

# **Report 390**

- **Administration of Taxation Rulings**
- **Commonwealth Estate Property Sales**
- **Administration of the Federation Fund Program**
- **Personnel Security—Management of Security Clearances**

Review of Auditor-General's Reports  
2001–2002  
First, Second and Third Quarters

Joint Committee of Public Accounts and Audit

August 2002  
Canberra

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## Foreword

**Report 390** is the outcome of the review by the Joint Committee of Public Accounts and Audit (JCPAA) of the Auditor-General's audit reports tabled in the first, second and third quarters of 2000–2001. Of the 38 audit reports reviewed, the Committee selected four for further examination.

Audit Report No. 3, *The Australian Taxation Office's Administration of Taxation Rulings*; Audit Report No. 4, *Commonwealth Estate Property Sales*, Department of Finance and Administration; Audit Report No 11, *Administration of the Federation Fund Program*, various agencies; and Audit Report no 22, *Personnel Security – Management of Security Clearances* were examined at public hearings in Canberra on 30 April 2002.

Audit Report No. 3 focused on the operation of the Australian Taxation Office's (ATO) administration of taxation rulings. The audit found that the processes for the production of public rulings of high technical quality operated effectively overall but the collection, analysis and use of performance information could be enhanced in some areas. However, the audit noted that the administrative processes for private rulings had operated poorly in many respects.

The Committee acknowledges the complex taxation matters dealt with and the rigorous review and approval processes employed by the ATO in issuing its public rulings. The Committee encourages the ATO to continue to improve its processes to enhance the clarity and content of public rulings.

The Committee considers that the ATO will have to monitor and assess the effectiveness and efficiency of procedures it has implemented to control the production of Private Binding Rulings and to ensure their quality.

Audit Report No. 4 focussed on the sale of nine properties in seven case studies, with a total value of \$619 million, and considered whether the property sale represented value for money to the Commonwealth.

While the Committee accepts that the differing views of the ANAO and DOFA as to the effectiveness of the properties sale are derived from differing policy perspectives on the matter, nevertheless, greater attention should have been paid to providing the Government with ongoing advice about the hurdle rate, especially as the economic factors were changing rapidly. In addition, DOFA should be considering the whole-of-life costs and benefits for each property to ensure that the Commonwealth achieves best value for money and actions taken are in its best interests. To ensure that the Commonwealth's financial position is maximised, the objective in the sale/leaseback property transaction is to negotiate a contract with the preferred bidder that delivers the highest possible Net Present Value (NPV).

The Committee endorses the audit suggestion that sale management better practices identified in Audit Report No. 4 should be applied to future Commonwealth property sales, including the forthcoming scheduled major sales at CSIRO and in the Defence portfolio.

When examining ANAO's Report No. 30, 1999–2000 *Examination of the Federation Cultural and Heritage Projects Program*, the Committee made two recommendations regarding grant programs. In particular the Committee recommended that all applicants, successful or otherwise, should be notified of the decision as soon as possible in writing and that those who were unsuccessful should be advised of relevant appeal processes and provided with guidance for improving subsequent applications.

The Committee was therefore concerned to find, when reviewing Audit Report No. 11, *Administration of the Federation Fund Program, 2001–2002*, that the time gap between decisions and announcements in the Major Projects program varied markedly. Having reviewed the audit report and considered the evidence presented, the Committee believes that the Federation Fund program could have been better managed from the start if a Commonwealth agency had been formally assigned a coordinating role and given monitoring responsibilities before actual applications were sought. Such coordination would have facilitated better sharing of experience and expertise across administering departments for the Federation Fund program.

Audit Report No. 22 reviewed a number of agencies to determine whether organisations were managing security clearance and vetting processes effectively and efficiently and in accordance with Commonwealth policy and the Protective Security Manual (PSM) 2000.



The audit found considerable scope for improvement. All but one of the organisations reviewed had a large number of security clearances overdue for review, few organisations had an up-to-date protective security risk management assessment and none had effectively integrated risk assessments into personnel security arrangements. The audit also found that effective information management systems were not in place to support personnel security in some organisations, and in most organisations, insufficient resources were allocated to the personnel security function to maintain new clearance requirements as well as clearance reviews.

The Committee encourages agencies to use the results of their risk management processes to achieve better informed clearance processes. Many agencies have not made sufficient resources available to deal with the backlog of security clearances and have not made changes to their information systems to support the security review clearance process.

The Committee recommends that all agencies allocate the resources necessary to bring their security clearance processes in line with the requirements of the Protective Security Manual, and that all agencies make the necessary changes to the Human Resource Management Information System to support management reporting in relation to security clearances and appropriate access to security clearance information.

The Committee also looked at portability of security clearances and the case for a central coordinating agency to take responsibility for the transfer of security clearances. The Committee recommends that the Attorney-General's Department report to the Committee on the cost effectiveness of the Department maintaining a central database of security clearances.

**Bob Charles MP**  
Chairman





# Membership of the Committee

## 40<sup>th</sup> Parliament

Chair            Mr Bob Charles MP

Deputy Chair   Ms Tanya Plibersek MP

Members        Senator Richard Colbeck

                    Senator John Hogg

                    Senator Claire Moore

                    Senator Andrew Murray

                    Senator Nigel Scullion

                    Senator John Watson

Mr Steven Ciobo MP

Mr John Cobb MP

Mr Petro Georgiou MP

Ms Sharon Grierson MP

Mr Alan Griffin MP

Ms Catherine King MP

Mr Peter King MP

The Hon Alex Somlyay MP



# Membership of the Sectional Committee

## 40<sup>th</sup> Parliament

Chair	Mr Bob Charles MP	
Deputy Chair	Ms Tanya Plibersek MP	
Members	Senator Richard Colbeck	Mr Steven Ciobo MP
	Senator John Hogg	Mr John Cobb MP
	Senator Claire Moore	Mr Petro Georgiou MP
	Senator Andrew Murray	Ms Sharon Grierson MP
	Senator Nigel Scullion	Mr Alan Griffin MP
	Senator John Watson	Ms Catherine King MP
		Mr Peter King MP
		The Hon Alex Somlyay MP

## Committee Secretariat

Secretary	Dr Margot Kerley
Inquiry staff	Ms Maureen Chan
	Ms Allyson Essex
	Ms Jennifer Hughson
	Ms Mary-Kate Jurcevic
	Ms Maria Pappas



## Duties of the Committee

The Joint Committee of Public Accounts and Audit is a statutory committee of the Australian Parliament, established by the *Public Accounts and Audit Committee Act 1951*.

Section 8(1) of the Act describes the Committee's duties as being:

- (a) to examine the accounts of the receipts and expenditure of the Commonwealth, including the financial statements given to the Auditor-General under subsections 49(1) and 55(2) of the *Financial Management and Accountability Act 1997*;
- (b) to examine the financial affairs of authorities of the Commonwealth to which this Act applies and of inter-governmental bodies to which this Act applies;
- (c) to examine all reports of the Auditor-General (including reports of the results of performance audits) that are tabled in each House of the Parliament;
- (d) to report to both Houses of the Parliament, with any comment it thinks fit, on any items or matters in those accounts, statements and reports, or any circumstances connected with them, that the Committee thinks should be drawn to the attention of the Parliament;
- (e) to report to both Houses of the Parliament any alteration that the Committee thinks desirable in:
  - (i) the form of the public accounts or in the method of keeping them; or
  - (ii) the mode of receipt, control, issue or payment of public moneys;
- (f) to inquire into any question connected with the public accounts which is referred to the Committee by either House of the Parliament, and to report to that House on that question;

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- (g) to consider:
    - (i) the operations of the Audit Office;
    - (ii) the resources of the Audit Office, including funding, staff and information technology;
    - (iii) reports of the Independent Auditor on operations of the Audit Office;
  - (h) to report to both Houses of the Parliament on any matter arising out of the Committee's consideration of the matters listed in paragraph (g), or on any other matter relating to the Auditor-General's functions and powers, that the Committee considers should be drawn to the attention of the Parliament;
  - (i) to report to both Houses of the Parliament on the performance of the Audit Office at any time;
  - (j) to consider draft estimates for the Audit Office submitted under section 53 of the *Auditor-General Act 1997*;
  - (k) to consider the level of fees determined by the Auditor-General under subsection 14(1) of the *Auditor-General Act 1997*;
  - (l) to make recommendations to both Houses of Parliament, and to the Minister who administers the *Auditor-General Act 1997*, on draft estimates referred to in paragraph (j);
  - (m) to determine the audit priorities of the Parliament and to advise the Auditor-General of those priorities;
  - (n) to determine the audit priorities of the Parliament for audits of the Audit Office and to advise the Independent Auditor of those priorities; and
  - (o) any other duties given to the Committee by this Act, by any other law or by Joint Standing Orders approved by both Houses of the Parliament.



## **List of abbreviations**

<b>AAT</b>	Administrative Appeals Tribunal
<b>ACS</b>	Australian Customs Service
<b>AFFA</b>	Department of Agriculture, Fisheries and Forestry—Australia
<b>AGSO</b>	Australian Geological Survey Office
<b>ANAO</b>	Australian National Audit Office
<b>ATO</b>	Australian Taxation Office
<b>AusAID</b>	Australian Agency for International Development
<b>AWM</b>	Australian War Memorial
<b>CPC</b>	Commonwealth Property Committee
<b>CPI</b>	Consumer Price Index
<b>CPPs</b>	Commonwealth Property Principles
<b>Customs</b>	Australian Customs Service
<b>DCITA</b>	Department of Communications, Information Technology and the Arts
<b>Defence</b>	Department of Defence
<b>DEH</b>	Department of Environment and Heritage

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<b>DFAT</b>	Department of Foreign Affairs and Trade
<b>DOFA</b>	Department of Finance and Administration
<b>DTRS</b>	Department of Transport and Regional Services
<b>FBT</b>	Fringe Benefits Tax
<b>FCHP</b>	Federation Cultural and Heritage Projects
<b>FCP</b>	Federation Community Projects
<b>GST</b>	Goods and Services Tax
<b>ISR</b>	Department of Industry, Science and Resources
<b>IT</b>	Information technology
<b>JCPAA</b>	Joint Committee of Public Accounts and Audit
<b>NTLG</b>	National Tax Liaison Group
<b>NPV</b>	Net Present Value
<b>PBR</b>	Private Binding Ruling
<b>PM&amp;C</b>	Department of Prime Minister and Cabinet
<b>PoA</b>	Provision of Advice (project)
<b>PSM</b>	Protective Security Manual
<b>SHFT</b>	Sydney Harbour Federation Trust
<b>SP&amp;I</b>	Special Purpose and Industrial Estate



## List of recommendations

### Audit Report No. 4, *Commonwealth Estate Property Sales*

#### Recommendation 1

- 3.58 The Committee recommends that the Department of Finance and Administrative Services accept all seven recommendations in Audit Report No. 4, 2001–2002, *Commonwealth Estate Property Sales*.

#### Recommendation 2

- 3.60 The Committee recommends that the Department of Finance and Administrative Services, in consultation with the Australian National Audit Office, by June 2003, develop, publish and apply a sale management better practice guide for the disposal of future Commonwealth estate properties.

### Audit Report No.11, *Administration of the Federation Fund Program*

#### Recommendation 3

- 4.15 The Committee recommends that government agencies responsible for Commonwealth grants ensure that after grant decisions have been made, all applicants, successful or otherwise, be notified of the results as soon as possible in writing, advised of relevant appeal processes and provided with guidance for improving future applications.

**Recommendation 4**

- 4.19 The Committee recommends that in future funding programs of national significance, a Commonwealth agency be given coordinating and monitoring responsibilities.

**Recommendation 5**

- 4.27 The Committee recommends that *Better Guide on the Administration of Grants* published by the Australian National Audit Office should be examined and adopted by Commonwealth agencies whenever they have grant management responsibilities.

**Recommendation 6**

- 4.51 The Committee recommends that a coordinating agency once appointed, will report on the funding programs it is overseeing against program outputs in its annual reports.

**Audit Report No.22, *Personnel Security—Management of Security Clearances*****Recommendation 7**

- 5.42 The Committee recommends that all agencies allocate the resources necessary to bring their security clearance processes in line with the requirements of the Protective Security Manual.

**Recommendation 8**

- 5.43 The Committee recommends that all agencies make the necessary changes to their Human Resource Management Information System to support management reporting in relation to security clearances and appropriate access to security clearance information.

**Recommendation 9**

- 5.54 The Committee recommends that the Attorney General's Department report to the JCPAA on the cost effectiveness of the Department's maintaining a central database of security clearances.



## Introduction

- 1.1 One of the statutory duties of the Joint Committee on Public Accounts and Audit (JCPAA) is to examine all reports of the Auditor-General. In doing this, the JCPAA considers the significance of the program or issues raised in the audit reports; the significance of the findings; the arguments advanced by the audited agencies; and the public interest of the report. The Committee then reports the results of its deliberations to both Houses of Parliament.
- 1.2 Upon consideration of the thirty-eight audit reports presented to the Parliament by the Auditor-General during the first, second and third quarters of 2001–2002, the JCPAA selected four reports for further scrutiny at public hearings. The public hearings were conducted in Canberra on Friday, 31 May 2002.
- 1.3 The reports selected were:
  - Audit Report No. 3, 2001-2002, *The Australian Taxation Office's Administration of Taxation Rulings*; **(Chapter 2)**
  - Audit Report No. 4, 2001-2002, *Commonwealth Estate Property Sales*, Department of Finance and Administration; **(Chapter 3)**
  - Audit Report No. 11, 2001-2002, *Administration of the Federation Fund Program*, various agencies; **(Chapter 4)** and
  - Audit Report No.22, 2001-2002, *Personnel Security—Management of Security Clearances*, various agencies. **(Chapter 5)**

## The Report

- 1.4 This report of the JCPAA's examination draws attention to the main issues raised at the public hearings. Where appropriate, the Committee has commented on unresolved or contentious issues and made recommendations.
- 1.5 A copy of this report is available on the JCPAA website at <http://www.aph.gov.au/house/committee/jpaa/reports.htm>

## Audit Report No. 3, 2001–2002

# Administration of Taxation Rulings

Australian Taxation Office

## Introduction

## Background

- 2.1 A significant element of the Australian Taxation Office's (ATO's) administration of the taxation law is the provision of interpretative advice on taxation issues to taxpayers. The provision of taxation advice is particularly important given Australia's self-assessment taxation system, which relies heavily upon taxpayers having a good understanding of the taxation law in order to fulfil their taxation obligations.<sup>1</sup>
- 2.2 A key mechanism used by the ATO to disseminate the Commissioner of Taxation's (the Commissioner's) interpretative advice on the Australian taxation law is taxation rulings. Taxation rulings were first introduced by the ATO in 1982. The taxation rulings system was refined further in 1992 to allow the ATO to give certain parts of the advice it was already giving, in a legally binding form (ie public rulings and private rulings). Private

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<sup>1</sup> ANAO, Audit Report No. 3, *The Australian Taxation Office's Administration of Taxation Rulings, 2001–2002*, Commonwealth of Australia, p. 13.

rulings became reviewable by the Administrative Appeals Tribunal or the courts.<sup>2</sup>

