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JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Monday, 15 September 2003

Members: Mr Charles (*Chair*), Senators Hogg, Humphries, Lundy, Murray, Scullion and Watson and Mr Ciobo, Mr John Cobb, Mr Georgiou, Ms Grierson, Mr Griffin, Ms Catherine King, Mr Peter King, Ms Plibersek and Mr Somlyay

Senators and members in attendance: Mr Charles, Ms Grierson and Ms Plibersek

Terms of reference for the inquiry:

Review of Auditor-General's reports—Audit Report No. 51, 2002-03.

WITNESSES

BROCKLEHURST, Mr Jon Howard Maxwell, Chief Finance Officer, Defence Housing Authority..... 1

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SMITH, Ms Danielle, Performance Analyst, Performance Audit Services Group, Australian National Audit Office..... 1

THATCHER, Ms Nicola, Director, Performance Audit Services Group, Australian National Audit Office 1

Committee met at 10.47 a.m.

BROCKLEHURST, Mr Jon Howard Maxwell, Chief Finance Officer, Defence Housing Authority

LYON, Mr Keith Thomas, Managing Director, Defence Housing Authority

HENDERSON, Mr Alan, Deputy Secretary, Corporate Services, Department of Defence

MOORE, Mr Ken, Head, National Operations Division, Department of Defence

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

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THATCHER, Ms Nicola, Director, Performance Audit Services Group, Australian National Audit Office

CHAIRMAN—I declare open today's public hearing of the Joint Standing Committee of Public Accounts and Audit. It is the fifth in a series of hearings to examine reports tabled by the Auditor-General in the 2002-03 financial year. This morning we will be taking evidence on Audit Report No. 51, *Defence housing relocation services*.

We will run today's session in a roundtable format. I ask participants to observe strictly a number of procedural rules. First, only members of the committee may put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I would ask them to direct their comments to me, and the committee will decide if it wishes to pursue the matter. It will not be possible for participants directly to respond to each other. Second, given the length of the program, statements and comments by witnesses should be relevant and succinct. Third, I remind witnesses that the hearing today is legal proceedings of the parliament and warrant the same respect as proceedings of the house itself. The giving of false or misleading evidence is a serious matter and may be regarded as a contempt of parliament. The evidence given today will be recorded by Hansard and will attract parliamentary privilege. Finally, I refer any members of the press who are present to the committee's statement about the broadcasting of proceedings. In particular, I draw the media's attention to the need to report fairly and accurately the proceedings of the committee. Copies of this committee statement are available from secretariat staff.

I welcome representatives from the Department of Defence, the Defence Housing Authority and the Australian National Audit Office to today's hearings. Does ANAO have a brief opening statement?

Mr Cochrane—No.

CHAIRMAN—Does DHA have a brief opening statement?

Mr Lyon—We have provided the committee with some additional information. Bearing in mind that DHA was not the focus of the audit, essentially we feel this additional material will provide the committee with a wider view than does what comes through the ANAO report.

CHAIRMAN—Mr Lyon, we have received your information and we have published it. I will stand up for ANAO and say that ANAO has no brief to audit DHA as a GBE. The CAC Act makes that quite clear.

Mr Lyon—We accept that, Mr Chairman.

CHAIRMAN—We have the right to do that, though.

Mr Lyon—We hope the additional material will be of benefit.

CHAIRMAN—We might ask you a few questions about what you have to say in that. Does Defence have an opening statement?

Mr Henderson—Mr Chairman, I would like to make a brief opening statement.

CHAIRMAN—Extremely brief, please, because we would like to ask questions.

Mr Henderson—If it is of that much concern to you, I will skip the opening statement.

CHAIRMAN—Would you like to have it incorporated in *Hansard* as part of today's hearings?

Mr Henderson—I would like to do that.

CHAIRMAN—We would be happy to do that. There being no objection, it is so ordered.

The statement read as follows—

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT.

HEARING ON AUDIT REPORT NO. 51, 2002-2003,

DEFENCE HOUSING AND RELOCATION SERVICES

Opening statement

Thank you, Mr Chairman,

I would like to record that for Defence, providing ADF members with appropriate levels of housing is of the highest importance, in terms of member morale and retention. The quality housing provided by DHA for Defence members with dependents is high.

Defence welcomes the ANAO Report and the incentive it provides for continuous improvement in the management of resources associated with Defence Housing and Relocation Services.

Mr Chairman, as you will be aware, Defence agrees with all five of the ANAO recommendations and is aiming to implement the recommendations by the end of this financial year.

During the course of the audit, Defence began to address some of the deficiencies identified. This work is being undertaken in conjunction with DHA. Some of these new arrangements are now operational.

For example, Defence and DHA have agreed to a revised timeframe for developing the Defence Housing Forecast. This change will bring consideration of housing and related costs more into line with the broader Defence Management Financial Plan.

Further DHA has participated in the development of a proposed revision, to the housing policy that defines the standard of housing provided to members.

Defence has recently completed an internal stocktake of all housing and accommodation issues and has agreed that the Defence Committee, the Department's most senior committee, will have visibility of housing and related costs on a monthly basis.

In addition, DHA has agreed to participate in the new Corporate Services Infrastructure Requirement process. This process enables Defence to systematically take account of infrastructure issues such as sewerage, power and water that are associated with housing developments within overall base design and future usage plans. It ensures that the ongoing budgetary implications of proposed on-base housing developments are fully considered.

We will be working with DHA to further refine our approach on this and other matters. Indeed, DHA has recently provided Heritage Conservation Plans to Defence. Through measures such as this we are already making headway in implementing Recommendation Two of the Report, the completion of outstanding transitional issues.

In closing, I reaffirm Defence's commitment to implementing the audit recommendations, and taking measures beyond this, to manage the delivery of housing and related services with greater efficiency and transparency.

CHAIRMAN—The first thing this committee is concerned about is the fact that, before Defence signed the agreement, its legal advisers expressed strong reservations about the agreement. We would like to know why those legal reservations were not passed on to senior executives in the Department of Defence and/or to the minister; or, if they were, why the agreement was proceeded with.

