DEPARTMENT OF
FINANCE AND
ADMINISTRATION

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RECEIVED
14 APR 2003
Senate Finance & Public Administration Committee

Mr Alistair Sands
Committee Secretary
Finance and Public Administration Legislation Committee
Parliament House
CANBERRA ACT 2600

Dear Mr Sands

Finance and Public Administration Legislation Committee - February 2003 Hearings

I refer to paragraphs 1.70 and 1.71 of the Finance and Public Administration Legislation Committee's report on the Additional Estimates 2002 - 2003. I note that this report states the Department of Finance and Administration was to ask the Auditor-General to examine the accounts of the Australian Industry Development Corporation (AIDC).

I note that this issue was also raised in a question by Senator Brandis to the Minister for Finance and Administration, Senator Minchin, in the Senate on 3 March 2003.

The AIDC accounts have been referred to the Auditor-General. I am pleased to provide the Committee with a copy of the documents that were tabled by Senator Minchin in the Senate on 3 March 2003, responding to Senator Brandis's question, including a letter from the Auditor-General dated 26 February 2003.

Attachment A contains the appropriate *Proof Hansard* pages for ease of reference.

Attachment B contains the documents that were tabled on 3 March 2003.

Should you have any queries regarding this matter, please do not hesitate to contact either myself on 6215 3533, or Mr John Dalton on 6215 3184.

Yours sincerely

Ian McAuley
Branch Manager
Parliamentary and Corporate Support
14 April 2003

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Senator COONAN—It seems that Senator Conroy has sat through four minutes of an explanation and has not heard a word of it. At the end of the day, it is the owners of companies, the shareholders, and their representatives, the boards, who can clearly play the most relevant and effective role in containing and setting the appropriate level of remuneration, but I have just gone into great detail about how the ASX will be releasing guidelines and rules that will address this issue.

Quite clearly, the ALP seem to think that the government should be some sort of arbiter, sitting in on company boards and setting pay rates. Those opposite should thank their lucky stars that their constituents do not get the same opportunity because, can you imagine, if the Labor Party were in government and setting remuneration, those opposite would not be getting any pay.

Australian Industry Development Corporation

Senator BRANDIS (2.45 p.m.)—My question is directed to the Minister for Finance and Administration, Senator Minchin. Will the minister advise the Senate whether the claims that the accounts of the Australian Industry Development Corporation were deliberately misleading and designed to avoid the AIDC reporting a loss of over $2 billion have been substantiated? Has the Auditor-General provided a report to the minister, as was agreed to at the recent Senate estimates hearing? If so, what is the Auditor-General's expert advice about those allegations?

Senator MINCHIN—I thank Senator Brandis for the question. Senator Brandis, in particular, will remember the pretty outrageous display put on by Senator Conroy at the finance department estimates a couple of weeks ago, when he abused finance dept officials and made slanderous remarks about officers of the AIDC.

Senator Conroy interjecting—

Senator MINCHIN—We are used to this from Labor senators, but I thought Senator Conroy's performance on that day was completely unacceptable.

Senator Conroy interjecting—

Senator MINCHIN—He has to play in the shadow of Senator Faulkner and Senator Ray, and that may have led him to this extraordinary behaviour. He came in thinking that he had a huge scoop. He basically asserted there was some sort of $2 billion hole in the accounts of the AIDC, which this government sold in 1998, that somehow this great hole had been covered up for four years—until Senator Conroy came along and found it—and that somehow the officers of the AIDC and the officers of the finance department were involved in a great conspiracy to cover up this $2 billion hole.

Senator Conroy interjecting—

Senator MINCHIN—It is interesting that we have heard absolutely nothing from Senator Conroy since the day that he made these claims.

The PRESIDENT—Order! Senator Conroy, you have been continually interjecting through the whole of question time, and I warn you.

Senator MINCHIN—As I was saying, Senator Conroy has said nothing of this, and I thank him for not perpetrating these outrageous claims. His most offensive behaviour was his abuse of finance department officials. At the suggestion of Senator Murray—and I thank him for the suggestion—we asked the Auditor-General to review the situation, and the Auditor-General has done that and has provided his report. The Auditor-General reconfirmed his December 1998 audit opinion, in which he issued an unqualified audit opinion on the AIDC. He concluded in his most recent letter:

> ... there is no evidence from my audit of the AIDC's financial statements for the year ended 1998 to indicate an improper construction of those financial statements to avoid reporting a loss of $2 billion.