- 2.3 Since that time, the ATO has created a number of other categories of taxation rulings to aid the provision of interpretative taxation advice to taxpayers.<sup>3</sup>
- 2.4 In the calendar year 2000, the ATO issued 133 public rulings, 102 product rulings and 89 779 private rulings.<sup>4</sup>

## The ANAO audit

- 2.5 In Audit Report No. 3, *The Australian Taxation Office's Administration of Taxation Rulings, 2001–2002*, the topic of rulings is of interest because of its significance to the effective functioning of the tax system. Taxpayers should be able to rely on applicable taxation rulings to assess their liability. For them to do so, it is imperative that taxation rulings are clear and unambiguous, comply with the taxation law, and are consistent with existing tax rulings.<sup>5</sup>
- 2.6 The objective of the audit was to report to Parliament on the operation of the ATO's administration of taxation rulings and, where appropriate, make recommendations for improvements having regard to efficiency and effectiveness, consistency and fairness for taxpayers, and good corporate governance.<sup>6</sup>

## Audit findings

- 2.7 Inter alia, Audit Report No. 3, 2001-2002, *The Australian Taxation Office's Administration of Taxation Rulings* found that:
- without taxation rulings systems, taxpayers would face a less certain, and probably more costly, environment in meeting their tax obligations;
  - the ATO has invested a large amount of resources in a comprehensive public rulings system which includes control measures that promote the production of public rulings of high technical quality. However, there is scope to improve the

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2 *Taxation Laws Amendment (Self-Assessment) Act 1992*

3 ANAO, Audit Report No. 3, 2001–2002, p. 13.

4 ANAO, Audit Report No. 3, 2001–2002, p. 14.

5 ANAO, Audit Report No. 3, 2001–2002, p. 45.

6 ANAO, Audit Report No. 3, 2001–2002, pp. 45-6.



collection, analysis and use of performance information relevant to public rulings;

- the mechanisms in place for public rulings substantially provide for consistent and fair treatment for taxpayers;
- the administrative processes for private rulings have operated poorly in many respects although the ATO has been improving its private rulings system and continues to do so;
- at the time of the audit, the lack of integration of systems and inadequate systems controls for private rulings undermined certainty, fairness and consistency of treatment for taxpayers;
- the overall management of the public and private rulings systems continues to be an area requiring careful ATO attention; and
- the ATO's corporate governance arrangements in respect of public and private rulings could be improved to achieve greater efficiency and effectiveness.<sup>7</sup>

2.8 The ATO agreed to all 12 audit report recommendations.

## The JCPAA's Review

2.9 At the public hearing, the Joint Committee of Public Accounts and Audit took evidence on the following issues:

- timeliness of public rulings;
- clarity of the content of public rulings;
- consistency of private rulings;
- cost of private rulings; and
- improvements to tax rulings administration.

## Timeliness of public rulings

2.10 Public rulings are the considered and decided position of the commissioner on the interpretation of the laws relating to income

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<sup>7</sup> ANAO, Audit Report No. 3, 2001–2002, p. 18.

tax, Fringe Benefits Tax (FBT) and the Goods and Services Tax (GST).<sup>8</sup>

- 2.11 Overall, the ANAO found that the ATO has a well-developed public rulings system. The system draws on the expertise of ATO staff with detailed knowledge of taxation law, industry and community group experts, academics and the general public. The ANAO stated that the ‘...system incorporates control mechanisms that allow the ATO to produce public rulings of high technical quality and the ATO can obtain feedback on the technical quality and clarity of rulings from stakeholders, for example through official ATO public rulings panels and the [National Tax Liaison Group] NTLG’.<sup>9</sup>
- 2.12 The ANAO noted in its audit that while some stakeholders were satisfied with, or complimentary about, the ATO’s topic selection and drafting processes associated with public rulings, some raised concern at the length of time it took the ATO to process and publish some public rulings.<sup>10</sup>
- 2.13 The Committee asked the ATO to comment on the timeliness of public rulings.<sup>11</sup>
- 2.14 In responding, the ATO acknowledged its concern about the timeliness of public rulings and advised that it had been looking closely over the last 12 months at ways to improve the timeliness:

...usually our public rulings are dealing with very controversial and grey areas of the laws.... With some of the public rulings that we put out, we go through a very long consultation process.

Sometimes there are difficulties in actually establishing a better view of the law. ...we are seeking to put out a product that provides guidance to taxpayers, that provides a better view of the law that is consistent with the underlying policy of the law. Nevertheless, we acknowledge it, and we are taking action to improve the timeliness of our public rulings processes. We have consulted in particular with external members of our public rulings panels. A number of suggestions made by

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8 ANAO, Audit Report No. 3, 2001–2002, p. 52.

9 ANAO, Audit Report No. 3, 2001–2002, p. 70.

10 ANAO, Audit Report No. 3, 2001–2002, p. 56.

11 *Transcript*, 31 May 2002, p. 4.

those members have been incorporated into our processes.<sup>12</sup>

- 2.15 The ATO made the point that in the last two to three years there had been an increased pressure on the public rulings process following the introduction of the GST and a number of other major tax reforms.<sup>13</sup>

## Committee comments

- 2.16 The Committee acknowledges the complex taxation matters dealt with and the rigorous review and approval processes employed by the ATO in issuing its public rulings. The Committee notes that the ATO has agreed to articulate the approach it uses to prioritise public rulings and to document how it has applied that approach to determine the priority of topics identified for its public rulings program.

## Clarity of the content of public rulings

- 2.17 The ANAO noted that an important source of feedback on public rulings were the courts and tribunals.<sup>14</sup>
- 2.18 The Committee drew the ATO's attention to the ANAO's finding that in 28 per cent of AAT decisions and 17 per cent of court judgments, public rulings had been commented on adversely. The Committee asked the ATO what it had done to reduce that figure.<sup>15</sup>
- 2.19 The ATO reiterated that public rulings were dealing with controversial issues and grey areas of the law, and that not everyone agreed with the ATO's final decision on issues:

The purpose of the ATO is to put out this advice to assist the community to comply with the tax law. We put out what we consider to be the better view of the law that is consistent with the underlying policy of the law that we are interpreting. Nevertheless, there are always going to

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12 *Transcript*, 31 May 2002, p. 4.

13 *Transcript*, 31 May 2002, p. 4.

14 ANAO, Audit Report No. 3, 2001–2002, p. 88.

15 *Transcript*, 31 May 2002, p. 6; ANAO, Audit Report No. 3, 2001–2002, p. 8.

be cases where the courts disagree with our view of the law.<sup>16</sup>

- 2.20 The ATO pointed out that some of the adverse comments were not directed at whether the ATO's view of the law was correct or not, but criticised the way in which the ATO articulated what part of a taxation ruling was a public ruling for the purpose of the Taxation Administration Act.<sup>17</sup>
- 2.21 The Committee asked the ATO what procedure it employed when, as a result of developing a public ruling or adverse comment from the courts, it became clear that legislation required clarification.<sup>18</sup>
- 2.22 In response, the ATO outlined its procedure:
- Where there is a decision of the court which we consider, for example, is not consistent with the underlying policy and rejects our interpretation of the law, that is something that we do bring to the attention of the government to ascertain whether or not the government ...wishes to make any changes to the law in that respect.<sup>19</sup>
- 2.23 In response to questioning about the mechanism for informing Parliament of a lack of certainty or clarity in the tax law, the ATO acknowledged that it had no process to report to the Parliament.<sup>20</sup>

## Committee comments

- 2.24 While the views of the courts and tribunals are diverse, the Committee notes the ANAO finding that in court and tribunal comment on public rulings there appears to be a tendency for approving references to increase slightly and disapproving references to decrease slightly.<sup>21</sup>
- 2.25 The Committee encourages the ATO to continue to improve its processes to enhance the clarity and content of public rulings.
- 2.26 The Committee notes that while the ATO has no mechanism for informing Parliament of a lack of certainty or clarity in the tax

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16 T Meredith, ATO, *Transcript*, 31 May 2002, p. 6.

17 Meredith, *Transcript*, 31 May 2002, pp. 6-7.

18 *Transcript*, 31 May 2002, p. 7.

19 Meredith, *Transcript*, 31 May 2002, p. 7.

20 P Foster, ATO, *Transcript*, 31 May 2002, p. 7.

21 ANAO, Audit Report No. 3, 2001-2002, p. 89.

law, it reports annually to Parliament and maintains a close relationship with the Parliament through discussions with parliamentary committees on legislation and other matters of concern.

## Consistency of private rulings

- 2.27 Private rulings, or Private Binding Rulings (PBRs) were introduced in 1992. A PBR is the Commissioner's written opinion on the way in which the tax laws apply to an income tax or FBT arrangement a taxpayer has entered into, or proposes to enter into, after 1 July 1992. Unlike public rulings which can address a number of arrangements for a number of taxpayers in a single ruling, PBRs address specific arrangements that are proposed, or have been entered into or completed by a particular taxpayer. Accordingly, the matters covered by a PBR are specific to the rulee, tax law, year of income and arrangement dealt with in the ruling.<sup>22</sup>
- 2.28 The audit found that the ATO's IT systems were a key weakness in the production and management of private rulings and the poor performance of these disparate systems has had a detrimental impact on the controls over the processes and the subsequent management of private rulings.<sup>23</sup>
- 2.29 The audit report stated that without a comprehensive, up to date precedential database, it would be difficult for the ATO to ensure that decisions taken in older PBRs were consistent, where necessary, with those being considered in respect of newer PBRs. The report noted that PBRs could be issued from numerous exit points and, in the absence of compensating controls, having numerous exit points decreased the control the ATO had in relation to the issue of legitimate PBRs.<sup>24</sup>
- 2.30 The Committee asked the ATO what changes to IT systems and other systems had been made to allow for greater consistency in issuing private rulings.<sup>25</sup>

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22 ANAO, Audit Report No. 3, 2001–2002, p. 98.

23 ANAO, Audit Report No. 3, 2001–2002, p. 22.

24 ANAO, Audit Report No. 3, 2001–2002, pp. 110, 111.

25 *Transcript*, 31 May 2002, p. 5.

- 2.31 In reply, the ATO advised the Committee that in an area of law where there was no PBR precedent in existence, it now required a PBR request to be forwarded to one of a number of identified centres of expertise. Formerly, this process had been followed only in relation to new business tax reform law:

[The centres] will be in full production and operational by the end of June. That is causing anything where there is not a precedent to come to a smaller group of experts. So that helps us a lot on consistency. Where there is a precedent, and that precedent can be identified by a unique identifier, our business line operatives must be able to sight that precedent before they can give advice.<sup>26</sup>

- 2.32 The ATO stated that its aim was to build the database of precedents (called ATO interpretative decisions) both for the use of its staff and the guidance of the community. To the latter end, the database has been placed on the *ATOassist* website.<sup>27</sup>
- 2.33 In response to further questioning, the ATO advised the Committee that it had placed approximately 1300 interpretive decisions on the database.<sup>28</sup>

## Committee comments

- 2.34 The Committee notes that as part of the Provision of Advice (PoA) project, it has made alterations to existing IT systems to allow a unique identifying number to be assigned to each PBR. The Committee also notes the ANAO's view that the sequential numbering of PBRs will go some way to improving the controls associated with issuing PBRs from numerous exit points.<sup>29</sup>
- 2.35 The Committee agrees with the ANAO that the test for the ATO is whether the procedures it has implemented to control the production of high quality PBRs result in a more efficient and effective PBR system.

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26 Foster, *Transcript*, 31 May 2002, p. 5.

27 M Bond, ATO, *Transcript*, 31 May 2002, p. 5.

28 Bond, *Transcript*, 31 May 2002, p. 6.

29 ANAO, Audit Report No. 3, 2001–2002, p. 112.

## Cost of private rulings

2.36 During its audit, the ANAO sought to obtain performance information concerning the overall performance of the PBR production process. This information included the total cost of issuing PBRs. The ATO was unable to determine the total costs associated with providing PBR services:

The principal cost in producing PBRs is the direct staff time spent drafting, reviewing and publishing PBRs. The ATO does not have a system to identify the number of ATO staff that have these PBR responsibilities.<sup>30</sup>

2.37 The Committee asked the ATO whether it could provide information on the range of costs incurred in producing PBRs.<sup>31</sup>

2.38 The ATO replied that while it was not able to provide the information currently, it had accepted the ANAO's recommendation and part of its systems development, due to come on stream late in 2002, would enable it to capture the costs of a private ruling.<sup>32</sup>

2.39 The ATO later advised the Committee that the second phase of system development would enable costing of public (including product) rulings.<sup>33</sup>

## Corporate governance

2.40 The audit report stated that good corporate governance would require a robust system of internal controls, including accurate and comprehensive sources of procedural guidance, vigorous checks on the quality of rulings made and effective training of staff to ensure that they have appropriate skills and experience. The audit found that the ATO's performance against these criteria was mixed.<sup>34</sup>

2.41 The Committee asked the ATO what its response had been to the criticism in the audit report that sources of procedural guidance

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30 ANAO, Audit Report No. 3, 2001–2002, pp. 114-15.

31 *Transcript*, 31 May 2002, p. 11.

32 Bond, *Transcript*, 31 May 2002, p. 11.

33 ATO, Submission No. 14, p. 2.

34 ANAO, Audit Report No. 3, 2001–2002, p. 169.

for public and private rulings were inadequate because of incomplete manuals and dispersed guidance.<sup>35</sup>

- 2.42 In response, the ATO noted that its advice manual had been updated to include process improvements to date:

It has been linked to our relative practice statements, which are our instructions to staff, and to procedural materials. It is now available in electronic form. It is supported by an electronic alert facility, so that staff can be quickly advised of changes to practices and processes.<sup>36</sup>

- 2.43 The ATO advised the Committee that it now had a process in place to continuously enhance the manual and maintain its currency.<sup>37</sup>

## Improvements to taxation rulings administration

- 2.44 The Committee sought information from the ATO about a number of initiatives it had in place, including the role of the Professional Excellence Forum and the resourcing and priorities of a new branch created within the ATO to facilitate the ATO's improvement program.<sup>38</sup>

- 2.45 The ATO stated that as suggested by the ANAO, it was using the Professional Excellence Program to ensure that it remained focused on delivering outcomes. The forum members are senior tax officers, members of the business community (including the small business community) and private sector tax professionals:

...the Professional Excellence Forums have been in existence for some time. .... We are using [the forum] as the vehicle to make sure that we carry through the things that we have to improve as a result of the report.<sup>39</sup>

- 2.46 In relation to its new branch, the ATO advised that it gave a stronger focus to the development and maintenance of the

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35 *Transcript*, 31 May 2002, p. 16; ANAO, Audit Report No. 3, 2001–2002, p. 169.

36 Meredith, *Transcript*, 31 May 2002, p. 16.

37 Meredith, *Transcript*, 31 May 2002, p. 16.

38 *Transcript*, 31 May 2002, pp. 8, 9.

39 Foster, *Transcript*, 31 May 2002, pp. 3, 9.



infrastructure for technical decision making, especially the binding advice area:

... we basically have three arms in the branch. The first arm looks at work practice and process. .... We are trying to make sure that there are some core practices and processes in place so that we can have a corporate control over the production of rulings and other things.