Mr Henderson—Mr Chairman, perhaps I will make an initial comment on that question. The concerns about the nature of the contract were drawn to the attention of the secretary of the department. I would have to say that, if the details of legal opinions on every contract—albeit a very important contract—that the department signs were provided to the secretary, his in-tray would become even more overloaded than it is at present. In my experience, when the defence secretary leaves the office for half a day, he comes back to a leaning tower of Pisa in his in-tray. So the concerns were summarised in the advice that went to the secretary. He did not choose to seek further advice.

CHAIRMAN—He sought no further advice?

Mr Henderson—That is right.

CHAIRMAN—As we understand it, the legal advisers expressed strong reservation about the issues in the advice that the agreement would not meet Defence's objective of putting arrangements with DHA on a more commercial footing.

Mr Henderson—That is accepted. What I would have said in my opening statement is that it should be noted that we have accepted all the recommendations in this report and we are getting on with those. Some are already implemented, some are under way; and we are aiming to have them all implemented this year. We accept there is room for improvement in the way this contract is managed.

CHAIRMAN—Does the contract itself give you the room to make those changes?

Mr Henderson—We expect it will, with goodwill on either side. One of the issues in relation to this contract that the ANAO report addresses is the question: is this a real contract? For example, would these two parties ever end up in a court of law? Well, I would have the thought the answer to that is probably no—because, in the finish, ministers would pull us into line. When it says 'putting the Commonwealth at risk' under this contract, we have to bear in mind that the Commonwealth owns the other party. So it is a little different. But having said all of that, we are talking about some history which neither my colleague nor I was involved with. But we accept that this agreement, this contract, has to be managed on a more commercial basis.

CHAIRMAN—Mr Henderson, isn't it self-evident that there is a basic conflict of objectives between DHA and Defence in this area? Defence wants housing for its personnel at the most affordable price at the quality that is specified. I suspect that DHA will tell us—certainly, they will have the opportunity to, in a second—that their chief aim is to increase their rate of return.

Mr Henderson—And in achieving that end, I do not see a basic conflict. We are both in the business of trying to provide satisfactory, if not better than satisfactory, housing for the ADF, because it is an important issue in relation to morale and retention, and recent times mean that that is a very high priority for everybody. We are in the business of trying to provide good housing. I would have thought that, in terms of the administrative and management costs of that providing of that house, it is in the interests of Mr Lyon and the Department of Defence to try to do that in the most efficient way possible. I do not see any fundamental conflict in this arrangement. Let us face it, other countries provide this service in-house. The governments of the day decided that it should be provided by a commercial government business enterprise. But we are still in the same business of providing good housing at a low cost, and that is in Mr Lyon's interests as far as I can see—obviously he can speak for himself—and in Defence's interests.

Mr Lyon—I agree with Mr Henderson. The Defence Housing Authority was created in 1988 to fix a major problem then existing, which was all about providing quality housing at a time when the defence budget had lots of other pressures. The defence budget still has lots of other pressures. The fact that DHA is required to operate commercially makes a lot of sense, because of the significant assets involved in performing the function. DHA does not pursue profit in the first instance. What it pursues is ensuring that we provide the right housing in the right place at the right time to support the ADF. That is what we are focused on.

CHAIRMAN—I will follow up on that and then let my colleagues address the issues they want to address. If in meeting those objectives defence's requirement over the short term of one month, two months or whatever is for two-bedroom houses—which come at a standard price, I assume—but DHA supplies houses of 3 bedrooms then that would come at a different standard cost. DHA will certainly be meeting its commercial objectives, but I do not see how on earth it can be meeting Defence's objectives for economical housing.

Mr Lyon—If I can answer it this way—

CHAIRMAN—I do not know if you can, but you may.

Mr Lyon—I will try. The most cost-efficient way of providing housing for Defence is to use private investors' capital; that is, essentially mum and dad investors who dominate the residential housing market. There are no significant institutional players at the present time, because market rents produce yields that are simply not commercial in that sense. If we are required by Mr Henderson of Defence to provide two-bedroom houses that we cannot get out of the marketplace, then we would need to go back to Mr Henderson and say, 'Look, Defence will need to provide the capital and take the capital risk and the vacancy risk that goes with those sort of houses, because we simply can't get them out of the market in the most cost-effective way.' I do not think the two things are in conflict in terms of what we are seeking to do. Indeed, we have been very careful to avoid that. Where it is possible for us to upgrade stock, particularly in regional and remote areas where there is no market, again we do that with Defence's agreement.

CHAIRMAN—Does Audit have a comment?

Mr Cochrane—Just to say that, clearly, paying for a three-bedroom house is going to cost you more than paying for a two-bedroom. So there is a conflict.

CHAIRMAN—Mr Lyon?

Mr Lyon—In most markets that is not the case, because essentially our private investors who buy the houses that we produce for members of the ADF buy from the market. Unless we are talking about places like Sydney, where housing is much more expensive and where basically we are talking about strata townhouse-type developments which we produce for the ADF, the typical house in the market that we can put on the sale-and-leaseback program because of the prospects of capital growth for the investor tends to be about a four-bedroom house. That is typically what you will see if you go into any housing development.

If we come to the point in relation to the sort of houses that the auditor was referring to here, which are A-category houses, they are houses that do not have ensuites or family rooms. The markets stopped producing those sorts of houses quite some time ago. Indeed, the audit report back in 1994 refers to that. We are working with Defence to modernise the housing specifications, which are a Defence responsibility, not DHA's.

CHAIRMAN—Mr Henderson, you heard what Mr Lyon had to say. If this is a situation that goes back over even more than a decade—that is, you are specifying housing that no longer exists—wouldn't that give rise to a skewed audit report?

Mr Henderson—A skewed audit report?

CHAIRMAN—One that is critical that DHA is supplying higher quality housing than is required by Defence's specifications—at least, that is the way I read the audit report.