The Auditor-General's finding, of course, is consistent with the written advice of the AIDC's chief executive that Senator Conroy's claims were quite baseless in every respect and quite without any substance—a view the AIDC's advisers in Treasury matters, KPMG, have also confirmed. The AIDC letter shows that Senator Conroy's claims arose 'from his lack of understanding and erroneous interpretation of the AIDC's financial statements'.

Further, a letter from UBS Warburg, an internationally renowned bank, which bought most of the AIDC business, states that there were no grounds for asserting that the transactions to which it was a party were in any way designed to cover up any so-called losses, and it goes on to explain the nature of the transaction. That view was confirmed by the AIDC's auditors, Ernst and Young, and its accountants, PricewaterhouseCoopers. PricewaterhouseCoopers' written advice states, 'There was no $2.1 billion hole in the AIDC portfolio and there was no loss. Senator Conroy was clearly confusing loans and losses.' AIDC's auditors, Ernst and Young, also confirmed:

> There was no loss of $2.1 billion trading currency derivatives.

As Ernst and Young clearly showed, what happened was Senator Conroy came in with this outrageous assertion based solely on a small note at the bottom of the balance sheet, which he could not understand or maliciously misrepresented.

There is no $2 billion loss by the AIDC, there is no sneaky change to accounting policies and there is no attempt to cover up. Senator Conroy owes an apology to the department of finance officials he abused and to the AIDC officers he slandered. I table the relevant documents that I have referred to today.

Business: Executive Remuneration

Senator CONROY (2.50 p.m.)—My question is to Senator Coonan, the Minister for Revenue and Assistant Treasurer. Is the minister aware of Senator Ian Campbell's comments on the John Laws program last week in relation to the multimillion dollar payouts to AMP executives that:

> ... these deals should be revealed to the shareholders—and revealed to the whole world, quite frankly—at the time they're entered into so that the grilling can take place at the annual general meeting when the ink's not even dry.

Given that the minister believes that it is up to shareholders to grill company executives, why has the government circulated for comment a draft bill called the Corporations Amendment Bill 2002 that actively reduces shareholders' rights by abolishing the right of a single director of a listed company to call a meeting of members and by reducing the 28-day minimum notice period for calling a meeting of a listed company to 21 days?

Senator COONAN—Thank you, Senator Conroy, for yet again a non-question. Senator Conroy does not seem to be able to understand what is being achieved by the government in its suite of reforms that will relate to the disclosure of executive remuneration. The Labor Party's approach to this whole matter is flawed. The government has now addressed the fact that it is important that there be tighter controls and greater transparency. The government has released an exposure draft to amend the Corporations Act that will provide for more effective disclosure of director and executive remuneration. Also, if companies become insolvent, the government has introduced the Corporations Amendment (Repayment of Directors' Bonuses) Bill 2002 to allow for unreasonable bonuses paid to directors in the lead-up to a company failure to be reclaimed for payment of the company's employees and creditors.

That, together with the ASX Corporate Governance Council guidelines and rules, will amount to best practice on disclosure recommendations, and of course the ASX will be releasing its report next week—that is, in March 2003. Senator Conroy is once again barking up the wrong tree. Not only has he been rude to officials and not only can he not distinguish between a loss and a profit, in these circumstances he has absolutely no idea how to address the problem of excessive employee payouts.

The comments by Senator Campbell have addressed the fact that there does need to be real-time disclosure so that shareholders can have a better opportunity to have a say at the time that a contract is entered into or shortly afterwards and that these amounts are not paid out at the end when the shareholders have no idea what amount has been agreed. It is largely a matter for contract and for boards, but clearly the disclosure rules need to be improved and they need to be improved so that there can be a better opportunity at

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Senator The Hon Nick Minchin
Minister for Finance and Administration
Parliament House
Canberra ACT 2600

Fax No: 02 62 734110

COPY

25 February 2003

AIDC

Dear Minister,

We would like to make the following points in relation to comments that were made by Senator Conroy on Tuesday, 11 February 2003 in the course of deliberations of the Finance and Public Administration Legislation Committee as reported in Hansard:

- The sale of AIDC Limited ("AIDC") was a result of a public tender process conducted by the Commonwealth Government Office of Asset Sales. UBS does not consider there are grounds for asserting that the transactions to which it was a party were in any way designed to cover-up any so called "losses".
- As part of the overall transaction UBS Australia Ltd ("UBS") purchased most of AIDC's financial assets and agreed to manage its ongoing Commonwealth government guaranteed borrowings, which are due to mature by 2008. These borrowings consist mainly of medium term bonds that were issued by AIDC in various currencies prior to its sale and which would have been logistically difficult to buy back at the time.
- In order to give effect to these arrangements a portfolio of securities was transferred by UBS to AIDC Corporation as part of the consideration paid by UBS for the purchase of the assets. This portfolio of securities is managed by UBS for the express purpose of ensuring that AIDC Corporation is effectively fully funded in respect of these obligations up to and including their maturity out of receipts from this portfolio of securities. This has been achieved by UBS agreeing to ensure that the cash flows between the portfolio and the borrowings are fully matched. The cash flow matching arrangement in no way constituted a $2 billion loan from UBS to AIDC and UBS does not receive any ongoing fees.
- The amount paid by UBS for the financial assets that it bought from AIDC and the price of the securities transferred to AIDC Corporation by UBS in consideration for the purchase of these assets were subject to verification by independent third parties. All such transactions were effected on commercial terms at fair value.

UBS believes it and all other parties to the transactions acted with the utmost good faith in accordance with the best standards of business practice.

Yours sincerely,

Gordon Dickinson
Chairman and Joint CEO

Philip Coleman
Chief Operating Officer

AIDC2.doc

Australian Industry Development Corporation

14 February, 2003

COPY

Senator the Hon Nick Minchin
Minister for Finance and Administration
Parliament House
Canberra ACT 2600

Dear Senator Minchin

Claims made by Senator Conroy

We refer to the recent claims by Senator Conroy of a $2.1bn loss by the Corporation in 1997/98.

The Corporation dismisses outright the claims made by Senator Conroy and stands by the signed 1997/98 Accounts, and indeed all its subsequent Accounts, all of which are true and correct.

The allegations are baseless in every respect. There was no $2.1bn loss on derivatives trading or on any other account. Nor has anything been hidden.

The claims by the Senator seem to arise due to a lack of understanding of the nature and financial effects of the transactions at the time of the sale of AIDC Ltd and erroneous extraction of figures from various sections of the financial statements.

We have obtained confirmatory advice from our Accountants, PricewaterhouseCoopers and our Auditors, Ernst & Young (who audit the Corporation in their own right, as required by the Bearer Bond Issues, and as agent for the ANAO). The advices confirm that the claims of Senator Conroy, including the claimed derivatives trading losses of $2.1bn, are without any substance.

Our advisers in treasury risk matters, KPMG of Melbourne, have also confirmed the above position.

The Ernst & Young advice provides a clear explanation of the financial transactions and the proper construction of the relevant financial statements.

The claims by Senator Conroy have resulted in the Corporation incurring substantial expenses, both in internal executive time spent, and the fees payable to our external advisers. In our view, the Senator has caused a waste of money that the Corporation ultimately would have returned to the Commonwealth, to the benefit of the Australian Public.

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Further, as a result of the Press Release by the Senator, the Corporation and its Chief Executive are both seeking advice from a leading defamation practitioner and may take the matter further, including seeking a withdrawal of the claims and an apology.

Yours sincerely

Ian Morison
Chief Executive

Mr Mark Heazlett
Asset Sales Branch
Department of Finance & Administration
Fax: 02 62673539

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Fax cover sheet

To:	Peter Williams
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Company:	Ernst & Young
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From:	Michael J. Empson
Fax number:	(02) 6271 3999
Date:	13 February 2003
Pages:	2 (including this page)

If this fax is illegible please contact:

Dear Peter,

Re: Senate Estimates Allegation – AIDC

I refer to your facsimile today on Senator Conroy's media statement and comment as follows on Paragraph's 3, 4 and 5 as follows.

