they are seeing which are causing them problems in the work they are doing. That is very much the focus in the first stage of our work. The broader issue of the compliance profile of practitioners is part of future phases. It is worth mentioning, though, that the ATO has a compliance program which ought to address this issue. As you are aware, we have a range of compliance activities around industries or particular issues. The way we would approach those compliance risks is to have regard to the role of the tax practitioner in that system and whether there are factors there. In fairly blunt terms, we see the tax practitioner as a leverage opportunity to influence compliance.

Ms PLIBERSEK—You mentioned that this sort of examination reporting has existed for some time, that evaluations have been done in the past about the level of client satisfaction with the phone line, for example. Why weren't these problems addressed before the National Audit Office did this report? We all know the frustrations that people experienced, particularly straight after the introduction of the GST, with waiting online, calls dropping out, never being able to talk to the same person twice and getting different advice every time a phone call was made. Surely it does not take an ANAO report to tell you that the phone service was a major problem.

Ms Granger—To put it in context, first of all the number of calls that we were receiving at this stage in the tax practitioner area was a 900 per cent increase on what it had been previously, and it shifted during the form process from advice to transactions, as the system started to bed down. We were aware that we had problems and we had already started to address that. The audit report acknowledges that there had already been an announcement about what we would do and that we were working with the ICAA. Our first priority over that period was to implement reform and support the tax practitioner community, and the community more generally, with the advice it needed to do that. In the time frame, we were not able to do some of the system design we wanted to do. The statistics we have taken and are taking around our telephone system to be able to support this process involve a major investment in infrastructure. The process that Mr Chapman described to you where agents can now ring one main number and get priority et cetera meant rolling out what is called 'genesis technology' to more areas of the Tax Office.

That is ongoing. We are going beyond even what we said last year, into new areas of the office, to be able to do that. To put it in context, I mentioned a 900 per cent increase. The number of calls has actually reduced but not necessarily from tax practitioners. The numbers are changing but part of this technology now gives us the ability to analyse who is calling and why. For example, for the first time now we know that when we receive roughly 60,000 to 65,000 calls a week from tax agents, about 7,000 of those are tax practitioners who are calling us. So some are calling us many times and some are not. We are using that to analyse why the high-volume callers are calling—often we find that it is because they do not know about where they could get the information for themselves—or it may alert us to something we can fix.

So part of this has been a fairly sophisticated roll-out of technology to help with those issues. That could not be implemented overnight but we have done it as quickly as we could, as we were able to move into the process. And we will be making more changes. It has led to products such as the tax agent portal, where they can now get a lot of that transactional information without even having to ring us.

Ms PLIBERSEK—Can you tell us what the portal is capable of providing for tax agents? And can you tell us a bit about the security of the portal?

Ms Granger—I will ask Mr Chapman to do that in more detail, but essentially that arose from what the agents wanted from us. They are now engaged three or four times a year, depending on whether it is a quarterly or monthly activity statement, in looking at accounts. They wanted to be able to see their clients' accounts. They had a lot of requests to try and understand the different accounts and how they worked. One of their key desires, in terms of a better service from us, was to be able to see it rather than have to call us about things. That drove the desire to have a taxation portal.

They were also saying, 'For simple things, can't I send you an email?' To be able to do that, we need a secure process. We also need to understand what the service demands will be before we promise what we can deliver around that. As a strategy we have built on this and we are starting to populate it. We are piloting things as we go along to understand and make sure that we can deliver them. Certainly there are also issues around security. I will ask Mr Chapman to go into some more detail for you.

Mr Chapman—I am quite happy to reveal that we are going to release in the next few days a new booklet for tax agents outlining to them exactly what they will get from the portal.

Ms PLIBERSEK—It would be great if you could leave us a copy.

Mr Chapman—Broadly, the information we are offering is around their clients, so they can get client lists of who has lodged and who has not lodged. That helps them with their own internal practice management. It shows them which of their clients have debts and which do not. It will provide them with online and real-time access to their clients' accounts so that they can see the debt, the make-up of the debt and the transaction history of the debt. It will offer a secure message service which allows for a particular set of requests. They can fill in a form that enables them to use secure transmission, unlike normal email services. As we move forward—and some of this functionality is yet to come—they will be able to request refunds or transfers of funds between particular accounts. Importantly, they will also be able to use the portal, if they so wish, to go through to our business register to update changes of addresses. I think accountants were saying that they wanted to be able to send us messages simply and conveniently, they wanted to get accounting information, and they wanted registration and address information and to be able to update that. This facility will be able to provide that.

On the security level that you mentioned, the current security is at the SSL level—128-bit security. There is a password and a PIN. We have indicated, as a policy decision within the ATO, that we would like to move to a public-private key infrastructure—or PKI—level of security, and we would be looking to move to that over the coming months.

Senator WATSON—I had a letter from one of the tax practitioners that you have used very extensively over the years. He said that, because of the level of demand on his time and the remunerative structure, he has had to give it away—simply because you have been making so many demands on his time. He has been highly respected both within the tax office and in the accounting profession. It has affected the manner of his practice in terms of his remuneration. I think it is a little bit worrying that some good people are being forced out of the system simply because of the amount of time and consultation that is required for you to get their views. It all

sounds very good, but unless these people have been adequately remunerated you are not going to get the spread of views that is necessary to enable you to get a proper perspective.

Mr Diment—One key element of our working relationship is, as you say, to get the views of the agents directly. We are not about designing a process or procedures which do not take the user into account. This calendar year we have talked to over 3,000 tax agents, and we always ask them if they are interested in being part of one of our consultative committees, whether it is a standing committee or whether it is an ad hoc issue type of committee where we need to get people together quickly.

The other side of the discussion is the income of agents. Our research shows that there has been an increase in that and, certainly, in the profitability of practices. We never pressure agents into consulting with us; we always ask them and we are very conscious of getting a wide range and a base so that we get a representative sample of agents.

Senator WATSON—I am suggesting that you might have to look at your remunerative structure, because you cannot make these sorts of demands on people and not reward them appropriately.

Mr Chapman—I will comment on that. We like to spread the range of agents that are involved with our various activities. One of the very positive things that I find in my role is the number and range of agents who do want to contribute in a positive way to the design of the system. It is quite uplifting in many ways. It is a challenge for us to spread that load across a range of people.

Senator WATSON—I saw the hours that he put in during a quarter, and they are extremely high. Obviously he was making a good contribution, but his practice was suffering, and the remuneration for the hours that he was putting in was quite inadequate. I am saying that when you get these experts you may have to look at your remunerative structure.

Mr Konza—We do not generally pay agents to consult with us over these issues.

Senator WATSON—But there are cases where you do pay them.

Mr Konza—Yes, but not generally. I think we might consider payment where we are accessing a particular expertise that we need, but where we are consulting more because of an agent's ability to represent their clients' experience and represent the experiences of their peers and so forth, we do not generally remunerate in those situations. But we are concerned that agents sometimes do end up overcommitting themselves. It is laudable, in many respects, because they are so enthusiastic. We have worked with a number of agents in recent times to allow them to contribute at a more manageable level for them. Part of being able to do that has involved finding more representative agents who can participate in the various forums that we have got under way. We have worked with the agents themselves to bring on and bring forward people in their networks, people that they can trust as good representatives. That is rather than one person being a member of several consultative forums, which would impact on their practice. We have had at least a couple of instances that come to my mind where we have got them to restrict themselves to perhaps one key consultative forum, and they have helped us find other representational agents who can fill the spots in other places.

CHAIRMAN—Have you thought about an advertising campaign: ‘I am from the tax office and I am here to help’?

Mr Chapman—As we always are.

Ms PLIBERSEK—I had one final question. In the research and analysis program that you have instituted into issues confronting the profession, you are working with the professional bodies. Have you considered doing any of the tests that they did on financial advisers, where you have people pretending to be clients going into tax agents and asking for help and evaluating the sort of help they get?

Mr Chapman—The short answer to that is no. That is coming to the issue from a consumer protection angle. Most tax agents belong to a professional body and are therefore bound by the code of conduct and ethical arrangements of those professional bodies. I do know, from personal experience and other ways, that the disciplinary committees of the various professional bodies from time to time deal with and review matters there. The other mechanism of looking at the standards of tax practitioners is dealt with through the various state taxation boards. In instances where we think a tax agent has been deficient, it is open to the ATO to refer that situation to the independent taxation board in each state for them to review and investigate the matter. But a hidden-customer approach has not been a feature of our arrangements to date.

Ms PLIBERSEK—Do you know if any of the state boards would use that sort of technique? If they have had someone referred to them, for example, do they call them in and ask them to lay open all their papers—

Mr Chapman—I do not believe they have, but Mr Konza is more directly involved with the New South Wales state board and could perhaps offer some more information.

Mr Konza—I have been involved with the New South Wales board, which looks after almost half the agents in Australia. I am not directly familiar with what all the other boards do, because they are independent; but I can certainly say that I am unaware of any other board engaging in that sort of activity. The New South Wales board has not done so in the last five years. What we tend to find is that you get a good feel for how an agent is operating if you start to get a number of complaints about an agent. Almost all agents will have a run-in with a client from time to time, and there are always two to every tango there. The board that I am a member of would get concerned if it began to see several complaints about an agent.

Ms PLIBERSEK—You actually have to stuff up pretty badly for someone to make a complaint to your professional body, don't you? You would have to imagine that, for every one complaint that gets made about a tax agent—unless it is a frivolous complaint—there are probably many more people that are affected by unprofessional standards there.

Mr Konza—Certainly the general research tells us that that is what happens in consumer situations—remembering, though, that the tax agents boards are registration boards and do not do anything other than control the registration of a tax agent. They do not operate like a department of fair trading; they make assessments as to whether someone continues to be fit for registration. So in that respect, as you said, you do have to stuff up pretty badly to really warrant any sort of stern action from a tax agents board. Generally, those sorts of complaints are referred

to a department of fair trading, because a lot of what is complained about is governed by the contract that was implicitly or explicitly entered into between the taxpayer and the tax agent.

Mr Chapman—I will add to that response by distinguishing the tax system from the normal consumer affairs arrangement. The ATO, through its various compliance activities, might from time to time find occasions where a tax agent is doing something wrong such as claiming the wrong things for their clients. This is at a more systemic level rather than at the individual level, in that across the board they are either claiming incorrect amounts for their clients or applying the law incorrectly. So there is another check in the system in the ATO's broader compliance activities that would prompt us to go back to that agent and have discussions with them about what they are doing for their broader clientele. If it is a more extreme case, the option is then open for us to refer that matter to an independent taxation board.

Ms PLIBERSEK—But this is what has prompted me to ask the question: both of these things are after-the-fact ways of checking whether someone is doing their job; there is no system in place that would make tax agents think that they were being scrutinised in a random way as there is in some other industries.