Mr Henderson—Just to backtrack to the discussion about whether this is a conflict, I do not want to get into a semantics debate but I do not think it is fair to call it a 'conflict'. I think it is a trade-off that has to be made in managing a huge organisation like Defence. I mean, if you doubled my salary, I might be more likely to stay on until I am 65. If you doubled the size of all houses and the salaries for the ADF, you would retain a higher proportion of them. We have to make judgments. If houses are not consistent with, or within cooeee of, community standards, that will be an issue in terms of retention. So there has to be a trade-off here. I would not call it a conflict.

Ms GRIERSON—But the conflict exists because your specifications do not perhaps reflect the reality in the market these days.

Mr Henderson—The classifications are being reviewed right now, and DHA has been involved in that process. My next meeting today is a meeting in the department where we assess recommendations in relation to classifications before they transition up to the government to make a decision on this matter.

Ms GRIERSON—What is the timing for that?

Mr Henderson—The internal Defence processes will take a few weeks, maybe a couple of months. Then it would be in the hands of government ministers.

Ms PLIBERSEK—I want to pursue a little more the issue of the way the contract was written. It is my understanding that the minister's request was for a more commercial sort of contract, but the ANAO seem to think that the contract that you ended up signing is more like a policy document than a commercial contract. You say that it is unlikely that you will end up in court, and that is why a decision was taken not to have what would seem like quite normal things in a commercial contract, such as penalty clauses and so on. I am curious about the reasoning whereby you accept that the government of the day has made a decision to take something out of a department and make it into a GBE, and has told the people responsible for making that transition that they want a commercial arrangement, but then someone in Defence—I accept you were not there at the time—decides that that is not really what the government wants at all and that what they really want is the same arrangement under a different name. They want defence housing to still be part of Defence. That is really what has happened, isn't it? You have the same arrangement under a slightly different name, but it is still treated as if it is part of the defence department.

Mr Henderson—I would have to acknowledge that DHA, being a wholly owned Commonwealth government business enterprise within the portfolio and being on budget—although most of its contributions are to the budget rather than drawing on it—is a bit different from the \$½ billion worth of contracts that my group sign with garrison support contractors or maintenance contractors for the defence estate. In those situations, the taxpayers' dollars are really at stake. They are the taxpayers' dollars or the private sector's.

I would accept that across the spectrum, yes, the DHA situation is a little different. But we are still approaching it—and it is implicit in our acceptance of the recommendations—such that in certain areas it probably needs to be on a more commercial basis. But that will not alter the fact that the Defence Housing Authority is within the portfolio and a wholly owned, on budget, government business enterprise. It is a bit different from Australia Post.

Ms PLIBERSEK—A number of times you have commented that it is a net contributor to the budget, but the biggest savings would be in a reduction in the demand for housing rather than from any fundamental change in the way that the housing stock is managed. It says that there is a 3,500 drop in the number of houses required. Is that right?

Mr Lyon—That is absolutely right, but there are a couple of things I should add. First, very few commercial organisations would have been able to achieve those sorts of reductions, which required a mammoth effort, because it involved negotiations with lessors as well as with ourselves where we own properties. The second thing is that we were able to do that without drawing on the compensation arrangements that exist in the services agreement. In addition to that, there was also a significant reduction in vacancy costs, about which I have given further details in the additional material.

To come back to your first question, I would put a DHA perspective on this. Firstly, the requests from ministers were wider than just a commercial agreement. In fact, I have a letter from ministers, which I could table for the committee if need be. DHA was created in 1998 and it operated until the 2000 without a formal agreement between the defence department and the organisation. Secondly, what ministers were on about was an agreement that specified risk-sharing. They wanted the arrangement to be transparent so that there were the right price signals. Thirdly, they were keen for the arrangement to be based on residential market rent, which by itself does not produce the sort of returns that attract institutional investors.

A key background consideration to the negotiations is the report entitled *The review of the Commonwealth ownership of the Defence Housing Authority* of June 1998, which I did refer the auditors to, which looked at whether or not DHA could be privatised. Attached to this report are two expert reports from two institutional providers: one was Oxley's and the other one was Allens. In considering this agreement, I think you need to take into account all those factors which have led to a situation where the pricing arrangements are quite clear and the risk-sharing arrangements are quite clear. There are even arrangements to terminate DHA, but it is with ministers' agreement, not following a normal standard commercial arrangement.

The reason the DHA board was not keen to go down the track with the draft contract that was put on the table very late in the negotiation process was simply that when you have in broad terms \$4 billion worth of stock under management, with more than half of it owned by private investors, the contractual and legal issues involved in that would have been very difficult to resolve. Indeed, those sorts of things are referred to by the experts in their attached report. This is not a situation where we are talking about a contract for services that are simple to provide. They are quite difficult, particularly in the market environment.

Ms PLIBERSEK—The Audit Office was not looking at how DHA managed its contracts with the private providers, and so I am not really in a position to ask you about that. I will ask one question: in your contracts with private providers, how long is the average lease?

Mr Lyon—Our typical standard sale-and-leaseback product is on what we call a nine-year lease. It is structured in such a way that DHA have options from the eight-year point through to the 14-year point. We do that because we try to manage the properties in such a way that it is our call when to terminate the lease, because we do not want to evict ADF members and families, and no-one knows exactly how long they are going to stay in the property.

We have a range of other leases. They might be short, at three or six years, because our whole philosophy is to direct-lease properties as much as we can. In other words, it is not to invest the Commonwealth's capital into the business. When you look at what DHA is, Defence is, if you like, engaging a contract management specialist in the first instance to provide its housing services.

Ms PLIBERSEK—That is why I ask. You say the reason you did not want a particularly legalistic contract is that you have all these other contracts with all these other people that you have to manage. But, surely, when you are signing contracts with commercial investors down the track, it would not be such a difficult feature to write into those future contracts any contractual arrangements or obligations that you have entered into with Defence. Presumably, if you had a contract with Defence that reflected a more commercial business relationship between the two of you, then you would just rewrite the contracts that you have with new private investors down the track. Do you understand what I am saying?

Mr Lyon—We would try to, but let me tease this out a bit. What the Defence lawyers actually presented us with was a set of arrangements whereby the contract could be terminated in—how many days notice?

Mr Brocklehurst—Ten days notice.