The second stream looks at the technology side. ... we have basically done some work on our systems already. We have made them more integrated, as the ANAO wished, and we are taking further steps now to improve those systems once more. The third stream is a stream that has, in some ways, two roles. There is a resource of eight or nine who are purely involved in publishing private rulings....

The other important role which we are currently resourcing, now that we have got better systems and have the ATO interpretive decisions on a database and have the public register of private binding rulings,...[is] the ability to start trawling that information to see what trends...are showing up. We might use that to improve compliance practices...<sup>40</sup>

2.47 The Committee sought assurance from the ATO on its ability to meet the challenge of putting the PoA initiative in place as comprehensively and expeditiously as intended.<sup>41</sup>

2.48 The ATO advised the Committee that it had great confidence that it could meet the challenge. It noted that a lot of the work had already been done: better systems were in place to capture information, stronger databases had been established, and professional accreditation had been put in place to ensure that people authorising rulings had the appropriate skills and qualifications:

We are going further with systems improvement. We are going further with [the] corporate approach to setting precedent...with centres of expertise et cetera...

...additional resources for new branches [has been sought and obtained]. We have got a very high priority

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40 Bond, *Transcript*, 31 May 2002, pp. 2, 9-10.

41 *Transcript*, 31 May 2002, p. 15; ANAO, Audit Report No. 3, 2001-2002, pp. 22-3.

in our IT system-build plans...and [we are] subjecting ourselves to a large degree of external reporting back through [the Professional Excellence Forum].<sup>42</sup>

- 2.49 The ATO told the Committee that while there had been incremental improvements since 1992 when private rulings were introduced, the issue had never had the internal degree of importance and emphasis that it had now.

### Committee comments

- 2.50 The Committee is pleased with the focus of the ATO on getting the rulings system working as it should and on the priority the issue appears to have within the ATO.
- 2.51 The Committee acknowledges the cooperative approach of the ATO and praises its willingness to move forward on issues brought to its attention. The Committee also notes the positive view of the ANAO in relation to the ATO's response to the audit process, the constructive approach it is taking in addressing some major issues and its implementation of both ANAO and Sherman report recommendations.<sup>43</sup>

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42 Bond, Foster, *Transcript*, 31 May 2002, p. 15.

43 The Sherman review was prompted by the intense public and parliamentary interest which followed the laying of charges against a former senior executive of the ATO involved in providing private rulings, and media criticism of aspects of the private rulings system. (Sherman T., *Report of an Internal Review of the Systems and Procedures relating to Private Binding Rulings and Advance Opinions in the Australian Tax Office*, August 2000)

## Audit Report No. 4, 2001–2002

# Commonwealth Estate Property Sales

Department of Finance and Administration

## Background

- 3.1 In the 1996–97 Budget context, a set of Commonwealth Property Principles (CPPs) was endorsed by the Government, setting the framework for decisions to retain or dispose of Commonwealth property. Basically there were two tests applied in the divestment: (a) was it in the national interest to own rather than lease properties; and (b) did the proposed sale meet the hurdle rate?<sup>1</sup>
- 3.2 The Government decided that all properties that did not meet the criteria laid down in the CPPs should not be owned by the Commonwealth.<sup>2</sup> A Commonwealth Property Committee (CPC) was established to implement the CPPs and to independently advise the responsible Minister on the whole-of-government management and coordination of the strategy for the divestment of property no longer to be owned by the Commonwealth.<sup>3</sup>

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1 ANAO, Audit Report No. 4, *Commonwealth Estate Property Sales*, Department of Finance and Administration, 2001–2002, Commonwealth of Australia, pp.27–32, 36–37.

2 ANAO, Audit Report No. 4, 2001–2002, pp. 36–37.

3 ANAO, Audit Report No. 4, 2001–2002, p. 36.

- 3.3 Prior to commencing the divestment program in 1997–98, the domestic estate comprised 790 properties valued at \$2.33 billion. The Commercial Office Estate (Office Estate)—valued at \$1.254 billion—was the largest component; followed by the Special Purpose and Industrial (SP&I) Estate (\$694 m); and Public Interest Estate (\$385 m).<sup>4</sup>
- 3.4 Review of the domestic estate by the CPC began during 1996–97 with the assessment of individual properties within the Office Estate against the CPPs which stated that the Commonwealth should own property only where the long-term yield rate exceeds the social opportunity cost of capital or where it is in the public interest to do so. The divestment strategy recommended by the CPC was endorsed by the Government in April 1997 and involved the divestment of 57 (later 59) Office Estate properties over a three-year period.<sup>5</sup> The aggregate book value of the properties identified for divestment was \$1.05 billion as at 30 June 1996.<sup>6</sup> The Government was advised that the sale of the properties would increase net budget outlays in the longer term as future rental payments to the private sector grew.
- 3.5 In implementing the divestment program, the Department of Finance and Administration (DOFA) relied on the private sector to manage the sales process.<sup>7</sup> This included the use of consultants for property sales advice, legal advice, property marketing, and sales preparation including property due diligence. The divestment process was coordinated by the Divestment Unit within the Property Group of DOFA.

## The audit

- 3.6 The Australian National Audit Office (ANAO) reviewed the sale of properties from that portion of the domestic property estate managed by DOFA and identified for sale in April 1997, via a three year divestment strategy of the Commercial Office Estate. DOFA advised ANAO in April 2001 that its role was to implement a

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4 ANAO, Audit Report No. 4, 2001–2002, p. 27.

5 ANAO, Audit Report No. 4, 2001–2002, pp. 27, 30.

6 The book values were the basis on which the rates of return were initially calculated. ANAO, Audit Report No. 4, 2001–2002, p. 32.

7 ANAO, Audit Report No. 4, 2001–2002, p. 47.

property divestment program endorsed by Ministers and that it was not charged with the role of protecting the overall interest of the Commonwealth.<sup>8</sup>

3.7 Within this audit mandate, ANAO felt it was quite appropriate to review:

- the advice given to ministers, in terms of its completeness and accuracy; and
- the financial consequences of the advice given and taken.

3.8 The audit focused on the sale of nine properties in seven case studies, with a total value of \$619 m, and considered whether the property sale represented value for money to the Commonwealth.<sup>9</sup>

## Audit findings

3.9 Inter alia, Audit Report No. 4, *Commonwealth Estate Property Sales* found that:

- Total gross proceeds from the Office Estate properties sale included in the three year divestment program were \$983m as at April 2001, with three of the 59 properties remaining unsold.<sup>10</sup>
  - ⇒ The sales program was successful in that total proceeds to April 2001 have exceeded revenue targets by \$130m or 15 per cent.<sup>11</sup>
- One-quarter of the total properties recommended for divestment were packaged, and these realised 85 per cent of the total sale proceeds.<sup>12</sup> Most material properties reviewed in the audit were sold at, or above, the final market value at the time of the sale.<sup>13</sup>
  - ⇒ The majority of the bids for the packages, however, were categorised as non-conforming.
  - ⇒ Some of the non-conforming bids were successful purchasers.<sup>14</sup>

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8 ANAO, Audit Report No. 4, 2001–2002, p. 14.

9 See Table 1.3 in ANAO, Audit Report No. 4, 2001–2002, p. 33.

10 See Table 1.3 in ANAO, Audit Report No. 4, 2001–2002, p. 33.

11 ANAO, Audit Report No. 4, 2001–2002, p. 55.

12 See Table 1.3 in ANAO, Audit Report No. 4, 2001–2002, p. 55.

13 ANAO, Audit Report No. 4, 2001–2002, p. 13.

14 ANAO, Audit Report No. 4, 2001–2002, p. 85.

- Each of the lower value property sales reviewed by ANAO at Rockhampton, Bendigo and Wagga Wagga sold for prices well below the valuations used in the initial decision to divest the properties.<sup>15</sup>
- The successful tender for Package 3 (RG Casey Building and Adelaide Commonwealth Centre) included a condition whereby the purchase price could fall by up to \$15 m in the event that interest rates increased.
  - ⇒ DOFA did not obtain advice as to whether the interest rate condition in the successful tender needed to be managed, or how this should be done.<sup>16</sup>
- DOFA did not conduct financial capability assessments on short-listed tenderers or require bidders to lodge a security with the bid.
  - ⇒ As a result, when the selected tenderer for the AGSO property withdrew after being advised of its success, the Commonwealth ended up accepting a price some \$5.6m less than it would have received had the sale been completed with the original choice.<sup>17</sup>
- The cost of sales was estimated by DOFA as \$20.6m or 2.1 per cent of sale proceeds.<sup>18</sup>
- The cost of legal services provided for the sale of the packaged properties was estimated as \$3.6m.<sup>19</sup>

## Committee's concerns

3.10 At the public hearing, the Committee raised the following issues.

- The high level of disagreement between ANAO and DOFA.
- Among the Committee's concerns was DOFA's rejection of all seven audit recommendations because it considered 'the concepts that underpin the report are fundamentally flawed'.<sup>20</sup> ANAO, on the other hand, maintained that its

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15 ANAO, Audit Report No. 4, 2001–2002, p. 79.

16 ANAO, Audit Report No. 4, 2001–2002, p. 86.

17 ANAO, Audit Report No. 4, 2001–2002, p. 98.

18 ANAO, Audit Report No. 4, 2001–2002, p. 58.

19 ANAO, Audit Report No. 4, 2001–2002, p. 71.

20 ANAO, Audit Report No. 4, 2001–2002, p. 21.

recommendations were ‘framed to achieve improved administrative practices for future property sales’.<sup>21</sup>

- The basis of DOFA’s advice to the Government on the hurdle rate of 15 per cent—an issue of major difference between ANAO and DOFA were examined by the Committee.
- The committee also examined DOFA’s reported comment to ANAO that, while its role was to implement Government decisions for the divestment of property, it ‘was not charged with the role of protecting the overall interest of the Commonwealth’.<sup>22</sup> The Committee wanted to examine this more fully.

3.11 Finally, the Committee examined the management of the sale process including the sale and leaseback arrangements.

## Commonwealth interests

3.12 ANAO reported that DOFA had stated that its role was to implement Government decisions for the divestment of property: it was not charged with the role of protecting the overall interest of the Commonwealth.<sup>23</sup> In previous sales of Commonwealth assets, DOFA had sought to determine best value to the Commonwealth through evaluation of the price offered, and risk of non-completion through adherence to foreign ownership and other tender conformity requirements.<sup>24</sup> In the sales being reviewed by ANAO, DOFA had obtained a market valuation of the property to establish a best estimate of the potential sale price. A valuation had also been sought for each package of properties.

3.13 ANAO maintained that for the sales of Commonwealth estate properties:

...the individual tender evaluation criteria did not explicitly address how Finance would determine which offer represented the best value to the Commonwealth beyond being the highest price, as opposed to the option

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21 ANAO, Audit Report No. 4, 2001–2002, p. 21.

22 ANAO, Audit Report No. 4, 2001–2002, pp. 52, 92.

23 ANAO, Audit Report No. 4, 2001–2002, p. 52.

24 ANAO, Audit Report No. 4, 2001–2002, p. 53.

of retention if this provided a greater financial benefit to the Commonwealth.<sup>25</sup>

3.14 Five of the six packages sold above market value, while five of the 15 properties included in the packaged property sales were sold at notional prices below the current market valuation. During the sale process, DOFA evaluated the purchase price for each package rather than the notional purchase price assigned by the purchaser to each property within the package. Of the 37 properties divested individually, 10 property sales (23 per cent) were concluded at sale prices below the current market valuation.<sup>26</sup>

3.15 These transactions led ANAO to conclude that in the property sale transactions audited:

...it was not apparent that a systematic process of inquiry, as required under the FMA Regulations and the Guidelines, was conducted by Finance prior to executing the sale contract and leasing arrangements with the purchasers. If a decision is made for example, that the lease does not represent value for money...a further decision could include that the property to be sold ...should be withdrawn from sale and retained. Similarly, a decision might also be made that the terms and conditions of the lease be revisited and the property sale proceed subject to a lease with different terms and conditions.<sup>27</sup>

3.16 At the public hearing, DOFA officers were at pains to correct the impression that it was not 'protecting the overall interest of the Commonwealth'. The Committee was directed to paragraph 4.42 of the Audit Report No. 4, where DOFA had advised ANAO that:

DOFA's role was to implement the Cabinet decisions to divest property in accordance with the Commonwealth Property Committee (CPC) reports. ...The overall interests of the Commonwealth were considered in the development of the Commonwealth Property Principles (CPP) and the CPC's implementation. Each occupying

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25 ANAO, Audit Report No. 4, 2001–2002, p. 53.

26 ANAO, Audit Report No. 4, 2001–2002, pp. 54–55.

27 ANAO, Audit Report No. 4, 2001–2002, p. 89.



Department was involved in negotiating leases and thus ensuring the operating and financial arrangement for their agency.<sup>28</sup>

3.17 DOFA added: 'I do not want it left on the record in any way that Finance does not believe it has a whole of government responsibility for value for money decisions. We do, and we treat that responsibility very seriously'.<sup>29</sup>

3.18 DOFA believed that the Government achieved value for money because:

At the point of adopting that hurdle rate of return, it made a value for money judgment. That value for money judgment was this: it would not retain property, unless there was a public interest reason for doing so, that had an internal rate of return of less than the hurdle. So by the government's standard of a hurdle rate, the fact that properties that were sold did not achieve the hurdle rate meant that by definition the government achieved value for money under its criteria.<sup>30</sup>

3.19 The Committee noted the comment that DOFA saw its role as protecting the overall interest of the Commonwealth, although it was mindful of the audit view that a whole-of-life evaluation should have been made. The Committee firmly believes that DOFA is the only agency best positioned to:

- ensure that property divestment is consistent with the CPPs;
- make an informed judgment as to whether a property sale and leaseback transaction represents efficient and effective use of Commonwealth resources; and
- decide if a transaction is in the overall interest of the Commonwealth.

## Divestment strategy

3.20 The Committee was interested to know the basis of the hurdle rate of 15 per cent used as the basis for the divestment strategy.

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28 ANAO, Audit Report No. 4, 2001–2002, p. 89.

29 E. Bowen, DOFA, *Transcript*, 31 May 2002, p. 34.

30 Bowen, *Transcript*, 31 May 2002, p. 38.

A hurdle rate, based on DOFA advice, was central to the Government decision to divest itself of estate properties.<sup>31</sup> As DOFA explained at the public hearing:

It was not open to Finance to arbitrarily change or take a view on a particular hurdle rate that had been adopted by the government. The government adopted that rate in 1996 when interest rates, the cost of funds, were substantially higher than they are today. It applied a risk premium to that cost of funds to arrive at a rate between 14 and 15 per cent—it was actually a band. The government has recently, in the latest budget in fact, adopted a revised hurdle rate. That is a rate of 11 per cent. That rate is aligned with the government's capital use charge rate and it is the rate that the government has said it will use in determining the appropriateness of long-term investment decisions.<sup>32</sup>

3.21 In 1999 and 2000, DOFA commissioned two consultant reports to help determine the revised hurdle rate.<sup>33</sup> The 1999 report suggested that 'the most likely estimate of the return to property is around 10 per cent, although there is considerable uncertainty surrounding this estimate'.<sup>34</sup> The July 2000 report suggested that 'a wide range for the property hurdle return is appropriate, with the upper bound at approximately 11%'.<sup>35</sup>

3.22 When questioned on how the hurdle rates were developed, DOFA explained that the 2002–2003 hurdle rate was based on:

...the 10-year average of the 10-year bond rate, to get a bit of stability into it. You are not investing by hopping into the market and hopping out. They are long-term decisions, whether you buy or whether you sell and rent. The government has adopted a rate which is based on that 10-year average of the long-term bond rate. It has added to that a premium for risk based on the 10-year average of the premium obtained in the equity market. It

31 See the diagram in ANAO, Audit Report No. 4, 2001–2002, p. 38. In the audit report, ANAO outlined how the final hurdle rate was derived before its final adoption by the Government.