Mr Konza—We analyse claim data and return data, so they know that the data that is being sent to the ATO is being scrutinised on an ongoing basis. But we do not engage in any sort of randomised process such as you have described.

Ms Granger—We have decided ourselves that there needs to be more marketing and transparency around what we actually do in our compliance program, which goes right through from education to auditing. Last December, for the first time, we published in a summary form where we saw our key concerns right across every part of the tax system and what action would be taken. For example, in relation to Senator Watson's earlier question, we have actually said, 'These are the number of cases where we plan to contact employers in relation to where we think they are underpaying their super guarantee, and this is how many audits we are going to do.' We expose all of that to the tax industry, including to tax practitioners, and that is telling the industry that we are concerned that they are getting these things wrong and that this will be the likely outcome in terms of audits. We have the objective of looking at not only our strongest risks but also what we call coverage generally in the community. So tax practitioners will be seeing more of us as we roll out this program.

The program is prefaced on a process that Mr Konza was telling you about that we have been doing for many years. In the lead-up to a new financial year, we provide feedback on things we have been concerned about in the last financial year—that is, where we can see patters in the things that people are getting wrong—so that agents and taxpayers themselves can be made aware of the things they should pay particular attention to in the coming year. So, as well as picking that up, it has a forward focus, because we do find that in a lot of cases there is an issue about the fact that there may be some misunderstanding. We finetune publications and we do a whole range of things to try to educate people and make them aware of where they need to be particularly careful. We do brief the industry again, and we communicate that to tax agents.

CHAIRMAN—I can tell you from a personal point of view that, for a very long time—and I have not seen any change in the short term or immediate term—there has been an attitude out there that tax agents or advisers, which might be both, can give you bad tax planning advice, which impacts on the constituent and does not impact on the adviser or tax agent. It leaves them

off the hook. I have not seen any major strategic change in that situation to convince me that you are trying to convince the industry that its schemes and planning and all the rest of it have to be straight up and down.

Senator WATSON—There are laws going through, or they have gone through, to pick up promoters.

Ms Granger—I am not in a position, obviously, to comment in relation to that. I am not sure whether you are aware, Mr Chairman, that there is a promoters task force—which we have expanded—that is particularly focusing in that area. I do not have all of the detail, but some of the techniques involve looking at and trying to identify in the early stages arrangements that we would be concerned about. Where we are aware that particular tax practitioners have been approached with arrangements, we are going as far as sending alerts to advise that we have concerns about those, and we are investigating those particular promoters. So there is actually an increased emphasis around that particular issue.

CHAIRMAN—Does the ANAO have any comments? We have not asked you any questions, although we asked you questions earlier on the public record regarding the things that our friends from the ATO told us.

Mr Cochrane—We are going to have a further look at aggressive tax planning in the coming audit. We will close off that area. What the ATO is saying at the moment is quite reasonable. I think it is very important that the tax agent industry does the right thing in terms of not only good tax advice but also bad tax advice. From personal experience, it can have a tremendous effect if agents are not competent.

CHAIRMAN—Yes, we know.

Senator WATSON—On pages 28 and 29 of Audit report No. 19, it says:

While progress on reforming the regulatory framework for tax agents and possibly other types of tax practitioners has been slow, we recognise that the ATO has recently taken sound measures to secure administrative efficiencies—

Can you take on notice to provide us with the measures that you have undertaken to improve administrative efficiencies within the current regulatory framework or how you would like the current regulatory framework to be able to improve those efficiencies? We noticed that, in 1980, only about 20 per cent of individuals lodged through tax agents. Now it is about 80 per cent. Can you give us some profiles in terms of numbers of tax agents, information you have about tax agents?

Ms Granger—In relation to how many lodgments they do?

Senator WATSON—In terms of numbers, lodgments per taxpayer et cetera; you can take it on notice.

Ms Granger—We will see if we can give you enough information just very briefly. In relation to that second one, roughly about 98 per cent of business income tax returns are lodged by agents. That has been stable for some time. In relation to individuals who are not in business—and that is roughly eight million at the moment—it peaked at a little over 75 per cent

and has started to shift a bit back from that, which can mean substantial numbers simply because that is a big proportion. Part of that has been due to the evolution of e-tax—new people coming in tend to use e-tax—so the self-preparer on the individual side of things has actually increased. So that is where we are at and it has stayed fairly stable. The new area of work is, of course, lodgment of activity statements, and we would not have a longitudinal profile of that for you. I am not sure if that helps you.

Senator WATSON—Yes; thank you. That is for the second part.

Ms Granger—In relation to the first part, we certainly can list for you the current innovations. We are not in a position to comment in relation to new regulatory frameworks. Obviously that is a matter with the Treasury and government. But we did outline some of those for you this morning. We have already outlined what we have done in relation to telephones—

Senator WATSON—The telephone network, yes.

Ms Granger—and the tax agent portal, and they are both very key measures in relation to that. We have quite an ambitious change program that we are settling right at the moment, driven personally by the commissioners, that will involve a redevelopment of what we call our payment and product processing process, which involves everything from registration through to how we process returns et cetera. One of the things under consideration there is tax agents having a much more direct interaction with our systems. They are certainly two of the main initiatives now.

Senator WATSON—Has your relationship with the institute improved in the last few months?

Ms Granger—I will get Mr Chapman to respond further. I believe so.

CHAIRMAN—If he could do so very quickly, please, because we are out of time.

Mr Chapman—Yes, it has.

CHAIRMAN—Does the ANAO have any more comments?

Mr Cochrane—No.

CHAIRMAN—I will suspend the public hearing until 2 o'clock, and the committee will come back for a private briefing at 1.15 p.m.

Proceedings suspended from 12.37 p.m. to 1.52 p.m.

BURGESS, Mr Trevor, Group Executive Officer, Assurance Audit Services Group, Australian National Audit Office

JARRETT, Mr Brandon Mark, Senior Executive, Australian National Audit Office

McKEAN, Mr David, Executive Director, Australian National Audit Office

THOMPSON, Mr Allan, Executive Director, Australian National Audit Office

WATSON, Mr Michael, Group Executive Director, Assurance Audit Services Group, Australian National Audit Office

MOODY, Ms Donna, Chief Finance Officer, Australian Taxation Office

KAUFMANN, Mr Brett Andrew, Branch Manager, Accounting Policy, Department of Finance and Administration

KERWIN, Mr James Roy, Divisional Manager, Financial Reporting and Cash Management Branch, Department of Finance and Administration

McPHEE, Mr Ian, General Manager, Financial Management Group, Department of Finance and Administration

STAUN, Mr Dominic Hoeg, General Manager, Finance and e-Solutions Group, Department of Finance and Administration

BENNETT, Mr Lloyd, Chief Finance Officer, Department of Defence

THORPE, Ms Ann, Head, Materiel Finance Division, Department of Defence

WEBER, Mr Graham, Assistant Secretary, Accounting Policy and Practices, Department of Defence

WELSH, Mr Gregory Frank, First Assistant Secretary, Financial Services, 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 proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of the 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. 25: *Audits of the financial statements of Commonwealth entities for period ended 30 June 2002*. I welcome representatives from the Australian National Audit Office, the Department of Finance and Administration, the Department of Defence and the Australian Taxation Office to today's

hearing. Would any representatives of the three agencies like to make a brief statement before we start asking our penetrating questions?

Mr McPhee—I have a short statement that I would like to make. The audit report which is the subject of this inquiry provides a comprehensive overview of the financial statement audits undertaken by the Australian National Audit Office for the year ended 30 June 2002. This report indicates for each portfolio the audit opinions which were qualified and the significant audit issues arising.

Because of its financial framework and budgetary roles, the Department of Finance and Administration is interested in this high-level reporting of financial issues on a portfolio-by-portfolio basis as well as the particular issues highlighted by the Auditor-General in his commentary, such as the timeliness of reporting and the harmonisation of the CFS and GFS frameworks. Our interest to enhance the quality and timeliness of financial reporting are complementary to those of the ANAO. We work closely with the ANAO in developing the reporting for Commonwealth bodies and liaise with them on significant accounting issues.

Our submission addresses issues raised by the ANAO relating to the finance department. In this context, I should mention that, as far as the finance department itself is concerned, there were no significant audit issues arising from the 2001-02 audit of the department's financial statements and the finance department managed to produce its statements earlier than in the prior year.

CHAIRMAN—Would anyone else like to make a brief statement?

Mr Bennett—The ANAO audit report correctly identifies that the Department of Defence has a range of significant audit and accounting issues that need to be addressed. Of the eight category A findings, six relate to asset accounting and inventory. The resolution of system and process issues which underpin these findings represents a significant challenge. These findings are the reason for the qualification of our financial statements. Hopefully our submission has outlined to you our approach to addressing these findings, many of which require major system and process changes over a number of years to rectify, and the progress we have achieved to date.

Since the completion of the 2001-02 financial statements, we have put in place many initiatives to address all audit findings. We have a major cross-functional financial transformation program under way involving over 30 projects. We have enhanced the financial statement planning process, targeting a signing date two months ahead of that achieved in 2001-02. We have initiated a business skilling review to identify needs across the department. We have advanced work in terms of our budget and output reporting and cost attribution work. Work is under way on a costing methodology and approach to support decision making at executive levels. We are also working towards implementing a major upgrade of the logistic system, which will improve asset accounting and entry issues. Our goal is to be recognised as a respected financial manager, so we have some way to go.

Mr Watson—I have a short statement which I will make available to the committee.

CHAIRMAN—Is it the wish of the committee to accept that statement as part of proceedings? There being no objection, it is so ordered. Does the ATO wish to make a brief statement?

Ms Moody—No.

CHAIRMAN—Then we will proceed with questions. I suppose I should direct my question to both Mr McPhee and to our friends from audit. This audit report says that, on average, Commonwealth entities needed 45 days to prepare a first draft financial statement for presentation to the ANAO compared with 26 days in 2000-01, 65 days to sign financial statements versus 60 days the year before, and 116 days to table financial statements compared to 110. Does anyone want to tell me why we are taking longer?

Mr McPhee—Sorry. I will defer to Mr Kerwin on this one.

Mr Kerwin—I do not particularly have an answer that would go precisely to what is happening in each department. However, what I suspect is happening in the broader sense is that, over a period of time, the level of financial management and the quality of that financial management across departments has been improving. That is reflected in a number of ways. If I can firstly draw attention to the question of materiality and the level at which agencies are now being expected to produce their financial statements, I have noticed over a period of time that the level of materiality has been decreasing over time, which is a proper thing to do. I suspect, however, that as that is coming down it is taking some agencies more time to conclude their statements. I think it is a tension which is a good tension across the Commonwealth, and I suspect that the increased number of days has something to do with that. I would suggest that most agencies have put in their financial systems. Most agencies have made available staff with accounting knowledge to do the things that need to be done, but I think this particular tension caused more time to occur than it has done in the past.