Mr Lyon—There is no way in the world that anyone could write a contract with private investors involving those sorts of terms. Secondly, the whole flavour of the contract that was put on the table—

CHAIRMAN—You could write it but you might not get anybody to sign it.

Mr Lyon—We accept that.

Ms PLIBERSEK—But isn't that the point, as well? You can go back to Defence and say, 'This is ridiculous. We cannot run a business like this. If you want us to run a business, we have to have three months notice,' or whatever the thing is. Then you write a commercial contract that says that that is what you need.

Mr Lyon—But it gets back to the whole purpose of the agreement. Bear in mind that this was an agreement that was structured on a partnering basis in the context that there had not been an agreement operating before and in the context where the two parties agreed right at the very front that we would be reviewing the defence housing classification system—and in addition to that, it was envisaged that DHA would seek also to provide one-stop shop services involving tenancy management functions, which we did not have at that time—as well as the relocation arrangements. Both the defence department and DHA saw possibilities in all of those things for very significant program savings for Defence. I think we all need to take into account that

context. The other element in all of this is that the agreement provides for a major review point after five years of operation, by which time both parties will have significant experience in terms of what the costs are and what issues come out of it.

Ms PLIBERSEK—Just on that, on page 60 of the Audit Office report, there are a number of outstanding issues listed, including housing management instructions, continuous improvement program, key performance indicators, terms of reference for the management committees, capital inclusions charge, property register, rent bill processes, allocations contract, heritage properties, and review of deemed effective markets. I notice that all, except for the last two issues, were due to be completed within three months of the services agreement being signed. More than two years later, there is no progress or little progress on a number of those. Can either of you explain that, Defence or DHA?

Mr Henderson—Clearly the delays involved are not acceptable. In terms of getting on with the job now, if you want some detail on the progress that has been made on some of them—

Ms PLIBERSEK—Has there been progress since the Audit Office report?

Mr Henderson—Even before the report was finalised, but it was probably spurred on by the audit process. Mr Moore can give you a bit of detail on some of the particularities.

Mr Moore—Mr Chairman, we are addressing each of the issues that were highlighted in the audit report. The first thing we have done inside Defence is to look at our management framework that we have in place for the services agreement and to highlighting any deficiencies in that framework that come through the audit report. I am currently waiting for key stakeholders in Defence to sign off on that proposed framework. Once I have that, hopefully within the next few weeks, we propose going to the Defence Housing Authority to address the fundamentals that are in the audit report, if you like, and how we can work within the current agreement to fix the findings.

On some of the specific issues, the key performance indicators are probably the priority for us. The action has been on Defence for some time. We had a set proposed by DHA and we expect them to go through our committee processes within the next month or two, in consultation with DHA. We have initiated a review of the deemed defective markets. We are hopeful of engaging an independent authority, someone like the Australian Valuation Office, to have a look at those markets, such as Canberra, Brisbane and Adelaide, that we have agreed are deemed defective where we, Defence, incur a charge on top of the market rent because of the state of the capital market in those particular locations. DHA is now providing us with the property register on a six-monthly basis. One issue that we really have not yet tackled with DHA is the continuous improvement program. We are yet to engage with them on how we can reduce Defence's costs in the provision of housing.

Ms PLIBERSEK—Going back to the property register, you are being provided with one every six months; are you checking it?

Mr Moore—Yes.

Ms PLIBERSEK—So detailed classifications of the stock are being agreed to on that register?

Mr Moore—Yes.

Mr Henderson—We will be providing DHA with feedback on that in October.

Mr Moore—One other item I would like to mention is the housing management instructions. We see the HMIs as the best way of defining our respective responsibilities and liabilities under the agreement. It is the thing that we really want to push the hardest. There is not the clarity in the agreement now re what we are liable for compared with what DHA is liable for. Housing management instructions as a term probably does not convey the full meaning of what we are trying to get out of that. It is a set of agreed definitions and responsibilities so that we in Defence fully know what we are up for on the rent bill.

Ms PLIBERSEK—Wouldn't it would be more usual in the writing of a contract to agree on these things before the signing of the contract?

Mr Moore—Yes.

Ms PLIBERSEK—Do you think it is an oversight in the contract that you signed?

Mr Lyon—A lot of these things simply were not really known in a way for which anyone could write a contract at that particular time. That is why the review mechanisms are articulated in the agreement. When these things were done back in 2000, there simply was not the recordkeeping and there was split administration. You were talking about a different type of organisation with a totally different situation from what we have now. We now have good records in each of these areas, so that one can make judgments about where the real risk is and what to do with it.

Ms PLIBERSEK—Okay. I am sorry; I think you were still going through the list of issues when I interrupted you.

Mr Moore—I think I had finished.

Ms PLIBERSEK—Do the Audit Office want to make any comment about the list?

Mr Cochrane—Just to say that we didn't look at the state of things at 2000. I mean, physically we were not there.

Ms PLIBERSEK—But would you agree, Warren, that it is difficult to write those sorts of things into the contract if the information isn't available?

Mr Cochrane—Yes, it can be, if your management information systems are not giving you the right data. But clearly, in a policy environment where ministers were expecting things to have commercial disciplines around them, you do need things like key performance indicators, property registers and all these things before you can make those commercial disciplines work.

Ms PLIBERSEK—Just following on from this, after the services agreement was signed in August 2000, Defence began developing a contract management strategy with overarching principles to govern the relationship with DHA. The strategy was not completed nor implemented. It seems extraordinary to me that Defence are getting rent bills and you have no way of checking when people are moving in and out: you get the bill and you pay it. Is that essentially what is happening?

Mr Moore—We do have a bill verification process, but it is fair to say that Defence does rely on the database maintained by DHA to a large extent. The property register is there to make sure we are only paying for houses that we are supposed to be. But there is a verification process, as is required under the FMA Act, that we go through when we are presented with data by DHA; we use that to verify before we pay.

