COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Reference: Review of Auditor-General's reports tabled between 18 January and 18 April 2005

MONDAY, 5 SEPTEMBER 2005

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://parlinfoweb.aph.gov.au

JOINT COMMITTEE OF PUBLIC ACCOUNTS AND AUDIT

Monday, 5 September 2005

Members: Mr Baldwin *(Chair)*, Ms Grierson *(Deputy Chair)*, Senators Hogg, Humphries, Moore, Murray, Nash and Watson and Mrs Bronwyn Bishop, Mr Broadbent, Ms Burke, Miss Jackie Kelly, Ms King, Mr Laming, Mr Tanner and Mr Ticehurst

Senators and members in attendance: Senators Hogg, Moore and Watson and Mr Baldwin, Mr Broadbent, Ms Grierson, Miss Jackie Kelly, Mr Laming, Mr Tanner and Mr Ticehurst

Terms of reference for the inquiry:

To inquire into and report on:

Review of Audit reports Nos 22 and 42

WITNESSES

Committee met at 10.02 am

BOYD, Mr Brian, Executive Director, Performance Audit Services, Australian National Audit Office

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

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

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

HUTSON, Mr Jonathan, Acting General Manager, Financial Management Group, Department of Finance and Administration

PENNIALL, Mr Wayne, General Manager, Defence Service Homes Insurance Scheme and Branch Head, Aged and Community Care, Department of Veterans' Affairs

WALSH, Mr Dermot Gerard, National Manager, Defence Service Homes Insurance Scheme, Department of Veterans' Affairs

FILEMAN, Mr Michael Charles, Director, Financial Management and Reporting, Department of Immigration and Multicultural and Indigenous Affairs

FLAVEL, Mr Matthew James, Manager, Budget Policy Division, Department of the Treasury

CHAIR (Mr Baldwin)—I open today's public hearing, which examines two reports tabled by the Auditor-General in the financial year 2004-05. First, we will be taking evidence on Audit report No. 22 2004-05: *Investment of public funds*. Later today, we will be taking evidence on Audit report No. 42 2004-05: *Commonwealth debt management: follow-up audit*.

I welcome representatives from the Australian National Audit Office, the Department of Finance and Administration, the Department of the Treasury, the Department of Veterans' Affairs and the Department of Immigration and Multicultural and Indigenous Affairs to this morning's hearing. I ask all participants to remember that only members of the committee can put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I would ask them to direct comments to the committee. It will not be possible for participants to directly respond to each other.

Given the short time available today, I ask that statements and comments by witnesses should be relevant and succinct. I remind witnesses that the hearing today is a legal proceeding 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 a contempt of parliament. The evidence given today will be recorded by Hansard and will attract parliamentary privilege. Do representatives of organisations present wish to make brief opening statements before we proceed to questions?

Mr Cochrane—We are happy to let the report speak for itself.

Mr Hutson—We are fine, thank you.

Mr Flavel—I have no statement.

Mr Fileman—I have no statement, thank you.

Mr Penniall—We have no statement.

CHAIR—Thank you for coming today. The committee has some concerns. We have had a briefing from the Audit Office. The concerns are about direct compliance with the acts as laid down. We have been briefed that some $20.208 billion of investments amongst the agencies has not been invested by the correct means, nor has it been invested to attract the best possible financial return to the Commonwealth. Also concerning is the risk association with those investments in that triple B investments have been placed at times, rather than ascertaining a risk profile and investing in that direction. The members of the committee have some very serious concerns. I will open straight up to members of the committee for questions.

Ms GRIERSON—DVA, I note that your investments were in a trust that had next day access. Why was that the case? Was it so that you could access it even though you did not need to; you had a covenant on it that allowed next day access to those funds, which meant they always had to be available? It seems that that attracted a lesser return for DVA. Why was next day access important?

Mr Penniall—Funds were invested in both the trust fund and an on call account. The reason for this was to ensure quick emergency access, if needed, in terms of any major insurance catastrophes or payouts that were required. Following this audit, we reviewed the on call account, realised that we did not need it and have closed that account.

Ms GRIERSON—What sort of catastrophe would DVA expect? What sort of catastrophe would you have put into your risk management?

Mr Penniall—What sort of catastrophe?

Ms GRIERSON—You said that you may have needed to call on those funds in the case of a catastrophe. That implies that it was a considered risk and therefore you had set it up in that way for that reason.

Mr Penniall—The funds were invested for an insurance account. If there was a major incident such as a major storm, earthquake, bushfire et cetera and some of the clients needed emergency access to funds for relocations or other expenses then we needed to access that money quickly.

Ms GRIERSON—The findings from the Audit Office suggest to me that there were not procedures in place for the reasoning behind your investment strategy. Was there an investment strategy in place?

Mr Walsh—There was an investment strategy, which was established back in 1995. That investment strategy, rightly or wrongly, has not been reviewed throughout that time. We are looking at that now and updating our investment strategy. The core considerations in that strategy still hold in that we need ready access to funds, as Wayne has mentioned, in terms of large disasters where we need to support our policyholders. In the insurance industry you do need ready access and liquid funds for large natural disasters. So, yes, there was an investment strategy. It had not been reviewed for some time, and the department is working on reviewing and updating that.

CHAIR—Is it the wish of the committee that the submission from the Department of Finance and Administration dated 29 August 2005 be accepted as evidence into the committee’s sectional review of auditor’s reports and be an authorised publication? There being no objection, it is so ordered.

Ms GRIERSON—Do you, representatives of the Department of Finance and Administration and Department of the Treasury, see any reason for a next day access type of provision in an investment strategy for any agency or department?

Mr Hutson—Two things are relevant here. The first is that very clearly under the legislation the responsibility for managing these types of affairs is given to agencies. That is the first part of the question. Agencies are responsible for that. Your substantive question was: do we see any need for next-day access? The answer is that in some circumstances it seems entirely appropriate that an agency would require next-day access. The sorts of answers which have been provided by the Department of Veterans’ Affairs, on the face of it, sound like the sorts of circumstances where you may well require next-day access. If there had been a major insurance catastrophe, and they require money in a hurry, then next-day access would seem legitimate, but again how they manage their affairs is a matter for the department.

Ms GRIERSON—And do you provide any guidelines on investments?

Mr Hutson—Yes, we do. Attached to our submission are a number of additional finance circulars which we put out, both prior to the audit being completed and subsequent to the audit, on a number of activities concerning investment strategies.

Ms GRIERSON—In DVA, going back to where you are now with your investment strategy, could you tell me a bit more about what you are doing about that strategy?

Mr Walsh—We have got a range of issues to work through in terms of the insurance scheme. We have looked at the current arrangements we have with UBS, who are our funds asset manager. We looked at their risk management strategies, and looked at their compliance arrangements in terms of ongoing compliance. We are currently working through the best process in terms of going out and market testing that outsourced investment in terms of whether we are getting value for money in terms of managing that.

Ms GRIERSON—Are you doing that yourself internally, or are you getting someone else to advise you on that?

Mr Walsh—We are doing it internally at this stage, but we will be seeking some external advice once we are clear on the exact approach in terms of the contracting arrangements.

Ms GRIERSON—So do you have credit risk management policies and procedures in place?

Mr Walsh—The investment manager has a credit risk policy in place, and we have reviewed that and we will be referencing that in terms of our internal investment strategy.

Ms GRIERSON—So you have a base. You feel confident you have a base. So that is good.

Senator MOORE—You now have a regular meeting process built in.

Mr Walsh—Yes.

Senator MOORE—When is the next one due? You have done it now, so what is going to be the sequence of reviewing from now on?

Mr Walsh—In terms of the investment strategy? We are still finalising the investment but we do have an ongoing monthly review process in terms of the performance of the investment.

Mr Penniall—We get a report every month.

Senator MOORE—And that was in the monthly report that you are going to do that. So you get a monthly report and then at some stage in your structure there will be a general review looking at it, so it will not go for 10 years again.

Mr Walsh—That is right.

Senator HOGG—Could you outline for me the way in which you invest money? Is it in a single investment, or is it in a number of investments? How do you invest your money, and do you pay anyone to invest that for you?

Mr Penniall—We contract with UBS Global Asset Management. They are an internationally renowned professional money manager. We invest with them. We pay them a fee for that.

Senator HOGG—What charges are applicable?

Mr Penniall—It is approximately 0.2 per cent.

Ms GRIERSON—Has it been the same money manager since 1995?

Mr Penniall—Yes.

Ms GRIERSON—You have had the same financial investment manager since 1995.

Mr Penniall—Yes.

Senator HOGG—And has that fee changed from 0.2 per cent over that period of time, or has it been stayed? Has it been renegotiated?

Mr Penniall—I think we would have to take that on notice. It has certainly been constant for the past few years.

CHAIR—You will take it on notice and report back to the committee.

Mr Penniall—Yes.

Ms GRIERSON—How do you judge if you are satisfied with what they are doing in terms of the return you have been getting?

Mr Walsh—They benchmark that against their own internal return rate in terms of the bond market and we also benchmark that on a monthly basis in terms of internal reports against the RBA cash rate. So we monitor that and in terms of their reports they provide monitoring. We also monitor that internally.

CHAIR—I have a question of all departments. Each of your departments has a chief financial officer; is that correct? I assume so. I understand that we pay performance bonuses to each of them.

Mr Walsh—Yes.

CHAIR—Given that you have such a limited vehicle in which to place your money, can you put to the committee for their understanding why you actually need a financial adviser that you pay a fee to when the money can really only be placed into secure areas such as banks? Why are we paying millions of dollars to advisers; and, in particular, why do you hang onto them for nine years under the same policy without going to competitive tender? Given the narrowness of the market that you can invest in, why isn’t it all done in house?

Mr Penniall—That is one of the options we are looking at in our review.

CHAIR—Why has it taken nine years to come to that view?

Mr Penniall—One of the issues raised in the audit was that the investment strategy had not been reviewed for nine years. Now that we are aware of that, we are certainly keen to ensure that proper reviews happen. One of the elements in the review is whether to outsource the management of that or do that in house. They are some of the issues being examined at the moment.

CHAIR—Mr Fileman, I understand you now have the ATSIC land fund under your control. Is that correct?

Mr Fileman—That is correct.

CHAIR—What investment strategies have there been in placing that fund?

Mr Fileman—The investment strategy has probably changed in the transition from ATSIC to Immigration, not necessarily because of the transition itself but because of the migration from what was category A years to category B years. Category A was basically a 10-year period, looking to build up the land fund to a self-sustainable target value. There was a yearly government injection of funds. The objective during that phase was to grow the fund to the maximum level—basically, to reach the target.

