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Report 402

**Review of Auditor-General's Reports 2003-2004
First and Second Quarters**

Joint Committee of Public Accounts and Audit

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Foreword

Report 402 records the findings of the Committee's examination of six Australian National Audit Office (ANAO) performance audits selected for review by public hearing from a total of 24 reports presented by ANAO to the Presiding Officers during the first and second quarters of 2003-2004.

The reports examined were:

Audit Report No. 1, 2003-2004, Administration of Three Key Components of the Agriculture – Advancing Australia (AAA) Package; Audit Report No. 4, 2003-2004 Management of the Extension Option Review – Plasma Fractionation Agreement; Audit Report No. 6, APRA's Prudential Supervision of Superannuation Entities; Audit Report No. 11, Annual Performance Reporting; Audit Report No. 21 Special Employee Entitlements Scheme for Ansett Group Employees (SEESA); and Audit Report No. 24, Agency Management of Special Accounts.

In addition to reviewing these reports, the Committee has committed to a full examination of Audit Report No. 13, 2003-2004, *ATSIS Law and Justice Program*. Several public hearings across Australia have been held to review Indigenous law and justice issues. This work is ongoing so no further reference will be made to it here.

The six audit reviews in Report 402 examined respectively, the implementation of two industry assistance schemes, a statutory supervisory function, management of a private sector supply contract to government, and the audits of two areas of public sector transparency.

The Committee found that the overall efficiency of the delivery to rural communities of the AAA package — FarmBis II, Farm Help, and Farm Management Deposits (FMD) — had improved since ANAO's audit. The lead agency the Department of Agriculture, Fisheries and Forestry (AFFA) had responded to the audit by reducing FarmBis II expenses and correcting Farm Help

Performance issues. The Farm Management Deposits scheme is now operating well. The Committee found, however, that AFFA needs to recast the FMD scheme KPIs in realistic terms because they are set far too low to provide a useful reference point for judging performance.

The Special Employment Entitlements Scheme for Ansett Group Employees (SEESA) was the second industry assistance scheme examined. Shortly after the collapse of various Ansett companies in September 2001, the Government established a special entitlements scheme for eligible employees who had been stood down. The Committee found that, in most regards, the agencies involved (Department of Employment and Workplace Relations (DEWR), and Department of Transport and Regional Services) had quickly and effectively responded to the requirement to collect and distribute the assessed entitlements.

The scheme structure, however, had generated an unintended income taxation problem.

The Committee recommended that The Treasury and DEWR jointly resolve the taxation problem. This should restore the integrity of the SEESA model for possible future use in the delivery of early payments of assessed employee entitlements in the case of employer insolvency.

Two ANAO audits relating to public sector supervisory performance – the blood plasma supply contract and the supervision of certain superannuation funds - were reviewed.

The Committee was disappointed by the lackadaisical approach shown by the Department of Health and Ageing (Health) to resolving the Government's position on the Blood Plasma Fractionation Agreement extension option. Health exhibited a history of disregard for advice by ANAO and indeed, the Committee itself, to expedite the task of assessing the extension option. Further, when Health did get on with the task, it did not comply with Department of Finance and Administration guidelines.

The Committee believed that Health needed to put some extra effort into developing staff skills in competitive tendering and contracting. Those staff involved in contract management must comply with the Commonwealth Procurement Guidelines and circulars, especially with regard to value-for-money.

The Committee reviewed the performance audit by ANAO of the Australian Prudential Regulation Authority (APRA) and its supervision of funds under the *Superannuation Industry (Supervision) Act 1993*. The Committee found that, generally, APRA restructuring and its subsequent responses to the audit covered the issues identified by ANAO for attention. The Committee identified two issues requiring further clarification – taxation return lodgement and capital adequacy - and recommended attention by Australian Taxation Office and APRA respectively.

Annual performance reporting is a fundamental mechanism to achieve public sector accountability. The Committee was pleased to note that there has been a ready acceptance by agencies of the ANAO's Better Practice Guide for annual reporting. The Committee noted that agencies eagerly report achievements, but it wants reporting on unmet targets to be given equal attention.

Cost-benefit analysis is a technique that is sparingly used by agencies and the Committee felt that agencies should usefully adopt the technique in overall performance evaluations.

With regard to Special Accounts, the Committee found that agencies have a long way to go in managing special accounts adequately. The ANAO audit found widespread mismanagement by agencies of their special accounts with some very big dollar amounts involved, of magnitudes the Committee found breathtaking.

There was no suggestion of fraudulent behaviour, but management could have been tighter. In this regard the Committee concluded that agencies generally require more guidance from the Department of Finance and Administration to raise the level of agency accuracy, accountability, attention-to-detail and adoption of appropriate Special Account management standards.

Bob Charles MP
Chairman



Membership of the Committee

40th Parliament

Chairman Mr Bob Charles MP

Deputy Chair Ms Tanya Plibersek MP

Members	Senator Richard Colbeck (from 14 February 2002 to 25 March 2003)	Mr Steven Ciobo MP
	Senator Stephen Conroy (from 5 February 2003 to 10 September 2003)	Mr John Cobb MP
	Senator John Hogg (to 5 February 2003 and from 10 September 2003)	Mr Petro Georgiou MP
	Senator Gary Humphries (from 25 March 2004)	Mr Alan Griffin MP
	Senator Kate Lundy (from 19 November 2002 to 1 April 2004)	Ms Sharon Grierson MP
	Senator Claire Moore (from 1 July 2002 to 19 November 2002 and from 1 April 2004)	Ms Catherine King MP
	Senator Andrew Murray	Mr Peter King MP
	Senator Nigel Scullion	The Hon Alex Somlyay MP
	Senator John Watson	