Mr Lyon—If I can just add to that: when this arrangement was set up, from DHA's credibility point of view, accurate billing was identified by me and the board as being a significant issue. The process we have followed is that we have agreed terms of reference between Defence and DHA for our independent internal auditors to validate the billing arrangements. It is reasonable for Defence to look at DHA's quality assurance arrangements in determining what steps it needs to independently take in validating things like billing. Indeed, the audit report itself—given the nature of this operation, with 17,000 homes and huge numbers of movements in and out each year—did not really finger any particular issue. It made comments on process rather than on outcomes.

CHAIRMAN—Do you have a comment, Mr Cochrane?

Mr Cochrane—Where we have any sort of arrangement where the Commonwealth is spending money, Chairman, we would look to see whether the requirements of the FMA Act can be met; in other words, the department has to satisfy itself that it is valid expenditure and is reasonably accurate and correct, and so forth. That does not mean to say that there cannot be procedures that are uniquely designed between the two entities to satisfy that goal. But what we wanted to see when we were auditing the department was that the department had that rationalised in its own mind and could be confident that the money and the billing were accurate.

Ms PLIBERSEK—The report says in paragraph 5.11 that some Defence staff also considered that the proposed charges were high and that some involved paying twice for a service. However, these new charges were accepted because Defence was being fully supplemented for the additional moneys. Would that be your understanding of what happened at the time of the writing of the contract?

Mr Henderson—I cannot comment on the situation at the time the contract was written. I am not sure whether my colleague has anything to add on that. It may be evident to you that Mr Lyon was around in this situation when the contract was written, but I was not. So, off the top of my head, I cannot provide you with an answer to that.

CHAIRMAN—Mr Moore?

Mr Moore—Mr Chairman, I was not around either.

Ms PLIBERSEK—This is actually standard, whenever we have anyone from Defence appear.

Ms GRIERSON—Retention rates are a problem!

Ms PLIBERSEK—Yes. I know. If we improve your housing, will you hang around for a bit longer?

CHAIRMAN—I have to say that we still have a couple of the original characters on Collins class hanging around and coming back to see us from time to time.

Mr Henderson—I am prepared to take the question on notice. I am not trying to duck ever providing you with an answer.

Ms PLIBERSEK—I understand that. It is just frustrating from the point of view of the committee that, whenever we hear of something that does not quite stack up in Defence, we are sent people who were not around at the time of the writing of the contract, who agree that it was perhaps not written in the best possible way, that it would never happen again and who say, 'We are taking all measures to fix it.' And then there is another change of personnel.

Mr Moore—I can provide some specific comments on that paragraph.

Mr Lyon—I cannot see into the minds of the Defence people who made that observation but I can mention to the committee that the residential market rent is the primary basis. There is a stack of evidence showing there is no cheaper way to do that. The other fees and charges all had independent reports which were all made available to Defence as part of the arrangements. It is just a pity that the people involved, from the Defence point of view, were not around to maybe take the auditors through that sort of background.

Ms PLIBERSEK—Did the Audit Office want to make a comment on that?

Mr Cochrane—Clearly, the idea of reporting on 5.11 was to note the cultural aspects of the need to actually check what you are paying for rather than an overreliance on the other party.

Ms PLIBERSEK—The report notes that Defence has no available data on the total cost of housing and relocation assistance over recent years. You mentioned that recordkeeping is much better now than it was when the contracts were being negotiated. Is it still not possible to give us a global budget?

Mr Henderson—That matter is being addressed. There are now comprehensive figures and they are given monthly visibility to the Defence Committee, which is the highest internal committee within the organisation. That does not mean to say that we might not want to refine that data, but that has been addressed.

Ms PLIBERSEK—Is that because you have this new whizzbang computer—you know the thing they demonstrated to us?

CHAIR—We were shown the PowerPoint presentation. What was it called?

Ms PLIBERSEK—‘Boris’!—Is that because you have ‘Boris’ now?

Mr Moore—Part of the problem we have had in Defence is to try to capture the total housing and accommodation cost. What DHA does for us is provide housing for members with dependants, which is only half the ADF. The other half are members without dependants, a lot of whom live on bases in what we call living-in accommodation. Our real problem has been getting proper records on not only the DHA costs but, adding to that, what our real costs are for providing an accommodation solution for every member of the ADF who does not own his or her own house. That is where our problem is. The ‘Boris’ that was demonstrated to you is the budget tool or front end to our SAP based financial system. The application is not just for housing accommodation; it is for all sorts of different resource input costs.

Ms PLIBERSEK—Yes, but it is going to help you in your area.

Mr Moore—Yes, it will help. Apart from all that, we have now centralised the responsibility for all housing and accommodation issues, in a service delivery sense, in under Mr Henderson, with our personnel executive just concentrating on the policy issues.

Ms PLIBERSEK—I do have more questions but I am conscious that Ms Grierson might have some.

Ms GRIERSON—Thanks. I guess what is important to us as a committee is that Defence Housing Authority is a significant player in the housing market. A development will be attractive to private investors if they know it has a guaranteed take-out by the Defence Housing Authority. So we do know it has a great deal of impact on the commercial market. Therefore, it has a way of operating that has become commercially built into the housing market and it is also servicing the needs of the defence personnel in terms of housing. I am going to accept that modelling suggests that is a good way of operating and that it is a very attractive way for the government to reduce capital expenditure and perform the services it wants.

The problem for us is that, at a time when it is so important that defence budgets, contracts and arrangements are managed efficiently because of the times we live in, what we are seeing is the Defence Housing Authority perhaps operating in a way that does not reflect the management agreements and the contract agreements. Whereas Defence has the responsibility for knowing its asset base, its management structures, its relationship in every dimension with the Defence Housing Authority so it can then test whether it is getting value for money, we are seeing the lack of that framework first being put in place correctly and then being monitored. I guess that is a major concern for us.

The concern is not that our defence personnel are being looked after—every one of us in the committee would want that. We would accept that defence housing is the most important thing to families and individuals in the Defence Force and we would want that to continue. But we do want to know we are getting the most efficient use of our moneys in defence, so that it is available for other operations. I guess the concern is that the audit report clearly says that those contractual arrangements have not been written in a way that the auditors can look at and see exactly what is happening. Defence, are you satisfied that we will see that happen very rapidly and that therefore we can have confidence that that relationship is correct and is being managed well?