Miss JACKIE KELLY—What was it again?

Mr Fileman—It was just under $1½ billion, about $1.4 billion. I can get you the exact figure. The figure was set in about 1995 and it was indexed up each year. With the transition into category B years, the role of the fund is now basically to fund the Indigenous Land Corporation, and that is pretty much their only source of revenue at this point. So now the strategy has changed from growing the fund to providing the maximum return each year.

CHAIR—And, Treasury, as a central agency having the ability to approve or reject investment vehicles, why haven’t you taken a more active role in looking at the investment vehicles in which the various departments have placed their money?

Mr Flavel—Until recently Treasury had responsibility in relation to a particular subsection of the CAC Act. So, in relation to CAC bodies, that power has now been transferred to the Minister for Finance and Administration.

CHAIR—I am not worried about where it is going now; I am asking questions about why your department did not take a more active role in looking at the investment vehicles in which money was being placed.

Mr Flavel—I think we have come to a fundamental point here that, by law, CAC bodies are required to take accountability for their financial management.

CHAIR—But Treasury, as briefed by the Australian National Audit Office, was the ultimate approval authority for the placement.

Mr Flavel—Sure, approval authority; but I think your question is about where the investments are subsequently made, in compliance with any approvals. I think there are two separate points here. One is about the extent of approvals which have been given—in other words, the extent of products available to agencies—versus the agencies themselves that go away and invest within those and whether they in fact comply with the powers given to them.

CHAIR—But surely over the years Treasury would have noticed that money was being placed into areas which were not approved vehicles. Why was no action taken in relation to that?

Mr Flavel—I do not think Treasury did. Again, the point is: why would Treasury, in its role, have gone out and actively sought to second-guess what Commonwealth authorities and companies were investing in?

CHAIR—You did not see that as your role or responsibility in that period of time?

Mr Flavel—No, and in fact I think we have put that on the record.

CHAIR—Audit Office, you said to us that they had the ultimate consent authority where money could be placed and anything else was outside the bounds. What is your view on Treasury's reaction to those questions?

Mr Cochrane—Putting it in relation to CAC Act bodies, we would expect that Treasury would have been chasing down the separate approvals that needed to be made under the legislation. The difficulty that came out in the audit was that, when we went to the types of investments that Treasury were due to approve, we could not always find the evidence of that approval occurring. So it was a very specific action that had to occur under the act and, in our view, it was not being chased up properly.

CHAIR—What is your response to that, Mr Flavel?

Mr Flavel—If the comment is about the record keeping in relation to approvals which have been given and the ability to locate those, I think we are on the record in the audit report as having said that we agreed that we could have improved our record keeping, which was simply the ability to, in some cases, track down approvals that dated back to the mid-1980s, which were given to Commonwealth authorities—

CHAIR—Are there any other skeletons in the closet, where you have not perhaps been as diligent as you should have been in the financial management of other areas?

Mr Flavel—I am not sure what that question is supposed to imply.

CHAIR—In further audit reports that we may have into Treasury, are we likely to find: 'Perhaps we weren't as good as we should've been in certain areas in making sure there was compliance'?

Mr Flavel—It is difficult for me to answer that question on behalf of a department of 800 people.

CHAIR—You are here representing Treasury.

Mr Flavel—I am, but I am just not sure what the question is meant to imply.

CHAIR—Let me make it very simple for you. If the next audit report that comes out talks about financial management and comes out with recommendations that Treasury were not as diligent in their role as perhaps they should have been, are we likely to find any more of those?

Mr Flavel—I expect not. Again, I make the point that in relation to the financial management of Commonwealth agencies and agencies subject to the FMA Act, that power has now been transferred across to the minister for finance. So, going forward, it is going to be an issue for the department of finance, rather than for Treasury.

CHAIR—DOFA, could I have your response to that now that you will be taken on as the lead agency in controlling and managing all this. Where do you see it going?

Mr Hutson—I will explain what our role is and then take it from there. As I said in response to the question from the deputy chair concerning the Department of Veterans' Affairs, the primary role for the financial management of agencies, both at the CAC level and at the FMA Act level, is with the agency itself. Very clearly, though, there are, within both the FMA Act and the CAC Act, specific roles for—now—Finance concerning approvals. I will briefly tell you about CAC, and then I will go on to FMA. In the CAC Act, in general what the parliament has done is to have given a class of assets in which CAC agencies can invest, which as you correctly identified, Mr Chairman, is quite narrow. But it has also given the capacity for, formerly, the Treasurer, and now the Minister for Finance and Administration, to expand that class of assets if he thinks it appropriate. One of the things the audit found was that people had been expanding their class of assets without the necessary approval and, in some cases, the necessary approvals could not be located either at the Department of the Treasury or in the CAC agency concerned. We are certainly very cognisant of the finding of the Audit Office, and we have put in place a system to ensure that we have a complete and accurate record of all the approvals which have been given in the past and which will be given in the future.

CHAIR—That gets back to the fundamental question that you were given the process of making sure that people were investing in the right vehicles, and they have not, but over the years you have not brought them to account for their investments.

Mr Flavel—Again I make the point that what the Treasurer was responsible for was approving a particular set of asset classes which a CAC agency could invest in. Noncompliance with that—in other words, investing outside that scope—is ultimately a matter for the CAC agency themselves.

CHAIR—Audit Office, do you think that the role of Treasury and their powers and responsibilities were to make sure that the departments had invested in vehicles that were approved?

Mr Cochrane—What we say in the report is that we would have encouraged Treasury to take a more active role in encouraging compliance. As the Treasury representative says, ultimately the responsibility is with the CAC body itself, but in the role of good financial management and good financial administration we expect that essential agencies are out there encouraging compliance.

Ms GRIERSON—I want to go back to DVA, because I want to finish exploring some of the things that have happened there. You said that you have revisited your credit risk management policies. Do you have a document you could provide to the committee that shows us what this is now saying?

Mr Walsh—We have not finalised that process, because we are looking at potential restructuring, as Wayne mentioned. So, until we have finalised exactly how we will move ahead in managing the investments, we cannot finalise the procedure.

CHAIR—So you did not have one at all?

Mr Walsh—There was no credit strategy internally, but the fund manager had a credit risk policy which applied to the funds that we had invested.

CHAIR—Could you provide that to the committee?

Mr Walsh—Yes.

Ms GRIERSON—Did they provide advice on changing that credit risk management policy? The same manager since 1995—did you get documentation suggesting why strategy would change or would not change?

Mr Walsh—I cannot comment on that because I was not—

Ms GRIERSON—So who managed that contract with the fund manager?

Mr Walsh—Who within DVA? The national manager or the finance manager within the Defence Service Homes Insurance Scheme.

Ms GRIERSON—Who is that?

Mr Walsh—I am presently the national manager, but there have been a number of national managers over the past 10 years.

Ms GRIERSON—As you now have to manage that contract with the fund manager, have you gone to open tendering or does the contract still have some time ago? What is the situation?

Mr Walsh—We are currently looking at going to open tender or some sort of market testing. We are in discussions with the—

Mr Penniall—As we detailed earlier, we are currently looking at a range of options, which could include, potentially, managing that internally or going out to tender. One of the critical issues is how best to manage that and whether to do it in house or whether to go to the market.

Ms GRIERSON—I recall, from the audit report, that DSHIS was actually getting a higher return on its Reserve Bank investment than on its other investment. The report said:

… the interest rate being paid on the operating account with the Reserve Bank had been greater than the call account held with a financial institution.

But now I gather you have decided you do not need a call account. Is that right?

Mr Penniall—That is correct.

Ms GRIERSON—How long did it take to work out that you did not need a call account?

Mr Penniall—Once we had discussed this issue with the ANAO and had examined the interest rates et cetera, we were able to close that call account within several months of the report.

Ms GRIERSON—So you are looking at going to open tendering or internal investment. Can you give me some feeling of where you are up to in that process? When does the contract expire? Is there a contract?

Mr Walsh—There is no formal contract that has been renewed since the initial investment. The fund that we invest in is an open market cash fund that anyone can purchase shares in.

Ms GRIERSON—So, in a way, your fund managers have a perpetual contract without a review process. Is that right?

Mr Penniall—In a way, yes—where the option is that we can actually withdraw from that at any time.

Ms GRIERSON—You are going to be setting up a new form of tendering or assessing what the needs are for your investments. It may be that you stay with the same one because the results are so good. Have the results been that good?

Mr Walsh—It is hard to say. Previously, when the original decision was made, the decision was based on the fact that it had been managed in house, and that was more expensive than looking at an option of outsourcing it. That was done some years ago. We have certainly had initial discussions with the fund manager UBS about engaging in some sort of market testing, and I have had some discussions with our contract advisory unit on the best process to go through for that.

Ms GRIERSON—The report says that the return on the trust in 1998 was reported as 5.15 per cent and the benchmark was 5.25 per cent. So perhaps the return was not optimum.

Mr Walsh—In the past I would have agreed with that. For the last 12 months the return has been greater than the benchmark rate. The returns at the moment are competitive in terms of whether we invest that through UBS or whether it is invested through our operating account.

Ms GRIERSON—Do you scan how other agencies and departments are doing it?

Mr Walsh—It was only the ATSIC fund and a number of other small agencies, in terms of the FMA Act investments. I think there were seven FMA agencies—from the ANAO report—the largest of them being DIMIA. I did have some discussions with DIMIA late last year about what they were looking at doing in terms of managing theirs going forward and the returns they were looking for. But, due to the restrictions in the FMA Act, there is not a great deal of movement in terms of getting higher returns than perhaps you would get through investing through our operating account.

Ms GRIERSON—No, because one would hope that would be in your credit risk management policy as well.

Mr Hutson—I just wanted to complete the answer that I was giving to the chair earlier concerning FMA Act agencies. The big difference between CAC Act agencies and FMA Act agencies is that the class of investments in which FMA Act agencies may invest is not open to the minister to expand: it is fixed by parliament—quite appropriately in terms of dealing with public money. What the FMA Act does, though, is give the Minister for Finance and Administration the power to approve investment of public money at all, because that is not automatic with FMA Act agencies. At the moment that is given relatively rarely. We only have 13 agencies with investment powers. The investment powers are usually constrained to circumstances where, for example—and the Defence Service Homes Insurance Scheme is an excellent example—the department concerned is engaging in some form of quasi-commercial activity. Perhaps the biggest FMA Act agency with investment powers is the Australian Office of Financial Management, which manages the Commonwealth cash holdings on a whole-of-government basis.