Membership of the Sectional Committee

Chair Mr Bob Charles MP

Deputy Chair Ms Tanya Plibersek MP

Members Senator Gary Humphries (1st Quarter) Mr Steven Ciobo MP (1st Quarter)

Senator Andrew Murray (2nd Quarter) Ms Sharon Grierson MP

Senator John Watson Ms Catherine King MP

Mr Peter King MP (2nd Quarter)

Committee Secretariat

Secretary Mr James Catchpole

Inquiry Secretary Mr Frederick Cook

Research Officers Mr Alex Stock

Mr Paul Shepherd

Administrative Officers Ms Maria Miniutti

Ms Jessica Butler



List of abbreviations

AAA	Agriculture—Advancing Australia
ABS	Australian Bureau of Statistics
Administrator	A person appointed personally to take charge of the affairs of a company in place of the Board of Directors.
AFFA	Department of Agriculture, Fisheries and Forestry—Australia
AGS	Office of the Australian Government Solicitor
Air Passenger Ticket Levy	A levy that applied to the purchase of air passenger tickets from 1 October 2001 to 30 June 2003.
ANAO	Australian National Audit Office
APRA	Australian Prudential Regulation Authority
APS	Australian Public Service
ASIC	Australian Securities and Investments Commission. ASIC has responsibility for administration of the insolvency provisions of the <i>Corporations Act 2001</i> .
ATO	Australian Taxation Office
Bentleys MRI Sydney Pty Ltd	A Sydney-based private firm of chartered accountants providing accounting and related services.
<i>Better practice guide</i>	ANAO Better Practice Guide: <i>Better Practice in Annual Performance Reporting</i>

Blood Review	<i>Review of Australian Blood Banking and Plasma Product Sector</i> (also known as the Stephen Review)
BODT	Blood and Organ Donation Taskforce
CBA	Commonwealth Bank of Australia
CEI	Chief Executive's Instructions
CIOF	Certificate of Inability to Obtain Finance
Committee	The Joint Committee of Public Accounts and Audit
CPG	Commonwealth Procurement Guidelines
CRF	Consolidated Revenue Fund
CSL	CSL Limited
Customs	Australian Customs Service
DCITA	Department of Communications, Information Technology and the Arts
DEST	Department of Education, Science and Training
DEWR	Department of Employment and Workplace Relations
DID	APRA's Diversified Institutions Division
DIMIA	Department of Immigration and Multicultural and Indigenous Affairs
DOTARS	Department of Transport and Regional Services
EESS	Employee Entitlements Support Scheme
Executive Group	An executive of three APRA members appointed by the Treasurer.
Farm Help	Farm Help Supporting Families Through Change program
FarmBis II	FarmBis—Skilling Farmers for the Future program – second generation program
FHS Act	<i>Farm Household Support Act 1992</i>
Finance	Department of Finance and Administration
Finance Minister	Minister for Finance and Administration, referred to as the Finance Minister in the FMA Act
FMA Act	<i>Financial Management and Accountability Act 1997</i>

FMA Regulations	<i>Financial Management and Accountability Regulations 1997</i>
FMD	Farm Management Deposits
GST	Goods and Services Tax
Health	Department of Health and Ageing
Health Minister	Minister for Health and Ageing, referred to as the Health Minister in the FMA Act
ICT	Information and Communication Technology
Insolvency	Situation where an individual or a business is unable to pay debts as and when they fall due for payment.
JCPAA	Joint Committee of Public Accounts and Audit
KPI	Key Performance Indicator
McColl Review	A broad ranging view of the Rural Adjustment Scheme undertaken in 1996
MOU	Memorandum of Understanding
NBA	National Blood Authority
NHT	Natural Heritage Trust of Australia
NHT Act	<i>Natural Heritage Trust of Australia Act 1997</i>
OECD	Organisation for Economic Co-operation and Development
PAIRS	APRA's Probability And Impact Rating System for regulated financial entities
PBS	Portfolio Budget Statements
PFA	Plasma Fractionation Agreement
PM&C	Department of Prime Minister and Cabinet
PSA	<i>Public Service Act 1999</i>
SAF	Small APRA Fund
SEES Pty Ltd	A company established by Bentleys MRI, Sydney, to undertake work under contract for DEWR to implement SEESA.
SEESA	Special Employee Entitlements Scheme for Ansett group employees

SEESA Deed	A deed of agreement between the Government and the Ansett Administrators
SID	APRA's Specialised Institutions Division
SIS Act	<i>Superannuation Industry (Supervision) Act 1993</i>
SOARS	APRA's Supervisory Oversight And Response System for regulated financial entities
Steering Committee	Steering Committee for the Future of Plasma Fractionation and Diagnostic Products Arrangements
Stephen Review	<i>Review of Australian Blood Banking and Plasma Product Sector</i> (also known as the Blood review)
Treasury	Department of the Treasury



List of recommendations

2 Administration of Three Key Components of the Agriculture – Advancing Australia (AAA) Package

Recommendation 1

The Department of Agriculture, Fisheries and Forestry–Australia assemble a rigorous set of Key Performance Indicators for the Farm Management Deposits scheme that consist of credible administrative performance targets.

3 Management of the Extension Option Review - Plasma Fractionation Agreement

Recommendation 2

The Department of Health and Ageing develop staff skills and understanding of the guidelines relating to Competitive Tendering and Contracting set down by the Department of Finance and Administration.

The National Blood Authority take account of the Commonwealth Procurement Guidelines.