32 Bowen, *Transcript*, 31 May 2002, p. 36.

33 ANAO informed the Committee that the external reports were prepared by Access Economics, B Jackson, ANAO, *Transcript*, 31 May 2002, p. 46; ANAO advice dated 25 June 2002. ANAO, Audit Report No. 4, 2001–2002, pp. 40–41.

34 ANAO, Audit Report No. 4, 2001–2002, p. 40.

35 ANAO, Audit Report No. 4, 2001–2002, p. 41.

is not perfect, but it is a good approximation for a risk weighting on a broad spectrum of activity. That has resulted in the rate of 11 per cent.<sup>36</sup>

3.23 The hurdle rate of 14–15 per cent, in place from 1996 till 2002, however:

...was done on a slightly different basis. But both applied the capital asset pricing model that the ANAO recommends, in concept at least. But it was slightly different, in that it was more the interest rates at the time. We have now looked at a 10-year average, which we think is a better way to apply it for the future.<sup>37</sup>

3.24 When asked to comment on this, given its criticism of the previous hurdle rate of 14–15 per cent, ANAO explained that it 'would not quibble with the outcome' of 11 per cent but it 'would have a slightly different approach to calculating the rate'.<sup>38</sup> It had, however, quibbled with the calculation of the 15 per cent and the resultant outcome,<sup>39</sup> because the adoption of a hurdle rate of 15 per cent return for property overwhelmingly favoured the divestment of property over retention.

3.25 The Committee asked ANAO to provide an analysis of the sale of Commonwealth estate properties included in the three year divestment program reviewed by ANAO, by number and value for various hurdle rates. ANAO's response is provided in Table 3.1.

3.26 Table 3.1 shows that between 1997–1998 and 1999–2000, nearly 38 per cent of the 58 properties sold fell within the hurdle rate band of 12–15 per cent or more. If the hurdle rate had been set at the current bandwidth of 11 per cent, then some 62 per cent of those same properties would *not* have been sold.<sup>40</sup> It would appear that the 1996 hurdle rate determining which Commonwealth properties were to be sold up till June 2002, did not take into account subsequent significant changes in interest rates and economic circumstances.

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36 Bowen, *Transcript*, 31 May 2002, p. 43.

37 Bowen, *Transcript*, 31 May 2002, p. 44.

38 I. McPhee, ANAO, *Transcript*, 31 May 2002, p. 44.

39 McPhee, *Transcript*, 31 May 2002, p. 44.

40 Figure 2.2 in Audit Report No. 4, shows that the comparable percentages for 1996, were 31 per cent and 69 per cent respectively. ANAO, Audit Report No. 4, 2001–2002, p. 42.

**Table 3.1 Commercial Office Estate Properties included in three year divestment program 1997–1998 to 1999–2000**

Internal [Hurdle] Rate of Return <sup>(1)</sup>	Number of Properties	%	Value of Properties	%
Greater than 15%	6	10.3	\$13.85m	1.3
14-15%	9	15.5	\$258.75m	24.6
13-14%	7	12.1	\$59.45m	5.7
12-13%	13	22.4	\$393.8m	37.4
11-12%	9	15.5	\$38.22m	3.6
10-11%	6	10.3	\$55.68m	5.3
9-10%	4	6.9	\$207.5m	19.7
Less than 9%	4	6.9	\$24.65m	2.3
<b>Total</b>	<b>58</b>	<b>–</b>	<b>\$1051.9m</b>	<b>–</b>

(1) This table is derived from internal rates of return (IRR), used by the Commonwealth Property Committee in March 1997, that formed the basis of the properties selected in the divestment strategy. The IRRs were based on 30 June 1996 book values for the properties. These IRRs were determined prior to assessment of a market value for the properties and prior to implementation of leases based on commercial terms and conditions.

**Source:** ANAO, Submission no. 12, Attachment 1.

3.27 In response to comments about the hurdle rate, DOFA reiterated that the Government's view 'was that there is risk associated with holding property'—interest risks, facilities risks, rental risks, business changes and other post-September 11 risks. The Government believed that 'it was not necessarily in the business of owning property but in the business of using its resources in the best way to deliver services to the Australian people'. Therefore: 'The government adopted this hurdle rate. The sales program flows from that.'<sup>41</sup>

3.28 DOFA also pointed out that the initial hurdle rate was determined in the context of some uncertainty arising from a number of factors.

In 1996, when the Commonwealth property principles were being established, for the Commonwealth properties in question it was considered that there would be quite a large capital maintenance required on those

41 Bowen, *Transcript*, 31 May 2002, pp. 40–41.

properties in the coming years. There were no formal leases in place. There was no knowledge of adherence to local government regulations. They had been built by the Commonwealth on Commonwealth land, without reference to local and state government authorities.<sup>42</sup>

- 3.29 Given these factors, DOFA advised the Government to adopt the higher hurdle rate to cover anticipated maintenance and other risks. Namely, instead of a risk factor of 0.5 per cent, it used a three per cent factor.<sup>43</sup> DOFA told ANAO that the CPC had considered that some of the assumptions underlying the modelling 'were overly optimistic and had the effect of unduly inflating the calculated rate of return figure'.<sup>44</sup> However, as ANAO emphasised in its report, the project specific risks for the properties were not high.

A property with security of tenure to the Commonwealth in the form of a non-cancellable lease over a long period represents a low risk and the criteria used for the hold/sell decision should reflect that risk profile.<sup>45</sup>

- 3.30 As a result of the hurdle rate adopted, six in the list of divested buildings were sold even though their calculated value met the hurdle rate. The Committee was told by ANAO that these properties originally did not have a commercial lease and that the assumptions underpinning the rate of return calculations were changing as time went on.

ANAO's legal advice is that if there is a conflict between the efficient and effective use of public money and the requirements of the CPPs, it would be prudent to seek guidance or reconsideration of the policy. In circumstances where a proposed sale of Commonwealth property does not appear to represent value for money at the time of the sale, it would be good administrative practice for Finance to inform Minister(s) of the inquiries undertaken and seek their consent before proceeding with the sale.<sup>46</sup>

- 3.31 ANAO believes that DOFA failed to maintain an ongoing monitor of the sale process and to update advice to ministers as real data

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42 K. Campbell, DOFA, *Transcript*, 31 May 2002, p. 45.

43 Bowen, *Transcript*, 31 May 2002, p. 46; ANAO, Audit Report No. 4, 2001–2002, p. 39.

44 ANAO, Audit Report No. 4, 2001–2002, p. 48.

45 ANAO, Audit Report No. 4, 2001–2002, p. 44.

46 ANAO, Audit Report No. 4, 2001–2002, p. 92.

emerged. Instead the 15% hurdle rate remained in place even though it was based on assumptions made in 1996 in a changing market.

- 3.32 The book values of the properties being divested were adjusted to take account of market conditions at the time and of probable occupancy levels and leasing profiles. The revised assessments prepared by the advisers to the CPC were not revised valuations for divestment, but represented potential sale proceeds. The adjustments reduced the value of the properties recommended for divestment by some \$200 million, a one-fifth decrease in total value. Despite this, rates of return for the properties were not recalculated based on these revised assessments. If they had been, the rates of return would have increased, thus generally supporting a higher retention of properties in Commonwealth ownership.<sup>47</sup>

## Sale management

- 3.33 A number of matters arising from the management of the sale were examined by ANAO.
- 3.34 Because a number of the occupants were Commonwealth agencies leasing Commonwealth funded properties, some of which were specific purpose built, these agencies paid a capital use charge but were responsible for repairs, maintenance and refurbishment.<sup>48</sup> In preparation for the divestment of the properties, CPC's proposal—that the occupant agencies pay a commercial rent to DOFA which would fund repairs, maintenance and refurbishment from the rent money—was adopted.<sup>49</sup>
- 3.35 When the pro forma leases were subsequently developed by DOFA, these agencies found themselves responsible to the private sector landlords for both market rent as well as repair and maintenance costs.<sup>50</sup>

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47 ANAO, Audit Report No. 4, 2001–2002, p. 48.

48 ANAO, Audit Report No. 4, 2001–2002, p. 50.

49 ANAO, Audit Report No. 4, 2001–2002, p. 50.

50 ANAO, Audit Report No. 4, 2001–2002, p. 50.

- 3.36 Prior to the sale of the RG Casey building, DFAT as lessee, had a commitment to pay DOFA \$0.52 million annually in addition to rental and other charges under the lease as part of the provision of agreed capital works, reflecting amortisation of those costs over the original 15 year lease. On the sale of the RG Casey building, this clause remained in the executed lease, thereby providing the new owner an additional income stream from the property. ANAO stated that in the case of the Commonwealth, it 'is unaware of a general practice of agencies selling to the private sector a stream of transfer payments between Commonwealth agencies'.<sup>51</sup>
- 3.37 Similar arrangements occurred with the sale of the Commonwealth Offices in Bendigo, whereby an additional lease commitment of \$0.12 million per annum was included in the lease. This amount had resulted from the amortisation of the cost of the fitout of the premises—a cost incurred before any decision to sell. ANAO calculated that this additional amount represented about ten per cent of the market value of the property.<sup>52</sup>
- 3.38 The successful tender for Package 3 (RG Casey Building and Adelaide Commonwealth Centre) included a condition whereby the purchase price could fall by up to \$15 million in the event that interest rates increased. DOFA did not obtain advice as to whether the interest rate condition in the successful tender needed to be managed, or how this should be done. Instead, DOFA retained an open exposure to this risk and, as a result of interest rates increasing, the Commonwealth received \$4 million less for the package than the nominal tender price of \$221 million.<sup>53</sup>
- 3.39 ANAO discovered that during evaluation of tenders in April 2000, the sales adviser managing the sale, assessed the terminal value of the AGSO property to be \$15 million, which essentially equated the 20 year lease with the economic life of the property. After the May 2000 sale, that sales adviser re-assessed the terminal value to \$121.5 million in July 2000, based on an economic life of the building of 40 to 50 years.
- 3.40 ANAO believes the objective in a sale/leaseback property transaction is to negotiate a contract with the preferred bidder

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51 ANAO, Audit Report No. 4, 2001–2002, p. 76.

52 ANAO, Audit Report No. 4, 2001–2002, p. 76.

53 ANAO, Audit Report No. 4, 2001–2002, pp. 83–84.

that delivers the highest possible positive Net Present Value (NPV) in order to ensure that the Commonwealth's financial position is maximised. ANAO estimated that the AGSO property sale transaction could result in a *negative* NPV of \$95 million when the net sale proceeds are compared with possible lease payments over the 20 year lease term. The lease commitments include the costs of funding the lease payments, and projected annual rent increases based on historic movements in the CPI (All Groups) for Canberra. The NPV would be *negative* \$49 million based on the minimum lease payments over the 20 year lease.<sup>54</sup> DOFA calculations, in its advice to the Minister in April 2000, indicated a *positive* NPV of \$43 million.<sup>55</sup>

- 3.41 In its report, ANAO analyses of the whole-of-lease-term costs for sale and long-term leaseback of property found that they could result in a potential negative financial return to the Commonwealth within the lease period. The AGSO property and RG Casey Building both reach a possible financial break-even point in Year 11 and Discovery House in Year 8, after which the Commonwealth could be paying more in rent than it could receive if it invested the sale proceeds at the Commonwealth Treasury Bond rate.<sup>56</sup>
- 3.42 At the public hearing, DOFA maintained that it did not accept the break-even methodology used in the audit. For instance, DOFA's own analysis showed that the internal rate of return for Discovery House was 9.73 per cent which was below the hurdle rate 'then and now and for 2003'.<sup>57</sup> DOFA told the Committee that its analysis 'would show that it was a value for money decision and that in fact it would still be a value for money decision based on a 10 per cent or a 9.5 per cent hurdle'.<sup>58</sup>

## Committee comments

- 3.43 While the Committee accepts that the differing views of the ANAO and DOFA as to the effectiveness of the properties sale are derived from differing policy perspectives on the matter, nevertheless,

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54 ANAO, Audit Report No. 4, 2001–2002, p. 117.

55 ANAO, Audit Report No. 4, 2001–2002, pp. 114–117.

56 ANAO, Audit Report No. 4, 2001–2002, p. 106.

57 Campbell, *Transcript*, 31 May 2002, p. 43.

58 Bowen, *Transcript*, 31 May 2002, p. 43.



greater attention should have been paid to providing the Government with ongoing advice about the hurdle rate, especially as the economic factors were changing rapidly. In addition, DOFA should be considering the whole-of-life costs and benefits for each property to ensure that, in the total picture, the Commonwealth achieves best value for money and actions taken are in its best interests. To ensure that the Commonwealth's financial position is maximised, the objective in the sale/leaseback property transaction is to negotiate a contract with the preferred bidder that delivers the highest possible Net Present Value (NPV).<sup>59</sup>

## Risk transfer

3.44 The result is that the purchasers were able to revalue some properties post-sale and recoup some of the purchase price in their rental arrangements. ANAO found that the initial rentals paid under the AGSO property, RG Casey Building and Discovery House leases exceeded market values included in the market valuations for sale for those properties, by some 17, 12 and 7 per cent respectively.<sup>60</sup> The Australian Valuation Office noted in its valuation of 1 February 2000, that 'the above market rent' paid for the AGSO property accounted for \$19.2 million in the assessed \$135 million market valuation for sale.<sup>61</sup> However, DOFA maintained to the Committee that 'the rentals set, in negotiation with the building tenants, reflected the prevailing market values for purpose buildings'.<sup>62</sup>

3.45 In May 2001, the Department of Foreign Affairs and Trade advised ANAO that the net lettable area had been re-measured and that the new owner had formally notified the Department that they were seeking a 38 per cent increase in the base rent for the RG Casey Building to \$22 723 537.<sup>63</sup> When questioned about this at the public hearing, DOFA was able to tell the Committee:

Whilst you are correct in saying that the new owner sought an increase of 38 per cent for RG Casey House,

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59 ANAO, Audit Report No. 11, 2001–2002, p. 19.