Mr Henderson—We have accepted all the recommendations and we are aiming to have them all implemented within this financial year.

Ms GRIERSON—Do you accept that you cannot rely on the good will of the Defence Housing Authority to just keep taking the responsibility they do—because the report suggests that they take more responsibility than they should be doing under the contract—and that therefore you have to have some of that responsibility well demonstrated within your own management procedures; for example, the number of stock and the total cost of housing and relocation assistance—data that you really should be relying on?

Mr Henderson—I am not quite sure what the specific issue is.

Ms GRIERSON—My impression is that the Defence Housing Authority is actually probably exceeding their role in terms of being the one who is, hopefully, managing the procedures, the contracts and the economic imperatives, rather than Defence having those under its belt, and therefore just looking at how that client service is operating.

Mr Henderson—The auditor had that impression. That is stated. He has given us five recommendations, presumably to address that and other matters, and we are getting on with the job of implementing them.

Ms GRIERSON—The Audit Office also had concerns that the board structure of the Defence Housing Authority perhaps did not reflect its movement to becoming a government business enterprise. Could the three groups comment on that? I would like comments from each group on that particular situation, starting with the Audit Office.

Mr Cochrane—We looked at this as being a situation where the DHA Act had been set up in 1987, some five years prior to the DHA becoming a GBE. We also looked at it in the context of the governance arrangements for GBEs, which indicated that normally it would be an exceptional situation that you would have a Defence representative on the DHA board, given the possible conflict between commercial objectives and Defence's objectives—let alone five representatives on the board. What we are really saying in the report is that, given that the DHA Act is up for review, it was time to reconsider the composition of the board to see whether the balance could be perhaps more aligned to the government's own governance arrangements for GBEs.

Ms GRIERSON—DHA, is the board aware of that difference—even though you do not have the power to change the act—to make the board more reflective of the new responsibilities that it has? How have you made sure that perhaps there is not that conflict of interest?

Mr Lyon—Firstly, the board does have proposals to amend the act, as the ANAO referred to—and that does include the restructuring the composition of the board. The view of the present board of the DHA, which was confirmed just recently, is that they believe there is some benefit in having ADF members on the board. The board has in place arrangements to deal with either potential or real director conflict of interest—because it is not just on the Defence side where there could be conflict; we have commercial directors as well.

Ms GRIERSON—Yes; commercial.

Mr Lyon—So those arrangements are in place. The board referred me to the second reading speech back on 30 April 1987, which stated:

The Authority is to be independent of the Department of Defence. It must however ensure that its activities are fully supportive of Defence Force operational needs. Its planning must be consistent with Defence planning.

Then it goes on to mount the case for the present composition of the board. The board believes that, at the end of the day, this not a decision for it; it is obviously a matter for government. But if it were to be comprised entirely of commercial directors, the board would recommend that there be established some formal advisory arrangements to facilitate the board having a direct interface with the key players—because at the end of the day it is not profit but the quality of the housing service that is the key issue. And, of course, all of us want that to be done at the best possible price.

Ms GRIERSON—And I think that that has been recognised in that you are not corporatised or privatised; you are an arm of the Commonwealth government and Defence, and that has been seen as proper. Would you put forward any recommendations regarding any change in composition of the board?

Mr Henderson—In relation to that recommendation, it is a bit different from the others. With the other four, without refreshing my memory of the detail of each, it is fair to say they are basically my and Mr Lyon's responsibility to get cracking and act on them—in my case, that is in consultation with a number of other people in Defence. In relation to the DHA board membership, the department will be providing advice to the shareholder minister, Danna Vale, but I am not in a position to canvass here what that advice might be.

Ms GRIERSON—Okay, thank you.

Mr Henderson—That is clearly one for the government to decide on, as Mr Lyon has said—whereas it is fair to say the ball is in my court in relation to the other recommendations.

CHAIRMAN—I would like to ask a follow-up question of Mr Lyon: are you confident that you meet the requirements of the CAC Act?

Mr Lyon—Yes.

Ms PLIBERSEK—The agreement's provisions for managing vacant housing are not being implemented as Defence intended. Defence records indicate that dead rent cost about \$20 million in 2001-02. Can you tell us what you are doing to manage the dead rent figure?

Mr Lyon—This is one of those areas we have put a huge amount of effort into. While the performance targets have not been formalised by Defence, we are working and reporting to targets—

Ms PLIBERSEK—Informal targets.

Mr Lyon—Yes, but they are real targets in the sense that I am held accountable for them by the board. As a result, we have reduced vacancy costs—notwithstanding that 3,500 reduction,

which is a huge reduction in coming back to 17,000 houses—with savings which have all been fully passed on to Defence. In terms of the objectives, I was really surprised to read what the Auditor-General has said. One of the aims agreed between us and Defence was to reduce the amount of dead rent, but it was never—

Ms PLIBERSEK—If I can take you back, do we have an idea of what dead rental—

Mr Lyon—Yes.

Ms PLIBERSEK—So you went from a figure that you knew to a figure that you knew.

Mr Lyon—Yes, that is right.

Ms PLIBERSEK—This wasn't one of the areas where you had difficult recordkeeping?

Mr Lyon—No.

Mr Brocklehurst—The recordkeeping we have is from the time when we assumed responsibility for the allocations function, which in essence gives you the ability to manage the vacancies, and our records date back to 1999. We started doing the function in 2000.

Ms PLIBERSEK—What was the figure in 1999?

Mr Brocklehurst—It is in the papers that we provided. It is on page 13 of the submission that DHA made. Back in 1999, the average number of vacant houses was close to 2,000 and we are operating now with about 1,300 to 1,400. So the value of that reduction in the number of vacant houses is the \$7 million that we talked about.

Ms PLIBERSEK—What would they be as a proportion of the available stock?

Mr Lyon—Firstly, we have 17,000 houses on the rent bill.

Ms PLIBERSEK—You do at the moment?