CHAIRMAN—Do any other agencies have a comment? How about ANAO?

Mr Watson—Only that the facts speak for themselves. We watch this from year to year and fiscalise through. We will be watching the same thing and perhaps seeing a better outturn in the pattern of the delivery.

CHAIRMAN—Since DOFA responded, may I ask you if we could have a written response to my question? I would like it in some detail, because we have in some respects asked for faster reporting of financial accounts, as well as better reports, more analysis and more performance reporting. We expect them to be faster and not to take longer, so we would appreciate knowing why it is taking longer.

Mr McPhee—There are two components in that: the time to produce the annual report and table it in parliament and the time to produce financial statements. Of course, the audited financial statements are not made public until the annual report is tabled. We will see if we can provide some information on the financial reporting element of that.

CHAIRMAN—That is fine. Thank you very much. The second significant question—and, Mr Bennett, you referred to it in your opening statement—is about the qualification of your

accounts. I suspect, and I believe I am reliably advised, that if you are a private sector corporation your shareholders would be more than unhappy. Would you like to comment?

Mr Bennett—We are a not-for-profit organisation. The inventory pricing and repairable items do not have an impact on our capability to perform, nor do they reflect any demands on cash or any fraudulent activity. It is a problem that has been extant for many years. If anything, we are better at identifying the nature of that problem now than we have ever been.

CHAIRMAN—With the greatest of respect—and perhaps my memory is faulty—going back over the considerable time that I have been doing this job, I recall having discussions with Defence again and again about items such as an asset register, how you manage your major inventories and how you manage an issue called fraud related to what assets you might have that are stolen. There was an inability of Defence on almost every occasion to answer the questions, but they would say, ‘We are always going to do better.’ You tell me that, no, you are not a private sector organisation, but you are responsible for half of the budget outlays of the Commonwealth, unless I am wrong. Is that about right? I think that is pretty close to being right.

Mr Bennett—We have about \$50 billion in assets, and I think that represents about 75 per cent of the asset base.

CHAIRMAN—I do not know what your asset value is, because ANAO is unable to tell me that your accounts in terms of asset value are correct. But I believe that at least your operating expenses represent approximately 50 per cent of the Commonwealth budget outlay. That is pretty big-time. Notwithstanding that you are not a private sector company, I would have thought the value of your asset base and management of that asset base—including the spare parts, disposables and things which might be stolen—were pretty important to you, this committee and the parliament.

Mr Bennett—In large part the issues were around pricing. There was some uncertainty around the existence of items. I think there were about 2,500 items in question. We chose not to book those in the accounts because, whilst there was not a crossmatching of the ATO identification number, we were reasonably confident about the assets in question. I think that work to date, which Ann Thorpe might care to comment on, would answer part of that question.

Ms Thorpe—Part of the problem that Defence is facing is tied up with a very complex financial accounting issue rather than an asset management issue. I do not know whether this committee is aware of this, but we use a particular asset management system, called SDSS, for our repairable items and inventory. That is very much designed on quantity managing an item as opposed to capturing the financial information relating to it. It was developed in the early eighties. It took a while for Defence to get it up and running, but it was put in place before the requirement for accrual accounting came in. So it was never designed as a financial management tool. We have had to add on the finance part to try to capture that finance component of the asset management.

What has caused the issue in terms of the repairable items that ANAO are concerned about is the particular way we issue assets from the warehouses to the bases. In terms of quantity there is no debate: we know we have the assets and we know they are there. But it is a question of what the value is when you try to add them all up. That is what has been causing the problems. So it

is not an asset management issue. The quantity side, in terms of people out at the bases knowing what they have, is not in the debate. The issue is really with trying to capture information from the accounting point of view and trying to use a system that was never designed as an accounting tool. I think Mr Bennett referred to this in his opening statement. He identified that we are upgrading that system. It is being upgraded this year, which will improve its finance capability.

CHAIRMAN—I would like to know what the ANAO think about those two comments from Defence.

Mr Watson—Just as an opening comment, I think that, on pages 86 and 87 of our report, the facts stand for themselves. There are issues with quantity and inventory pricing. I think the report is self-explanatory. I am aware that the department is endeavouring to do things about particular issues, but it is still an open issue in terms of resolution for the fiscal year 2003.

CHAIRMAN—Within the ranks of the five of you, is there any corporate memory of our last inquiry, which followed your audit report into fraud control in Defence? It is my recollection, rightly or wrongly, that Defence had an extremely low reporting rate for what they called fraud because they were not identifying what was walking out of storerooms and off bases. Is my memory faulty, Mr Watson?

Mr Watson—No; generally, that is correct. There was a fraud control being done, and I think a performance audit was also done on this. But, as a statistical issue, yes, there is a low volume of reported fraud in the department.

Mr Jarrett—If there are concerns over recording of quantities on a system, there are also concerns about the recognition of fraud as an issue. That is your point as well.

CHAIRMAN—We do not seem to have agreement between Defence and the ANAO on this issue in terms of materiality and numbers of items.

Ms Thorpe—This is getting very technical, but on the SDSS system there are things called position accounts. When you issue assets from the warehouses to the bases—and the ANAO are quite happy with what we have in our warehouses; we have done 100 per cent stocktakes and things on that—that is where the system is weak at the moment. That is because it is allowing people to issue to the base, and the base does not necessarily keep that information up to date on the system. That is why you have the problem and that is why ANAO are nervous about quantities. We are not confident of the quantities on the system. We are now trying to get people to do the stocktakes on the bases to verify and clean up the numbers. It is a financial capture of information as opposed to the day-to-day management of the assets.

CHAIRMAN—We have to move on, because I know my colleagues have questions. We may want to revisit this issue. This question is for the Australian Taxation Office. My understanding is that your accounts have been qualified because ANAO are unhappy with your treatment of what they believe are finance leases which you treat as operating leases. Could I have your comment on that, please?

Ms Moody—That qualification arose from the initial contract that the ATO entered into with EDS for the outsourcing of our IT infrastructure. This is the third year of that qualification and

it has at least another two years to run—there is the current year and another year of that contract to run. We believe that, on the basis of advice that we took at the time, both from accounting professionals and from OASITO—

CHAIRMAN—Ms Moody, you have just said the wrong thing to this committee!

Ms Moody—Sorry, but we verified the intent of those leases and what we believed was the appropriate accounting treatment and we put that into place. ANAO, having taken their own advice on that, have a different point of view. We certainly record through the notes within our financial statements—and the Audit Office records in the audit certificate as well—the extent of the difference. In 2001-02, in particular, that difference exists on the statement of financial position and does not have any material effect on the statement of financial performance. In fact, I think it is less than \$1 million on the statement of financial performance, but the Audit Office believe our assets are understated by about \$46 million—and our liabilities similarly understated—and we do disclose that in our financial statements.

CHAIRMAN—When is the lease up for renegotiation?

Ms Moody—The original lease has the current financial year and another financial year to run. We have recently exercised a partial option on that contract for a range of services for another two years after that.

CHAIRMAN—So you intend to follow the same accounting treatment for another two years after the next financial year?

Ms Moody—We are currently reviewing whether, in the process of renewing that lease—and this is something also that the Audit Office will review with us—both of us need to look at that and say, ‘In the process of renewing that lease, is there anything that has changed that would make either side now review that accounting treatment?’ Similarly, if we move towards harmonisation of international standards and things like that, we would have cause to revisit it as well.

CHAIRMAN—Did I hear you use the word ‘if’?

Ms Moody—I meant ‘when’.

CHAIRMAN—I think that is a better adverb.

Ms Moody—It is a question of the time frame in which we do that.

Senator CONROY—Could we offer you one thing for you to consider when you are having those discussions about anything having changed. OASITO has, basically, been abolished because of its treatment and behaviour. You might want to give some thought to whether you want to quote them as a source when you are chatting with ANAO next time.

Ms Moody—I was trying to make the point—and this is true for a range of government departments, and it is unfortunate for us that it is a material issue—that we went through a range of processes before we came to a judgment about our accounting treatment and we believe that situation still exists. We would certainly like to get to a point where we were not qualified,

particularly on what is really a technical accounting issue, which is a debate between groups of accountants about what the appropriate treatment is. At this point, we do not believe that we have any basis to change our view of our treatment.

CHAIRMAN—My advice is to you is, whenever you respond to questions about this issue, not to quote OASITO. But you do not need to follow my advice. Does ANAO have any comments?

Mr Thompson—Just to confirm that we looked at their expert advice and we are still of the opinion that their IT assets are a finance lease.

CHAIRMAN—Your comments regarding the current procedures?

Mr Thompson—Their comments are correct. They are in the process of extending the contract. We will work with them. If there is an opportunity to change, we will certainly contribute to that process.

Senator CONROY—Who was their expert advice from?

Ms Moody—Ours was from DEWRSB. The Department of Finance and Administration, I think, took some expert advice at the same time from a different accounting firm. One way or another, between the department of finance, the ATO and the Audit Office we had a range of expert opinions from a range of experts.

CHAIRMAN—I could add somebody else at the table for their expert opinion but they would tell me to get lost.

Senator WATSON—If you are going to renegotiate this lease or extend it, and given the controversy surrounding the nature of the lease, won't you attempt to put that beyond doubt by changing the terms and conditions or the wording of that lease to make sure that it is perfectly clear to everybody and that you do not have to get expert opinion as to where the risk lies? You said it is not affecting you but nothing has gone wrong. If something significant goes wrong, it could have quite a material impact on your accounts. Where does the risk lie? That is going to be a big issue. You have a big responsibility to make sure that you get it right and fully understand it, even if it means not getting legal opinions but changing the words of the lease to make sure that it is beyond doubt as to what it really is.

Ms Moody—Certainly that is one thing we are looking at in that extension, and there are ways we could do that. I guess the issue that we are working through is whether we can do that in a way that does not cost the Commonwealth any more money and does not impact on the services or any of the other things in the contract. So we are certainly looking at that, Senator, but it is not yet clear to me whether we can achieve that.

Senator WATSON—It is a big issue. Where the risk lies must be a major determinant of where your price lies. That became quite clear with the other outsourcing lease, because the price structure changed enormously once it became clear where the risk lay.

Ms PLIBERSEK—It also made the selection between bidders—

Senator WATSON—Absolutely.

Ms PLIBERSEK—That is what you are talking about, isn't it?

Senator WATSON—Initially there was a big difference between bidders. Once it was in process it became clear and there was some renegotiation change. The price structure changed enormously, because the risk profile changed.

Senator CONROY—Mr McPhee, would DOFA still have the same view it had a couple of years ago?