Ms GRIERSON—Treasury, recommendation 6 is that the Department of the Treasury prepare and maintain a comprehensive and accurate record of all investment approvals provided by the Treasurer—that is under the other act—and their current status. Are you doing that, or is that appropriate?

Mr Hutson—That role has been passed now to the Department of Finance and Administration.

Ms GRIERSON—So you are now doing that?

Mr Hutson—We are doing both FMA and CAC.

Senator HOGG—I want to go back to DVA. I did not get an answer to an earlier question about where the fund manager actually placed the investment. What were the types of investments over the last nine years? Can you give me some idea? Was it a single investment fund? You did have a call account at one time, so I presume you would have had a couple of types of investments.

Mr Penniall —The investments currently are in bank bills, government guaranteed and a small amount of cash. The issue in the past—

Senator HOGG—So currently they are in bank bills and cash?

Mr Walsh—Bank bills, cash and government guaranteed securities.

Mr Penniall —They are all compliant under the FMA legislation.

Senator HOGG—I have no doubt about that.

Mr Penniall —When the ANAO did their audit, 5.3 per cent of the funds were in non-compliant investments which were actually certificates of deposit. But because that 5.3 per cent of CDs were part of the entire UBS fund, it was then considered that the entire fund, which was 97 per cent of our investments, was non-compliant. I do make the point that while they were not compliant they were not in risky or unsafe investments.

Senator HOGG—I just want to get to the point, though, that you are paying a fund manager 0.2 per cent—which is roughly how much per annum?

Mr Penniall —About $120,000.

Senator HOGG—To invest whatever funds in either bank bills, cash or government securities. Is that correct?

Mr Penniall —Yes.

CHAIR—I have to ask the question—perhaps this is a bit of forward thinking—of DOFA as to why there is not then a single person within government that all of the investment money, whether it be from Veterans' Affairs, DIMIA or other agencies, is placed with—a single in-house investment adviser—given the narrowness of vehicles that can be invested into?

Mr Hutson—The general default arrangement within the Commonwealth for FMA Act bodies is that there will be a single body doing all of the investment of surplus cash. That body is the Australian Office of Financial Management. The primary theory is really along the lines of the proposition you have put—that it is best placed centrally; and the AOFM does that.

There are circumstances, however, as I mentioned before, where FMA Act agencies have sought and have obtained approval—and sometimes those approvals are very longstanding—to make investments on their own behalf, on behalf of the money that they manage. In those circumstances, we certainly think it is appropriate that those agencies, where they have those powers, should be responsible for the management of those powers. If they see the need to engage external advisers to assist them, that is really their call rather than a call for the department of finance. If the argument runs that Finance should be running a central investment management service, we would say that, in those circumstances, the agencies should not have the investment powers and that the money should be managed through the Australian Office of Financial Management.

CHAIR—From my understanding of the financial market, the greater the volume of dollars that you have to place, the better the deal you can get. Would that be a fair statement?

Mr Hutson—I would probably defer to the Treasury on those sorts of questions.

Mr Flavel—There are obviously some issues of scale. You could generalise and say that beyond a certain point there may be benefits from scale in terms of investment but—

CHAIR—We are talking here about the difference between one, two, five, 10 and 50 percentage points. It is quite easy to see—even from my narrow income—that, when you look to place money, the bank offers you a whole different bunch of rates, depending on the size of the deposit you wish to place with them. Would it not perhaps be better for that to be consolidated through one investment arm within DOFA or for the financial investing arm to actually place that money and have a single person be responsible, rather than every agency going out to tender and having a range of people all competing against each other for what is relatively a very narrow market of investment?

Mr Hutson—There is another principle in action here and that is that financial management for individual agencies is absolutely in the hands of those agencies. The FMA Act makes it very clear that the responsible party is the chief executive. If you start putting another agency in, almost second-guessing, then you are muddying the waters regarding that accountability.

CHAIR—I can understand that if they were allowed to invest in a variety of vehicles with a level of risk, and some of those would return better than bank rates, but the risk is obviously associated with the return rate. But, given that there is a narrowness in where the money can be placed and how it can be placed, I would consider that it would perhaps be better if that were placed, to save fees, through one grouping. That could be through an outsourced arrangement or indeed through an official placed with that authority, or indeed within government, rather than outsourced.

Mr Hutson—As I said, I would come back to the earlier remark regarding the legislation which places the financial management with the agency concerned. We have recently issued a finance circular which suggests that any agency that does have investment powers should develop an investment management plan. It also suggests to the agencies that, as a foundation of that payment, they have access to an adequately skilled internal Treasury expert—which means an internal person—or to an investment adviser, an external person, if they do not have access to that sort of set-up.

CHAIR—Just to clarify for members of the committee, how much do you in Veterans' Affairs have in investment?

Mr Penniall—Currently, we have about $61.8 million invested.

CHAIR—And DIMIA—how much do you have in investment?

Mr Fileman—As at the end of July it was $1,505,000,000.

CHAIR—So, in round figures, $1.5 billion, and $61 million. Has anybody else got anything they would like to put on the table in terms of their investments? Because there were six agencies the Audit Office—

Ms GRIERSON—Wasn't the overall figure $20 billion?

Mr Cochrane—It was $20 billion for the Commonwealth, including AOFM, which is about $14 million.

CHAIR—So the main topic of discussion here is the $2.1 billion between DVA and DIMIA—is that correct?

Mr Boyd—AOFM's investments are very plain in the sense that they are basically term deposits with the Reserve Bank. That is roughly three-quarters of what we looked at, in that it is very straightforward—

CHAIR—Into the Reserve Bank?

Mr Boyd—Into the Reserve Bank.

Mr BROADBENT—I just want a clarification, Mr Hutson. Your organisation had some input into ATSIC's management of its funds, whereby you had appointments on the management committee out of your office?

Mr Hutson—I do not think we did. DIMIA confirms that we did not.

Mr BROADBENT—Have they transferred over to DIMIA that same management group that manages the land fund?

Mr Hutson—Perhaps DIMIA might take this question.

Mr Fileman—I will answer that, if I may. There was nobody from the department of finance. The group that you are referring to, if I understand the question correctly, is a consultative forum. That is made up of three main parties. Two appointees come from the Indigenous Land Corporation, and the third one used to come from ATSIC but now comes from the department of immigration. There is no department of finance representation there.

Mr BROADBENT—So there are no department of finance people there at all, and there have not been in the past?

Mr Fileman—They have only attended by invitation for specific issues. There is no ongoing representation there.

Senator MOORE—It was certainly our understanding that they were regularly invited when there were discussions about investment in the land fund. It is our understanding that department of finance people attended by invitation.

Mr Fileman—My history does not go back that far. I am not aware of that, but that does not mean it did not happen. I can find out for you.

Senator MOORE—We might ask for copies of those attendance sheets, just to confirm that.

Mr BROADBENT—We would probably like to know how many times they attended those meetings and what decisions—well, not what decisions; that is probably going too far, but when they attended those meetings.

Mr Boyd—The consultative forum that Mr Fileman refers to is made up of two directors of the Indigenous Land Corporation and, at that time, the CFO of ATSIC. As we point out in the report, the department of finance officials have only ever attended with an observer status, particularly with the issues such as in the early days, when it was discussing what would be the strategy of the fund to achieve the ultimate target, and how we would go about that. Obviously Finance officials had a great interest in that, given that ultimately there would be a call upon the budget. So Finance officials participated, although in an observer capacity. That is our understanding.

Mr BROADBENT—So they had no responsibility for decisions that were taken?

Mr Boyd—Ultimately, under the legislation, the decisions come down to the consultative forum, but clearly the department of finance are the keepers of the financial framework. Obviously they have a key role to play, particularly when, as the report notes, in the very early days ATSIC, as it was at that time, was arguing that the very narrow mandate, as it has been referred to, of the FMA Act did not provide sufficient scope for it to achieve the ultimate target balance and was arguing to be allowed to purchase a wider range of investments. The outcome of that was that an extra $100 million was provided to the land fund to help them get there and, at the same time, the department of finance said it simply would not contemplate expanding the investment mandate.

Senator WATSON—Not all entities are permitted to invest. The Australian National Audit Office discovered many entities investing without a permit. Having discovered there was a problem, did you send a general circular around to everybody?

Mr Boyd—It is probably easiest to divide the population into Commonwealth authorities and FMA Act agencies. All Commonwealth authorities have a general power to invest—

Senator WATSON—You have not answered my question.

Mr Boyd—I am getting to it, though. If you are a Commonwealth authority, you have a power to invest under the legislation that has been provided by the parliament. In that case, there is no point in testing whether there is anyone investing without authority, since they have authority. The question is: have they purchased only those types of investments which are approved? That is something we did test. The second one is FMA Act agencies where, as department of finance has pointed out recently, only those where they have a finance minister’s delegation—or, as in the case of AOFM, a Treasurer’s delegation—actually have a power to invest, so that issue does arise there. Yes, it is something we looked at in terms of was there any evidence of any FMA Act agencies investing that did not hold a delegation, and there was no evidence of that. There was evidence of agencies purchasing some investments which were not within the types of authorised investments.

Senator WATSON—So you did a comprehensive test to ensure that you did test all Commonwealth authorities? You sent a circular around?

Mr Boyd—We did not send a circular around. The department of finance sent a circular around the Commonwealth authorities post the audit reminding them what the legislation clearly says to them.

Senator WATSON—And what was the result of that? Did you get any feedback?

Mr Hutson—We have no evidence of anybody investing without authority in the FMA Act.

Senator WATSON—Why did the Treasury relinquish their oversight role to the department of finance?

Mr Hutson—It was part of the Financial Framework Legislation Amendment Act 2005. The general thought was that it was sensible, given the development of the financial framework, that all of those things should be centralised. The role of the Treasurer in many cases was historical.

In some cases it predated the creation of the Department of Finance and Administration. What the Financial Framework Legislation Amendment Act did was centralise it.

Senator WATSON—But the audit office found the approvals were both inaccurate and incomplete. I thought if an organisation was handing something over to another organisation, it would make sure that its records were up to scratch.

Mr Hutson—We have subsequently satisfied ourselves that our records are up to scratch.

Senator WATSON—Your records might be, but the audit criticism was that the Department of the Treasury records were not up to scratch. They were inaccurate and incomplete before they handed them over to you. You might have brought them up to date, but that was not a reason for the transfer?

Mr Hutson—No. The proposition of the transfer of functions was in the Financial Framework Legislation Amendment Bill, which was considered by this committee long before the audit was published.

Senator WATSON—What was your reaction when you were given records that were incomplete and inaccurate, when you received that authority?