Recommendation 3

The Secretary of the Department of Health and Ageing ensure that improvements occur in contract management, and that contract management staff comply with the Commonwealth's Procurement Guidelines and circulars as well as any related Chief Executive's Instructions.

4 APRA's Prudential Supervision of Superannuation Entities

Recommendation 4

The Australian Taxation Office review those superannuation funds that have switched from Australian Prudential Regulation Authority supervision to Australian Taxation Office supervision, to ensure that all have lodged taxation returns appropriately.

Recommendation 5

The Australian Prudential Regulation Authority conduct a review of the effectiveness of the new prudential provisions with respect to capital adequacy of superannuation funds registered under the *Superannuation Industry (Supervision) Act 1993* and implement corrective action targeting funds deemed still to be at high risk due to inadequate capital bases.

6 Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)

Recommendation 6

The Department of the Treasury, in conjunction with the Department of Employment and Workplace Relations, resolve the income tax uncertainty experienced by the private sector administrator of the Special Employee Entitlements Scheme for Ansett Group Employees (SEESA) prior to any future use of the SEESA model.

7 Agency Management of Special Accounts

Recommendation 7

The Department of Finance and Administration raise the level of agency accountability for their Special Accounts by developing appropriate Special Account management standards to complement the *Finance Guidelines for the Management of Special Accounts*.

For each Special Account they administer, agencies be required to report annually to the Department of Finance and Administration that they have complied with these standards.

Introduction

Background to the review

1.1 The Joint Committee of Public Accounts and Audit (JCPAA) has a statutory duty to examine all reports of the Auditor-General that are presented to the Presiding Officers of the Australian Parliament, and report the results of its deliberations to both Houses of Parliament. In selecting audit reports for review, the Committee considers:

- The significance of the program or issues raised in the audit reports;
- The significance of the audit findings;
- The arguments advanced by the audited agencies; and
- The public interest of the report.

1.2 Upon consideration of 24 audit reports presented to the Parliament by the Auditor-General between 1 July 2003 and 31 January 2004, the Committee selected six reports for further scrutiny at public hearings. The public hearings for the respective reports were held in Canberra on:

- Monday 16 February 2004 (ANAO Audit Report No. 1);
- Monday 8 March 2004 (ANAO Audit Report No. 4);
- Monday 29 March 2004 (ANAO Audit Report No. 6);
- Monday 24 May 2004 (ANAO Audit Report No. 11);
- Monday 31 May 2004 (ANAO Audit Report No. 21); and
- Monday 21 June 2004 (ANAO Audit Report No. 24).

The Committee's Report

- 1.3 This report of the Committee's examination draws attention to the main issues raised at the respective public hearings. Where appropriate, the Committee has commented on unresolved or contentious issues, and has made recommendations.
- 1.4 The Committee's report is structured as follows:
- Chapter 2 – ANAO Audit Report No. 1 of 2003-2004, *Administration of Three Key Components of the Agriculture – Advancing Australia (AAA) Package* (public hearing held on 16 February 2004);
 - Chapter 3 – ANAO Audit Report No. 4 of 2003-2004, *Management of the Extension Option Review – Plasma Fractionation Agreement* (8 March 2004);
 - Chapter 4 – ANAO Audit Report No. 6 of 2003-2004, *APRA's Prudential Supervision of Superannuation Entities* (29 March 2004);
 - Chapter 5 – ANAO Audit Report No. 11 of 2003-2004, *Annual Performance Reporting* (24 May 2004);
 - Chapter 6 – ANAO Audit Report No. 21 of 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)* (31 May 2004);
 - Chapter 7 – ANAO Audit Report No. 24 of 2003-2004, *Agency Management of Special Accounts* (21 June 2004);
 - Appendix A – Conduct of the Committee's review;
 - Appendix B – List of submissions authorised;
 - Appendix C – List of exhibits received;
 - Appendix D – List of witnesses who appeared at the public hearings; and
 - Appendix E – The National Blood Authority.
- 1.5 A copy of this report is available on the Committee's website at <http://www.aph.gov.au/house/committee/jcpaa/reports.htm>.

Audit Report No. 1, 2003-2004

Administration of Three Key Components of the Agriculture – Advancing Australia (AAA) Package

Introduction

Background

- 2.1 The *Agriculture–Advancing Australia (AAA)* package aims to help the rural sector to be more competitive, sustainable and profitable. There are four key objectives; to:
- Help farmers profit from change;
 - Encourage social and economic development in rural areas;
 - Provide incentives for ongoing farm adjustment; and
 - Give farmers access to an effective welfare safety net.
- 2.2 The AAA package was launched in 1997, with individual components progressively implemented over several years. The Department of Agriculture, Fisheries and Forestry–Australia (AFFA) is responsible for the AAA package.

The audit

- 2.3 The objective of the audit was to assess the adequacy of the Commonwealth's administration of three key components of the AAA package. These components are:
- FarmBis II;
 - Farm Help; and
 - Farm Management Deposits (FMD).

Audit findings

- 2.4 The Australian National Audit Office (ANAO) found that many aspects of administration of the AAA programs were well-managed. There were some weaknesses in administration, most notably relating to strategic management and compliance arrangements, which require strengthening for more effective outcomes.
- 2.5 ANAO found that the administrative framework for Farm Help required strengthening to enable AFFA to assess the quality of Centrelink's service delivery adequately and to obtain assurance that payments for Centrelink's administration represented value-for-money. The overlap of Farm Help with the Rural Financial Counselling Services program also required attention, as it eroded the value-for-money spent on the programs.
- 2.6 The absence of a documented agreement on the administrative arrangements between AFFA and the Australian Taxation Office (ATO) for the FMD scheme had contributed to communication shortcomings affecting scheme administration. A more systematic approach to risk management was also required to address program integrity.
- 2.7 Performance information indicated that the programs had been successful in addressing desired outcomes. Most service delivery standards were being met.