Mr McPhee—I am not sure, Senator Conroy. I think we are dealing with a complex standard. As you know, the test in the standard is where substantially all the risks lie, and that is a very hard assessment to make, in the sense that substantially all the risk is undefined or not clearly defined. So in the spectrum it can be a fine judgment.

Senator WATSON—The point that I am making is that the risk has got to be defined so that we know what sort of release it is going to be.

Mr McPhee—I think that is the point Donna Moody is making. If, for instance, there is to be a greater transfer of risk from the tax office to the provider, then it is probably not likely to come without cost. So cost is a factor in the judgment that the tax office will take into account.

Ms Moody—But, from the tax office's point of view, we believe that it is sufficiently clear and therefore is appropriate under the standard to be an operating lease. I guess the issue is that the Audit Office has a different view about that. We believe that we sufficiently understand the risk of the contract we are administering and that that is appropriately reflected in our financial records. That I guess is the heart of the disagreement between the Audit Office and us.

Senator CONROY—Will DOFA be providing advice to the tax office again, Mr McPhee?

Mr McPhee—I would not expect so, Mr Conroy—not unless we are asked. Generally these matters are sorted out between the agency and the Audit Office.

Senator CONROY—It is just that Ms Moody indicated that DOFA had provided advice previously.

Mr McPhee—I think that was in the context of the whole-of-government outsourcing of IT, and, as you know, the arrangements for that have changed significantly in recent years.

CHAIRMAN—Ms Moody, do you think the international accounting standard will make it a little clearer to you?

Ms Moody—We are working through an assessment of that. I am not necessarily convinced it will, but certainly any change to the standard would mean that we should reassess how our position is against that standard.

Ms PLIBERSEK—I would like to move to another area: the treatment of GST in Commonwealth financial statements. I wonder if the ATO will comment on the impact of the

whole-of-government accounts because of the discrepancy in recording the GST revenue. The ATO report suggests that it is a Commonwealth tax, and the associated payments to the states and territories are recognised by Treasury as grant expenses—but of course we know that the government does not.

Ms Moody—We do not feel it is particularly an issue for the ATO. We collect a range of taxes and remit those funds directly to the Treasury. From our perspective, we collect the GST and remit it to the Treasury, which then takes subsequent action with it. We treat all of those taxes that we collect in the same way. I guess the issue about how that is treated in the whole of government is really a question for my colleagues on the right.

Ms PLIBERSEK—There is an ongoing issue about the definition of it—whether it is a Commonwealth tax or not. It is a pretty important issue. I am interested to know whether you are having discussions to see whether you can find any common ground with the ANAO on this or whether you are prepared to say, ‘We will define it in this way.’

Ms Moody—It is not actually an issue for the ATO. It is an issue for the Treasury and the department of finance in the whole-of-government statements and the Treasury statements.

Ms PLIBERSEK—Mr McPhee, will you make a comment on that?

Mr McPhee—Certainly the tax office and Treasury represent their revenues and expenses as a Commonwealth tax—the GST as a Commonwealth tax.

Senator CONROY—Treasury themselves actually represent it as a tax.

Mr McPhee—Yes. The tax office does on the revenue side and I think Treasury represent the expenses as theirs. Firstly, I need to say that it is the finance minister who prepares the whole-of-government accounts, and I think the government have made it very clear—from their perspective, at least—that the GST is not a Commonwealth tax but a state tax. That reflects the treatment, therefore, that is represented in the government’s accounts.

Ms PLIBERSEK—But you do not just get to choose that, do you?

Mr McPhee—The rationale is that the Commonwealth collects the tax on an agency basis for the states.

Ms PLIBERSEK—But the Commonwealth distributes the money according to a formula that it sets. The states have no control over how much they get. It has no real relation to how much they collect. Sure, they spend the money, but equally you could say that the taxes that local government spends are therefore local government taxes, and they are obviously not.

Mr McPhee—These are arguments for why it should be treated as a Commonwealth tax; but, on the balance of the arguments, the government has taken a different view to that.

Senator CONROY—Is the government entitled to say, ‘Black is white’?

Mr McPhee—The minister for finance is entitled to reflect his opinion within the accounts.

Senator WATSON—In estimating the revenue for GST, do you use the same basis as for estimating income tax receipts?

Ms Moody—The Department of the Treasury are responsible for making estimates of what GST will be collected, which they do on advice from the tax office.

Senator WATSON—There are two different bases and there is some controversy, insofar as income tax is concerned, as to what is the most appropriate. I understand that a number of agencies are working to try to bring about finality on this. My question is: do we use the same basis for estimating our revenue for GST collection purposes as we do for income tax?

Mr McPhee—If I could answer in this way: we are all agreed on the numbers, on the calculations for the GST revenue. There is no difference of opinion, as far as I am aware, on how to calculate the accrual item and the GST collections. There is no disagreement on that. It is merely the accounting issue—whether it is a Commonwealth revenue—

Senator WATSON—Aside from the accounting issue, the question that I am asking is: in terms of budgeting for GST, does the Treasury use the same basis as for calculating estimated revenue for income tax purposes? You had better take it on notice, because there is some doubt.

Ms Moody—I think the answer is yes.

Senator WATSON—So my question is: for the purpose of estimating future revenue, do you use the same basis for income tax purposes as for GST purposes?

Ms Moody—We use the same accounting treatments, but because one is based on consumption and the other is based on expected employment patterns or company profitability, the actual estimation parameters and the impact of different economic factors, for instance, would be different on the different taxes.

Senator WATSON—I think you might have to take it to Treasury.

Mr McPhee—We are happy to provide you with a response, in consultation with the tax office and Treasury.

Senator CONROY—There are a couple of issues that we have dealt with previously that I want to work through quickly, if I can. We previously discussed a statement on page 19 in report No. 25 relating to audits of the Commonwealth financial statements that while the CFS are audited, the FBA report is not currently subject to audit. Can I confirm that the final budget outcome prepared according to the GFS accounting standards is not audited?

Mr Watson—That is correct.

Senator CONROY—Only the consolidated financial statements produced according to AAS31 accounting standards are audited?

Mr Watson—That is correct.

Senator CONROY—When the government presents the key budget aggregates in statements 1 and 2 of Budget Paper No. 1, including the underlying cash balance, the fiscal balance and government debt, these figures are prepared under GFS framework?

Mr Watson—That is correct.

Senator CONROY—So when the government publishes the actual outcome for these budget aggregates, the budget balance and debt in the final budget outcome, are these figures audited?

Mr Watson—No.

Senator CONROY—Is there any independent verification that these budget balance and debt data are prepared in accordance with accounting standards?

Mr Burgess—No.

Senator CONROY—So when the Treasurer stands up on budget night and says that the budget balance figure is \$2 billion in surplus—

Mr Watson—That is an unaudited figure.

Senator CONROY—It is an unaudited figure that no-one else but the Treasurer has verified?

Mr Watson—As far as I am aware, yes. The Department of Finance probably puts some validity check on that. In an audit context there is no verification per se.

Senator CONROY—I am just concerned that after Mr McPhee's answer, the government is allowed to say that black is white. I just wanted to make sure that I had not misunderstood what the actual auditing process was. I understand that in response to the unanimous recommendation of this committee, led by our chair, the ANAO confirmed its willingness to audit the FBO report if requested to do so, but that this was a matter for government and parliament to decide?

Mr Watson—Yes.

Senator CONROY—I just wanted to confirm that nothing had changed. The government have not invited you at this stage to audit?

Mr Watson—No.

Senator CONROY—They could just give you a ring and say, 'Come and audit the budget this week.'

Mr Watson—There has been no invitation to do that at the moment.

CHAIRMAN—To the best of your knowledge?

Mr Watson—To the best of my knowledge.

Senator CONROY—I am sure it would be big news if they did. I would like to go back to this question of taxation revenue, Ms Moody. I understand that the ATO recognises taxation revenue in its financial statements using the economics transactions method or ETM?

Ms Moody—That is correct.

Senator CONROY—On an accrual basis. Could you explain how that works? I know you have been chatting with Senator Watson about it, but I am a beginner on it.

Ms Moody—You will not actually find the tax revenue in the ATO statements in the primary financial statements; it exists in the notes to the statements. I guess in that sense the tax office is an agent on behalf of the Commonwealth collecting the revenue. The numbers in those notes are calculated using an ETM—economic transaction method—where the whole of government statements use a transaction liability method. Both are forms of accrual accounting. Neither are, for instance, the cash revenue received; both are accrual accounting methods.

Senator CONROY—When you issue the liability, that is when you account for it?

Ms Moody—No, that is TLM. TLM says that we have a liability, whether we have received the cash or not. Reflecting that liability is irrelevant. We will recognise it at the point that we recognise the liability. If you take ETM, that says that we expect that we will recognise a range of liabilities for a period, some of which are currently recognised, some of which may not be recognised until six, 12 or 18 months down the track, but we will try to estimate the total liabilities that we will have raised for that period.

Senator CONROY—That is good. Could you take me through the TLM—‘consolidated financial statements recognise the tax revenue when it is due and payable, using the tax liability method or TLM’.

Ms Moody—Basically that says that, if we have recognised a liability—for instance, somebody has lodged their business activity statement with us but they may not have made the matching payment; they have sent in their business activity statement and we have recognised that there is a liability—that would then become revenue. The cash will follow at some time in the future.

Senator CONROY—The report notes in paragraph 2.9, on page 28, that the TLM is aligned to modified cash accounting.

Mr Watson—That is correct.

Senator CONROY—Does that mean the government is accounting for revenue on a cash basis but expenses on an accruals basis?

Mr Watson—No, it means that some of the revenue is done on accrual basis and some is done on a cash basis.

Senator CONROY—Did you say it is a hybrid?

Mr Watson—Yes.

Senator CONROY—I thought you said ‘hybrid’.

Mr Watson—That comment is more about the credit going into the revenue statement, not so much a comment about the expense side of it.

Senator CONROY—Is it a pick and choose situation? Are there some rules that determine when they pick one ahead of the other?

Mr Watson—I am going back a bit from my time on it but, as I understand it now, in fiscal 2002, there is a much clearer definition of accrual. In the reporting period a lot of numbers actually crystallise now because the construct of the tax has changed.

Ms Moody—Yes, with activity statements and the quarterly bringing to account of liabilities in any case through that process, there is less timelag between the liability being recognised in tax records, so the two have actually moved closer together. The difficulty—and the department of finance might care to comment on this more than me—is that the economic transaction method requires a greater degree of estimation of what the revenue will be than the TLM method does. Therefore, I guess from a whole of government perspective, they have had concerns about whether, only a couple of years into the new tax system, we have sufficient history to get the precision that we would prefer in such an estimate. I think that is basically the argument for the whole of government.