60 ANAO, Audit Report No. 4, 2001–2002, p. 108.

61 ANAO, Audit Report No. 4, 2001–2002, p. 108.

62 DOFA, Submission no. 15, p. 2.

63 ANAO, Audit Report No. 4, 2001–2002, p. 110.

the end result was an increase—once it had gone through the appropriate negotiation clauses within the lease regarding rental increases—of \$6 per square metre. ...It is two per cent or thereabouts.<sup>64</sup>

- 3.46 The market valuation for the sale of Discovery House highlighted that the 15 year lease had the effect of insulating the investment from any market down turns and that normal market factors would have little initial effect on the value, given the high initial rental and minimum rental clauses. In its September 1997 report reviewing the property sales packages, the sales adviser also noted that the rent for Discovery House was well above the market rates for Woden at the time and that, as the rent reviews for the first six years were to Consumer Price Index (CPI), there was unlikely to be an adjustment to market.<sup>65</sup>
- 3.47 ANAO believed that its legal advice showed that a range of ownership risks with only some of the benefits had been transferred to AGSO, as the tenant, after the sale of AGSO Headquarters.<sup>66</sup> For instance, AGSO is responsible for, among other things:
- all operating expenses, including the landlord's insurance and landlord's management costs of the land and building;
  - all statutory charges;
  - replacement of all floor coverings in the building;
  - maintenance and painting of all surfaces, interior and exterior—including keeping the building watertight;
  - maintenance of the building and grounds under the landlord-approved general maintenance program; and
  - repairs and maintenance of plant in accordance with a landlord-approved program.<sup>67</sup>
- 3.48 DOFA advised ANAO in April 2001 that both the sales adviser for the AGSO property sale and DOFA had always considered the lease to be an operating one and that additional professional advice was sought only after ANAO raised concerns. ANAO

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64 Jackson, *Transcript*, 31 May 2002, pp. 42–43.

65 ANAO, Audit Report No. 4, 2001–2002, p. 111.

66 ANAO, Audit Report No. 4, 2001–2002, pp. 119–120.

67 ANAO, Audit Report No. 4, 2001–2002, pp. 119–120.

concurred with the DOFA position that it was an operating lease for financial statement purposes.<sup>68</sup> When asked to clarify the risks factor, DOFA informed the Committee that ‘a key aspect of an operating lease is that the bulk of the risks of ownership must rest with the owner rather than the tenant’.<sup>69</sup>

- 3.49 DOFA assured the Committee that because tenants are required to pay rents from their agreed departmental budgets, ‘these budgets were adjusted to reflect the agreed rents at the time agencies originally entered into the agreements’.<sup>70</sup>
- 3.50 Since AGSO did not subsequently require all the space available in the complex, it sub-let about five per cent of the total area to two Commonwealth agencies. Both sub-leases commenced in March 2000, prior to the sale of the property. One lease was for five years with options for two extensions of three years each, and the second was for eight months with no renewal option. The rent AGSO negotiated with the sub-leasing tenants was some 29 per cent below market rates and some 41 per cent below that paid by AGSO under the Head-lease.<sup>71</sup>
- 3.51 ANAO’s calculations on the financial evaluation of the AGSO property sale concluded that beyond Year 11, the cumulative rental outlays for the property would outstrip the value to the Commonwealth of the sale proceeds and any earnings from their reinvestment.<sup>72</sup> ANAO believes that the Commonwealth’s net cash outlay for the AGSO property could be as high as \$265 million at the end of the 20 year lease.<sup>73</sup>

## Committee comments

- 3.52 After reviewing these arrangements, the Committee agrees with ANAO that the sale of the Commonwealth estate properties with long leases in place provided the purchasers with guaranteed cash flows at high yields over long periods. In most of the leaseback arrangements, the properties sold were purpose specific, relatively new and requiring little maintenance or upkeep during the lease periods.

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68 ANAO, Audit Report No. 4, 2001–2002, pp. 19, 63–65.

69 DOFA, Submission no. 15, p. 2.

70 DOFA, Submission no. 15, p. 2.

71 ANAO, Audit Report No. 4, 2001–2002, pp. 113–114.

72 See Figure 5.3 in ANAO, Audit Report No. 4, 2001–2002, p. 116.

73 ANAO, Audit Report No. 4, 2001–2002, p. 121.

- 3.53 While it appears that the tenanting agencies had their budgets adjusted to reflect the initial agreed rents, nevertheless from a whole-of-government viewpoint, it seems that the Commonwealth is incurring additional costs.

## Rejection of audit recommendations

- 3.54 ANAO stated in its audit report that its recommendations 'are only included where it is not clear that action has taken place and/or is being contemplated'.<sup>74</sup> Where agencies have taken action or are in the process of making changes, 'such action is usually noted in the report'.<sup>75</sup> Having examined the audit recommendations in the report, the Committee asked at the public hearing why DOFA had rejected them all without any clear explanation other than to say that DOFA considered 'the concepts that underpin the report are fundamentally flawed'.<sup>76</sup>

- 3.55 DOFA responded:

It is quite noticeable in this case that Finance disagreed with each of the recommendations in the report. I would have to say in some cases that was a fine line. There were genuine differences in our views on the methodology that was applied in some parts of the report. On some of the recommendations I think Finance's disagreement was more a statement that it was already implementing the proposals put forward by Audit.

I think I have already said that there was a high level of dialogue and we will continue to have that with ANAO. On this particular audit, while it may not come through in the report, there was a high level of interaction between the officers of ANAO and Finance. Finance did provide a significant amount of written comment. However, where Finance could have done better was in providing a much more fulsome final response in a consolidated, comprehensive way to the section 19 report.<sup>77</sup>

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74 ANAO, Audit Report No. 4, 2001–2002, p. 21.

75 ANAO, Audit Report No. 4, 2001–2002, p. 21.

76 ANAO, Audit Report No. 4, 2001–2002, p. 21.

77 Bowen, *Transcript*, 31 May 2002, pp. 35–36.

- 3.56 The Committee notes that DOFA and ANAO have resolved their differences and that ‘there was a high level of interaction between the officers of ANAO and Finance’ during the audit.<sup>78</sup> The Committee has also noted DOFA’s comment that: ‘On some of the recommendations I think Finance’s disagreement was more a statement that it was already implementing the proposals put forward by Audit.’<sup>79</sup>

### Recommendation 1

- 3.57 **The Committee recommends that the Department of Finance and Administration report to the Committee on whether the substance of the Australian National Audit Office’s recommendations have been accepted and are being implemented. .**

### Better practices

- 3.58 The Committee endorses the audit suggestion that sale management better practices identified in Audit Report No. 4 should be applied to future Commonwealth property sales, including the forthcoming major sales at CSIRO and in the Defence portfolio. For instance, good administrative practice for an agency disposing of Commonwealth property with a long-term leaseback arrangement could include:
- determining whether or not the property should be sold in accordance with the relevant policy;  
⇒ and establishing the full market value for the property;
  - in determining the ‘full market value’, recognising whether there are special conditions attached to the property, and reflecting the fact that the property is sold with a secure Commonwealth lease-back arrangement, often for a lengthy period;
  - assessment of value for money during tender evaluation in sale and long-term leaseback transactions to the Commonwealth; and

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78 See *Transcript*, 31 May 2002, pp. 34–35.

79 Bowen, *Transcript*, 31 May 2002, p. 35.

- taking into consideration FMA Regulations 9 and 13, together with those inquiries required under the *Commonwealth Procurement Guidelines and Commonwealth Disposal Guidelines*.

## **Recommendation 2**

- 3.59 **The Committee recommends that the Department of Finance and Administration, in consultation with the Australian National Audit Office, by June 2003, develop, publish and apply a sale management better practice guide for the disposal of future Commonwealth estate properties underpinned by the Commonwealth Property Principles.**

## Audit Report No. 11, 2001–2002

# Administration of the Federation Fund Program

## Background

- 4.1 In May 1997, the \$1 billion Federation Fund was announced as part of the 1997–98 Budget, to fund a number of major projects of national significance to mark the Centenary of Federation in 2001. The Federation Fund program had three components:
- Federation Major Projects program (\$906.8 million);
  - Federation Cultural and Heritage Projects (FCHP) program (\$70.4 million); and
  - Federation Community Projects (FCP) program (\$29.8 million).
- 4.2 The Federation Major Projects program was set up to provide financial assistance to a number of major projects of national significance; to generate jobs in the construction phase; and to make a significant and ongoing contribution to Australia and the Australian economy. Projects were expected to be geographically spread around Australia and well advanced, but not necessarily complete, by 2001. Commonwealth monies were intended to either fully fund projects; augment existing funding; or match funding from other sources.<sup>1</sup>

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<sup>1</sup> ANAO, Audit Report No. 11, *Administration of the Federation Fund Program, 2001–2002*, Commonwealth of Australia, pp. 37–38.

- 4.3 The Prime Minister wrote to Premiers and Chief Ministers seeking nominations of major projects of national significance with a minimum of \$25 million per project as a guide. Projects, including those nominated from other sources, were to be considered on their individual merits although selected projects for funding should be 'of national interest'. The resulting proposals submitted ranged from cultural projects to church restorations; from road bridges to housing for research institutions. Many of the proposals were unsolicited and not from Premiers or Chief Ministers.<sup>2</sup>
- 4.4 Federal Ministers were closely involved throughout the selection process, culminating in the recommendation of projects by a Committee of eight senior Ministers to Cabinet and/or the Prime Minister for approval.<sup>3</sup> The Prime Minister was the Committee Chair. A Federation Fund Taskforce was set up by the Department of Prime Minister and Cabinet (PM&C) to shortlist proposals and advise Ministers.<sup>4</sup>
- 4.5 By the end of August 1998, the Major Projects program was fully committed with the approval of some 40 major projects. Funding assistance for approved projects ranged from \$0.8 million to \$147 million with a median grant of \$10 million.<sup>5</sup>
- 4.6 Because PM&C considered that its role focussed on the facilitation of proposal selection by Ministers, PM&C did not see itself having any part to play in considering planning issues common to funding assistance programs.<sup>6</sup> Once projects were approved, the ongoing management of selected major projects was transferred from the PM&C to ten other Commonwealth departments. These administering departments reported the progress of their respective funded projects to PM&C every six months.<sup>7</sup>

## The audit

- 4.7 In Audit Report No.11 2001–2002, *Administration of the Federation Fund Program*, ANAO audited the Federation Major Projects

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2 ANAO, Audit Report No. 11, 2001–2002, pp. 49, 51–55.

3 ANAO, Audit Report No. 11, 2001–2002, p. 38.

4 The Taskforce comprised seconded officers from key Commonwealth departments. ANAO, Audit Report No. 11, 2001–2002, p. 20.

5 ANAO, Audit Report No. 11, 2001–2002, p. 38.

6 ANAO, Audit Report No. 11, 2001–2002, pp. 19, 45–46.

7 ANAO, Audit Report No. 11, 2001–2002, p. 39.



program only, although it did examine the ongoing management of the FCHP program. This audit had been the subject of a review by the Committee. This current audit objective was to determine the extent to which the administration of the Federation Fund program met identified better practice for project management. ANAO focused on:

- policy development and program planning;
- the process of calling for, assessing, approving and announcing proposals; and
- ongoing program and project management.

4.8 ANAO based its examination on the better practice principles of rigour, transparency and equity which should be applicable to the selection of projects under funding assistance programs. The audit criteria for assessing the ongoing management of approved projects were drawn from the four key stages of the management cycle—planning, establishment, monitoring and evaluation.<sup>8</sup>

## Audit findings

4.9 ANAO's findings may be summarised as follows:

- PM&C's advice to the Government and the rigour of the departmental assessment process would have been improved by program planning and analysis.
- Program planning and analysis would also have better facilitated:
  - (a) the transfer of projects to the administering departments
  - (b) their project monitoring; and
  - (c) evaluation of the program as a whole.<sup>9</sup>
- The initial assessments prepared by the Taskforce were inconsistent because of the lack of guidance for Taskforce assessors; the lack of program guidelines; and the lack of a quality assurance process.
  - ⇒ Consequently ANAO could not be certain that only the best proposals were shortlisted.<sup>10</sup>
- The quality of *Detailed Assessments* would have been improved by:

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8 ANAO, Audit Report No. 11, 2001–2002, p. 39.

9 ANAO, Audit Report No. 11, 2001–2002, p. 19.

10 ANAO, Audit Report No. 11, 2001–2002, pp. 20–21.

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- ⇒ broader, better-structured, documented consultations within the Commonwealth; and
  - ⇒ consultations with State/Territory Governments (as was originally planned) and the private sector (for example, with construction analysts and business experts).<sup>11</sup>
  - While All forty approved projects met the broad program selection criteria.<sup>12</sup>
    - ⇒ Less than half of all approved projects were proposals nominated by Premiers and Chief Ministers, although these accounted for approximately 60% of approved funding.<sup>13</sup>
    - ⇒ The majority of the Federation Fund proposals approved were rated by the Taskforce as medium or higher suitability for Federation funding, were from unsolicited sources and did not follow planned selection process<sup>14</sup>
  - The majority of projects were selected from January to August 1998, with most of the results being announced in September.
  - Unsuccessful applicants were not informed till early February 1999, more than five months after the last selected project had been approved.<sup>15</sup>
  - Although the management of approved Federation Fund projects by administering departments had generally been sound<sup>16</sup>, there were some shortcomings in PM&C's transfer of projects to administering departments, thereby affecting these department's capacity to plan, establish, monitor and evaluate projects.<sup>17</sup>
  - Actual disbursements continually lagged behind original and revised estimates while project estimated completion dates slipped by an average of four months.<sup>18</sup>
  - In some instances, funding payments were made to recipients without commensurate progress against milestones.<sup>19</sup>
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11 ANAO, Audit Report No. 11, 2001–2002, pp. 21, 24.

12 ANAO, Audit Report No. 11, 2001–2002, p. 25.

13 ANAO, Audit Report No. 11, 2001–2002, p. 28.

14 ANAO, Audit Report No. 11, 2001–2002, p. 15.

15 ANAO, Audit Report No. 11, 2001–2002, p. 30.

16 ANAO, Audit Report No. 11, 2001–2002, p. 17.

17 ANAO, Audit Report No. 11, 2001–2002, p. 31.

18 ANAO, Audit Report No. 11, 2001–2002, p. 32.

19 ANAO, Audit Report No. 11, 2001–2002, p. 31.

- No Commonwealth department had the responsibility for monitoring the collective performance of Federation Fund projects against program objectives.
  - ⇒ As a result, ANAO found that very little performance information on the achievement of the program's overall objectives had been collected or reported to the Parliament, although some agencies had reported on projects in their individual Portfolio Budget Statements and annual reports.<sup>20</sup>

## Committee concerns

- 4.10 When examining ANAO's Report No. 30, 1999–2000 *Examination of the Federation Cultural and Heritage Projects Program*, on the Federation Cultural and Heritage Projects Program, the Committee made two recommendations regarding grant programs. The Committee referred to these earlier recommendations in its review of Audit Report No. 11, 2001–2002. In addition, the Committee was interested in examining the following:
- Project and program management
  - Risk management
  - Program evaluation and accountability.

## Application notification

- 4.11 In its *Report 380, Review of Auditor-General's Reports 1999–2000, Third Quarter*, referred to above, the Committee had recommended that:
- ...after the making of grant decisions, all applicants, successful or otherwise, should be notified of the decision as soon as possible in writing, advised of relevant appeal processes and provided with guidance for improving subsequent applications.<sup>21</sup>

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20 ANAO, Audit Report No. 11, 2001–2002, p. 32

21 JCPAA, Report 380, *Review of Auditor-General's Reports 1999–2000, Third Quarter*, February 2001, Commonwealth of Australia, p.20.