The Committee's review

- 2.8 The Committee held a public hearing on 16 February 2004 to review the progress made against the audit's recommendations. Witnesses from the following agencies attended the public hearing:
- Australian National Audit Office;
 - Australian Taxation Office;
 - Department of Agriculture, Fisheries and Forestry – Australia; and
 - Centrelink.
- 2.9 The Committee took evidence on the following issues:
- FarmBis II
 - ⇒ Administrative expenses;
 - Farm Help
 - ⇒ Compliance with legislative requirements;
 - ⇒ Value-for-money;
 - Farm Management Deposits (FMD)
 - ⇒ Key Performance Indicators (KPIs); and
 - ⇒ Cost to revenue.
- 2.10 At the outset the Committee places on record its satisfaction with the progress made by AFFA against the ANAO recommendations, particularly AFFA's close work with ANAO to fine-tune the AAA programs. The Committee is also pleased to note the harmonious working relationships that AFFA has with ANAO and ATO.

FarmBis II

- 2.11 FarmBis II is an AAA program that provides subsidies to primary producers, spouses, farm family members, partners and professional farm managers to improve their business and natural resource management skills to meet the challenges and opportunities ahead. Support is given to each farm manager to identify the exact type of training they need, and to

find the best learning options available, at a place and time that suits them.¹

- 2.12 FarmBis II is a continuation of the original FarmBis program, which was part of the first AAA package launched in 1997. The AAA package was developed in response to the McColl review, which was a broad ranging view of the Rural Adjustment Scheme undertaken in 1996.²
- 2.13 The Audit Report addressed one recommendation to FarmBis II (Recommendation 1 – AFFA to establish performance indicators). AFFA agreed to action this recommendation.³

Administrative expenses

- 2.14 The FarmBis II program management framework is established by agreements between the Commonwealth and each state. Each Commonwealth–State agreement provides for a cap on the percentage of total expenditure that can be allocated to program administration, co-ordination and communication. This cap, in part, seeks to address the risk of states not using funding consistent with the purpose of the program. Its use also aims to maximise the direct benefit of program funding to the primary producer/land manager.⁴
- 2.15 The Committee was concerned that FarmBis II administrative expenses exceeded the states' and territories' caps on administrative spending.
- 2.16 The audit report noted that in 2001–02 and the first half of 2002–03, most states were spending above their cap on program administration, co-ordination and communication. This was due to:
- High administrative costs incurred in establishing and maintaining co-ordination networks; and
 - Low expenditure on non-administrative activities due to low take up rates at the start of the program.⁵

1 Department of Agriculture, Fisheries and Forestry (AFFA), *FarmBis Commonwealth/State Component*, www.affa.gov.au/content/output.cfm?ObjectID=D2C48F86-BA1A-11A1-A2200060B0A00228, accessed 5 August 2004.

2 AFFA, *Transcript, 16 February 2004*, p. 3.

3 Australian National Audit Office (ANAO), Audit Report No.1, 2003–04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 47.

4 ANAO, Audit Report No.1, 2003–04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, pp. 36, 42.

5 ANAO, Audit Report No.1, 2003–04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 42.

2.17 AFFA had not expected full uptake of the FarmBis II program at the time that the audit was done. Uptake has increased over the past 12 months, however, and expenditure on non-administrative activities has increased accordingly. Consequently, the percentage of each state's and territories expenditure allocated to administration has fallen, and most are now spending within their caps.⁶

Committee Comment

2.18 The Committee accepts AFFA's explanation, and believes that administrative expenses have now reduced.

Farm Help

2.19 Farm Help is an AAA program that delivers improved welfare and adjustment support to primary producers in severe financial difficulties. The Farm Help program has several components including:

- Income support for up to 12 months;
- An Advice and Training Grant; and
- Assistance to re-establish out of farming.⁷

2.20 The Farm Help program commenced on 1 July 2000, replacing the Farm Family Restart Scheme.⁸

2.21 The Audit Report addressed four recommendations to Farm Help (Recommendations 2-5). AFFA agreed to these recommendations.⁹

2.22 The Committee addressed two issues relating to Farm Help:

- Compliance with legislative requirements; and
- Value-for-money.

6 AFFA, *Transcript, 16 February 2004*, p. 4.

7 AFFA, *AAA Farm Help Supporting Families Through Change*, www.ffa.gov.au/content/output.cfm?ObjectID=D2C48F86-BA1A-11A1-A2200060B0A00217, accessed 5 August 2004.

8 ANAO, Audit Report No.1, 2003–04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 51.

9 ANAO, Audit Report No.1, 2003–04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, pp. 57, 61, 63.

Compliance with legislative requirements

- 2.23 The Committee was concerned with the reported systematic non-compliance by Centrelink with legislative requirements relating to the processing of the Certificate of Inability to Obtain Finance (CIOF).
- 2.24 In order to obtain Farm Help income support, an applicant must obtain a CIOF. This is a document from a financial institution stating that the applicant applied for a loan which has subsequently been refused by the institution. At the time of the audit, the *Farm Household Support Act 1992* (FHS Act) specified that a CIOF had a maximum currency of six months during which it could be used to qualify for income support. Centrelink provisions required customers to provide two CIOFs to receive payments for the maximum allowable 12 month period.¹⁰
- 2.25 The starting date for the CIOF qualification period, however, is strictly defined in the FHS Act. Accordingly, there were circumstances where a third CIOF would have been necessary to cover the full 12 months of Farm Help payment.¹¹
- 2.26 At the time of the audit ANAO found that Centrelink was systematically issuing payments to customers for periods during which they did not have a current CIOF. It also found that the Centrelink system generally recorded an incorrect start date for the first CIOF.¹²
- 2.27 The audit report offered an explanation for Centrelink's non-compliance. It pointed out that if Centrelink were to fully comply with the legislation, then most farmers would be significantly burdened by having to obtain a third CIOF to qualify for a full 12 month period of payment. Further, delays in obtaining CIOFs from financial institutions could result in some farmers losing payments. In spite of this, Centrelink is still required to comply with the FHS Act.¹³

10 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 62; *Farm Household Support Act 1992*, s. 4(2).