Mr Thompson—Could I add a little bit to that. There is major difference between TLM and ETM, as far as the tax collection is concerned. They are fairly similar, because you lodge monthly returns with the GST, but the major difference, as far as the types of taxes are concerned, is between company tax and individual tax. I think that is correct. That is the major difference. As far as calculating is concerned—the way the tax operates—they calculate the TLM first and then they estimate the ETM additional; that is, the accrued income. So they say, ‘We’ve got the TLM’—the system is aligned to the TLM—and then, with their knowledge of the economy and the other processes, they estimate the likely additional revenue. Donna is right in the respect that there has been some variability in that, although the variability is reducing over time as Taxation gets a lot better at estimating that revenue.

Senator CONROY—I can understand that, on the GST and BAS, the point you make is valid. But on company and income—

Mr Thompson—There is a difference between when you lodge your return and when the financial year ends. After the financial year ends there may be a period of time before I lodge my return, so there are some differences there, whereas if you do your BAS monthly it is pretty close.

Senator CONROY—The volatility of company and income tax might have lessened, but I would not have thought that it would have changed much. They have had the same basis of calculation over 30 years. Their forecasting may have improved technically, but not in the way you describe for the BAS form.

Mr Thompson—There is still the gap, but their recent track record shows that they are getting better at forecasting—at calculating estimates.

Senator CONROY—The report notes that TLM does not conform with AAS31, *Financial reporting by governments*, whereas ETM clearly meets the requirements of AAS31. Could someone explain that to me?

Mr Thompson—ETM is more of a full accrual calculation. It lies with what we form as a definition of accrual income. When the financial year ends that is when you have got the income and that is when you recognise it, so you sit down and estimate accrued income. The other approach says, 'We've got some returns lodged—we'll recognise that bit,' so it falls short of what we call full accrual income.

Senator CONROY—I understand that, if the government had adopted ETM, the operating balance in the financial year 2000-01 would have been \$9.1 billion less. Is that right?

Mr Thompson—Yes. That was an unusual year. Last year the operating balance would have had \$2.8 billion in additional revenue. The overstatement was due to a one-off change in the timing of tax collections. I have forgotten exactly what it was, but they changed the timing for lodging your company returns and your provisional tax. So that comparative statement for 2001 is a one-off variance. I would tend to use this year's figure as a better guide to the normal difference.

Senator CONROY—Could you explain the methods used for the calculation of GFS revenues and the impact on the GFS budget balance?

Mr Thompson—I am not in a position to do that.

Mr McKean—We do not audit the GFS. I think it is a question for the Department of Finance and Administration.

Mr Kerwin—The GFS revenue is calculated on the basis of the tax liability method. What we are dealing with there is a number which is much more certain than the number that would come out of the ETM. To give you a feel for that, the consolidated statements—so the accounting statements—for 2001-02 had an adjustment of \$653 million because of the inability of the estimate under ETM to be accurate. The statements that were audited here had an adjustment of that order at the start. From a budgetary point of view, that sort of variation is probably generally considered to be intolerable.

Senator CONROY—It is a large dollar figure, but as a consolidated figure that would be less than one per cent, wouldn't it?

Mr Kerwin—No, it is around 60 per cent of the operating result.

Senator CONROY—I am not talking about the operating result; I am saying that, in relation to the total Commonwealth expenditures and receipts, that is a minuscule number.

Mr Kerwin—In relation to total revenue, yes, it would be.

Mr Kaufmann—It is 0.4 per cent.

Senator CONROY—Thank you. To the average punter and to most of us here \$623 million sounds like a terrifying number, but in relation to all that the government is up to—you described it in terms of a consolidated picture—it is 0.4 per cent.

Mr Kerwin—That is correct but, to put a slightly different complexion on that, when we prepare our consolidated statements for the ANAO to audit we prepare them within a materiality range of \$350 million. We have to present a set of statements which, at the operating result level, will be accurate to within \$350 million. If we do not, we get qualified.

Senator CONROY—Have you always used TLM?

Mr Kerwin—I have not been in Finance forever, but I think it began around three or four years ago. I think ETM was used in—I am guessing the date—1998-99 or maybe a bit further back than that.

Mr Kaufmann—I think Mr Kerwin is correct.

Senator CONROY—So in 1998-99 we changed from ETM to TLM?

Mr Kerwin—It may not have been that particular year, but there was one occasion when it was done.

Senator CONROY—When we moved off ETM onto TLM?

Mr Kerwin—Yes.

Senator CONROY—It was ETM before that?

Mr Kerwin—It was certainly ETM in one year.

CHAIRMAN—If you are not certain, do you want to take it on notice?

Mr Kerwin—I am happy to take it on notice. I think the period in which it was used was a period in which the consolidated statements in an accrual sense were still being developed, along with a whole range of other things, around 1998-99.

Senator CONROY—Ms Moody, would you agree that ETM is just too unreliable?

Ms Moody—It is a matter that we keep under review.

Senator CONROY—You use it.

Ms Moody—Yes, we do.

Senator CONROY—You do use it, so you must think that it is reasonably reliable, otherwise you would dump it as well, wouldn't you?

Ms Moody—We use it for our financial statements. For reporting during the year when we are reporting to the whole of government, for monthly financial statements, we use TLM. So, if you like, we run both methods.

Senator CONROY—But you do not pick and choose, depending on which one is the best for you?

Ms Moody—No; we consistently for the whole of government provide the TLM numbers and for the tax officers' own financial statements, once a year, we use ETM.

Senator CONROY—So for your own figures, you use ETM. You are satisfied that a 0.4 per cent variation that Mr Kerwin was describing is not something you would get overly concerned about?

Ms Moody—We are satisfied for the purposes of our financial statements. I think that there are some different materiality issues at work between the ATO's own statements and the whole of government statements which can make it more complicated. When we provide information for the whole of government statements there is a lower materiality threshold than when we are doing the ATO's own statements.

Mr McPhee—If I could add just for balance—

Senator CONROY—I did not know that Ms Moody had been unbalanced!

Mr McPhee—No, in fact, she has been very balanced. But the point I want to make is that, when the tax office are putting their accounts together, the materiality is based on the gross revenue number. The consideration of whether 0.4 or \$600 million, as Mr Kerwin said, is material or not is against the gross taxation revenue figure. That is what the Audit Office will be—

Senator CONROY—So \$623 million could not possibly be considered material against the Commonwealth budget?

Mr McPhee—No, but I am just making the point that at the revenue level it is not material. We would not argue with that nor I doubt would the finance minister. But there is an issue for the finance minister because materiality does not just have regard to the revenue number; it has regard to the bottom line as well.

Senator CONROY—I am sure he is sensitive about what the bottom line says.

Mr McPhee—Yes. But when you are running surpluses or deficits between—

Senator CONROY—Or in this case, deficits they should be.

Mr McPhee—But hypothetically, if you are running between plus five and minus five on a bottom line then a figure like \$653 million does have to be taken into account in a materiality sense. I just wanted to put the balance: from an accounting point of view, you do have to have regard to the revenue number as well as the baseline. I say nothing about the judgment made

whether it is material or not, but it is a very different question from the one the tax office has to deal with.

Senator CONROY—I appreciate that, Mr McPhee. I thought you were straying dangerously into a policy debate with me there.

Mr McPhee—Not at all.

Senator CONROY—I understand that Finance and Treasury agree that the comparative reliability of the two methods should be reviewed in future years. So are we going to change back?

Mr McPhee—I know that Finance, Tax and Treasury look at this issue on an annual basis and, as was mentioned earlier, the actual margin is reducing over time, so the estimation is improving. There is no question that, if you look at a time series—

Senator CONROY—When do you expect that the time series will bring them together—this financial year, for the preparation of this budget?

Mr McPhee—We are yet to look at this financial year, but we will be doing that very shortly.

Senator CONROY—So is there a change in this year's budget? I don't want to sound silly, but the budget is only a few weeks away.

Mr McPhee—We will look at it in terms of the context of preparing the Commonwealth financial statements to see whether there is any change.

Senator CONROY—You have some input into the budget, though, don't you?

Mr McPhee—As a department we do.

Senator CONROY—I know that Treasury do prepare the budget, so I appreciate the point that you make, but are you aware of a change in policy on ETM versus TLM in this coming year's budget?

Mr McPhee—Even if I were, I would not be able to say.

Senator WATSON—I think the point is that it is a process of refining them both to ultimately move to the economics of it to take away its volatility.

Mr McPhee—We recognise the benefit of the ETM; it is the variability that concerns us.

Senator CONROY—You will be looking at this in the next few weeks, did you say?

Mr McPhee—We will do so in the context of preparing this year's financial statements.

Senator CONROY—When would those financial statements be released?

CHAIRMAN—When they have time!

Mr McPhee—I could tell you when they were released last year.

Senator CONROY—Yes. When were they released last year?

Mr McPhee—They were released on 20 December. We would like to think that we can do better than that.

Senator CONROY—So you will do better than that; that is what I was coming to, really.

Senator WATSON—In regard to my earlier question and given this high-level discussion, I am still surprised that people cannot tell us what the basis is for lodgment for the GST.

Ms Moody—I think I was probably a bit confused as to what the question was. Was it about the accounting treatment? If that is the case, the GST is prepared using TLM for the whole of government and using ETM for the tax office, the same as with income tax. If it is the basis of estimation—

Senator WATSON—It is the basis of estimation.

Ms Moody—The basis of estimation uses economic factors related to consumption for the GST, whereas income tax relates to economic estimates of company profitability, salaries and wages and employment figures from the Australian Bureau of Statistics and those sorts of factors. We put it through the same sort of process of estimation, but the nature of the tax will change given the economic factors you take into account in forecasting that particular tax.

Senator WATSON—But in terms of classification, I need to know whether, in estimating future returns, you are using the same basis for income tax and GST purposes. That was my question.

Mr McPhee—And I think we agreed to take it on notice.

Senator WATSON—Yes, you did. I just wanted to make that observation.

Senator CONROY—Going back to the previous issue, you said you were reviewing the issue of ETM and TLM at the moment. Do you believe, on the information and evidence that you have before you, that they have come together sufficiently for you to recommend that change?

Mr McPhee—You will appreciate that I cannot let you know what sort of advice I may or may not provide to the minister at the time. The only observation I can make is that over time the variances have reduced. But certainly, looking back, in terms of the judgments made by the finance minister, even though they have improved there has still been too wide a swing on a materiality basis to allow him to change the approach.

Senator CONROY—Who makes that decision? Do you or DOFA make the decision, or do you make a recommendation that the minister can take or not take? What is the decision making process on this issue?

Mr McPhee—We would provide advice to the minister on a range of issues relating to the preparation of the accounts. At the end of the day, he would make the final decision.

Senator CONROY—I am concerned about the issue of the materiality of the bottom line. I want to know who makes that decision, because the materiality of the bottom line for the budget is a very sensitive political issue, as I am sure you understand, Mr McPhee.