- 4.12 This recommendation arose out of the manner of the announcements of the successful applicants in the FCHP program immediately prior to the 1998 October election. Not till after the 3 October 1998 election, was a 'bulk announcement', listing all successful and unsuccessful applicants, made following the mailout of all notification letters on 13 October 1998.<sup>22</sup>
- 4.13 The Committee was therefore concerned to find that the time gap between decisions and announcements in the Major Projects program varied markedly 'from the same day to two years nine months...with a mean of some 50 days and median of 24 days'.<sup>23</sup> While just over 70 per cent of funded projects were announced less than one month after approval, unsuccessful applicants 'were not notified that their proposals were unsuccessful until early-February 1999, more than five months after the last of the selected proposals had been approved'.<sup>24</sup>
- 4.14 Putting aside circumstances which may have determined this lapse, the Committee reiterates its earlier recommendation that all applicants, successful or otherwise, should be notified of the decision as soon as possible in writing and that those who were unsuccessful should be advised of relevant appeal processes and provided with guidance for improving subsequent applications.

### Recommendation 3

- 4.15 **The Committee recommends that government agencies responsible for Commonwealth grants ensure that after grant decisions have been made, all applicants, successful or otherwise, be notified of the results as soon as possible in writing, advised of relevant appeal processes and provided with guidance for improving future applications.**

## Project and program management

- 4.16 ANAO found that after the transfer of projects to administering departments, there was no evidence of continuing program-wide

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22 See *Transcript*, 6 October 2000, pp. 14–16.

23 ANAO, Audit Report No. 11, 2001–2002, p. 85.

24 ANAO, Audit Report No. 11, 2001–2002, p. 88.

coordination of the Federation Fund program other than *ad hoc* informal consultations between PM&C and administering departments.<sup>25</sup> Furthermore, the Taskforce was disbanded before the transfer meetings so that the broad experience and specific project risks that were known to the Taskforce during the selection process were no longer available to the administering agencies.<sup>26</sup>

- 4.17 Having reviewed the audit report and considered the evidence presented, the Committee believes that the Federation Fund program could have been better managed from the start if a Commonwealth agency had been formally assigned a coordinating role and given monitoring responsibilities before actual applications were sought.<sup>27</sup> A coordinating/ monitoring agency such as PM&C or the Department of Finance and Administration (DOFA) could have then drafted informative guidelines, acted as adviser to applicants and provided a preliminary risk assessment for each funded project. It would also have the responsibility for monitoring the collective performance of the program against overarching program objectives. Such coordination would have facilitated better sharing of experience and expertise across administering departments for the Federation Fund program.
- 4.18 To assist this suggested coordinating/monitoring agency, a steering taskforce could be appointed, comprising representatives of all relevant agencies. The chair of the steering taskforce would be a senior representative from the coordinating/monitoring agency. The taskforce would assist in developing project administration guidelines especially for the timing of payments, reporting requirements, performance measures and accountability procedures.

#### **Recommendation 4**

- 4.19 **The Committee recommends that in future funding programs of national significance, a Commonwealth agency be given coordinating and monitoring responsibilities.**

25 ANAO, Audit Report No. 11, 2001–2002, p. 93.

26 ANAO, Audit Report No. 11, 2001–2002, p. 94.

27 See *Transcript*, 31 May 2002, p. 54.

## Risk management

4.20 When PM&C transferred the management of approved major projects to administering departments, there was little transference of information and few additional resources allocated to the task.<sup>28</sup> Because the Taskforce was disbanded before the transfer, it was not possible for PM&C to advise line agencies of the nature of the risks inherent in particular projects, particularly where the funding assistance was less than the amount sought.<sup>29</sup> In addition, many of the projects required administering departments to oversee the delivery of a project by a third party recipient of Commonwealth funds.<sup>30</sup> As a result, it appears that most administering departments had little awareness of the risks/issues associated with particular projects under their administration.

4.21 ANAO found that:

A distinctive feature of the Federation Fund Major Projects programme is the separation of the project assessment/selection and ongoing management responsibilities. The ANAO considers that certain risks arise out of this separation that, if not well managed, could adversely impact on the success of the programme.<sup>31</sup>

4.22 The major risks were spelt out by ANAO in its report:

- Administering departments were not informed about their responsibility for maximising the achievement of Federation Fund program objectives as opposed to merely acting as a source of funding.
- Because most administering departments were unaware of the information on which decision-makers selected the projects and based their decisions, it became unclear to what extent administering departments could manoeuvre during funding agreement negotiations with the recipients.<sup>32</sup>
- The quality of the Federation Fund agreement deeds or memoranda of understanding were uneven and 'would have

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28 ANAO, Audit Report No. 11, 2001–2002, p. 31.

29 ANAO, Audit Report No. 11, 2001–2002, p. 94.

30 ANAO, Audit Report No. 11, 2001–2002, p. 91.

31 ANAO, Audit Report No. 11, 2001–2002, p. 92.

32 ANAO, Audit Report No. 11, 2001–2002, p. 93.

been improved had their establishment been coordinated centrally'.<sup>33</sup>

## Formal administrative guidelines

- 4.23 In its report, ANAO emphasised that departments managing multiple projects needed formal guidelines, endorsed by senior management, to aid new project managers to gain a rapid accurate understanding of Federation Fund administration arrangements and contribute to the consistent management of projects over the two to three year implementation periods.<sup>34</sup>
- 4.24 Only two departments—the Department of Industry, Science and Resources (ISR) and the Department of Communications, Information Technology and the Arts (DCITA)—developed comprehensive guidelines specific to the management of Federation Fund projects although neither of the departments had the guidelines endorsed by their departments' senior management at the time of the audit. This was unfortunate as ANAO reported that the guidelines were implemented with varying degrees of success across the projects examined.<sup>35</sup>
- 4.25 When questioned at the public hearing, DCITA told the Committee it 'has had draft guidelines in place for some time' but was waiting for the ANAO best practice report on grant administration as it seemed 'appropriate to take into account any further advice from the Audit Office before they are released'.<sup>36</sup> ANAO told the Committee that its Better Practice Guide had already been launched.<sup>37</sup> DCITA then said its guidelines would be formally endorsed in the near future.
- 4.26 The Committee fully supports the need for formal guidelines and believes that the ANAO *Better Guide on the Administration of Grants* should be examined and adopted by Commonwealth agencies whenever they have grant management responsibilities.

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33 ANAO, Audit Report No. 11, 2001–2002, p. 100.

34 ANAO, Audit Report No. 11, 2001–2002, p. 95.

35 ANAO, Audit Report No. 11, 2001–2002, p. 95.

36 K. Gosling, DCITA, *Transcript*, 31 May 2002, pp. 52–53.

37 M. Lewis, ANAO, *Transcript*, 31 May 2002, p. 53. The *Better Practice Guide on the Administration of Grants* was published on 15 May 2002 and is on the internet.

## Recommendation 5

- 4.27 **The Committee recommends that the *Better Guide on the Administration of Grants* published by the Australian National Audit Office should be adopted by Commonwealth agencies whenever they have grant management responsibilities.**

### Department of Communication, Information Technology and the Arts

- 4.28 In response to questions from the Committee about how it addressed risks, DCITA said it had developed comprehensive grant deeds or Memoranda of Understanding for its grantees, linking progress and payments to milestones. All its projects were administered by one section which worked closely with the grantees to overcome or minimise project risks, following a planning stage where risks were addressed prior to the projects commencing.<sup>38</sup> As DCITA said:

This enabled lessons learned from one project to be applied to others fairly easily and ensured a consistent approach was adopted to project management.<sup>39</sup>

- 4.29 Where risks arose, senior staff were informed and sometimes visited projects which were having serious problems, thereby assisting 'a number of projects to get back on track'.<sup>40</sup> DCITA pointed out, 'some issues did not become apparent until projects were under way...and some matters which seemed settled at the beginning became problems later'.<sup>41</sup>
- 4.30 DCITA took its monitoring role very seriously and initiated a monthly report to its Secretary and its Minister. As a result, its project management has ensured that the Federation Fund program objectives for its projects have been met.<sup>42</sup>

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38 DCITA, Submission no. 16, p. 1.

39 DCITA, Submission no. 16, p. 1.

40 DCITA, Submission no. 16, p. 2.

41 DCITA, Submission no. 16, p. 2.

42 DCITA, Submission no. 16, p. 2.



## Department of Environment and Heritage

- 4.31 The Department of Environment and Heritage (DEH) was directly involved with DCITA in the development and implementation of the FCHP program. All Federation Fund projects for which DEH had responsibility, with the exception of the Sydney Harbour Federation Trust (SHFT), were managed within the one area.<sup>43</sup>
- 4.32 Because DEH had a representative on the Taskforce, it had access to risk assessment information for all the projects at the assessment stage.<sup>44</sup> DEH set up special steering committees comprising all key stakeholders for each project.<sup>45</sup> All information was supplemented by site visits and discussions with grantees prior to the development of deeds of agreement for the projects. Project risks were reviewed where changes in circumstances or the environment indicated a review was needed.<sup>46</sup> DEH stated that it sought to be proactive in its administrative role and required each grantee to provide periodic reports linked to financial milestones. DEH told the Committee at the public hearing:
- We assessed the risks associated with the projects across the board. On that basis we picked projects which we felt had a slightly higher risk in terms of project management. We adjusted our management accordingly.<sup>47</sup>
- 4.33 In addition, DEH initially provided its Minister with monthly progress reports and then later, reports on an issues basis.<sup>48</sup>

## Other administrative agencies

- 4.34 Other administering departments had to cope with their responsibilities to the best of their abilities. As a result, there was little consistency in strategic and operational objectives, performance measures and evaluation criteria across the Federation Fund program. ANAO commented on the 'passive

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43 ANAO, Audit Report No. 11, 2001–2002, p. 95.

44 DEH, Submission no. 17, p. 1.

45 DEH, Submission no. 17, p. 2.

46 DEH, Submission no. 17, p. 1.

47 A. Archer, DEH, *Transcript*, 31 May 2002, p. 60

48 DEH, Submission no. 17, p. 2.

monitoring' approach which prevailed in some administering departments.<sup>49</sup>

- 4.35 ANAO found, however, that compensating factors did partially offset the risks resulting from the absence of formal administrative guidelines in some projects. For instance, the Department of Transport and Regional Services (DTRS) applied previously established program delivery mechanisms for the funding of land transport infrastructure as specified in the *Australian Land Transport Development Act 1988*. The Department of Agriculture, Fisheries and Forestry—Australia (AFFA) and the Australian War Memorial (AWM) were each responsible for managing a single project.<sup>50</sup>
- 4.36 In its report, ANAO had highlighted a number of the risks which arose, especially where funding had gone to small community groups which often were unaware of their accountability responsibilities. In addition, the scope of some projects changed over time and so impacted on the project's achievement of value for money. Another risk was that some projects were delayed, thereby adversely impacting on the achievement of the overall program objectives.<sup>51</sup> In other cases, the administering departments did not appear to assess progress reports against agreement requirements before making the next payments.<sup>52</sup>
- 4.37 Some administering departments saw their role as having little, if any, responsibility for project management. They believed they were responsible only for providing Commonwealth funds and ensuring the recipients' compliance with the Commonwealth's legal and policy obligations. Consequently, this resulted in funding agreements that poorly specified the project, project milestones, the roles and responsibilities of parties; and reporting requirements that did not greatly assist the management of the project by the administering department.<sup>53</sup>
- 4.38 Because administering departments had not been given additional resources to manage the projects transferred to them,

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49 ANAO, Audit Report No. 11, 2001–2002, pp. 105, 110.

50 ANAO, Audit Report No. 11, 2001–2002, p. 95.

51 ANAO, Audit Report No. 11, 2001–2002, p. 97.

52 ANAO, Audit Report No. 11, 2001–2002, p. 101.

53 ANAO, Audit Report No. 11, 2001–2002, p. 97.

the costs had to be absorbed within existing appropriations. As one agency pointed out:

a requirement to absorb project administration costs and a consequent reliance on existing departmental expertise generates risks to program performance by the administering departments.<sup>54</sup>

## Program evaluation and accountability

- 4.39 In the absence of a coordinating agency, ANAO found that no Commonwealth department either individually or collectively undertook responsibility for monitoring project performance against Federation Fund program objectives. Consequently, very little performance information on the achievement of the program's overall objectives had been collected or reported to Parliament because there never had been any continuing whole-of-government oversight of the Federation Fund program.<sup>55</sup>
- 4.40 Although project information had to be collected by the administering departments, PM&C did not specify the need to collect program outcome-related performance information from each project consistently across all administering departments. Therefore the six-monthly progress reports which administering departments gave to PM&C 'did not require administering departments to report on project performance against programme objectives'.<sup>56</sup>
- 4.41 While some administering departments reported in their annual reports on the specific projects they were managing, others did not. ANAO found that DEH was the only department able to comprehensively evaluate its Federation Fund major projects because its FCHP standard funding agreement required recipients to report progress against program objectives. DCITA, on the other hand, had developed an evaluation database and commenced gathering program objective related performance information from recipients.<sup>57</sup>

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54 ANAO, Audit Report No. 11, 2001–2002, p. 101.

55 ANAO, Audit Report No. 11, 2001–2002, p. 107.

56 ANAO, Audit Report No. 11, 2001–2002, p. 107.

57 ANAO, Audit Report No. 11, 2001–2002, p. 108.

- 4.42 If a coordinating agency were appointed as recommended above, this coordinating agency would be required to report on the funding programs against its outputs in its annual reports.

## Completion dates

- 4.43 One of the key Federation Fund program objectives was that projects should be 'well advanced, but not necessarily complete by 2001'. Appendix C shows the completion status of the major projects funded under the program as at 17 July 2002. Some were completed well before the expected completion dates while others have been delayed.

## Project funding

- 4.44 In its original conception, the Federation Fund Major Projects funding was intended to fully fund projects, augment existing funding or match funding from other sources. On 1 September 1998, the full Ministry noted that approved Federation Fund projects exceeded the \$1 billion appropriated to the Federation Fund by \$6.8 million and that additional funds would be required.<sup>58</sup>
- 4.45 The shortfall was met in different ways. For instance, when the Federation Fund projects were distributed to the administering departments to manage in March 1999, PM&C transferred to the DOFA, \$6.8 million less than the \$15.8 million approved from the Federation Fund for DOFA's project, the refurbishment of No.4 Treasury Place. DOFA, however, decided not to seek any extra appropriation and decided to use funds from its existing Capital Works Program to make up the shortfall.<sup>59</sup> Overall, more than a quarter of all approved projects received less than the amount sought by applicants.<sup>60</sup> Some were therefore placed at risk of not being able to complete the project if they could not make up the shortfall from elsewhere. Appendix D lists those projects which did not receive matching funds from non-Commonwealth sources. Those which are still not complete are listed in Appendix C.

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58 ANAO, Audit Report No. 11, 2001–2002, p. 82.

59 ANAO, Audit Report No. 11, 2001–2002, p. 82.

60 ANAO, Audit Report No. 11, 2001–2002, p. 29.

## Accountability

4.46 The Committee pursued the issue of public accountability. At the public hearing, it asked DCITA and DEH what each had done to ensure that value for money and full accountability occurred in the projects each managed.