1. **Paragraph 3.**

   As a result of the sale and cash flow matching arrangement in the 1997/98 financial year, there was no $2.1 billion hole in its portfolio as the amounts payable to the Group and Corporation was sold and substituted by other assets being Government and Semi-Government bonds and swaps. This movement between the 1997 and 1998 financial years in derivatives was adequately explained in the written commentary in Note 34.

2. **Paragraph 4.**

   As there was no loss it would not affect the profit and loss account or the results of the Corporation. There was also no change in accounting policy which affected these loans.

PRICEWATERHOUSECOOPERS

3. **Paragraph 5.**

The entering into the cash flow matching arrangement was to negate AIDC of any exposure on its long term borrowings. The purchase of the Government and Semi-Government Bonds to match the long-term borrowings changed the nature of the assets which were to offset the borrowings. The Government and semi-Government bonds were investments not derivatives as were the previous loans.

4. **Paragraph 6.**

Whilst we were not requested to comment on this paragraph, we note that the 2002 Annual Report for AIDC does not state that they have $1.35 billion in "losses" outstanding. AIDC has $1.35 billion in loans outstanding to the numerous lenders to the Corporation.

I have discussed the above comments with your auditors, Ernst & Young, who agree with them.

Please contact me on (02) 6271 9207 should you require any further clarification.

Yours sincerely,

Michael J. Empson
Partner

ERNST & YOUNG

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13 January 2003

Mr Peter Williams
Secretary
Australian Industry Development Corporation
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15 Torrens Street
BARTON ACT 2601

Dear Peter

Senate Estimates Allegations

We refer to the copy of the media statement by Senator Conroy, in particular the issues raised in paragraphs 3,4 and 5. Our comments are as follows:

Paragraph 3 of the Media Statement

There was no loss of $2.1 billion trading currency derivatives. The alleged shortfall of $2.1 billion (rounded to one decimal place) was the difference between $2,866,121,000 (a payable) and $780,639,000 (a receivable). These balances were extracted from Note 34 of the 1998 Annual Report.

It would appear that the allegation has been drawn solely from Note 34 without a review of the entire balance sheet including the movements of assets and liabilities contained therein.

In September 1997, the Australian Industry Development Corporation (the Corporation) entered into a contract for the sale of certain assets of AIDC Ltd to UBS Warburg and for the sale of the entire share capital of AIDC Ltd to Babcock and Brown Group. This sale was completed in February 1998. Prior to the sale, AIDC Ltd had an intercompany loan payable to the Corporation of approximately $3.070 billion at 30 June 1997. As part of the arrangements associated with the sale, AIDC Ltd's debt to the Corporation was repaid. The cash received was reinvested by the Corporation in Government and Semi-Government Bonds.

The above transactions were also described in the 1998 Directors' Report "Changes in State of Affairs".

ERNST & YOUNG

At 30 June 1998, the total amount of the investment was:

Maturity	Amount $
Current	241,000,000
Non-Current	1,842,025,000
Total	$2,083,025,000

As mentioned above, the alleged shortfall of $2.1 billion appears to have been determined by using the financial information contained in Note 34: Schedule of Maturity of Estimated Amounts Payable to and by the Corporation, in isolation. There was a significant reduction in the amount of receivables by the Corporation in 1998 due to:

- Repayment of the debt by AIDC Ltd; and
- Note 34 does not include investments for the purpose of maturity analysis.

The amount payable by the Corporation did not change materially during the year.

Based on the above analysis, there was no shortfall or loss as alleged in the Media Statement. In essence, the difference between the payables and receivables in the 1998 financial year was attributable to a change in the nature of the assets (i.e. the intercompany loan was substituted by Government and Semi-Government Bonds) after the sale of AIDC Ltd. This matter was also explained in the written commentary in Note 34.

Paragraph 4 of the Media Statement

There was no loss and there were no transactions that would have given rise to a loss.

The comments in paragraph 4 of the media Statement that "such losses would have hit the bottom line in the year in which they were incurred" have no basis. There was a change in the nature of the asset portfolio as describe in our comments above. However, this change did not affect the profit and loss account or the results of the Corporation for the year ended 30 June 1998.

ERNST & YOUNG

Paragraph 6 of the Media Statement

The creation of a matched portfolio is to enable the Corporation to minimise any exposure on its long-term borrowings. Although the term of the government and semi-government bonds match those of the long-term borrowings, they are held for investment purposes. They are not derivatives.