Mr McPhee—Absolutely.

Senator CONROY—There is a calculation available that suggests that at some point soon it will be possible to move from one method to the other. Before, if we operated on ETM we would have been \$9 billion in deficit, but in the very near future, if we operated on ETM, we would be able to boost the bottom line by \$2 million—just by a simple policy change like that. You can imagine the degree of cynicism out there in the broader community if the moment the government chooses to change from TLM to ETM happens to coincide with the fact that it goes from a \$9 billion move in its bottom line to a \$2 billion boost of its bottom line in the opposite direction. It would lead to some public comment.

Senator WATSON—There were some unusual factors which led to the discrepancy.

Senator CONROY—No, that was a one-off. It is not the same as this issue of policy.

Mr McPhee—Obviously, all we provide advice on are the accounting and the technical issues. The minister makes the decision.

Senator CONROY—I appreciate that the minister makes the decision, but it goes to whether or not you believe—I am not talking about the recommendation you make—that the calculations are sufficiently robust, if I can use that phrase, now that you can go back to the method you used to use. That is not a political decision; that is whether or not, at the end of the day, the calculations of Finance—it would be supported by ANAO, I presume—are sufficiently robust to switch back to the method that was previously used.

Mr McPhee—I do not know the minister's tolerance for this materiality.

Senator CONROY—I know his tolerance; it is very high, or low, depending upon your perspective! Thank you; I will not press you any further on that. Can you please explain the dramatic increase in the average number of days—and we did discuss this a little bit earlier—that Commonwealth entities need to prepare the first draft of financial statements, from 26 days to 45 days?

Senator WATSON—We already did that.

Senator CONROY—No. Earlier we were talking about accrual accounting and the difficulties there and saying that we hoped that the departments were getting better across that.

Mr McPhee—We are cautiously optimistic that that can improve. We have said that on notice we will see whether we can provide some more concrete information.

Senator CONROY—You have set a target of 20 days now, haven't you?

Mr McPhee—That is about right. Certainly this is for reporting in terms of the monthly budget outcome. As you know, departments are required to provide us with outcome figures at each month. So we have progressively got better and more timely information from agencies. That suggests to me that the systems are becoming more streamlined and of greater integrity. I am expecting that that will transfer across to the preparation of the whole-of-government accounts as well.

Senator CONROY—The government has set a target of 20 days—I think that that is the famous Bowen memo, is that right?

Mr McPhee—Yes, that is correct.

Senator CONROY—ANAO give better practice as being 10 to 15 days. Are they just being too bolshie, Mr McPhee?

Mr McPhee—They set a high standard for us all, Senator Conroy. We are happy to aspire to it.

Senator CONROY—You do not think it is achievable in the near future?

Mr Kerwin—We are looking at the 20 days; I think it is in the 2004-05 year. What that would do for us—

Senator CONROY—Any projection on the 10 to 15 days? In 2010-11?

Mr Kerwin—The only comment that I can make is that, when the major corporations in Australia go to market after the end of a financial year, it is probably around the end of August. If government goes to market or whatever around that period or earlier, it would be meeting the market.

Senator CONROY—You would not like to meet that ‘high standard’ that Mr McPhee was just talking about?

Mr Kerwin—I think it would be great.

Senator CONROY—I want to go back to one of the issues that we were talking about earlier. I understand from page 36 of the ANAO report that, for the third year running, ATO financial statements were qualified, as we discussed, because IT outsourcing leases were incorrectly, in the view of the ANAO, classified as operating not financing leases, understating expenses by \$945 million. Is that figure correct?

Mr McPhee—It is \$0.945 million.

Senator CONROY—What is the total amount that expenses have been understated over the three years?

Ms Moody—I would have to take that on notice, Senator.

Senator CONROY—I understand from chapter 3 of Defence's annual report that the department did not sign off on their financial accounts until 24 October—seven days before the annual report was due to be tabled. Is that right?

Mr Bennett—That is correct.

Senator CONROY—We did have some discussion earlier, backwards and forwards, around some very technical issues. The audit report talks about the scale of problems in Defence financial systems and processes. Would ANAO like to elaborate on that, or do you think that the discussion we had earlier covered it? I am not sure whether you dealt with the macro issue; you were talking about one specific issue. Do you think that one specific issue—I cannot even remember the acronym that you were using—goes to the heart of the macro issue that ANAO is talking about?

Mr Bennett—We noted in our financial statements that there is uncertainty around those items. The problem we have is an old system that was not designed for this environment, which forces us to rely on substantive processes, quality assurance processes and work-around processes to achieve quality in the results. I think you would see that we had our numbers into DOFA in a timely fashion last year, but there was considerable work and debate between us and the ANAO on some of those extant issues. This year, we are confident that it will not take us anywhere near that long to get the signed off reports, with a target date being around 30 August this year. But that is the root cause, that is the interrelationship and that is the challenge we had around problems that have existed in prior years.

CHAIRMAN—Do the ANAO agree with what Mr Bennett has said?

Mr Watson—We held discussions with the CFO of the Department of Defence last week, and our view would be that our judgment for that to come to pass will become very clear towards the latter part of June. It is still an open issue.

Senator CONROY—This is a question for the ANAO. On page 174, you indicate that total audit findings are that 70 per cent of Defence accounts are rated A. You go on to say:

Audit findings which pose a significant business, or financial, risk to the entity—

that is a big call—

and which must be addressed as a matter of urgency ...

I appreciate that Defence have indicated that they got the information in faster. Do you think they are at a stage where you can withdraw that sort of qualification? Will you still qualify them in the same way in the coming financial statements?

Mr Watson—As I said, that is a very big strategic call for the ANAO in management. We are currently working through those two or three big issues. As I said, I think we will be in a position—both Defence management and the ANAO—to get our thought process pretty clear on that by the end of June.²

Senator CONROY—What do they have to do? You make the point on page 89:

Until Defence IT systems and supporting business processes, especially in relation to the logistics systems, are substantially improved, the relatively large number of audit findings and the qualified audit opinion are likely to remain.

Mr Watson—That is it: in the meantime, the Department of Defence and the ANAO have that challenge for a while. As Mr Bennett was saying earlier, the issue with the audit and the management is that you always have to do a significant number of work-arounds because there are, say, system issues that you just cannot fix in year 1 or year 2. So you always have a date with destiny in belting the numbers around, and that is always in the latter part of a fiscal year. I think that is with us for a while.

CHAIRMAN—Can I confirm something. My understanding from earlier discussion is that Defence believe that they have the quantities right and Audit does not necessarily agree with that.

Mr Watson—I listened to that with interest, Mr Chair, but I think the quantities we were talking about on page 87 in relation to the reparable items are something in excess of—

CHAIRMAN—You mean you think they have been able to count the number of FA18s okay?

Mr Watson—On page 87 there is about a half a billion dollars that the department clearly concedes there is an issue about.

Senator CONROY—Figure 1 on page 20 shows a significant increase in the number of days Treasury took to prepare its draft financial statements—from 21 to 43—and the number of days before the statements were signed off. Would you just explain what was going on with Treasury? I do not think they are here per se.

Mr Burgess—The issue for Treasury on why they took longer to sign off on their financial statements for 2002 as compared to previous years was simply in regard to the two support schemes that they were administering. One was the HIH support scheme and the other was the medical assistance scheme. There were two very large numbers in relation to liability that they had to bring to account, and those numbers were subject to actuarial review. Given the relative immaturity of the schemes in place, it took them some time to get the numbers to put into their accounts.

Senator CONROY—Just on those two matters, HIH Claims Support Ltd and UMP-AML, were they accounted for under AAS31?

Mr Burgess—That is correct.

Senator CONROY—Were they treated as an expense above the line and a liability below the line?

Mr Burgess—No, they were both treated as expenses above the line and liabilities above the line.

Senator CONROY—It was above the line?

Mr Burgess—Yes, for their financial statements.

Senator CONROY—How were they treated under GFS?

Mr Burgess—You would have to refer to the department of finance for that.

Mr Kerwin—They would have been treated similarly.

Senator CONROY—Under GFS?

Mr Kerwin—Yes.

Senator CONROY—Do you know that they were or do you just expect that they were? I am happy for you to take it on notice if you need to double-check that.

Mr Kerwin—I would be pretty certain. If I can just explain a little, the GFS numbers are derived out of the accounting numbers. In this particular case, the booking of the liability would flow through to the liability in the GFS balance sheet. I am not too sure where the expense would be.

Senator CONROY—Not too sure where the expense would be?

Mr Kerwin—In terms of whether it is in other economic flows or whether it is in the normal operating statement for GFS. I can get back to you on that.

Senator CONROY—Please. I just have a suspicion or a sense that it is not quite as straightforward as the ANAO have it under AAS31. Anyway, you will come back to me on that one. The government has released finance minister's orders for the preparation of statements, which are subject to disallowance—were they released relatively recently?

Mr Kaufmann—That is correct.

Senator CONROY—Could you tell the committee what were the major changes to the orders from the previous year?

Mr Kaufmann—In administered items, instead of reporting by note disclosure, we have created some separate schedules. We have eliminated the option of reporting on business operations and made that mandatory now. We have added some increased disclosures on special accounts in terms of some reconciliations, we have picked up a few changes in accounting standards, such as provisions and employee entitlements, and we have reinforced our position following discussions with the ANAO on the accounting for appropriations.

Senator CONROY—I congratulate you on those changes.

Mr Kaufmann—Thank you.

Senator CONROY—As you know, the committee has campaigned for and carried on about transparency and those sorts of things. They are all very politic changes, and it should be put on

the record that they are welcome. What were the key issues raised in the ANAO model agency accounts report released yesterday? Is there anyone here who handles that?

Mr McKean—That document really does not raise issues per se; it provides some guidance to agencies on how to interpret the FMOs.

Senator CONROY—What were the key guidances?

Mr McKean—Perhaps I will defer to the technical expert who is behind me.

Mr Burgess—In the main, the same as what Mr Kaufmann mentioned. The AMODEL accounts are what we call a better practice guide, just to assist agencies in preparing their accounts.

Senator CONROY—So DOFA has picked up most of what you believe is the AMODEL agency report?

Mr Burgess—It is the other way around: DOFA prepare the FMOs and we pick that up in the AMODEL better practice guide.

Senator CONROY—And you have picked them all up?

Mr Burgess—Yes. We consult extensively with DOFA when we put the AMODEL together. Also, when DOFA are preparing the FMOs for the current year, we consult backwards with them.

Senator CONROY—So both agencies are happy.

Mr Kaufmann—If I can just clarify, at the moment we are going through AMODEL. We have provided some comments back to the ANAO, but there are still some areas of AMODEL that we are continuing to look at.

Senator CONROY—Last year there were some changes you were critical of. Do you support all of the changes this year?