11 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 62.

12 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 63.

13 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 63.

- 2.28 ANAO made two recommendations to address this situation:
- Seek appropriate amendments to the legislation from the Minister (Recommendation No. 4); and
 - Build on existing arrangements with service providers to ensure that they comply with legislative requirements (Recommendation No. 5).¹⁴
- 2.29 AFFA's implementation of Recommendation No. 4 has led to the legislation being amended within the *Farm Household Support Amendment Act 2003*. The amendment streamlines the administrative arrangements for obtaining a CIOF.¹⁵
- 2.30 Changes in the FHS Amendment Act have addressed the situation where two CIOFs do not cover the entire 12 month period of payment. The period for which a CIOF is effective has been extended from six months to 13 months from its date of issue. As a consequence, some customers now require only one CIOF to receive Farm Help payments¹⁶

Committee comment

- 2.31 The Committee is satisfied with AFFA's efforts to address the issue of Centrelink's systematic non-compliance with legislative requirements relating to CIOFs. The Committee is pleased too that the unnecessary compliance burden formerly experienced by Farm Help beneficiaries has been significantly reduced through timely legislative amendment.

Value-for-money

- 2.32 The Committee addressed the issue of whether AFFA was receiving value-for-money through its administrative arrangement with Centrelink. Participation in Farm Help was found to be lower than what had been expected when the Memorandum of Understanding (MOU) between the two agencies had been struck in December 2001. ANAO is generally satisfied with the MOU which covers Farm Help and a number of other programs.¹⁷

14 ANAO, Audit Report No.1, 2003–04, *Administration of Three Key Components of the Agriculture-- Advancing Australia (AAA) Package*, p. 63.

15 AFFA, *Transcript, 16 February 2004*, p. 2.

16 AFFA, *Transcript, 16 February 2004*, p. 4; *Farm Household Support Amendment Act 2003*, s. 1(5).

17 ANAO, Audit Report No.1, 2003–04, *Administration of Three Key Components of the Agriculture-- Advancing Australia (AAA) Package*, pp. 53, 55.

- 2.33 Under the terms of the MOU, AFFA pays Centrelink in advance each quarter for administering Farm Help payments and services, based on a fixed payment schedule. There is no provision to vary the amount paid to Centrelink to reflect the number of customers who may apply for payments and services.¹⁸
- 2.34 The fixed payment schedule was agreed in May 2000 prior to the commencement of Farm Help and was based on estimates of customer numbers for the four-year term of the program. The audit report states that actual customer numbers have been significantly below these estimates, meaning that AFFA has been paying far more for administration than was intended.¹⁹
- 2.35 Centrelink upheld the fixed payment schedule. It informed the Committee that setting up the Farm Help program involved significant fixed costs.
- no matter how many customers turn up, there will always be the need for us to set up the required systems, forms, staff available to take inquiries et cetera.²⁰
- 2.36 Centrelink completed an exercise to identify its fixed and variable Farm Help administrative costs in January 2003. Based on the results of this exercise, AFFA and Centrelink agreed to, and implemented, a new funding arrangement which took effect from 2002-03.²¹
- 2.37 A flexible funding model had not been agreed upon until some two years into the program. The initial MOU had failed to provide for a variable cost model. As trends started to emerge, however, AFFA's relationship with Centrelink allowed it to raise the issue towards the end of the first year.
- it was about nine months into the program that some monitoring had indicated that uptake was not as high and so we raised the issue with Centrelink. We continued to have discussions over the way that a variable costing model might actually get put into place. The discussions were quite cooperative but they did take a little time and also involved some data collection by Centrelink that enabled us to come up with a variable model. In discussion

18 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 58.

19 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 58.

20 Centrelink, *Transcript, 16 February 2004*, p. 5.

21 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 58.

between the two agencies we implemented that at a time when we could actually set a changeover date, if you like.²²

- 2.38 Centrelink did not have an estimate of the overpayments made by AFFA in previous years.²³

Committee comment

- 2.39 The Committee agrees with ANAO that the variable cost model should have been implemented sooner. This would have saved money and ensured accountability and value-for-money. Despite the unavailability of figures that would show the extent of past overpayments, the Committee agrees with AFFA and Centrelink that it would be impractical to attempt to apply now the new funding model, to previous years' payments. The Committee therefore accepts that the past payments should stand.