We hope the above comments would assist you in your response to the Media Statement. If you need further clarification, please do not hesitate to contact me at this office.

Yours sincerely
Ernst & Young

Ernst & Young

Geoffrey R Applebee
Executive Partner

Auditor-General for Australia

Received
27 FEB 2003
Office of Senator Nick Minchin
Minister for Finance and Administration

Australian National
Audit Office

26 February 2003

Senator the Hon Nick Minchin
Minister for Finance and Administration
Parliament House
Canberra ACT 2600

Dear Senator Minchin

I refer to your letter of 13 February requesting advice on whether the accounts of the Australian Industry Development Corporation (AIDC) for the financial years ended 30 June 1997 and 1998 may have been constructed in some way to avoid the AIDC reporting a loss of $2 billion or presenting information in an artificial or misleading manner.

In reviewing this matter, I have considered:

- the Hansard report of the Committee's hearings on 11 February 2003;
- the media statement (and attachments) issued on 11 February 2003 by Senator Conroy;
- ANAO files on the financial statement audits of the AIDC for the years ended 30 June 1998, 1999, 2000, 2001 and 2002; and
- information provided by Ernst & Young (joint auditors of AIDC), PricewaterhouseCoopers (accountants to AIDC) and AIDC itself.

The AIDC's financial statements for the year ended 30 June 1998, to which your request largely refers, were subject to my audit and issued with an unqualified audit opinion on 22 December 1998. A copy of those financial statements and the audit report thereon was forwarded to you in your then capacity as Minister for Industry, Science and Resources on 14 January 1999.

A review of the contemporaneous evidence relating to the audit of the AIDC's financial statements for the year ended 30 June 1998 indicates that, at the time of audit, there was no concern in relation to the accounting treatment adopted by the AIDC in reporting the events associated with the sale of AIDC Ltd. Nor was there any evidence, obtained as part of the audit, to indicate that those financial statements

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had been constructed to avoid the AIDC reporting a loss of $2 billion, or to present information in an artificial or misleading manner.

In essence, the suggestion that AIDC incurred an unreported $2.1 billion loss in association with the sale of AIDC Ltd could be derived from an analysis of Note 34 to the AIDC's financial statements for the year ended 30 June 1998. Note 34 of thefinancial statements is a Schedule of Maturity of Estimated Amounts Payable to, and by, the AIDC which indicates a $2.4 billion reduction in the amount due to the AIDC between the 1997 and 1998 years and a $0.3 billion reduction in the amount payable by the AIDC. Also described in that note, was that a significant portion of this difference was represented by Government and Semi-Government Bonds being held as investments ($2.08 billion for the AIDC).

As a consequence of the sale of AIDC Ltd, assets held by the AIDC in the form of a loan to AIDC Ltd were repaid and subsequently invested by AIDC in Government and Semi-Government Bonds. In AIDC's financial statements for the year ended 30 June 1998, this was reflected as a reduction in the asset classification - Receivables, and an increase in the asset classification - Investments. I also note there was no change in accounting policy that impacted on the accounting treatment of those Government and Semi-Government investments.

It was also suggested that there was still $1.35 billion in losses outstanding as at 30 June 2002 and that the last of these liabilities was not due to mature until December 2008. This amount is derived from Note 23 of the AIDC's Financial Report for the year ended 30 June 2002, which is a Schedule of Maturity of Estimated Amounts Payable to and by the AIDC. The $1.35 billion simply represents the difference between the amounts payable to, and by, the AIDC. Note 23 also indicates a significant portion of this difference is represented by Government and Semi-Government Bonds being held as investments ($1.3 billion for the AIDC).

In conclusion, there is no evidence from my audit of the AIDC's financial statements for the year ended 1998 to indicate an improper construction of those financial statements to avoid reporting a loss of $2 billion.

I have not undertaken a separate review of the sale agreement to address such issues as the flow of funds between parties to the sale agreement or compliance with the terms and conditions of the sale agreement. My office would normally cover these matters in any performance audit of major asset sales by the Government. I am therefore not able to comment on any other possible arrangements and/or transactions that may have been associated with the sale.

Yours sincerely

P.J. Barrett