Mr Lyon—At the moment, it is in that sort of order. Secondly, the effective vacancy risk—and bear in mind that we need to make certain we have houses available for the peak posting period—is given on the next page, where you can see that we are operating at between two per cent and three per cent.

CHAIRMAN—That is 12 per cent of your stock.

Mr Lyon—Twelve per cent of the stock, in that sort of terminology.

CHAIRMAN—1,421 is 12 per cent of 17,000.

Mr Lyon—We are operating in an environment where a defence member—this is what was explained in the next paragraph—can buy their own house and move out with almost no notice

at all. We have this policy of either disposing of the stock or putting civilian tenants in it as quickly as possible. Indeed, we have substantial numbers of civilian tenants now in our stock as a means to deal with vacancies.

Ms PLIBERSEK—How quickly are you are getting people—any tenants?

Mr Lyon—In terms of turnover between stock that is being maintained, we are averaging about 30 days at the present time. Compared with overseas experience in the only places we can get a handle on for comparison, that is a lot better. It is substantially less than the British experience and substantially less than others.

Ms PLIBERSEK—So in 2001-02 dead rent was about \$20 million, and you say that the annualised effect of the reductions that you have achieved is about \$7 million. Is that right?

Mr Lyon—Yes.

Ms PLIBERSEK—There was a plan to have a cost reduction program?

Mr Lyon—Yes. That is one area we have focused a lot of attention on. Another area since DHA has taken over responsibility for relocations has been to put in place arrangements whereby members preselect their house before they move, which means their furniture and furnishings can move from door to door.

Ms PLIBERSEK—It can go straight there.

Mr Lyon—That has also resulted in substantial savings. They have been the two key areas in terms of cost reductions.

Ms PLIBERSEK—Have you formalised that cost reduction plan now? Do you have a supporting document?

Mr Lyon—Internally we do.

Ms PLIBERSEK—Is that something that is agreed to between DHA and Defence, or is that something that you have created for your internal management?

Mr Lyon—We will report on vacancies and all the rest of it, but the benefit of the cost reduction program comes back to the government—because we are working to a pricing structure and arrangements that are set in the services agreement.

Ms PLIBERSEK—Did the Audit Office have a comment on that?

Mr Cochrane—We have not seen the DHA extra submissions but we were focusing on where Defence could answer the questions.

Ms PLIBERSEK—Defence, have you made any effort to negotiate with the DHA on this cost reduction program? Is that something you would be interested in doing? Would you see that as part of your contract management responsibilities here?

Mr Henderson—To minimise the costs? Sure.

Ms PLIBERSEK—To negotiate with DHA about what would make up a cost reduction program, if they are going to have one.

Mr Henderson—If there are ways in which we can assist that process, yes, we would.

Ms PLIBERSEK—Defence, I was interested when you said earlier that you were going to have a discussion later today about looking at the classifications and seeing whether it may be appropriate to change the description of each classification because of changes in community standards of housing. Paragraph 4.78 of the Audit Office report states that DHA is driving up Defence's costs by disposing of the lowest category of housing and replacing it with higher classification houses. It seems from what you are saying that that is acceptable because you expect there will be a change in the classifications soon anyway. You do not have a problem with that, because the lower classification houses are probably on their way out from a policy perspective. Is that what you are saying?

Mr Henderson—Yes.

Ms PLIBERSEK—So that is something that you would not be concerned about in terms of increased costs, because you accept that you are on your way there anyway.

Mr Henderson—We accept that the lowest classifications under the old classification, still the existing one—

Ms PLIBERSEK—The current classification, yes.

Mr Henderson—are not consistent with community standards. The issue is: where do you draw the new line?

Ms PLIBERSEK—Yes. When do you expect that those new classifications would be finalised?

Mr Henderson—There are questions about when the department is in a position to put a final position to ministers to consider. Those are processes that I envisage would be happening before Christmas. Then there is the question of at what point do you—

Ms PLIBERSEK—When will you get a response?

Mr Henderson—No, not at all; when can you implement these issues. There are quite a few implementation challenges involved there.

Mr Lyon—I would add two things. Firstly, the rent bill has been coming down significantly. This is not an area in terms of DHA's arrangements where there has been a blow-out. There has been a substantial reduction in costs to Defence, which I mention in my report. Secondly, notwithstanding the progressive upgrading of houses, the average annual cost increase has been 2.5 per cent in recent years, which is well below the CPI.

Ms PLIBERSEK—The average increase in the cost of rental, did you say?

Mr Lyon—The average increase in cost per house supplied by DHA has been 2.5 per cent.

Ms PLIBERSEK—But we still go back to the fact that the cost reductions are mainly because you have required less housing stock.

Mr Lyon—There are both those elements, and each of them is important. You have to have a benchmark to compare whether this area is efficient compared with another. If you compare what has been happening with average rents in DHA, notwithstanding the fact that stocks continue to be improved, it has been less than what departments have had to pay by way of increases in rental ceilings. Coinciding with this is that we have phased out a lot of leases, which we call pre-1996 leases, which were more expensive. Those leases were the sorts of things that had to be entered into at the time because DHA did not have the sort of market situation it now has.

Ms PLIBERSEK—Just one final question: recommendation No. 5 of the audit report goes to invoices. It reads:

The ANAO recommends that, to improve processes for payment of DHA's monthly invoices, Defence:

(a) adjust, in consultation with DHA, the rent bill format to facilitate checking of particulars in the bill; and

(b) develop a system to validate invoices appropriately, including the addition or removal of properties from the rent bill, to ensure timely action in accordance with the agreed housing forecast and corresponding Provisioning Schedule.

Can you tell me a little about the implementation of recommendation No. 5?

Mr Moore—Mr Chairman, as Mr Henderson said, we have accepted this recommendation and we plan on working with DHA to ensure that this happens. One thing that we do not know at this stage is the extent of information technology changes that are required within DHA—and that is something Mr Lyon might like to comment on. I am unable right now to give you a definitive date on which we can fully implement this recommendation.

Mr Lyon—Obviously we are happy to provide Defence with whatever information they need. It is just a question of them defining it, and we will look at how best we can provide it.

Ms PLIBERSEK—What form it comes in.