4.47 DEH told the Committee that it had set up appropriate checks in its project administration. It had:

...requirements of independent audits of financial expenditure throughout the project, which required the receiving agency to go out and provide us with independently audited statements to show that the money they had received had been spent on the project appropriately. They had to break that down to a great deal of detail. That was done not just at the end but right through the project at various stages. They also had to provide us with other degrees of evidence in terms of the outcome reports, photographs and documentation of works carried out. In our case, they were all place-related heritage outcomes. We also had checks in place with our planning processes with both State bodies and with other heritage advisers on site, as well as our own visits, to make sure that they were complying with all the statutory requirements. They were some of the checks.<sup>61</sup>

4.48 DCITA told the Committee that it had similar requirements, including annual audits on larger projects. The projects also had to comply with a range of cultural requirements, including plans for the development of their collections and ensuring that they comply with federal and State responsibilities. DCITA project managers were required to take into account all the various items for each milestone before they paid the next instalment, discussing them with the grantees where there were any issues of noncompliance.<sup>62</sup>

Sometimes we have had to wait for a significant amount of time to ensure that we got what we wanted. In some of the major projects where we felt they perhaps were not going to complete their buildings to the required standards, or where they were not going to have enough other money to

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61 Archer, *Transcript*, 31 May 2002, p. 60.

62 R. Thorpe, *Transcript*, 31 May 2002, p. 60.

complete, they have had to demonstrate that other money was available.<sup>63</sup>

## Committee comments

- 4.49 The Committee had invited DCITA and DEH to its public hearing not only because they managed a large number of the major projects but because they had been commended by ANAO in its report. The Committee was re-assured from the evidence that both departments were fulfilling their responsibilities. It believes that other agencies can learn from their sound practices.
- 4.50 However, the Committee remains concerned that very little performance information on the achievement of the Federation Fund Major Projects program objectives have been collected or reported to Parliament. It believes that in future programs of national significance, this aspect needs to be incorporated into the program so that there is greater detailed public accountability for expenditure of public funds. If a coordinating agency were appointed as recommended above, this coordinating agency would be required to report on the funding programs against its outputs in its annual reports.

### Recommendation 6

- 4.51 **The Committee recommends that a coordinating agency once appointed, will report on the funding programs it is overseeing against program outputs in its annual reports.**

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63 Thorpe, DCITA, *Transcript*, 31 May 2002, p. 60.

## Audit Report No. 22, 2001–2002

# Personnel Security—Management of Security Clearances

## Introduction

### Background

- 5.1 Protective security concerns the protection of information, assets and human resources from potential threats. It includes physical security, personnel security, information security and computer and communications security.
- 5.2 The Commonwealth Attorney-General is responsible for protective security policy, which is disseminated through the Commonwealth Protective Security Manual (PSM). Responsibility for the day-to-day management of protective security processes in each Commonwealth organisation lies with the head of the organisation.<sup>1</sup>
- 5.3 Personnel security, including the security clearance process, is an essential element of managing the risk inherent in allowing Commonwealth and other personnel access to classified information. There is an increased exposure to security breaches and the associated costs and risks if the security clearance process

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<sup>1</sup> ANAO, Audit Report No. 22, *Personnel Security – Management of Security Clearances*, 2001–2002, Commonwealth of Australia, p. 21.

is not conducted objectively and with consideration of current threats and risks.<sup>2</sup>

## The ANAO audit

- 5.4 The objective of the audit was to determine whether organisations were managing security clearance and vetting processes effectively and efficiently and in accordance with Commonwealth policy, as outlined in PSM 2000. It was also intended that the audit would provide recommendations for improvement and identify and disseminate any identified better practice.<sup>3</sup>
- 5.5 The audit focussed on those security clearances which involve the process known as 'negative vetting'. The basis of negative vetting is that unless the clearance process reveals any information that brings into question the subject's suitability, a security clearance is granted.<sup>4</sup>

## Audit findings

- 5.6 Audit Report No. 22, 2001-2002, *Personnel Security – Management of Security Clearances*, found considerable scope for improvement in several areas:
- all but one of the organisations reviewed had a large number of security clearances overdue for review;
  - most organisations did not have an up-to-date protective security risk management assessment as required by Part B of the PSM, and at the time of the audit, none had effectively integrated risk assessments into personnel security arrangements;
  - effective information management systems were not in place to support personnel security in some organisations; and
  - in most organisations, insufficient resources were allocated to the personnel security function to maintain new clearance requirements as well as clearance reviews.<sup>5</sup>

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2 ANAO, Audit Report No. 22, 2001–2002, pp. 21-2.

3 ANAO, Audit Report No. 22, 2001–2002, p. 10.

4 ANAO, Audit Report No. 22, 2001–2002, p. 10.

5 ANAO, Audit Report No. 22, 2001–2002, pp. 12-13.



## The JCPAA's review

- 5.7 On 31 May 2002, the Joint Committee of Public Accounts and Audit held a public hearing to review the progress made by some of the agencies which were the subject of the ANAO audit. The agencies were:
- Australian Agency for International Development (AusAID);
  - Australian Customs Service (Customs);
  - Department of Defence (Defence); and
  - Department of Immigration and Multicultural and Indigenous Affairs (Immigration).
- 5.8 The Committee also invited the Attorney-General's Department to appear before it because of its role in personnel security policy.
- 5.9 The Committee took evidence on the following issues:
- security risk management assessments;
  - security clearance backlog; and
  - portability of security clearances.

## Security risk management assessments

- 5.10 Effective personnel security involves assessing both the subject and the environment in which the subject will be employed. Knowledge of potential risk factors, their consequences, and the development of strategies to mitigate these risks are essential to the effectiveness of personnel security procedures and policies.
- 5.11 The ANAO audit found that while each of the organisations reviewed had established risk management frameworks, these were often limited to operational or program delivery matters and did not extend to protective security or other corporate functions. Only two organisations had formally considered their protective security risk environment but had not fully assessed how the risk factors identified might be reflected in, or used to

inform personnel security practices, including the conduct of security clearances and the assessment of suitability.<sup>6</sup>

5.12 The Committee asked Defence whether it now had an up-to-date risk assessment.<sup>7</sup>

5.13 In reply, Defence stated that it was in the process of developing a Defence security plan based on risk assessment principles:

The first stage in [the Defence security plan] is a very high level document covering the whole of Defence. For that plan to be meaningful, it obviously needs to be cascaded down across the 13 groups because they each face slightly different risks and threats.<sup>8</sup>

5.14 Defence advised that it had allocated a staff member to work almost exclusively with other parts of Defence on the security plan.<sup>9</sup>

5.15 The Committee inquired whether Defence was developing the security plan in response to the ANAO audit or if it had been in development before the audit.<sup>10</sup>

5.16 In response, Defence stated that the development of the Defence security plan had been more a response to the requirements of the PSM than to the ANAO audit.<sup>11</sup>

5.17 Defence advised the Committee that it recognised the need for the security plan to address all aspects of security and would certainly take into account personnel security as an important area of risk.<sup>12</sup>

5.18 AusAID informed the Committee that due to AusAID's and the Department of Foreign Affairs and Trade's (DFAT's) common operational environment, the DFAT security risk management plan would be used as a blueprint for AusAID's security risk management plan. The Committee was advised that DFAT's

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6 ANAO, Audit Report No. 22, 2001–2002, p. 31.

7 *Transcript*, 31 May 2002, p. 26.

8 M McCarthy, Defence, *Transcript*, 31 May 2002, pp. 26-7.

9 McCarthy, *Transcript*, 31 May 2002, p. 27.

10 *Transcript*, 31 May 2002, p. 27.

11 McCarthy, *Transcript*, 31 May 2002, p. 27.

12 McCarthy, *Transcript*, 31 May 2002, p. 27.

security risk review was due to be completed by the end of June 2002.<sup>13</sup>

## Committee comments

- 5.19 Comprehensive information collection, collation and analysis should support both the assessment of clearance suitability and should reflect the organisation's threat/risk environment.
- 5.20 The audit found that while agencies involved in the audit had undertaken organisation-wide risk management clearance processes and reviews, not enough agencies had looked at the particular circumstances of their protective requirements in that process, and had not integrated it into suitability assessments.<sup>14</sup>
- 5.21 The Committee encourages agencies to use the results of their risk management processes to achieve a better informed clearance process.

## Security clearance backlog

- 5.22 Two of the more pressing personnel security issues facing organisations audited were the lengthy delays often encountered undertaking security clearances and the associated backlog in the number of clearances being processed or awaiting processing.
- 5.23 The reasons for the delays and the associated backlog included a lack of resources; increased clearance requirements; and delays obtaining external evidence.<sup>15</sup>
- 5.24 The Committee asked agencies what progress was being made to address the backlog of security clearances.<sup>16</sup>
- 5.25 Defence replied that vetting staff would increase by 50 per cent, from about 60 to 90 personnel, in the following few months and that Defence hoped to make inroads into the backlog in re-evaluations.<sup>17</sup>

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13 AusAID, Submission No. 3, p. 2.

14 ANAO, Audit Report No. 22, 2001–2002, pp. 44–5.

15 ANAO, Audit Report No. 22, 2001–2002, p. 34.

16 *Transcript*, 31 May 2002, p. 20.

17 McCarthy, *Transcript*, 31 May 2002, pp. 20, 24.

5.26 Customs advised the Committee that an additional \$415,000 had been allocated for personnel security vetting resources. At the start of the project, Customs had 342 subjects requiring clearance or review, and at the end of April 2002 the figure had reduced to 64. At the hearing on 31 May 2002, Customs were certain that the figure had been further reduced.<sup>18</sup>

5.27 Immigration said that it was on track with its re-evaluations, and both AusAID and Attorney-General's indicated that they did not consider there were backlogs within their agencies.<sup>19</sup>

5.28 The Committee noted that Defence had first mentioned the issue of additional vetting staff in February 2002 during the Senate estimates process. At that time, Defence had indicated that there was a backlog of 10,969 clearance re-evaluations. The Committee put further questions to Defence in relation to the progress made since that time and Defence's estimate of the backlog in terms of processing time.<sup>20</sup>

5.29 Defence responded that an advertising campaign for additional vetting staff and other staff to supplement security resources had been run immediately prior to the estimates hearings and that new staff were expected to commence around August-September 2002. Defence pointed out that although additional resources would become available, it was government policy that vettors could not undertake security clearances until they had been adequately trained, and Defence had yet to make a significant impact on the security clearance backlog:

...we hope that our backlog of initial clearances – that is, people who cannot yet start their job in Defence until they have received their clearance, which currently stands at around 1,100 – will be well under control in the first quarter of next year. But we estimate that it may take 18 months from now to get the re-evaluation backlog under control, which, as you rightly pointed out, is significant and is of concern to us.<sup>21</sup>

5.30 The Commonwealth PSM was issued in 2000 and for the first time mandated minimum standards for security clearances across the

18 G Collins, Customs, *Transcript*, 31 May 2002, p. 20.

19 C Hannah, Immigration, M Fleeton, AusAID, E Tyrie, Attorney-General's, *Transcript*, 31 May 2002, pp. 20-1.

20 *Transcript*, 31 May 2002, p. 21.

21 McCarthy, *Transcript*, 31 May 2002, p. 21.

Commonwealth. The life of a secret clearance was reduced from 10 years to five. As Defence noted, a significant factor in the large backlog of re-evaluations was this new requirement in the PSM.

- 5.31 Defence advised the Committee that staff due for re-evaluation continue to perform their duties:

It is our hope that we are effectively risk managing that re-evaluation backlog through practices in the workplace to ensure that supervisors are taking account of their environment and the behaviour of the people working with them.<sup>22</sup>

- 5.32 Defence advised the Committee that since the figure of 10,969 re-evaluations due at the time of Senate estimates in February 2002, the number of re-evaluations due had grown to 13,900:

A high proportion of people in Defence need some level of access to national security classified information, even if at [a] very low level of restricted information.<sup>23</sup>

- 5.33 Defence acknowledged that a large part of the problem related to resourcing:

...an understanding of the level of resourcing required is a facet of management control. It would be true to say that we have not in the past afforded [the backlog of evaluations] as high a priority as we might, but are now doing so.<sup>24</sup>

- 5.34 In response to Committee inquiries as to what the trend would be going forward in clearances requiring re-evaluation, Defence stated that prior to additional staff being fully trained and productive, the numbers clearances requiring re-evaluation would increase. However, Defence was uncertain at what figure the backlog would peak:

...our priority, once we bring these new people on board, will be to get them trained as quickly as we possibly can, without sacrificing the quality of that training of course, so that they can start working on the backlog.<sup>25</sup>

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22 McCarthy, *Transcript*, 31 May 2002, pp. 21-2.

23 McCarthy, *Transcript*, 31 May 2002, p. 23.

24 McCarthy, *Transcript*, 31 May 2002, p. 26.

25 McCarthy, *Transcript*, 31 May 2002, p. 27.

- 5.35 The Committee asked what strategies were in place to maintain security review processes at acceptable levels.<sup>26</sup>
- 5.36 In response, Immigration advised that it had increased the strength of the monitoring and evaluation component of its departmental security committee which had created an opportunity to ensure that resourcing levels were in line with recently increased PSM requirements.<sup>27</sup>
- 5.37 Defence advised that it was undertaking a full review of the security clearance review process to identify opportunities for streamlining. It is also integrating its personnel clearance information system with the Defence human resource management system to allow electronic records checking and to substantially automate the routine data-checking aspects of the vetting process.<sup>28</sup>
- 5.38 Customs responded that additional funding of \$30 000 had been provided to improve IT management information systems to support security clearance processes, and that additional funding of \$415 000 had been made available for personnel security vetting resources to ensure that reviews of existing security clearances and initial security clearance processes were properly conducted.<sup>29</sup>

## Committee comments

- 5.39 It is clear to the Committee that there is a resource management issue. Generally, agencies have not made sufficient resources available to maintain new clearance requirements or to avoid, or deal with, the backlog of security clearance re-evaluations.
- 5.40 In addition, the Committee notes that one of the audit findings was that many agencies do not have adequate information management systems to support the security review clearance process, and that this impacts upon their ability to manage the re-evaluation process.
- 5.41 The Committee understands that some agencies were not able to accurately estimate the number of clearances overdue for re-

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26 *Transcript*, 31 May 2002, p. 26.

27 Hannah, *Transcript*, 31 May 2002, p. 26.

28 Defence, Submission no. 2, pp. 2-3.

29 Customs, Submission no. 8 p. 2.

evaluation, because of shortcomings in their management information systems.

### **Recommendation 7**

- 5.42 The Committee recommends that all agencies allocate the resources necessary to bring their security clearance processes in line with the requirements of the Protective Security Manual.**

### **Recommendation 8**

- 5.43 The Committee recommends that all agencies make the necessary changes to their Human Resource Management Information System to support management reporting in relation to security clearances and appropriate access to security clearance information.**

## **Portability of security clearances**

- 5.44 A contemporary issue is the transfer of an individual's security clearance between Commonwealth organisations, commonly known as 'portability'. The main benefits of portability are a reduction in unnecessary duplication in security clearance activity, reduction in costs and delays and increased efficiency.
- 5.45 The portability of security clearances depends largely on the respective organisations' compliance with the PSM's minimum checking standards.
- 5.46 The audit found that each of the organisations audited accepted the principle of security clearance portability and had instituted procedures requiring the review of clearances previously provided by other Commonwealth organisations. Better practice noted in one organisation was that clearances from other organisations were assessed against risk factors specific to that organisation before they were accepted.<sup>30</sup>

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30 ANAO, Audit Report No. 22, 2001–2002, pp. 40-1.