Mr Hutson—Partly because of the audit we knew what we were getting and we, as a matter of due course, set about putting things right. I am sure that if the function remained within the Department of the Treasury, the Treasury filing the audit report would have done exactly the same thing.

Senator WATSON—So you knew what you were getting. You knew that you were getting inaccurate and incomplete documentation from Treasury?

Mr Hutson—Yes.

Senator WATSON—And then you immediately set about to get that right?

Mr Hutson—That is right.

Senator WATSON—Didn't the managed investment trust ring alarm bells when that sort of vehicle was chosen by somebody? A management investment trust, unless it is a cash trust, can be quite a volatile investment. Whoever was responsible for that, a management investment trust?

Mr Boyd—DVA.

Mr Walsh—That might be the case, but the particular managed investment trust that the Department of Veterans' Affairs or Defence Service Homes Insurance Scheme invests in requires all investments to be Financial Management and Accountability Act compliant. It is not a very broad investment trust and investments held in it are required to be compliant with the FMA Act.

Senator WATSON—So the managed investment trust was obviously set up just to pick up these sorts of investments, was it? To make sure that what they invested in was compliant within the FMA Act?

Mr Walsh—Yes.

Senator WATSON—Are you absolutely certain that it is 100 per cent?

Mr Walsh—Yes. I understand that originally the trust was set up purely for the Department of Veterans' Affairs, but sometime after that UBS chose to open it up to the market and there are a couple of other investors who hold units within that trust.

Senator WATSON—You can tell us that all of those investments held by that trust, apart from cash, are authorised investments of those holdings?

Mr Walsh—Yes.

Senator WATSON—What is the name of the company? What is the name of the trust?

Mr Walsh—It is held with UBS Global Asset Management and the fund is called the cash bond fund.

Senator WATSON—Who is your investment adviser?

Mr Walsh—It is UBS Global Asset Management.

Senator WATSON—So you have an investment adviser who tells you to invest in one of their own vehicles?

Mr Walsh—Let me clarify: we purchase from them the services of managing that cash bond fund. So whoever purchases the services pays the same fees in terms of investing in that cash bond fund.

Senator WATSON—We now have two separate issues. Firstly, you have satisfied me that all the investments within that managed investment trust are authorised FMA type investments. Secondly, you have told me that your investment adviser is one and the same body—that UBS advised you to put the money into one of their own investments. Is there a strong Chinese wall there?

Mr Penniall—We monitor those investments on a monthly basis to ensure that they are compliant and that UBS are investing in investments that we are comfortable with.

Senator WATSON—And in accordance with the FMA Act?

Mr Penniall—And in accordance with the FMA Act.

Senator WATSON—And you have not discovered any month in which there have been deviations from that?

Mr Penniall—Since this audit was done, that is correct.

Senator WATSON—You do not see any problem of having an investment adviser advising you to put investments in their own corporate portfolio?

Mr Penniall—Their corporate portfolio is made up of a range of approved investments. The funds are not invested in their own companies, for example.

Senator WATSON—But you told me that the management investment trust is a UBS trust.

Mr Penniall—Yes.

Senator WATSON—And your investment adviser is UBS?

Mr Penniall—In the sense that they manage that trust, yes.

Senator WATSON—And you see no particular issue in having one and the same body? I would have thought there would have been a problem—that in terms of transparency there should be a separation.

Mr Penniall—We give them funds to invest, we rely on their expertise and knowledge of financial markets to manage that money in the best way possible, and we monitor that on a monthly basis to ensure returns.

Senator WATSON—I am not suggesting that they do not invest it in the best way possible, but I am telling you that it does seem strange. Certainly in a superannuation sense we would very much frown on investment managers also pushing moneys into their own managed operations.

Mr Walsh—They do not provide us with adviser services; we purchase funds within—

Miss JACKIE KELLY—So the person that you pay $120,000 to to give you financial advice is not UBS?

Senator WATSON—Yes, it is.

Mr Walsh—We do not pay $120,000 for financial advice; we pay $120,000 for management of the units we hold in that trust. That goes to UBS, who manage that—

Miss JACKIE KELLY—So who has had the contract for the last 10 years?

Mr Walsh—UBS.

CHAIR—And you do not see that as a conflict of interest—that they are advising you to invest your money in their own vehicle?

Miss JACKIE KELLY—You have had UBS ongoing since 1995, with no review of them.

CHAIR—Audit Office, perhaps you could clarify how you see that in relation to Senator Watson's questioning. Would you see that as a conflict of interest—when you are paying an adviser from UBS to provide you with advice and they are placing the money within their own vehicle?

Mr Cochrane—We would certainly see that there are wiser ways to approach that question, yes.

Mr Boyd—With respect, I am not sure that the department is doing a particularly good job in explaining the role that UBS plays. As we understand it, UBS is not providing the department with advice to purchase this investment rather than that investment. Essentially, the department has chosen to place its money with UBS, who take a fee for providing other services such as custodial services. But in a general sense, yes, we do have a concern if someone is providing you with advice to purchase their own investments. Our audit report raised that concern not so much in respect of DVA but more in respect of the land fund. We found that situation existed more so in the land fund than in DVA.

Senator WATSON—It is really a matter of degree, isn't it? They are both wrong, so we are not exonerating one at the expense of the other. But what concerns me is that there is potential for a commission, a fee or a kickback which might go to UBS as a result of that particular investment. You might like to ask them what I am asking you. Do they receive a fee for that investment? As investment advisers, do they receive a fee in the form of a commission, gratuity, emolument or kickback—whatever word you would like to use—as a result of securing that particular investment?

Mr Penniall—We can certainly ask UBS that.

Senator WATSON—I will ask you firstly: are you aware of any kickback?

Mr Penniall—No, I am not.

Senator WATSON—That is the first base. I would like you now to also ask your investment adviser whether they received any fee as a result of that particular investment that was undertaken.

CHAIR—Could you take that on notice and provide an answer to the committee, please.

Mr Penniall—Yes.

Mr TANNER—You are effectively just buying an off-the-shelf product, aren't you?

Mr Penniall—Basically, yes.

Mr TANNER—So the real issue is not whether there is an adequate tendering process; the real issue is why there has not been the capacity to examine alternatives, not the question of the financial adviser.

Mr Penniall—That is something that we are working towards.

Senator WATSON—Finally, could we have a list of those investments listed which were outside the authorised permits by naming the actual investments where this occurred? You talked about sums of money, but I am interested in the particulars.

CHAIR—Could you take that on notice and provide a report back to the committee.

Mr Penniall—Yes.

Senator WATSON—And the particulars leading to that accumulated amount.

Mr BROADBENT—Isn't that in the report?

Mr Cochrane—There is certainly a summary on page 60 of the report. It is not a listing of the individual investments.

Senator WATSON—I just want to separate those that were outside the guidelines.

Mr TANNER—Sorry to drag the conversation away from this specifically. This may be more appropriate for a subsequent session. Apologies for being late. I had shadow cabinet responsibilities. I want to go back to the point with the Audit Office about the fact that three-quarters of the total amount of money invested is currently held with the Reserve Bank. The amount that was held in 1996 on deposit by the Commonwealth and Reserve Bank was roughly $2 billion. Since that time that amount has steadily increased, particularly in the past few years, off the back of substantial surpluses and a Commonwealth decision not to further pay down outstanding debt. The last time I looked at it, it had escalated to about $16 billion on account. I am advised that that is currently earning 5.5 per cent. So the question that I am interested in finding out whether you have had a look at and whether we are in a position to judge is to what extent the Commonwealth, until the creation of the future fund, is subsidising the retention of the bond market by earning in interest, in aggregate, less than it is paying out in interest on the outstanding debt. Of course, that is a complex question because the maturities of the debts, the rates of the various instruments et cetera are mixed and it may not necessarily be that the difference between the two is a very large sum. But I am not sure. But, clearly, where you have something in the vicinity of $15 billion or $16 billion being held on deposit at 5½ per cent by the government instead of being used to repay debt, the question that arises is: with the debt that is outstanding that would otherwise be repaid, how much is the Commonwealth paying in interest on that debt, and where does the net equation between the two end up?

Mr Cochrane—It certainly is a very complex question, and I would think it would take some work to actually even get close to an answer on that. We have not looked at that specifically in the audit because it is not a consideration in the Audit Office in the sense that the government decides the policy on how much debt and whether it is going to retain a bond market. In no way do we have any sort of responsibility to check whether that is a sensible policy decision or not.

Mr TANNER—My question is not so much whether it is sensible; that is the secondary question. The primary question is: how much is it costing us?

CHAIR—Perhaps Finance could take that on board and provide an answer—

Mr TANNER—I am hoping I will be here when the office of financial—

CHAIR—Between Treasury and Finance.

Mr TANNER—I am hoping I will be here but I apologise for being in and out because of shadow cabinet commitments.

Mr Flavel—It would best be an issue addressed when the AOFM gets here, because, as Mr Cochrane said, it is quite complex.

Miss JACKIE KELLY—Mr Walsh, is your background in finance and financial investments?

Mr Walsh—A background in finance—yes.

Miss JACKIE KELLY—Any of your predecessors? Do you have a background in the Finance department?

Mr Walsh—No, I have a background in government financial management.

Miss JACKIE KELLY—In?

Mr Walsh—The Department of Veterans' Affairs.

Miss JACKIE KELLY—What about investment?

Mr Walsh—None.

Miss JACKIE KELLY—What about any of your successors? Has it been part of the job description for your role to have some investment—

Mr Walsh—I do not believe so.

Mr Penniall—Not specifically.

Miss JACKIE KELLY—So you do not really contract out advice, do you? Who, in 1995, made the original decision to go with UBS? Obviously someone in your position, with no financial background in investments, made a decision to go with UBS.

Mr Penniall—Back in 1995—yes.

Miss JACKIE KELLY—And no-one in your position since has questioned that or reviewed that?

Mr Walsh—I do not believe so.

Miss JACKIE KELLY—If the authorised agencies are to continue with approvals to have investments, maybe that should become part of the job description for your position—some background in investments, some idea. A training program could be put in across government for people in your position to get that sort of expertise or work with Finance in terms of developing an ongoing list, a current list—a daily—of what is approved today and what is a good list or whatever.

Mr Hutson—I will sit by our circular that requires agencies, in developing their plan, to have access to appropriate internally skilled people or an external investment adviser.

Miss JACKIE KELLY—Is there any plan to provide that internal training for people?

Mr Hutson—No. I do not think it would be our role to provide that particular training for people; that is a skilled task.

Miss JACKIE KELLY—So you would have to contract it out.