Farm Management Deposits

- 2.40 The Farm Management Deposits (FMD) scheme is an AAA scheme that allows deposit holders to set aside pre-tax primary production income in profitable years to help balance income between good and bad times. Deposits also provide tax benefits if kept for a minimum of twelve months. Interest is earned on the full amount of the deposit at market interest rates. The money deposited can be withdrawn in later years when needed, often in a lower income, lower tax year.²⁴
- 2.41 The FMD scheme commenced in April 1999, replacing the Income Equalisation Deposits and Farm Management Bonds schemes.²⁵
- 2.42 The Audit Report addressed four recommendations relating to FMD (Recommendations 6-9). AFFA agreed to these recommendations.²⁶
- 2.43 The Committee was concerned with two issues concerning the FMD scheme:

22 AFFA, *Transcript*, 16 February 2004, p. 5.

23 Centrelink, *Transcript*, 16 February 2004, p. 6.

24 AFFA, *Farm Management Deposits (AAA)*, www.affa.gov.au/content/output.cfm?ObjectID=D2C48F86-BA1A-11A1-A2200060B0A05703, accessed 5 August.

25 ANAO, Audit Report No.1, 2003–04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 70.

26 ANAO, Audit Report No.1, 2003–04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, pp. 73, 76, 84, 86.

- Key Performance Indicators; and
- Cost to revenue.

Key Performance Indicators (KPIs)

- 2.44 The Committee was concerned about the effectiveness of the FMD KPI of effective use of FMD as a risk management tool. The target growth rate for this KPI was found to be far lower than growth rates for preceding schemes.
- 2.45 AFFA has developed a monitoring and evaluation framework for the FMD scheme, as part of an overall framework for the AAA package. This framework describes the methodology for monitoring and evaluating the FMD scheme, its KPIs and its targets.²⁷
- 2.46 The FMD KPI of effective use as a risk management tool states:
- The amount deposited will show an increase (targeted at one per cent) in year[s] when conditions are optimal and will show that funds are drawn down when incomes from primary production fall.²⁸
- 2.47 This KPI has a target growth rate of only one per cent. However, the average annual growth rate for preceding schemes was over 44 per cent. Furthermore, considerable growth was expected because FMD have a more generous tax treatment than the schemes they replaced, and access has improved through private sector delivery.²⁹
- 2.48 In response to this situation and concerns over other FMD KPIs, ANAO recommended that AFFA, in consultation with ATO, revise its KPIs and targets to ensure that they provide appropriate means of assessing administrative performance, and effectiveness in achieving required outcomes (Recommendation 8). Both AFFA and ATO agreed to this recommendation.³⁰
- 2.49 AFFA agreed with the Committee's suggestion that the one per cent growth rate target was exceedingly low, and could not provide a strong

27 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 83.

28 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 83.

29 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, pp. 83-4.

30 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 84.

foundation for the selection of that performance target. It denied, however, that the target had been chosen so as to be easily met and exceeded.³¹

- 2.50 AFFA suggested that a better KPI of effective use as a risk management tool would be “the percentage of farm families participating in the FMD scheme”. ANAO agreed with this suggestion. ATO, however, stated that this figure would not be an effective long term indicator because participation in FMD is cyclic. AFFA observed that participants are likely to leave the scheme and draw down their deposits in bad years, and return to the scheme in good years.³²

Committee comment

- 2.51 The Committee considers the KPIs developed for the FMD scheme to be unsatisfactory. The Committee agrees with ANAO that the targets specified in these KPIs are too low to provide a useful reference point for judging performance.
- 2.52 The Committee endorses the ANAO recommendation that AFFA revise upwards its KPIs and targets to credible levels that are sensitive to the measurement of administrative performance, and are effective in identifying desired outcomes.
- 2.53 Accordingly, the Committee makes the following recommendation:

Recommendation 1

- 2.54 **The Department of Agriculture, Fisheries and Forestry–Australia assemble a rigorous set of Key Performance Indicators for the Farm Management Deposits scheme that consist of credible administrative performance targets.**

Cost to revenue

- 2.55 The Committee was concerned at the high cost to revenue of the FMD scheme.
- 2.56 The estimated cost to revenue of the FMD scheme is the difference between the estimated revenue that would be collected if the FMD scheme

31 AFFA, *Transcript, 16 February 2004*, pp. 6-7.

32 AFFA, *Transcript, 16 February 2004*, p. 6; ANAO, *Transcript, 16 February 2004*, p. 7; Australian Taxation Office (ATO), AFFA, *Transcript, 16 February 2004*, p. 8..

were abolished and the estimated revenue that would be collected if the scheme were to continue.³³

- 2.57 The preliminary estimate of cost to revenue in 2002-2003 was \$410 million. This markedly exceeded initial estimates published in the Explanatory Memorandum to the *Taxation Laws Amendment (Farm Management Deposits) Bill 1998*, reflecting higher than anticipated growth in usage.³⁴
- 2.58 This \$410 million was a cash cost, rather than a public debt cost, and represents about 20 percent of the total amount on deposit for the FMD scheme. The FMD scheme therefore has approximately \$2 billion on deposit.³⁵
- 2.59 One of the factors contributing to the high estimated cost to revenue is the lower marginal rate of tax paid by depositors:
- If the deposit is made, tax is not paid on that in that year, so the deposit may be made when the amounts would otherwise be subject to the higher rate of tax and drawn out when they are at a lower rate of tax.³⁶
- 2.60 The FMD scheme is complementary to the ATO tax averaging scheme for primary producers. Farmers are given greater flexibility through the option of participating in one or both of the schemes.³⁷
- 2.61 The amount of tax that a farmer could save through the FMD scheme is limited by features that impose a ceiling of \$300 000 on their participation at any time.³⁸

Committee comment

- 2.62 The Committee remains concerned at the high cash cost to revenue of the FMD scheme. The Committee is also concerned that the cost to revenue represents such a large proportion of the total amount on deposit for the FMD scheme. The Committee accepts, however, the ANAO explanation that this high cost to revenue is due to higher than anticipated growth in usage.

33 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 87.