Mr Burgess—By and large, yes.

Senator CONROY—Which ones? I am happy for the gentleman to sit at the table, rather than be asked through the director.

Mr Burgess—We cannot be specific, but generally we are pretty happy.

Senator CONROY—If you could take it on notice to give us a little bit of a brief in the areas where there was some disagreement, that would be great.

Mr Kaufmann—If I can just clarify, in finalising the finance minister's orders before they were provided to our minister for clearance, we had a clearance from the ANAO.

Senator CONROY—And the minister did not make any changes to them? He accepted them as you recommended?

Mr Kaufmann—Correct. But the point I am making is that we had a clearance from the ANAO.

Senator CONROY—I think there is an indication that there were only relatively minor issues—that is the sense I get from that end of the table. I am not trying to suggest that there is some huge disparity between them. I think they are trying to let me know that they were relatively minor matters. Thank you; that is all I have, Mr Chair.

CHAIRMAN—I have a question for DOFA on harmonisation. It is not easy; we understand that. We understand that everybody is working towards it. How difficult is it going to be to get there, both for your department and for consolidated reports?

Mr McPhee—It is a very challenging exercise, but the good news is that a lot of people are working to the same end. I will ask Brett Kaufmann, who is a member of the AASB and recently attended an OECD conference, to tell you about some of the initiatives that are occurring to harmonise the two standard sets.

Mr Kaufmann—I am going on the basis of bringing GFS and generally accepted accounting principles—those accounting standards—together to create a single reporting framework. Internationally, the public sector committee of the International Federation of Accountants, who set international public sector standards or are in the process of so doing, have a project on their plate to deal with harmonising GFS and the international GAAP. They are in fact meeting with Eurostat and the IMF next month to talk through some of the technical differences. The OECD—and I attended a conference at the OECD in February—have a very keen interest in creating a single reporting framework and are in consultations with the IMF and Eurostat on this very issue. They looked at one of the technical differences only last week, and that is how weapons platforms are treated differently between the two frameworks.

Senator CONROY—Weapons platforms?

Mr Kaufmann—Specialist military equipment.

Senator CONROY—Missiles and bombs.

Mr Kaufmann—And planes and ships.

CHAIRMAN—And submarines.

Mr Kaufmann—Internationally, the IMF, who are the gatekeepers and preparers of GFS, have acknowledged some of the issues that we have with GFS. They are going to commence a review of the system of national accounts and GFS, and we will be invited to submit to that review. Domestically, I think we understand that in December the Financial Reporting Council issued its strategic direction on public sector to the AASB. The focus of that strategic direction was the creation, as a matter of urgency, of a harmonised reporting framework. Subsequent to that, earlier this month the FRC issued a clarification to that to make it clear that issues of scope and accounting technical content are the responsibility of the board. The AASB has started

reviewing a draft strategic plan to deal with GFS and GAAP harmonisation. As it stands, that draft plan calls for the board to review draft standards in March-April next year. Supporting that, the heads of Treasury accounting and reporting committee has a working group, which I am chairing, that is looking at and reviewing all the technical differences, the conceptual differences and logistic issues, and much of that work is intended to feed into the AASB's program.

CHAIRMAN—Mr Kaufmann, since you just answered that question as a member of the AASB, could you tell me whether you have reviewed the draft international standard on the accounting treatment of leases?

Mr Kaufmann—The International Accounting Standards Board has made it clear that it does not intend to review leasing, either as an improvement or to create a new standard on leasing, until after the 2005 deadline. The only thing I can add is that one of the things it is looking at is a G4+1 paper that was prepared several years ago which provided some significant insights into changing lease accounting. The G4+1 recommended that all leases should be finance leases. But we are waiting to see what happens at the International Accounting Standards Board.

Senator CONROY—I thought Sir David Tweedie made it fairly straightforward.

Senator WATSON—The Chairman of the Accounting Standards Board, Mr Alfredson, expressed concern about his inability to get sufficiently high-level people out of the public sector onto the board. Has that been resolved?

Mr Kaufmann—I would like to think so, but the answer is no. It is a continuing problem—and it is not just the public sector but also the private sector—to find good accounting policy and technical people. Even the board itself is struggling to keep some of its senior people.

Senator WATSON—Who are the most recent senior people to have been recruited from the Commonwealth public sector?

Mr Kaufmann—I am the person—

Senator CONROY—It is Mr Kaufmann. You will make him blush in a minute.

Mr Kaufmann—I am the only one from the Commonwealth public sector on the AASB. There is also the Victorian Auditor-General and a person from Tasmania.

Senator CONROY—That is Mr Challen, isn't it?

Mr Kaufmann—No, he is on the Financial Reporting Council.

Senator WATSON— Congratulations on your appointment.

Senator CONROY—Or commiserations, Mr Kaufmann—whichever you prefer.

CHAIRMAN—I assume, in the absence of any negative statement that you make to me now, that you would be happy to receive in writing any further questions that we have on this issue

and reply in writing, rather than come before this committee again. I thank witnesses for appearing today.

[3.17 p.m.]

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

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

SPEDDING, Mr David, Audit Manager, Performance Audit Services Group, Australian National Audit Office

CULHANE, Mr Michael, Branch Manager, Finance and Banking, Department of Finance and Administration

HUTSON, Mr Jonathan, Division Manager, Financial Framework, Department of Finance and Administration

McPHEE, Mr Ian, General Manager, Financial Management Group, Department of Finance and Administration

STAUN, Mr Dominic Hoeg, General Manager, Financial and e-Solutions Group, Department of Finance and Administration

CHANDLER, Mr Jeremy Paul, Chief Finance Officer, Department of Transport and Regional Services

CLEGG, Mr Simon, Director, Aviation and Maritime Legal, Department of Transport and Regional Services

DOLAN, Mr Martin Nicholas, First Assistant Secretary, Aviation and Airports Policy, Department of Transport and Regional Services

FRASER, Mr Bede, Manager, Accounting and Financial Management Unit, Department of the Treasury

WELCH, Mrs Bernadette Tracy, Manager, Insurance Programs Unit, Financial System Division, Margets Group, Department of the Treasury

CHAIRMAN—We now come to the fourth audit report to be examined in today's public hearing. I remind witnesses that the hearings today are legal proceedings of the parliament and warrant the same respect as proceedings of the House itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of the 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. 27, *Management of Commonwealth Guarantees, Warranties, Indemnities and Letters of Comfort*. I welcome representatives from the Australian National Audit Office, the Department of Finance and

Administration, the Department of Transport and Regional Services and the Department of the Treasury to today's hearing. Does anybody have a 30-second or less opening statement?

Mr McPhee—Mr Chairman, I have an opening statement and I would be happy to table it, if you like.

CHAIRMAN—Thank you very much. For each of the departments, very quickly in turn: one of the things I do not understand is how on earth you can issue a guarantee or an indemnity—I never have understood letters of comfort—without knowing exactly where the document is or having an adequate register of the document. Can we start with Transport? I believe the ANAO said that nobody was 100 per cent clean. Is that right?

Mr Cochrane—We have said that it has substantially improved over the three audits that we have done and you have looked at, but there are still some issues in terms of getting everything recorded.

Mr Chandler—If I could respond: we do have a central indemnity register which contains copies of all current and past indemnities, and I believe it is complete. It has been improved over time. During the period of the audit our register was a complete record of all indemnities on issue.

CHAIRMAN—So you reckon your register is complete and you can find all the original documents as signed? If I took you to court, you could supply the original document?

Mr Chandler—In one or two instances of old indemnities, we have copies of the original but we still have not located the certified document. But we do have a record of each indemnity.

CHAIRMAN—Have you issued any new ones and failed to keep the originals?

Mr Chandler—No.

CHAIRMAN—Very good. What about the Department of Finance and Administration?

Mr Staun—We have a register of all of the guarantees, warranties and indemnities and the letter of comfort. We review the register on a quarterly basis and present it to the management board for their review. We update it and review it on an annual basis as part of our financial statement arrangements.

CHAIRMAN—Do you have all the original documents?

Mr Staun—Yes.

CHAIRMAN—What about Treasury?

Mr Fraser—The Department of the Treasury has a comprehensive electronic records register. We have copies of all documentation. The originals, though, are held by the program areas. We are currently updating our chief executive instructions. Once that is signed off by our secretary, we are going to ensure that all the original documents come down to my central area. So, in future, we will have all the original documentation in the central area.

CHAIRMAN—Is the ANAO happy with that?

Mr Cronin—Yes.

CHAIRMAN—One of the things that the ANAO has recommended—and continues to recommend, I must say, in audit after audit—is doing a better job of risk management. I noticed that the guarantees have gone down by 100 per cent in the last three years. Is that correct?

Mr Cronin—Yes.

CHAIRMAN—But we have had a substantial increase in outlays as a result of indemnities as a result of things like September 11 and HIH. Could each of you in turn tell me what you think you are doing to improve your risk profile ahead of issuing indemnities—that is, are you limiting your own risk by no longer agreeing to supply guarantees or indemnities that have unlimited liability? Are you managing those risks before you sign these documents? Once you are confronted with the issue, because you are faced with the event—for example, September 11—do you try to manage the flow of expenditure to reduce the Commonwealth's exposure? Maybe we could hear from the Department of Transport and Regional Services.

Mr Clegg—I was responsible for dealing with a large number of the indemnities associated with September 11, and I thought it might be useful to explain the basic process adopted.

CHAIRMAN—Could you do that fairly rapidly, please?

Mr Clegg—That is not a problem. Once the policy decision had been made, there were a number of procedural steps—which I think the department of finance can probably outline—which required some approval from the Minister for Finance and Administration. A risk assessment was undertaken in conjunction with the issue of those or shortly thereafter. The timing of the issue meant that some of that work had to be done in parallel rather than perhaps the preferred method, which was a risk assessment and then a decision. But, in respect of all the indemnities on which a risk assessment was made, there were four elements recommended in Finance circular 1997/06. They go to a financial limit, a time limit, subrogation so that the Commonwealth can pursue recovery against third parties and termination clauses. The initial indemnities were given for a period of a month. They all have a financial cap, so they meet all the requirements of that.

There is an additional way to manage risk. At the time, the whole reason for the indemnities was that the insurance market withdrew the cover. But as cover progressively came back, we required people to buy that commercial cover. So, while we were covering from a very low level of risk to start with, progressively over a period of 18 months we have moved to having a large offsetting insurance policy in front of the Commonwealth's step-in and payments under the indemnity.

CHAIRMAN—Do you have any current outstanding guarantees or indemnities which are unlimited?

Mr Clegg—In respect of war risk, they are all capped. In respect of other indemnities, I would have to refer you to our chief financial officer, who has the full details of the register.