Mr Hutson—You either contract it out or find someone who has that skill base. It is not something that we would—

Miss JACKIE KELLY—I imagine Mr Walsh's salary cap is not really going to cut it with someone from Reynolds or something. We are not going to get them internally, so we are going to have to keep contracting this out.

Mr Hutson—I think so. With some of these issues you are right.

Miss JACKIE KELLY—When that person is in Mr Walsh's position and he has to negotiate this contract with an investment provider, what skills would a person in his situation need so that we do not end up with UBS selling you their own product?

Mr Hutson—I do not know that it has entirely been the case that UBS have been selling their own product below that.

Miss JACKIE KELLY—We will come to DIMIA in a minute. Let us move on to DIMIA.

Mr Hutson—Ensuring that there is no conflict of interest with the person selling you a product is reasonably fundamental in terms of the way in which you go about procuring any service.

Miss JACKIE KELLY—We might say that, but obviously for 10 years it has gone on as an undissented issue. It is not as blatant as being non-financially trained.

Mr Hutson—Again, I will rest on the position that those issues are issues for the department concerned.

Miss JACKIE KELLY—The key thing about managing a contract is to know from year to year that you have value for that contract. You are going to need some financial background to say, ‘Was that good value for DIMIA to have paid that much for that advice and got that outcome, given the financial markets at that time?’

Mr Hutson—That is a good question. The law makes the accountability of that question very clearly—and it was not DIMIA that we were talking about; it was Veterans’ Affairs—in the Department of Veterans’ Affairs.

Miss JACKIE KELLY—Yes, but he has no training, no background.

Mr Hutson—You cannot look at it that way. The responsibilities under the FMA Act are not with Mr Walsh; they are with the chief executive of the agency.

Miss JACKIE KELLY—Under the Financial Framework Legislation Amendment Act, are you now keeping a comprehensive and accurate record of all approvals?

Mr Hutson—In terms of the FMA Act, yes.

Miss JACKIE KELLY—Have you ticked off DIMIA’s current approvals?

Mr Hutson—I have. I will explain again that the issue of the accuracy of records concerned CAC agencies. The ones we are talking about today are not CAC agencies, they are FMA Act agencies. FMA Act agencies are much more limited in scope. With CAC agencies, every CAC agency has the authority to invest. With FMA Act agencies, only 13 have the authority to invest; it is a much smaller group.

Miss JACKIE KELLY—Don’t you keep their approvals?

Mr Hutson—We keep the approvals for them to invest. I want to make it clear that when you said, ‘You’ve now got accurate records,’ the answer is that we always had accurate records in the FMA Act. That issue was not found in the audit report.

Miss JACKIE KELLY—You just never picked up the fact—although your records were accurate—that something was going wrong. We now have a system where someone within DIMIA has to manage an investment advice contract.

Mr Fileman—Are you referring to DIMIA or—

Miss JACKIE KELLY—Yes, it is DIMIA’s turn now. I think poor old DVA has had it for today. Recommendation 1 says:

ANAO *recommends* that, as a priority, internal controls over the implementation of the Land Fund’s investment strategy be enhanced by:

(a) segregating the roles of investment adviser and security custodian;

How are you doing that?

Mr Fileman—I will come to that question after I clarify one that you asked before. You asked about the target value on 30 June 2004. The exact amount was $1,000,431,000. In terms of the specific question that you just asked, currently the investments are managed in-house. However, there is a tender which closes next Tuesday, which is the provision of investment advice to DIMIA. From that point there will be two other tenders. The second will be the investment manager and the third will be the security custodian. The sequencing is done for a reason. With the investment adviser, the first part of the job is to establish a suitable benchmark—what should the fund be returning? We then go to the investment manager. If it is cost effective to do so, that will be put out to either one or up to three investment managers.

Ms GRIERSON—Is that being managed in-house or is someone contracted to do it?

Mr Fileman—The management of the tender process?

Ms GRIERSON—Yes.

Mr Fileman—That is being managed in-house.

Miss JACKIE KELLY—In terms of the background of the people managing that contract, again what is their financial expertise?

Mr Fileman—The contract is probably in two parts. The contract management component of it is done through the contracts management unit within the department. The investments component is being done by me.

Miss JACKIE KELLY—Two or three years from now, would you make a call on whether that investment adviser had let you down and whether you would renew that contract or just plod along with this? Is the winner of this tender going to plod along for 10 years or do you have sufficient confidence in your background that you will be able to call to account this investment adviser if he is not managing the contract.

Mr Fileman—The maximum length of time that this contract can go for is five years. The contract is for three years. It has a two-year provision to roll on if the consultative forum is satisfied with the performance.

Ms GRIERSON—Do you set up a special committee to award that tender?

Mr Fileman—There is a special committee to go through that tender but the ultimate decision-making body will be the consultative forum.

Senator HOGG—Is in-house one option still?

Mr Fileman—Absolutely. We have structured our affairs so that we could go either way. As I said, the awarding of this contract to an investment manager will only go ahead if it is cost effective to do so. The increased returns have to more than offset the increased fees. If that condition does not hold, we will retain the running of the portfolio in-house.

Mr BROADBENT—But, Mr Fileman, that is a judgment.

Mr Fileman—It will be on this basis: does the forum believe that the investment manager will be able to justify increased returns? The fees are fixed; we will know exactly what the fees are. Yes, we will have to form a judgment as to whether any indications of increased returns are tangible.

CHAIR—For clarification: are you talking about a fixed per annum fee or a percentage fee of the investment?

Mr Fileman—It is open.

Senator HOGG—Are there penalties for failing to meet benchmarks?

Mr Fileman—The investment manager tender has not gone out, but we are looking to put it out in November.

Senator HOGG—I have a general question that may be answered by Finance. Is any central reporting done from the various agencies, whether under the FMA Act or otherwise, where a central repository says, for example, 'This is the way DVA manage their investments: fund manager, fee charged, amount invested and type of investments,' so that we do not have to go to varied sources trying to glean this information? From what I have heard here today, it seems that this has come about because the Audit Office goes across a number of agencies in pulling together information—and obviously it is not able to do all the agencies. Is there any such opportunity for this to happen through Finance?

Mr Hutson—I think the short answer is no. It is a matter of each agency reporting separately.

Senator HOGG—So there is no consolidated place where this committee can see what is happening on a year-to-year basis; it is a matter of trawling through each agency or each department. Is that what you are saying?

Mr Hutson—Yes.

Senator HOGG—Is there merit, therefore, in having a central repository—not taking away the responsibility under the acts—to which this reporting would go so that it could be readily accessible to people such as us?

Mr Hutson—You might find the answer to that a little frustrating. The answer is a little like how long is a piece of string, with the level of information there would be in a centralised collection and how much of it would be utilised. This issue has come up in a wide variety of different aspects in the past about what information should be collected and presented centrally and it has varied over the years. But at the moment this piece of information that you are looking for—that is, the amount invested externally—has not been collected or presented centrally.

Senator HOGG—But this gets to a slightly different issue than most other information. This gets down to cold hard investment, the return on the investment and our ability to see that investments are in accordance with the various acts. That is not trying to take the accountability away—I am not suggesting that for one moment—from the individual agencies or their CEOs.

Mr Hutson—I will take on notice the interest of the committee in a centralised piece of information. But at the moment no system does that and there is no centralised reporting of it. The Audit Office is probably the first organisation that did that when it produced its report.

Senator HOGG—Would the collection of such information pose any major difficulty for an agency such as you, Finance, if you were the repository—and I do not know where the repository would be?

Mr Hutson—The answer is no, we would not be provided with a major problem in doing that. It is just an additional task and one more collection of a piece of information. The question is how much information would be required and how much interest would there be in that information. I have noted the interest of this committee in the information, but you will appreciate that there are various bits of public information that people would like collected centrally because it makes it easier.

Ms GRIERSON—Let me suggest that each departmental agency does its own annual reporting and it certainly has its own internal audit function for its financial performance and its operations. Surely you must be able to pull some of that together to get that sort of information across all agencies. The Audit Office is an external auditor and there must be internal audit processes that must pick this stuff up. It keeps coming up repeatedly with us that there is noncompliance with financial acts and the Constitution and you would not expect to keep finding it in special accounts, appropriations and the investment of public funds.

Mr Hutson—I am glad you brought that issue up. There is no doubt that we are not deaf to the findings of the Audit Office over a period of a series of audits—and the ones you have mentioned are probably some of the main ones—about the Commonwealth financial framework. What we have been doing over the past few years is expanding our role of advice, and we now have three circulars out on the investment of public moneys. I do not know how many circulars we have put out in the last few years, but it is a substantial number. It is perhaps 40 or 50, so it has been a substantial number trying to get agency compliance up to speed. We have also got a training program for departments about the basic compliance requirements with the FMA Act. We have a number of other things in preparation, which I am not really in a position to talk about today because they are still in preparation. I certainly hear what you are saying. I think that is a fair comment.

Ms GRIERSON—Some alarm bells should be ringing, and I hope they are ringing. If DIMIA is going through this process with a really large amount of money, would either of you people want to oversight that? Would you be involved in giving advice on that? Would you want to be sure, seeing as there were many non-compliant areas before, that this process is right? Why wait five years until it is reviewed by the Audit Office to find out that this one was not a really good deal either? Given the impact on your department recently—and we are concerned for everybody in DIMIA, thinking that they are already under a great deal of stress and pressure—have you been assisted through this process?

Mr Fileman—I will answer in two parts. With regard to the tender, it is a very straightforward process to develop the tender documentation.

Ms GRIERSON—Putting it out is fine.

Mr Fileman—Indeed. The issue for us has really been around what sort of investments are allowable. That was very much a threshold question. It is all very well to say that we want some assistance in investment management or advisory function, but the first question the recipients would ask is: what can we invest in?

Ms GRIERSON—You should have rung up Treasury or Finance and got a list of those or something, shouldn't you?

Mr Fileman—That has certainly been the case, and there has been very good work with the Department of Finance and Administration. A circular was finalised on Friday. We saw that and made comment on it. That was a two-way process. There was a lot of ambiguity around what was a legitimate investment, and, without a legislative background, it was not intuitive as to what a deposit with a bank would have been. We had very good feedback from the Department of Finance and Administration.

Ms GRIERSON—What about the rest of the process? When you get those people to do tender for that, what is happening then? Have you discussed how that is going to happen? Is that a normal process, or do you have to make any changes to the process—that is, this forum that is going to decide the awarding of the tender?

Mr Fileman—The governance framework does put this with the consultative forum.

Ms GRIERSON— Excuse my ignorance, but what is the consultative forum? It sounds good.