- 5.47 At the hearing, Customs indicated that it agreed in principle with the portability of security clearances, but that as a law enforcement agency, it would reserve the right to augment security clearances with supplementary questions.<sup>31</sup>
- 5.48 The Committee asked Attorney-General's whether it would be helpful for a central coordinating agency to be responsible for the transfer of security clearances when staff moved from one agency to another.<sup>32</sup>
- 5.49 Attorney-General's responded that it was an issue that had been before the security committee at a number of its meetings:
- The portability of security clearances is an issue which has not been resolved. In my view, it is just commonsense that if the minimum standard is reached in the PSM with regard to a security clearance, and that is the standard for the Commonwealth, then it should be accepted across the Commonwealth. The matter of coordinating that has not been resolved yet ...<sup>33</sup>
- 5.50 In response to the Committee's inquiry as to whether Attorney-General's would be the logical agency to perform the coordinating function, Attorney-General's acknowledged that it would be the logical agency.<sup>34</sup>

## Committee comments

- 5.51 The Committee considers that organisation suitability indicators should supplement, rather than replace, standard PSM security clearances.
- 5.52 The Committee agrees with the ANAO that if the receiving organisation conducts a quality assurance review or revalidation there would be no impact upon clearance portability.
- 5.53 The Committee notes that all of the organisations audited accepted the principle of security clearance portability. It appears to the Committee that it would be desirable to have a central coordinating agency responsible for the maintenance of security

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31 Collins, *Transcript*, 31 May 2002, p. 33.

32 *Transcript*, 31 May 2002, p. 32.

33 Tyrie, *Transcript*, 31 May 2002, pp. 32-3.

34 Tyrie, *Transcript*, 31 May 2002, p. 33.



clearances and that the agency which should take on that responsibility is Attorney-General's.

### **Recommendation 9**

- 5.54 The Committee recommends that the Attorney General's Department report to the Joint Committee of Public Accounts and Audit on the cost effectiveness of the Department maintaining a central database of security clearances.**

Bob Charles MP  
August 2002





## **Appendix A—Conduct of the Committee’s review**

### **Selection of audit reports**

The Auditor-General presented 38 reports in the First, Second & Third Quarters of 2001–2002. These were:

- No. 1 Financial Statement Audit  
*Control Structures as part of the audits of the Financial Statements of Major Commonwealth Entities for the Year Ended 30 June 2001*  
Various agencies
- No. 2 Performance Audit  
Examination of Allegations Relating to Sales Tax Fraud  
Australian Taxation Office
- No. 3 Performance Audit  
*Australian Taxation Office’s Administration of Taxation Rulings*  
Australian Taxation Office
- No. 4 Performance Audit  
*Commonwealth Estate Property Sales*  
Department of Finance and Administration
- No. 5 Performance Audit  
*Parliamentarians’ Entitlements 1999-2000*
- No. 6 Performance Audit  
*Commonwealth Fisheries Management: Follow-up Audit*  
Australian Fisheries Management Authority

- No. 7 Audit Activity Report  
*Audit Activity Report: January to June 2001*  
Summary of Outcomes
- No. 8 Assurance and Control Assessment Audit  
*Disposal of Infrastructure, Plant and Equipment*
- No. 9 Performance Audit  
*Learning for Skills and Knowledge – Customer Service Officers*  
Centrelink
- No. 10 Assurance and Control Assessment Audit  
*Management of Bank Accounts by Agencies*  
Department of Immigration and Multicultural Affairs
- No. 11 Performance Audit  
*Administration of the Federation Fund Programme*  
Various agencies
- No. 12 Financial Control and Administration Audit  
*Selection, Implementation and Management of Financial Management*  
*Information Systems in Commonwealth Agencies*
- No. 13 Performance Audit  
*Internet Security within Commonwealth Government Agencies*
- No. 14 Performance Audit  
*Client Service Initiatives Follow-up Audit*  
Australian Trade Commission (Austrade)
- No. 15 Performance Audit  
*Agencies' Oversight of Works Australia Client Advances*
- No. 16 Performance Audit  
*Defence Reform Program Management and Outcomes*  
Department of Defence
- No. 17 Performance Audit  
*Administration of Petroleum Excise Collections*  
Australian Taxation Office
- No. 18 Performance Audit  
*Performance Information in Portfolio Budget Statements*

- No. 19 Assurance and Control Assessment Audit  
*Payroll Management*
- No. 20 Performance Audit  
*Fraud Control Arrangements in the Department of Agriculture, Fisheries and Forestry-Australia (AFFA)*  
Department of Agriculture, Fisheries and Forestry-Australia
- No. 21 Performance Audit  
*Developing Policy Advice*  
Department of Education, Training and Youth Affairs, Department of Employment, Workplace Relations and Small Business, Department of Family and Community Services
- No. 22 Protective Security Audit  
*Personnel Security – Management of Security Clearances*
- No. 23 Performance Audit  
*Broadcasting Planning and Licensing*  
The Australian Broadcasting Authority
- No. 24 Protective Security Audit  
*Status Reporting of Major Defence Acquisition Projects*  
Department of Defence
- No. 25 Assurance and Control Assessment Audit  
*Accounts Receivable*
- No. 26 Performance Audit  
*Management of Fraud and Incorrect Payment in Centrelink*  
Centrelink
- No. 27 Assurance and Control Assessment Audit  
*Agency Management of Software Licensing*
- No. 28 Information Support Services  
*An Analysis of the Chief Financial Officer Function in Commonwealth Organisations*  
Benchmark Study
- No. 29 Financial Statement Audit  
*Audits of the Financial Statements of Commonwealth Entities for the period ended 30 June 2001*
- No. 30 Performance Audit  
*Test and Evaluation of Major Defence Equipment Acquisitions*  
Department of Defence
- No. 31 Audit Activity Audit  
*Audit Activity Report: July to December 2001: Summary of Outcomes*  
Australian National Audit Office

- ❑ No. 32 Performance Audit  
*Home and Community Care Follow-up Audit*  
Department of Health and Ageing
- ❑ No. 33 Assurance and Control Assessment Audit  
*Senate Order of 20 June 2001 (February 2002)*
- ❑ No. 34 Assurance and Control Assessment Audit  
*Management of Travel – Use of Taxis*
- ❑ No. 35 Performance Audit  
*ATO Progress in Addressing the Cash Economy*  
Australian Taxation Office
- ❑ No. 36 Information Support Services  
*Benchmarking Implementation and Production Costs of Financial Management Information Systems*
- ❑ No. 37 Performance Audit  
*Purchase of Hospital Services from State Governments Follow-up Audit*  
Department of Veterans' Affairs
- ❑ No. 38 Performance Audit  
*Management of Australian Defence Force Deployments to East Timor*  
Department of Defence

The Joint Committee of Public Accounts and Audit discussed the above audit reports and considered whether the issues and findings in the reports warranted further examination at a public hearing. In making this assessment the Committee considered, in relation to each audit report:

- the significance of the program or issues canvassed in the audit report;
- the significance of the audit findings;
- the response of the audited agencies, as detailed in each audit report, and
- the extent of any public interest in the audit report.

Following this consideration, the Committee decided to take evidence at public hearings on the following audit reports:

- ❑ No. 3 Performance Audit  
*Australian Taxation Office's Administration of Taxation Rulings*  
Australian Taxation Office
- ❑ No. 4 Performance Audit  
*Commonwealth Estate Property Sales*  
Department of Finance and Administration

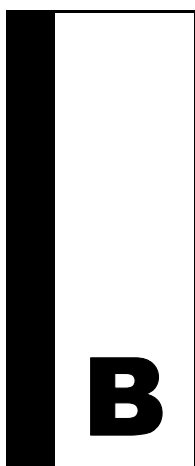
- No. 11 Performance Audit  
*Administration of the Federation Fund Programme*
  
- No. 22 Protective Security Audit  
*Personnel Security – Management of Security Clearances.*

### **The evidence**

The Committee held public hearings in Canberra on 31 May 2002. The transcript of evidence taken at the hearings is reproduced at Appendix E.







## **Appendix B—Submissions & Exhibits**

### **Submissions**

<b>No.</b>	<b>Individual/Organisation</b>
1	Department of Immigration & Multicultural & Indigenous Affairs
2	Department of Defence
3	AusAID
4	Australian National Audit Office
5	Australian Taxation Office
6	Australian National Audit Office
7	Attorney-General's Department
8	Australian Customs Service
9	Australian National Audit Office
10	Australian National Audit Office
11	Australian National Audit Office
12	Australian National Audit Office
13	Department of Communications Information Technology & the Arts
14	Australian Taxation Office
15	Department of Finance and Administration

- 16 Department of Communications Information Technology & the Arts
- 17 Environment Australia
- 18 Department of the Prime Minister & Cabinet

## Exhibits

**No. Individual/Organisation and Title**

1. Attorney-General's Department, *Commonwealth Protective Security Manual 2000*
2. Attorney-General's Department, *Commonwealth Protective Security Executive Handbook*





## Appendix C—Federation Fund Major Projects

### Completed projects.

Completion dates refer to official openings where appropriate. Construction was often completed well before the official opening. Final acquittal may pre- or post-date the official opening. Original estimated completion dates are those incorporated in the original grant deeds.

Project	Completion date	Original estimated completion date
<b>National/ACT</b>		
National Museum of Australia	11 March 2001	11 March 2001
VFT Proving Up	Feb 2000	February 2000
Manuka Oval	7 Dec 2000	31 December 2000
Anzac Hall, Australian War Memorial	21 June 2001	25 April 2001
Australian Federation Centre	27 Sept 2001	31 January 2001
<b>NSW</b>		
Tamworth Regional Entertainment Centre	22 Jan 1999	22 Jan 1999
*St Andrew's Cathedral Restoration	31 Dec 2001	31 December 2001**
Grahame Park Stadium	6 Feb 2000	30 August 1999
Gunnedah Performing Arts and Cultural Centre	31 March 2001	13 January 2001
Line of Lode, Broken Hill	21 April 2001	31 December 2000
Australian Museum of Flight, Nowra	1 June 2001	30 September 2001
Oddfellows Hall, Corowa	28 July 2001	31 December 2001
Centennial and Moore Parks	9 December 2001	31 December 2001
Shearers' Hall of Fame, Hay	26 Jan 2002	31 December 2001
National Marine Science Centre, Coffs Harbour	17 Nov 2001	31 December 2001

<b>Project</b>	<b>Completion date</b>	<b>Original estimated completion date</b>
<b>NSW</b> [continued]		
National Institute of Dramatic Art	26 Oct 2001	<i>6 November 2001</i>
Remediation of Garden Island	18 Dec 2000	30 June 2000 <sup>1</sup>
<b>VIC</b>		
Bendigo Regional Athletics Facility	4 Dec 1999	30 September 1999
Ballarat Athletics Facility	March 2000	30 January 2000
4 Treasury Place	8 May 2001	8 March 2001
Walhalla Goldfields Railway	March 2002	3 May 2001
*Otama Submarine Relocation	May 2002	
<b>QLD</b>		
Comprehensive Cancer Research Centre	30 Aug 2001	Mid-2001
<b>SA</b>		
National Wine Centre	3 Oct 2001	March 2001
Torrens Parade Ground	21 Oct 2001	Official handover to SA Government
<b>WA</b>		
Australian Prospectors' and Miners' Hall of Fame, Kalgoorlie	30 Oct 2001	30 September 2001
<b>TAS</b>		
Tasmanian Symphony Orchestra Concert Hall	31 March 2001	30 September 2000

\* Not completed but all Commonwealth funds acquitted.

\*\* deed grant required that Commonwealth funds be acquitted by 31 December 2001.

**Source:** PM&C, Submission no. 18, p. 2.

## Projects yet to be completed

Project	Estimated completion date
<b>NSW</b>	
Holsworthy Shooting Range	Not known at this stage
Sydney Harbour Federation Trust – including remediation of Cockatoo Island	Various stages of the project will continue to 2010
Murray River Bridges: Echuca Corowa Robinvale	Mid 2003
<b>VIC</b>	
Victorian College of the Arts Redevelopment	Two component projects are completed, the remainder will be completed by Sept/Oct 2002
National Gallery of Victoria Redevelopment	Mid 2003
Australian Centre for the Moving Image (the Alfred Deakin Building) – Federation Square	July 2002
Victorian Regional Art Galleries (16 component projects)	15 projects are completed, remaining one is due for completion in December 2003
Commonwealth Technology Port	Construction likely to continue to 2010, but Federation Fund grant will be expended by end 2002-03
St Paul's Cathedral, Melbourne	May 2003
Murray River Bridges	See above
Undercroft at Melbourne Shrine of Remembrance	April 2003
Portsea Heritage Restoration	June 2003
<b>QLD</b>	
Institute for Molecular Bioscience	December 2002
Queensland Heritage Trails Network	August 2003
Caboolture Motorway	Mid 2003
Beaudesert Shire Railway	December 2002
<b>WA</b>	
Jervoise Bay Infrastructure	December 2002 (operational in July 2002)
<b>TAS</b>	
Abt Railway	Opening delayed while safety testing processes completed by State authorities
<b>SA/NT</b>	
Alice Springs to Darwin Railway	December 2003

Source: PM&C, Submission no. 18, p. 3.







## **Appendix D—Federation Fund Major Projects without matching funds from non-Commonwealth sources**

<b>Projects</b>	<b>Comments</b>
<b>National/ACT</b>	
National Museum of Australia	
Australian Federation Centre	
Australian War Memorial (ANZAC Hall)	
<b>NSW</b>	
Sydney Harbour Federation Trust	
National Marine Science Centre	
National Institute of Dramatic Art	\$25m from Federation Fund—non-Commonwealth contribution \$7m
Holsworthy Shooting Range	
Centennial and Moore Parks	\$10m from Federation Fund—non-Commonwealth contribution \$0.68m
Line of Lode, Broken Hill	
Australian Shearers' Hall of Fame	
Australian Museum of Flight, Nowra	\$1.6m from Federation Fund—non-Commonwealth contribution \$1.03m
Oddfellows Hall, Corowa	\$0.75m from Federation Fund—non-Commonwealth contribution \$0.5m
<b>VIC</b>	
Shrine of Remembrance	\$5m from Federation Fund—non-Commonwealth contribution \$2.26m
No 4 Treasury Place	
Walhalla Goldfields Railway	\$1m from Federation Fund—non-Commonwealth contribution of \$0.5m

<b>Projects</b>	<b>Comments</b>
<b>VIC</b>	
Defence lands (Portsea)	
St Paul's Cathedral, Melbourne	\$2.5m from Federation Fund for conservation of spires—other phases of the project are planned and will be funded from non-Commonwealth sources
<b>QLD</b>	
Caboolture Motorway	National Highway project, fully funded by Commonwealth
Beaudesert Railway	\$5m from Federation Fund—non-Commonwealth contribution \$0.5m
<b>SA</b>	
Torrens Parade Ground	
<b>TAS</b>	
Abt Railway	\$20.45m from the Federation Fund—non-Commonwealth contribution of about \$14m

**Source:** PM&C, Submission no. 18, p. 4.



## **Appendix E—Transcript of evidence**