34 ANAO, Audit Report No.1, 2003-04, *Administration of Three Key Components of the Agriculture--Advancing Australia (AAA) Package*, p. 87.

35 ATO, ANAO, *Transcript, 16 February 2004*, pp. 9-10.

36 ANAO, *Transcript, 16 February 2004*, p. 9.

37 ATO, *Transcript, 16 February 2004*, p. 9.

38 ATO, *Transcript, 16 February 2004*, p. 10.

2.63 Information provided by the ATO on the limit to farmers' participation in the FMD scheme suggests to the Committee that money is being distributed fairly amongst participating farmers. The Committee therefore presumes that the tax averaging function of the FMD scheme is successful in that it has a high acceptance rate across a wide spread of beneficiaries.

Audit Report No. 4, 2002-2003

Management of the Extension Option Review - Plasma Fractionation Agreement

Introduction

Background

- 3.1 The governments of the Australian states and territories and the Commonwealth spend around \$350 million annually on the production and supply of blood and blood products for the Australian community. Commonwealth expenditure on plasma products under the *Plasma Fractionation Agreement* (PFA) – a contract between the Commonwealth Government and CSL Limited (CSL) - represents more than one-third of the total annual expenditure on the sector by Australian governments. Expenditure under the PFA amounted to \$124.1 million in 2001–02.
- 3.2 The material nature of this expenditure, together with the importance of plasma products to the care of Australian citizens with serious health problems, makes the ongoing procurement of plasma products an important public issue. Until 1 July 2003, the PFA was the largest single commercial contract managed by the Commonwealth Department of Health and Ageing (Health). At the contract signing in December 1993, it was estimated that total Commonwealth expenditure over the 10.5 years of the initial term of the PFA (i.e. to June 2004) would be around \$1 billion. Actual expenditure by the Commonwealth under the contract over the

first eight and a half years of the PFA (i.e. to 30 June 2002) totalled some \$800 million and hence has been on target.

- 3.3 Under the PFA, the Commonwealth was provided with a unilateral extension option to extend the agreement to 30 June 2009, *under its existing terms and conditions*, so long as it exercised the option and notified CSL of its decision to do so by *23 June 2002*, at which time it would have become an enforceable contract. Such a decision by the Commonwealth was at the sole discretion of the Commonwealth. In other words, CSL could not have refused to accept the extension had the Commonwealth chosen to exercise its option, nor could CSL have required the Commonwealth to exercise it.
- 3.4 In May 1999, the then Minister for Health and Aged Care announced the establishment of a Review of Australian Blood Banking and Plasma Product Sector (the 'Blood Review', also known as the 'Stephen Review'). The review was to cover blood collection and banking activities as well as the processing and distribution of blood and blood products, and was originally expected to report by mid-2000.¹
- 3.5 Because of the complexity of the task, the Blood Review report was submitted later than expected on 27 March 2001 to the then Minister for Health and Aged Care. The review recommended the establishment of a National Blood Authority (NBA) to provide national management and oversight of Australia's blood supply.
- 3.6 The Blood Review further recommended fundamental reform of the blood sector both in terms of how it should be funded by the Commonwealth, state and territory governments and how it should be administered in the future. Two of the Blood Review's terms of reference had particular reference to the Commonwealth's consideration as to whether or not to exercise its option to extend the PFA unilaterally after the contract's expiry on 30 June 2004.
- 3.7 In December 2001 Health formed a high level Steering Committee for the Future of Plasma Fractionation and Diagnostic Products Arrangements (Steering Committee).
- 3.8 At the fourth and last Steering Committee meeting on 18 April 2002 the decision to recommend that the PFA extension option *not* be exercised was reached. Instead the Steering Committee recommended that the Commonwealth enter into a second shorter-term PFA with CSL at the expiry of the existing agreement to ensure that Australia's future needs for

1 Review of the Australian Blood Banking and Plasma Product Sector, www.health.gov.au/archive/bodt/review.htm, accessed 5 August 2004.

plasma products would be met. These recommendations were forwarded to the Minister for Health and Ageing on 11 June 2002.²

- 3.9 The NBA was established under the *National Blood Authority Act 2003* and came into effect from 1 July 2003, and accordingly took over management of the PFA. Its role and principal services to stakeholders are summarised in Appendix E.
- 3.10 Historically, CSL's activities were carried on within the Commonwealth Department of Health until November 1961 when a statutory corporation - Commonwealth Serum Laboratories Commission - was established. On 1 April 1991 the corporation was converted to a public company and renamed Commonwealth Serum Laboratories Limited. The company's present name was adopted on 7 October 1991. The Commonwealth Government divested all of its shares in CSL by public float on 3 June 1994. CSL's ordinary shares have been traded on the Australian Stock Exchange since 30 May 1994.³

The audit

- 3.11 The triggers for ANAO's present audit were the audit by the Auditor-General, documented in Audit Report No. 24, 1999–2000, *Commonwealth Management and Regulation of Plasma Fractionation* (tabled in December 1999) and the subsequent October 2000 review of that audit by the Joint Committee of Public Accounts and Audit (JCPAA) presented in Report 378, *Review of Auditor-General's Reports 1999-2000 Second Quarter*.
- 3.12 The ANAO Audit Report No 24, 1999-2000 examined the administrative and financial effectiveness of Health's management of the PFA contract, as well as some regulatory aspects of plasma fractionation. ANAO found that there was significant scope for improvement in Health's contract management practices in relation to the PFA.⁴ Then, flowing from JCPAA's findings from its review of Audit Report No. 24, two relevant recommendations to Health's management of the PFA extension option were made by the Committee in Report 378. In summary, they were that:
- Health raise skills and training levels and ensure the availability to contract managers of relevant technical and legal advice;⁵ and

2 Australian National Audit Office (ANAO), *Audit Report No. 4, 2002-2003, Management of the Extension Option Review – Plasma Fractionation Agreement*, p. 27.