Mr Fileman—It is set up under the Aboriginal and Torres Strait Islander Act, which is now the successor to the ATSIC Act. The consultative forum is set up under that act and basically brings the two parties who are interested into a formal process. It is two directors of the Indigenous Land Corporation. At the moment it is the chairperson of the Indigenous Land Corporation and the external director. They are on the receiver side. The other formal member of the consultative forum is the minister's delegate.

Ms GRIERSON—Who is your internal financial auditor on that one? Nobody really.

Miss JACKIE KELLY—It only meets twice a year to look at investment policy.

Mr Fileman—It has to meet twice a year, but it does not preclude it meeting more often. Since December last year, it has met three times. While there is a bit of movement around what the investments are and the direction it should go in, it is meeting more frequently.

Ms GRIERSON—Who is going to give advice to the forum on what decision to make?

Mr Fileman—The department of immigration will be providing advice.

Ms GRIERSON—Who in DIMIA is going to advise the forum? I would think that they will give a briefing to the forum on all the tenders. Is that right?

Mr Fileman—That is correct.

Ms GRIERSON—Who will do that?

Mr Fileman—That will be my responsibility.

Ms GRIERSON—Your responsibility?

Mr Fileman—That is correct.

Senator MOORE—Your position's responsibility?

Mr Fileman—Yes.

Mr BROADBENT—Are you going to invite Finance along to the consultative forum?

Mr Fileman—Finance are always welcome to attend. To put that into context, of the last three consultative forums, the Department of Finance and Administration attended two.

Senator MOORE—Did they attend as observers?

Mr Fileman—They cannot be members because that is laid down by statute. They have attended as observers.

Mr BROADBENT—I think Finance really went through where you are headed with their last answer where they talked about 50 reports, training programs and the future projects coming online which you do not want to detail at the moment. Treasury, do you have anything to say about the response to the audit report from your position? Where are you headed after this report?

Mr Flavel—The point is that this function has transferred across to the finance minister and Finance. We have provided assistance in relation to transferring files, but essentially in terms of the policy and administration—

Mr BROADBENT—It is good to have you here. Michael, are you happy with your department's response after the report?

Mr Fileman—The ATSIC response to the report?

Mr BROADBENT—Yes.

Mr Fileman—Yes, quite comfortable with it.

Mr BROADBENT—Has there been any change in your policy from the time you took over ATSIC until now, or is this part of that process you are going through now as to how you will manage that?

Mr Fileman—The policy did have to change, if for no other reason than it was coming from a CAC agency, ATSIC, to an FMA agency, DIMIA. DIMIA did a due diligence review of the land fund which was completed by an external firm. The recommendations are unarguable: that there should be a separation of some of the functions and there should be greater transparency. That process is being put into place.

Mr BROADBENT—There is a consultation forum that is in the ATSIC pile now. Your position has responsibility for all of those moneys within your department. Do you treat them separately? Do you do a consultation forum for the ATSIC money or the land fund and another process running at the same time? If you have another process, do you invite Finance to come along to that other process? There are two processes?

Mr Fileman—Yes. The ATSIC money is no longer a separate issue or a separate case or a separate group of funds. The passing of the ATSI Act put that into the Commonwealth and the Commonwealth here is defined as the department of immigration. We cannot regard it now as a separate entity from the department.

Mr BROADBENT—I understand that. Talk about the process. You have two different processes. One is the ATSIC stream coming into the department and that affects the consultation forum.

Mr Fileman—Yes.

Mr BROADBENT—You have responsibility for the DIMIA side of the department concerning investment funds. I am sorry if I was not clear in that regard.

Mr Fileman—I missed the subtlety. Apart from the Aboriginal benefits account there are no other investment moneys in the department.

Mr BROADBENT—In DIMIA?

Mr Fileman—No.

Mr BROADBENT—To the other department, are you happy with your department's response after the report?

Mr Penniall—Yes.

Mr LAMING—I want to follow up the questions from Senator Watson, Senator Hogg, Miss Kelly and Ms Grierson. We have talked a little today about the $556 million of incorrectly invested moneys out of a total of $20 billion of public finances. My question pertains to these management fees. We heard that DIMIA are paying 0.1 per cent and veterans' affairs are paying 0.2 per cent in management fees on their respective investments. How much is being paid for the land fund?

Mr Fileman—There was no comment made as to what the fees were.

Miss JACKIE KELLY—There was no comment required.

Mr LAMING—Working on that denominator, the management fees for $20 billion of public funds, whether they be correctly invested at present or not, at 0.1 per cent is in the order of $20 million. We are talking large amounts of money, potentially, in the future being paid in management fees and every department individually taking their own decisions. There is no requirement whatsoever—if I am right in my understanding of this, Mr Hutson—because all authority rests individually with departments. Mr Hutson, is there any way we are confusing ultimate authority, which does rest with departments, with some form of collaborative process so that when it comes to buying very simple, low risk, off-the-shelf products—effectively a very narrow range of products, as the chair has already said—we cannot we do any better than paying out a percentage commission for extremely large investments? Is there no other way of doing it?

Mr Hutson—I will answer the question this way. You mention $20 billion. The first thing about the $20 billion is that $14 billion is managed by the Australian Office of Financial Management. That is pretty much their sole role in relation to investments. I do not know what their arrangements are, but I do not think you can extrapolate your analysis and say that is therefore $20 billion because I do not think that is accurate.

Regarding the question about such a narrow range and whether that narrow range is suitable for centralised management, I said two things earlier. The first was that the fundamental principle is that centralised management of the Commonwealth cash holdings is the preferred course, and that is with the Australian Office of Financial Management. It is only the exception where some people get the power to invest outside—so it is a relatively rare instance. I believe the reason that the range of investments is so tightly constrained by the parliament is the risk profile when you are dealing with public money. For as long as there has been a commonwealth I think we have been a very low-risk investor in these sorts of instruments. That is a longstanding thing. I am not sure that it is entirely as simple, though, as you suggest. One of the other members of the committee mentioned earlier that there are, even with the very tightly constrained list of investments, quite a lot of bodies around that can provide you with various products that do fit within that list—and not only with the number of products. Although the risk profile tends to be very low, the yield curve tends to be different depending on the term in which you put those investments out. We heard earlier that the Department of Veterans' Affairs had made a decision that they wanted a significant amount of money on call. That is a fundamental decision which they can make and not something which is really easily done centrally—we would be almost second-guessing them.

The third point I would make is about the really strong legislative situation that provides that chief executives are responsible for the proper management of Commonwealth resources. Finance very much shies away from stepping into the middle of that legislative responsibility.

Miss JACKIE KELLY—I take it DIMIA has now traded out of all of its noncompliant investments?

Mr Fileman—That is correct.

Miss JACKIE KELLY—All of them?

Mr Fileman—That is correct.

Miss JACKIE KELLY—So we are back in the realm of people within DIMIA and DVA staying within compliant investments and being able to, as some of the ANAO report recommendations say, compare how their investments are doing to published market rates. Do you know what the current long-term bond rate is?

Mr Fileman—The last time we placed money it was at 5.6 per cent for the period we were going for.

Miss JACKIE KELLY—And was it trending up and down?

Mr Fileman—There was a problem with the yield curve in that we were looking to go a little bit longer but it was inverse at about 18 months.

Miss JACKIE KELLY—So you can make some comparisons. What about cash?

Mr Fileman—The call account last time I looked was at 5.4 per cent.

Miss JACKIE KELLY—And how regularly do you update yourself on those—weekly, monthly or only when you are making a decision to place things? Are you actively watching the market?

Mr Fileman—We update daily, but we only trade when investments fall due.

Miss JACKIE KELLY—So making a comparison, say, would your preference at the moment be for a government guaranteed security?

Mr Fileman—If you could get them, my preference would be to have them. My preference would be to have them longer dated, but that is not in the current market all that readily available.

Miss JACKIE KELLY—Mr Walsh, do you have the same sort of understanding of the markets? Do you follow the markets and can you make comparisons? Are you really absolutely confident in your ability to compare how DIMIA and DVA are doing against published market rates?

Mr Walsh—We are somewhat different to the way DIMIA does it. We are not engaged in trading in securities. That service is provided by UBS. We merely monitor at the higher level that the returns over the funds are competitive with the bond index. So they make the decisions in terms of the trading times and they provide us—

Miss JACKIE KELLY—But you still have to be able to monitor UBS's performance and say: 'We did good. UBS was a good way to go. Stay with them rather than going out to tender and finding some other adviser to do it.'

Mr Walsh—At this point in time, yes.

Miss JACKIE KELLY—So you are really confident about that.

Mr Fileman—Can I come back to one part of that question. One of the first aspects of the investment adviser, which is the tender which will close next Tuesday, is for a benchmark rate to be set for the land fund. For us, that is very important. While we may think it is doing well, can we prove that? Are we assured that that is the case? That is point 1. The first thing they will do is set a benchmark, and then it will be wanted against that benchmark.

Miss JACKIE KELLY—I just wanted to know that all that sort of thing is in place. We often say that the internal people are supposed to be doing this, but then we never give them the skills or the training to be able to do it. In terms of keeping up to date with markets, do you do that in your own time or is that something that you can do nine to five?

Mr Fileman—It is certainly part of the job description.

Ms GRIERSON—Mr Fileman, I am concerned that the next piece of decision making be done with the right process. Could you provide the audit committee with a copy of the tender document? It is on the public record, I would have thought, so that is fine.

Mr Fileman—Yes.

Ms GRIERSON—Good. And could you provide us with the tender appraisal format or the pro forma that will be used to assess those tenders?

Mr Fileman—It is in the tender documents and I can provide that.

Ms GRIERSON—And you will base your advice to the consultative forum on that?

Mr Fileman—That is correct.

Ms GRIERSON—And they may not accept your decision?

Mr Fileman—It is a forum and DIMIA is one part of that.

Ms GRIERSON—All right. That would be helpful, thank you.

CHAIR—Do you wish to submit that document?

Mr Fileman—Yes.

CHAIR—Is it the wish of the committee that the document entitled 'Request for tender from the Department of Immigration and Multicultural and Indigenous Affairs, document RFT0549', with 13 September 2005 as its closing date and presented by DIMIA be accepted as evidence to the JCPAA sectional committee review of the Auditors-General's report and be included in the committee's records as an exhibit? There being no objection, it is so ordered.

That brings to an end this part of the hearing. On behalf of the committee, I thank those who have attended here today. We appreciate the frankness of the evidence. Please note that the committee will authorise publication, including publication on the parliamentary database, of the proof of the transcript of the evidence given before it today.