Mr Lyon—And that is consistent with our whole approach. There would be some costs. If you picked up some of the comments in the Auditor-General's report, I think there is a reference to a weekly review at one point. That is way above what is provided in industry, either commercially or in the residential market. Notwithstanding that, we are well and truly happy to do what we can.

Ms PLIBERSEK—Thank you.

Ms GRIERSON—If cost control is going to be important, the ANAO report found that the proposed pricing structure referred to the quality maintenance fee. They considered that this was a double fee, because you are already being given that. I am referring to paragraph 5.9 on page 86 of the report.

Mr Lyon—I would make this comment. The maintenance standards that DHA provides are well above what is provided in the industry. That, again, is referred to in the back of this 1998 report. Secondly, the reason for this is particularly true now, but it has always been true: the ADF is on a very high level of operational readiness and, quite often, the partner is left by themselves away from the extended family. So our maintenance services include a 24-hour helpline, which no-one else provides. It also provides for booking contractors to turn up at agreed times.

Ms GRIERSON—Are you saying that the market just does not provide that sort of service?

Mr Lyon—No, it does not.

Ms GRIERSON—Then surely you can impact on that in other ways. You are already being charged by the market a maintenance fee being built into the rents—

Mr Lyon—No, we are not; and that is what this independent report says, which is at the back of the 1998 report. I will pull out the references for you. It says that DHA is providing a service standard required by Defence for very good reasons, to support the ADF and their families. That is what ministers were keen to get in terms of a transparent pricing regime, because it is a service level that is higher.

Ms GRIERSON—Then I would expect you to be getting a lower rental set from the commercial sector if you are taking on that extra service provision of the maintenance to a higher standard. Do you think that is true that you have negotiated lower rental payments to the commercial sector?

Mr Lyon—Sorry; lower?

Ms GRIERSON—If you are renting a property from a commercial provider and their rent fee is including a maintenance fee, which most commercial rents do, and you are also providing an additional maintenance service or a 24-hour response line and contractors, et cetera, shouldn't you be getting a reduction in that commercial arrangement?

Mr Lyon—No, it does not work that way at all. What we are doing is providing a higher standard of service which has higher costs with it. In an agreement, which ministers requested from us to put it onto a transparent basis so that the costs were visible to all the parties concerned, it is only right and proper that that additional cost be identified, which it was independently, and that it be charged for.

Ms GRIERSON—I would imagine the commercial sector is quite pleased about that.

Mr Lyon—In the residential market, if you are a tenant of a house and you have a maintenance problem, you certainly do not get the sort of service that we provide.

Ms GRIERSON—No, obviously. And if you are providing an extra service, then I would have thought it might be a good negotiating point for some commercial savings.

Mr Lyon—Sorry; that is not it at all.

Ms GRIERSON—Do you think that is an unrealistic expectation?

Mr Lyon—Yes.

Ms GRIERSON—I am not sure about it. I would like ANAO to comment on the use of supplementary funding and whether you feel that has been adequately addressed.

Ms Thatcher—When we were looking at the audit, we were talking to the department about supplementary funding. At the time, they were still working out exactly how to record the reporting of the amounts of supplementary funding. That supplementary funding was to cover the costs that arose as a result of the additional charges within the services agreement. The reporting on it was being finalised at the time.

Ms GRIERSON—You are satisfied that it has been passed on correctly?

Ms Thatcher—It was still being finalised at the time as to how they would report on it. That is my understanding.

Ms GRIERSON—Thank you; that is fine.

CHAIRMAN—Mr Brocklehurst, in your supplementary letter to us, you say that DHA has been able to make very large special dividend and capital returns to Government—\$957 million paid in the past two years, and with a total of \$1.4 billion ‘to be paid’. What does that mean?

Mr Brocklehurst—We are also planning to make further payments during the next—

CHAIRMAN—What period of time?

Mr Brocklehurst—three years. We have a three-year corporate plan cycle.

CHAIRMAN—You go on to say that, based on DHA’s knowledge of the market, the cost of providing housing by Defence and the government would be substantially more expensive—‘perhaps as much as 40 per cent higher than if DHA did not exist’. Is that an subjective or an objective comment?

Mr Lyon—We have drawn on material, again, that is published in the back of this 1998 report. There have been several reviews looking at the most efficient way of providing assets. Obviously there is a judgment there: until one went to the marketplace, depending on how the contract was written, you would never know. This has been looked at continuously since 1998.

CHAIRMAN—Well, that was 1998, and this is coming to the end of 2003.

Mr Lyon—The biggest thing that has happened in the marketplace between 1998 and now is that residential housing yields have actually dropped. Valuations have gone up. In terms of our own portfolios, compared with when we wrote the services agreement, they have fallen a full percentage point; so the market has got tougher not easier.

CHAIRMAN—I would like to make a brief statement and then I have one final question for both of you. First, the brief statement: Mr Lyon, when I read your submission to us, I thought you were being overly defensive about the ANAO report. May I say to you for whatever it is worth that this committee views Audit as adding value. We also happen to think that we add value. It has been our experience that those who accept Audit recommendations and get on with implementing them, rather than complaining about something they might or might not have left out, have better performance as result of adopting those procedures.

Now, because of a couple of occurrences in the week before last, I should ask both of you if there is anything that you have not told this committee on this topic but should have.

Mr Henderson—Reflecting on the things that you are referring to that were omitted, I cannot think of any surprises that we have left out of the story, Mr Chairman.

Mr Lyon—Nor can I.

CHAIRMAN—Does Audit have any final comment?

Mr Cochrane—No, Mr Chairman.

CHAIRMAN—Is there something you want to give us as a supplementary submission?

Mr Lyon—Yes; if the committee would like this report, it was published.

CHAIRMAN—Is it the wish of the committee to accept the report entitled *The review of the Commonwealth ownership of the Defence Housing Authority, June 1998* as evidence to this inquiry? 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—I thank the officials who appeared at these hearings. I thank my colleagues, I thank the secretariat—and, last but not least, God bless Hansard! I declare this public hearing closed.

Committee adjourned at 12.03 p.m.