Mr Chandler—The answer to your question is yes, there are indemnities which are not capped in financial terms. They relate to specific risks. They have been issued in the past without a financial cap because it has not been possible to identify a specific financial limit or for policy reasons it has not been possible to establish a financial limit in relation to a particular risk. For example, in the past in the case of the sale of railways on land that was being taken over by the new owner, the Commonwealth was in the practice of giving indemnities in relation to any costs that subsequently arose out of redressing environmental pollution issues. They indemnified the company that took over the railway and the land it was on. It was not possible in those circumstances to identify a specific financial amount, but it was confined as to purpose.

CHAIRMAN—I hope you do not mind if I disagree with you, Mr Chandler. I would have thought it was entirely possible to specify a limit. As a contractor to both the Commonwealth and the state of Victoria, I rejected any contract that came in our direction that had unlimited guarantees—and the Commonwealth continued to put them out from time to time, as did the state of Victoria. Could DOFA answer the questions regarding this issue?

Mr Staun—In the general sense there is a detailed risk management process within the organisation. We undertook a major one two years ago. It is reviewed annually as part of our audit plan. Also, each business group prepares annual business plans which incorporate a specific risk analysis. In relation to the second question, on specific remote contingencies, warranties and indemnities, clearly the asset sales section of the department which has been formed out of OASITO has given quite a number of warranties and indemnities in the past. These are detailed in our financial statements on page 224 and onwards.

CHAIRMAN—Are any of them unlimited?

Mr Staun—Quite clearly. For instance, an indemnity was given to Ernst and Young to indemnify them against legal costs. There is no cap, as I understand it, on a number of these items.

CHAIRMAN—Have you issued any in the last year or so?

Mr Staun—The answer to that would be yes. I would need to confirm which ones have been issued, however.

CHAIRMAN—No, I mean any indemnities, warranties or guarantees that are uncapped.

Mr Staun—I would have to take that question on notice. In the last 12 months, I am thinking of part of the sale of the Sydney Airports Corporation. I would need to check that.

CHAIRMAN—Can you explain to me why even that would have to be uncapped?

Mr Staun—I would have to consult with the people involved in the asset sales group who undertook that transaction.

Mr Dolan—My understanding was that indemnities in relation to that sale process were capped, but I would have to confirm that.

CHAIRMAN—I would hope so. It is just a personal view—and I cannot speak for the committee—but I do not know of any reason why we could not cap anything. Treasury?

Mrs Welch—I cannot talk about all of the guarantees and indemnities in the department, but I can discuss the ones that I look after. They relate to HIH, to UMP—which I have some knowledge of, as we were involved in putting together the deed of indemnity, but which is now with Health—and to HLIC. The indemnities that relate to HIH relate to a Commonwealth program, and the insurance industry are providing services on a cost recovery basis; they are not providing services to the Commonwealth on a profit basis. Those indemnities relate to covering the subsidiary of the Insurance Council and their employees and agents relating to liabilities that arise from the work they do in relation to the scheme. So this indemnity is somewhat different from indemnities that are given on a commercial contract basis. We do have a comprehensive risk management program and a comprehensive audit program involved with the scheme.

The Housing Loan Insurance Commission represents a guarantee to meet the Commonwealth's liabilities; that is, to meet the liabilities from the old book policies that the Commonwealth wrote. We still have a liability for any claims made under those policies. You are probably quite well aware of the issues around UMP-AMIL, but the legislation that confirmed the guarantee that was given to UMP-AMIL and the provisional liquidator was given royal assent on 2 December 2002; that has been enshrined in legislation now. That related to guaranteeing certain aspects of the UMP-AMIL operations—and I will not go into detail about that because there are quite a few different ones—to ensure that doctors could keep carrying on their businesses.

CHAIRMAN—ANAO?

Mr Cochrane—I will ask Mr Cronin to comment on that, but basically appendix 2 has a listing of all of the relevant indemnities and documents. You will see from that appendix that quite a number of them are unlimited. I have to agree with the comments that have been made that, particularly in the Department of Finance and Administration, a number of those unlimited positions arise from the old OASITO.

Mr Cronin—I would like to comment on just one thing in relation to Sydney airport. Two indemnities were reported to us. One related to indemnifying the board and that was unlimited, but the department of finance did issue a limited indemnity for the potential payment of stamp duty in respect of Sydney airport. That is reported on page 80 of the report. We are reporting \$282 million there.

Senator CONROY—Can I clarify something. Is that the ongoing board or the previous board?

Mr Cronin—It would have been the board that undertook the sale of Sydney airport—that is, the existing board. It is quite common in large asset sales for the boards to seek an indemnification.

CHAIRMAN—Sure, I can understand that.

Senator CONROY—Before Max Moore-Wilton joined the board?

Mr Cronin—It would be in respect of the existing board at the time of the sale.

Senator WATSON—I welcome this audit report on *Management of Commonwealth Guarantees, Warranties, Indemnities and Letters of Comfort*, because as far as I am concerned it does indicate a weakness in terms of parliamentary accountability for all these different instruments. I am grateful that the Audit Office drew attention to the practice in the UK, because my understanding of public accountability in Australia is that we have an inkling of what commitments are made only until the agency reports are issued and given to the parliamentarians, whereas in the UK three steps are required. Firstly, there must be Treasury approval; secondly, it must go before the parliament by way of a minute; and, thirdly, there is then a 14-day waiting period before it can be enforced. While Australia was previously regarded as at the forefront of matters such as public accountability, it is now well behind the eight ball. Mr McPhee and others who are very much up in this area, why have we have allowed a system to develop where we are just so far behind in terms of public accountability? Is it just for historical reasons that we have not got up to date?

Mr McPhee—Our position is slightly different from the UK. I would not necessarily suggest that we are so far behind. Let me explain.

Senator WATSON—From a parliamentary sense.

Mr McPhee—In the budget papers and also in the Mid-Year Economic and Fiscal Outlook, the government sets out a statement of all contingent liabilities greater than \$20 million within the year or \$40 million over the forward estimates period.

Senator WATSON—But that is after it has all happened, isn't it?

Mr McPhee—That is after it has all happened, of course. For instance, the Sydney airport is one—the indemnification of the directors is mentioned there in terms of an unquantified contingent liability. So there is a statement by portfolio of the liabilities that exceed those thresholds, and that is consistent with the Charter of Budget Honesty. Then, as you rightly say, departments in their own agency reports disclose all material contingent liabilities and even remote contingencies in their accounts. So, if you like, we have an approach which captures the full extent of these indemnities and guarantees—

Senator WATSON—Ultimately.

Mr McPhee—Ultimately. We have done some research because we are interested in the issue as well. The UK approach is slightly different and it is arguably a more timely approach, but it is not necessarily as comprehensive, on the face of it, as ours.

Senator WATSON—But what I am saying is that we really should have parliamentary involvement earlier. I am not objecting to what is done. I am suggesting that we should have an earlier step linking the parliament at an earlier date, such as after Treasury has given approval. Then the finance minute has to be tabled in the parliament and, if there is no objection, there are 14 days before it is an enforceable document. I regard that as good public accountability from the parliamentary perspective.

Senator CONROY—Mind you, you are asking a policy question at the end of the day, Senator Watson. I am not trying to defend Mr McPhee and get him out of answering.

Senator WATSON—No, Mr McPhee is very much, in terms of bringing Australian accounting standards and practices into line with world's best practice.

Senator CONROY—Yes, but he is in the department of finance.

Mr McPhee—The Australian government has reported at three different times during the year on these things. The UK model is not necessarily, on the face of it, comprehensive; it also allows outs. I think that sometimes you need to move quickly, obviously, to issue indemnities if the program requirements are such that you cannot wait for two or three weeks to issue the indemnity. The UK model does allow an out and parliament would still be presented with a fait accompli, if that is your concern. From a program—

Senator WATSON—No, our concern is to involve the parliament at an earlier stage.

Mr McPhee—I appreciate that.

Senator CONROY—It is sort of an appropriation, just slightly different. Other appropriations go through first before they can be paid.

Mr McPhee—There are two points. We fully accept the point of view that these instruments need to be controlled. Being the finance department, we are right behind you on that.

Senator CONROY—Back on the job—good to see.

Mr McPhee—But it is just a question of the timeliness of the reporting that seems to be at issue. At the end of the day, if the committee had a strong view on that we would obviously take it into account. The other point that I should make is that, despite these indemnities being given, it is up to the parliament eventually to decide whether the appropriation should be made. Parliament still has a very important role.

Senator CONROY—Are you suggesting parliament would renege on an indemnity that has been given?

Mr McPhee—I am just making the point that the parliament has got an important role and the transactions are both separate.

Senator WATSON—At that stage.

Senator CONROY—They might be both separate—

Senator WATSON—It is a bit unrealistic, Mr McPhee, at that stage.

Senator CONROY—Anyway, I do believe that is a policy question.

Senator WATSON—No, it is a parliamentary question.

Senator CONROY—I think you have covered with Senator Watson most of the issues that I wanted to raise, but I understand that the UK government has an accounting manual which establishes detailed accountability requirements that must be met before guarantees can be issued, including risk appraisal and reporting to parliament, but that there are no such requirements here in Australia.

Mr Cronin—The UK has very detailed requirements spelt out in the UK accounting manual, yes. The Australian one is somewhat different.

Senator CONROY—The UK requirement includes that you have got to obtain treasury approval before you can go down this path?

Mr Cronin—Yes, we can give you an extract of the UK manual. It picks up a whole range of matters, including confidentiality reporting and the role of the chairman of the public accounts committee.

Senator CONROY—Was anyone in the room consulted over the terrorism insurance bill, which I think is before parliament shortly—in terms of the indemnity? Is Treasury drafting that one?

Mrs Welch—Yes, I can take any questions on notice for you.

Senator CONROY—I am interested in whether or not there is any quantification of the terrorism bill. However, I will probably see Treasury tomorrow morning. Are you coming?

Mrs Welch—No, not tomorrow.

Senator CONROY—You do not have to look so relieved. I will take it up with Treasury in the morning.

CHAIRMAN—Is it the wish of the committee that the report *Compliance program 2002-03* presented by the ATO be accepted as evidence to the Auditor-General's Reports Sectional Committee's review into the second and third quarters audit reports 2002-03 and included in the committee's records as an exhibit?

Ms PLIBERSEK—It is.

CHAIRMAN—There being no objection, it is so ordered. Is it the wish of the committee that the document entitled *Summary of key points: UK accounting manual, chapter 26* also be included in the committee's records as an exhibit?

Ms PLIBERSEK—It is.

CHAIRMAN—There being no objection, it is so ordered.

Resolved (on motion by **Ms Plibersek**):

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.

CHAIRMAN—Thank you respondents and witnesses attending this public hearing, my secretariat staff, committee members and, most importantly, Hansard.

Committee adjourned at 3.42 p.m.