Proceedings suspended from 11.33 am to 12.01 pm

BATH, Mr Michael Paul, Director, Financial Risk Management, Australian Office of Financial Management

HYDEN, Mr Neil Francis, Chief Executive Officer, Australian Office of Financial Management

POWER, Mr Paul Francis, Chief Operating Officer, Australian Office of Financial Management

BOYD, Mr Brian, Executive Director, Performance Audit Services, Australian National Audit Office

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

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

FLAVEL, Mr Matthew James, Manager, Budget Policy Division, Department of the Treasury

CHAIR (Mr Baldwin)—I welcome representatives from the Australian National Audit Office, the Australian Office of Financial Management, the Department of Finance and Administration and the Department of the Treasury to this afternoon's public hearing on Audit Report No. 42, *Commonwealth debt management follow-up audit*. I ask participants to remember that only members of the committee can put questions to witnesses if this hearing is to constitute formal proceedings of the parliament and attract parliamentary privilege. If other participants wish to raise issues for discussion, I would ask them to direct comments to the committee. It will not be possible for participants to directly respond to each other. Secondly, given the short time available today, statements and comments by witnesses should be relevant and succinct. 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 attract parliamentary privilege. If the representatives of the organisations do not wish to make a brief opening statement, we will proceed to questions.

Mr TANNER—I want to explore the implications of the government's decision in 2003 to maintain the bond market and to ask whether the OAFM has developed a calculation that, at a glance, tells us the cost of maintaining the bond market on an interest basis averaged across the entire debt holding. The issue that has caused me to consider this is that we now have around $15 billion—I am not sure of the most up-to-date figure—on deposit in the Reserve Bank, which I understand is at 5½ per cent. Given that the government has made a decision not to use the bulk of that money to repay debt—and ultimately, if the legislation proceeds, it will flow into the Future Fund in some form or other—what is the effective cost of maintaining that debt? Is it, on average, greater than 5½ per cent? If so, is there a net government subsidy to the bond market?

Do you now have the capacity to determine the total net cost to the Commonwealth of the outstanding debt on issue on an annual basis? If so, what is it?

Mr Hyden—Firstly, the terms that the government obtains on the proceeds from issuing beyond the needs of the government for financing—which essentially is a rolling over of existing debt—is placed in terms deposits. The return on those term deposits varies a little, depending on the specific term of the term deposits. The term deposits are used to manage our within-year cash flows.

Mr TANNER—Is this the Reserve Bank deposit you were referring to?

Mr Hyden—These are the deposits with the Reserve Bank. Their term may vary from a couple of days, if money comes in and then needs to go out very quickly, to a longer period over the course of the year. Basically those returns are short-term returns. Out of the total term deposits we identify an ongoing level that represents the stable component around which the day-to-day holdings may fluctuate. The ongoing level of term deposits is separately identified in what we call our debt hedge book and is held against a portfolio of bonds so that it in a way emulates what would have happened had we retired that volume of debt against the ongoing level of term deposits.

Mr TANNER—How does that work?

Mr Hyden—It is done by internal accounting arrangements within our accounts.

Mr TANNER—Effectively you are saying that you tell the Reserve Bank how much it is going to pay in interest.

Mr Hyden—The returns we get on the term deposit are agreed between us and the Reserve Bank and are based on a formula that depends on a market index. It does not depend on day-to-day negotiation; it is a matter of referring to an index to determine the ongoing rate for that term deposit at that particular time.

Mr TANNER—I am sorry to interrupt, but it would seem that you are suggesting that, in a sense, there is an automatic mechanism that guarantees that the return to the government from the money on deposit in a sense is the same as the return that the government would get by using the money to retire debt. Is that a correct interpretation?

Mr Hyden—No. I am saying that the return we get on the term deposits is linked to a market rate.

Mr TANNER—But that is a market rate for deposits, not for debt.

Mr Hyden—That is right. On the assets that we hold in the debt hedge book—that is, the ongoing level of term deposits—we also conduct swaps. That adds to the return we get on the term deposit to give us a higher total return. In the financial year 2003-04, the last one on which we reported, the combined return from swaps and term deposits in the debt hedge book was a little over 6.2 per cent. So that is comparable to the return we get on bonds.

Mr TANNER—So, effectively, that 6.2 per cent is your net outcome for the year for money deposited with the Reserve Bank. That is the aggregated outcome, is it?

Mr Hyden—That is the return we get for the ongoing component of the term deposit. There are also daily flows in and out. There is a residual against which swaps are not productive.

Mr TANNER—When the amount is around $15 billion I would presume the overwhelming majority of the money is the ongoing money, given that less than 10 years ago the equivalent figure was only $2 billion.

Mr Hyden—Yes, I think that is right. Our within-year swings are quite large—about $20 billion from peak to trough—and that is tending to increase. The ongoing element is the best indication of the continuing effect of the term deposits.

Mr TANNER—So in a sense you have an aggregated figure on the deposit side that is a benchmark against which you can say, 'By holding this money rather than using it to pay off debt, here is what we are earning from it.' Do you have an equivalent figure that indicates the aggregated cost of maintaining the debt, which can be juxtaposed against that 6.2 per cent, so that we can determine whether the two match, whether we are making a profit or whether we are effectively subsidising the continued existence of the bond market by not paying down the debt?

Mr Hyden—Yes, we do, and we have published that in our annual report. In last year's report there was a small net gain—I think it was $11 million—for the debt hedge book, which in effect meant that we achieved total returns on term deposits plus swaps that were a little higher than the cost of the bond portfolio that we had matched with it.

Mr TANNER—Was that in 2003-04 or 2004-05?

Mr Hyden—It was 2003-04.

Mr TANNER—So we are talking apples and apples here. So, in other words, the net cost of the debt portfolio in that financial year was a bee's appendage below the 6.2 per cent return on the deposits?

Mr Hyden—That is right: for that component of our ongoing debt which we had placed in the debt hedge book as matching.

Mr TANNER—I am talking about the totality of the debt. What I am getting at is a simple opportunity cost issue, where a government makes a decision that, although it has cash on hand, it will not to use that cash to repay debt. Therefore, there is an opportunity cost issue because that debt continues to incur interest. Can we assure ourselves that the Commonwealth is not losing out as a result of this decision? If so, we should know the magnitude of the negative financial implication for the Commonwealth so we can then judge whether that is a price worth paying to keep the bond market in existence. That is the question I am asking. I am talking about the total debt holdings and the cost to the Commonwealth, aggregated, of the total debt holdings. Do you have a figure—presumably it varies—that says that maintaining the outstanding, let us say, $60 billion of debt for the Commonwealth costs us on average, across the entire holdings, X per cent in interest per annum?

Mr Hyden—Yes.

Mr TANNER—Is that the figure you quoted before?

Mr Hyden—No. The figure I quoted before was the figure on that component of the debt that we are matching with the ongoing level of term deposits or ongoing assets. That is designed to simulate the opportunity cost. What is the difference between our using the ongoing level of assets that come from continued bond issuance in our portfolio, compared with the alternative, which would have been to have bought back debt or to retire debt.

Mr TANNER—What is the total figure?

Mr Hyden—The figure I had in mind was the return on our net debt portfolio, which is the total debt, net of assets, and that was 6.46 in 2003-04.

Mr TANNER—Which assets are we netting out of that? I am thinking essentially of gross debt here. Why would we net assets out of it?

Mr Hyden—That is taking the term deposits out. I am not sure that I can recall a figure for the gross debt.

Mr Bath—The way we structure the portfolio is to get at the very question that you have asked, Mr Tanner. We look to isolate the excess of gross over net debt that occurs as a result of the build-up of a continuing trend level of assets. The level of assets fluctuated from close to zero to nearly $30 billion in 2003-04; therefore, the trend grew to somewhere in the order of $15 billion.

Mr TANNER—These are semi-liquid assets you are talking about?

Mr Bath—These are term deposits with the Reserve Bank. We are excluding any balances in the official public accounts; they are not in our administered portfolio. Given that we want to identify what is the true cost of holding an ongoing holding of short-term assets, and given that elsewhere within our portfolio management framework we rely on the existence of a generally upwards-sloping L-curve, it would be inconsistent to assume it away conveniently. So we try to identify the cost that arises, in net terms, from holding that balance of short-term assets against debt that has been issued over the last X number of years. The way that we do that is to replicate the repurchase of physical nominal bonds as the assets accrue. So they are repurchased at the market rate.

Mr TANNER—You are saying that the hedging operation is, in a sense, like a sample that is reflective of what the cost would be.

Mr Bath—Essentially, it is replicating a repurchase across the nominal bond portfolio as the assets accrue. We do not go back to time immemorial and say, ‘That particular bond that we are now looking to buy back was issued at a rate of 10 per cent.’ What we do is say, ‘Today if we bought it back we would have to buy it back at a rate of six per cent,’ for example, and against that we will hold a hypothetical term deposit, because, you will recall, the actual term deposit balances fluctuate from zero to $30 billion, so we will have a hypothetical balance of, let us say,

$15 billion. That will not always be backed by term deposits with the Reserve Bank. For roughly half the year it will—and then some—and for roughly half the year it will be a hypothetical term deposit. The interest rate swaps that we allocate to the debt hedge book are to cover the mismatch in terms of interest rate risk between long-term bonds, with an average duration of maybe four years, and short-term term deposits that might have an average duration of about three months.

Mr TANNER—If you were considering the buying back of debt—this is an area that I do not know a huge amount about, so there may be a simple answer; let’s say you have got enough money to buy back $30 billion out of that $60 billion. Wouldn’t you be trying to buy back the more expensive? Wouldn’t you be trying to buy back the debt that has, in effect, got a higher interest rate attached to it? I suppose the market would equalise it all anyway, wouldn’t it?

Mr Bath—That is right. Essentially we buy back, or replicate, the repurchase of an even cross-section of the nominal debt portfolio.

Mr TANNER—Is the nominal effectively uniform because, on a given day, the market will price it according—

Mr Bath—Essentially the market is always right. That is our starting point.

Mr TANNER—Would it therefore be true to say that, where things sit at the moment, the hurdle point for breaking even is somewhere in the low sixes? If you taking are this pile of money and doing something else with it other than repaying the debt, is it true to say that, broadly, the location of the hurdle point is in the low sixes territory? If you were well above that you would be patting yourself on the back and if you were well below it you would be worrying. Is that a fair assessment?

Mr Bath—Almost. If we were to add assets today to the debt defeasance strategy—and I will point out that we have actually wound it down in preparation for producing seed capital for the Future Fund—we would essentially be replicating the repurchase of nominal debt, which would be roughly at a rate of five per cent across the board, I believe.

Mr Hyden—That is the current yield on bonds.

Mr TANNER—Yes. In other words, that has dropped compared with the financial year that you were referring to.

Mr Hyden—That is right.

Mr TANNER—My final question: presumably the same issue emerges with the Future Fund, and therefore, in effect, that five per cent as it is now—and whatever the bond rate may be in the future, plus a little bit of frictional cost—is going to be a benchmark for what the future fund should earn.

Mr Bath—I am not sure I am a position to answer that.

Mr Flavel—In loose terms, it sets that benchmark. It depends a bit on the broader objectives that the government has in establishing the fund for offsetting a liability and what benchmark portfolio it attached to that.

Mr TANNER—But assume you have, as has been announced, independent fund managers whose only obligation is to maximise returns, compliant with the usual fiduciary obligations and so forth. Presumably the government is going to want it to earn a rate higher than what they would effectively gain by paying off the debt with the same money.

Mr Flavel—Sure, but the point I am making is that it would not necessarily be a case of saying: 'The cost of debt is X; therefore we have beaten that by one basis point. That is a good outcome.' It would be a case of saying that the benchmark for the fund once established and the return—

Mr TANNER—I am seeing that as essentially a minimum outcome.

Mr Flavel—Yes, if you were pitching in those terms.

Mr TANNER—If the debt were five per cent and you were earning three per cent, you would be a bit worried.

CHAIR—How much money does the government have in the bond market at the moment?

Mr Hyden—We had about $55 billion at the end of the last financial year.

CHAIR—How much do we have on deposit as an offset against that?

Mr Hyden—As of the end of last financial year it was $25 billion, but that is a figure that fluctuates over the course of the year.

CHAIR—I understand that. So the net difference we are still carrying in debt is $30 billion. Is that correct?

Mr Hyden—The ongoing level of term deposits would be somewhat less than that.

CHAIR—If we were to pay out the bond market and we were in a situation where there was no government debt being carried and then the unfortunate happened and a government ran into a deficit situation, what would be the cost of re-establishing a bond market?

Mr Hyden—That is difficult to say. People often tell us that you need to keep issuing, keep your name in the market and keep people used to buying that asset or holding that asset so that when you do need to borrow you can borrow more easily. There is some weight to that. But my experience has been that there is usually a market for issuing high-quality debt. I do recall some estimates that were made a number of years ago that it could be a couple of hundred million dollars, but I do not know that that had a very scientific basis.

CHAIR—What I am looking at on the back of Mr Tanner's questions is the cost of holding a bond market as against the return rate off the deposits that you have. Is that figure outweighed by the cost of reopening up a bond market if all debt and bonds were cleared?

Mr Hyden—As I said, our experience from the last year for which we have figures, which was 2003-04, showed that the yield on the ongoing assets, together with swaps, pretty much matched the cost of the alternative, buying back debt. So there is no big loss or gain one way or the other. I think I said that in 2003-04 we made a profit of $11 million. I see from checking the report that it was actually $13 million, but it could be either way—these things will not always match exactly. But there is no big cost to the Commonwealth in maintaining the bond market as it is currently functioning. In the future, if assets are placed in the Future Fund, then it will depend on what the Future Fund earns as to what the net result is.

Senator WATSON—How much has been paid off debt through budget revenue measures other than asset sales, firstly, in the last year and, secondly, in the last five years?

Mr Hyden—I am not sure I can answer that question off the top of my head. We could take that on notice.

Senator WATSON—How long before the error was discovered in respect of swap 477?

Mr Hyden—It was discovered very shortly after the swap was concluded. It was within a minute or two—a couple of minutes.

Senator WATSON—So you lost $52,000 within a couple of minutes?

Mr Hyden—The loss—if you can call it a loss—was made when the wrong bid was selected. That occurred when the bid was selected or the choice was made for the wrong bid. The discovery of it was within a few minutes.

Senator WATSON—What procedures were put in place as a result of that? You said that procedures have now been put in place to prevent a repetition of such happenings.

Mr Hyden—We have changed our process by which the bids are recorded and monitored, so that each of the officers who is in telephone contact with the counterparty has their own computer screen. We now link all those computer screens so that all of the officers can see the figures.

Senator WATSON—And previously they were not linked—it was just one person?

Mr Hyden—They were transcribed by a single person. I think that is where the error occurred. By each person putting in their own figures and everyone having access it means that everyone can see the figures.

Senator WATSON—Are the new procedures adequate?

Mr Hyden—Yes.

Ms GRIERSON—You are saying that, at the moment, the Reserve Bank earnings at 5.5 per cent is comparable to what you would achieve in retiring debt. Is that right?

Mr Hyden—The 5.5 per cent is the current overnight cash rate that the Reserve Bank provides. The term deposits are not overnight; they are for longer periods—maybe a few days or a few weeks. The rate depends on the term of the term deposit. But that is the general order of magnitude.

Ms GRIERSON—How do you decide how much is in cash and how much is in swaps et cetera?

Mr Hyden—Decisions on term deposits are directed entirely by our cash management task—that is, how much cash the government is expected to receive and pay out day by day. That is quite variable because we get days on which tax payments are made where there can be a very large inflow and then there are other days when there are large payments, for example, to the states. We have to juggle the expected inflows and outflows. We keep a margin in the official public account in cash and the remainder is put in term deposits. The term of the term deposits is basically when we expect to need to draw on those funds.

Ms GRIERSON—The report—which you have agreed with and made satisfactory progress on—indicates that you keep Treasury informed regularly about the current portfolio interest rate exposure. It was suggested by ANAO that you establish a reporting trigger to inform Treasury—that, instead of doing it by time phases, you do it via a reporting trigger that says, 'You'd better know about this.' Does that happen?

Mr Hyden—The answer is yes—though we have not done it using a trigger. We have introduced a regular report. We now report to the Treasurer and to Treasury on the market value of the total portfolio and the swaps.

Ms GRIERSON—But still on a time basis?

Mr Hyden—It is on a time basis. The recommendation was to have a trigger when the swap portfolio lost money over a particular threshold. The value of the swap portfolio is still positive, so we would not be reporting at this stage.

Ms GRIERSON—How often does it go into the negative over an annual period?

Mr Hyden—We have not been in the negative for the last couple of years. I think there is a chart in the audit report, if I remember correctly, which shows the movement over a five- or six-year period, and we were negative because of cross-currency swaps for a long time.

Ms GRIERSON—And you have changed your practice over that, yes. Did Treasury have a view on that? Should that be set up anyway, even though we are going to be optimistic at the moment?

Mr Flavel—No, I think we agree with the response to the recommendation and the course of action, which I think provides in a way a more holistic picture of what is going on—saying that there is a trigger.

Ms GRIERSON—ANAO, you did recommend a trigger, didn't you, in that, if it ever falls into that area, there should be automatic reporting of that?

Mr Boyd—Yes, we did. Without knowing the frequency and so forth, one would still expect that, if there was a sudden untoward very large adverse movement, advice would come forward more quickly—rather than just the specified regular—

Ms GRIERSON—So if you had met the week before, you still think you might like to tell them, 'We are not going to make the three months,' or something?

Mr Boyd—Indeed.

Ms GRIERSON—Why would you resist that sort of reporting framework?

Mr Hyden—We would not resist providing the information. The question is: what sort of framework provides the most effective way to do it? I think we felt that providing a regular report on the whole portfolio was going to keep the Treasurer better informed than not reporting until something exceptional came along. But we do report regularly to our board, and the secretary of Treasury chairs that board, so there is a constant flow of reporting information.

Ms GRIERSON—How often does that happen?

Mr Hyden—The board meets every two months.

Ms GRIERSON—How often do you inform Treasury of the exposure rate? Less frequently than every two months?

Mr Hyden—We provide a report at each board meeting on the credit exposure. That is similar to the total exposure of the swap portfolio, because—

Ms GRIERSON—So you are saying that the secretary of Treasury is there, so he gets that report?

Mr Hyden—That is right.

Ms GRIERSON—But you do not report to Treasury in any other way?

Mr Hyden—The reporting through the board papers is the main way we provide regular reports to Treasury. The audit report did point out that our regular reporting to the board on credit exposures only goes one way because you only have a credit exposure when the swaps have a positive value, so the process we have introduced provides this broader picture. But that is being done on an annual basis.

Ms GRIERSON—That is now being done annually?

Mr Hyden—Yes.

Ms GRIERSON—And you think that is okay, Treasury? Does the secretary attend all those meetings, every two months?

Mr Hyden—Yes, normally.

Ms GRIERSON—Or his delegate? No, he cannot have a delegate; he has to attend himself, does he?

Mr Hyden—He normally attends. There can be occasions when he is not able to.

Mr Power—If I could mention a mitigating factor: the swaps represent off balance sheet assets. We have a huge portfolio of debt, so when interest rates go up that portfolio of debt has real value because we have borrowed at a certain rate. The net position on swaps is offsetting some of that, because we are moving from gross to net debt, so any fall in the value of the swaps is a positive to the whole picture. The government's position market to market—

Ms GRIERSON—Yes, so you would not want to get nervous on small changes. If there is a big change, it is counterbalanced. Is that what you are saying?

Mr Power—Yes.

Mr Hyden—I should also add that we do, in our financial statements, report on the market value of the portfolio, including the market value of the swap component of the portfolio. We are in the process of changing our accounting standards Commonwealth wide, which will come into effect from the end of this year. In our case, we have undertaken to report on a fair value basis—that is a market value basis—for virtually the entire portfolio.

Ms GRIERSON—In reporting to the parliament on the fiscal net debt portfolio and the swaps, is that just in your annual report?

Mr Hyden—Yes.

Ms GRIERSON—Have you changed your annual reporting format in the annual report, particularly on the efficiency of swap transactions?

Mr Hyden—We are working on our next annual report at the moment, and we are planning to make a number of changes in light of the audit.

Ms GRIERSON—So there will be efficiency measures in it.

Mr Hyden—We are looking to include an efficiency measure on the swap. It is very difficult to get a good measure, but we will use the best we can.

Ms GRIERSON—Everyone hates to put it down on paper, don't they?

Mr Hyden—It is not that we do not like putting it down, it is a problem of whether it is something which will be comprehensible to the reader. Some of our measures become quite technical because we are trying to get the right concept.

Ms GRIERSON—That is one of the challenges in economics, isn't it? Thank you.

CHAIR—Does anybody from the Audit Office wish to make any comments in relation to this hearing?

Mr Cochrane—No, thank you.

CHAIR—On behalf of the committee I would like to thank all the witnesses who have given evidence at the public hearing today.

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

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

Committee adjourned at 12.37 pm