3 CSL Limited (CSL), *CSL Limited Annual Report 2002-2003*, p. 42.

4 ANAO, *Audit Report No. 24, 1999-2000, Commonwealth Management and Regulation of Plasma Fractionation, Department of Health and Aged Care*, p. 12.

5 Joint Committee of Public Accounts and Audit (JCPAA), Report No. 378, Recommendation 9, "that the Chief Executive Officer of the Department of Health and Aged Care assess the skill

- ANAO undertake a timely performance audit of Health's handling of the PFA extension review.⁶
- 3.13 ANAO's response to the latter recommendation by JCPAA was to include an audit of the PFA extension review in its 2001–02 Audit Work Program proposals. The audit commenced in late June 2002 following the expiry on 23 June 2002 of the Commonwealth's unilateral option to extend the PFA. The scope of the audit was limited to the planning and conduct of the PFA extension option review. The objective of this second audit by ANAO was to review the efficiency and effectiveness of Health's planning and conduct of this review, to accord with the Committee's recommendation.
- 3.14 In June 2002 at the commencement of ANAO's performance audit, Health proposed to ANAO that the audit scope should also include Health's subsequent work on securing a supply of plasma and related products beyond 30 June 2004. Health's reasoning was that the full implications of the planning and conduct of the extension review could not be properly assessed until this subsequent work was completed in 2004.
- 3.15 ANAO noted that, as Health did not expect the process for securing plasma and related products beyond the expiry of the PFA to be completed until mid-2004, any audit of the complete process could not be completed until early 2005. Accordingly, rather than delay reporting to the Parliament, and, in line with JCPAA's request for a *timely* audit of the PFA extension review, ANAO proceeded with the requested limited scope audit.
- 3.16 ANAO noted that the audit was not aimed at determining whether Health should have negotiated another contract or trigger the extension, rather its focus was on whether the extension decision was based on a proper analysis.⁷ ANAO examined:
- Timeliness of the process;
 - Analyses employed to determine value-for-money;
 - Consultation;
 - Advice to Government; and
 - Procedural ambiguity.

base and training needs of its contract managers, and ensure that appropriate legal and technical advice is readily available to them" (paragraph 4.56).

6 JCPAA, Report No. 378, Recommendation No. 10, "that the Australian National Audit Office undertake a timely performance audit of [Health]'s handling of the Plasma Fractionation Agreement extension review" (paragraph 4.57).

7 ANAO, *Transcript*, 8 March 2004, p. 15.

Audit findings

- 3.17 ANAO found that insufficient information was made available to Health's Steering Committee to allow it to form an objective view as to the financial merit of the advice it provided to the Health Minister on the value of the PFA extension option. In line with its overall objective ANAO made no judgement about whether or not the decision not to extend the current agreement was a correct decision.
- 3.18 In July 2003, Health disputed ANAO's conclusion that Health's analysis and advice to its Minister was financially inadequate.
- 3.19 In supporting its conclusion, however, ANAO noted that the Steering Committee's record (dated 1 May 2002) of its decision on the option contained no explicit consideration of the value of the two-tier pricing regime. By 2001–02, the proportion of total payments under the PFA for products at the lower tier-two price had increased by more than four-fold as compared to 1995–96 expenditure. The Steering Committee concluded that the current pricing arrangements were unlikely to be the most advantageous available to the Commonwealth. The main analysis underpinning this conclusion appeared to have been a scenario analysis undertaken on 16 April 2002 by the Steering Committee's advisers in liaison with the Blood and Organ Donation Taskforce (BODT). This scenario analysis did not include any data on the costs of alternative options. At a meeting with Health on 14 June 2002, officers of the Department of Finance and Administration (Finance) expressed their concern to Health on 14 June 2002 about the breadth of the risk analysis undertaken by Health, particularly in relation to costs.⁸
- 3.20 Notwithstanding Health's comments outlined above, ANAO concluded that there were five key areas where improvements could have been made in Health's handling of the PFA extension option review. They were:
- The Steering Committee did not commence its analysis of this complex matter until December 2001, some six months before the expiry of the extension option, despite an early warning by ANAO in December 1999, and coverage of this issue by the JCPAA during 2000;
 - Health under-rated the nature of the analysis required in its advice to the Government on whether or not to exercise the option;
 - The Steering Committee determined that it did not have to establish the best value-for-money approach for the future supply of plasma

8 ANAO, *Audit Report No. 4, 2002-2003, Management of the Extension Option Review – Plasma Fractionation Agreement*, p. 18.

products before making its recommendation whether or not to exercise the extension option;

- Health did not consult CSL about extending the PFA; and
- Health's recommendation to the Government not to exercise the option was transmitted very late, thereby restricting the opportunity for consultation and sufficiently detailed consideration of Health's advice by senior ministers.

Committee comment

- 3.21 The Committee is surprised by the apparent lack of planning and foresight shown by Health with regard to its handling of the PFA extension option review.

The Committee's review

- 3.22 On 8 March 2004 the Committee held a public hearing to review the progress made against the recommendations that came from ANAO's audit. The public hearing was attended by:

- Australian National Audit Office;
- CSL Limited;
- Department of Finance and Administration; and
- Department of Health and Ageing.

- 3.23 The Committee took evidence on the following issues:

- Changing nature of the blood products market;
- Australian plasma product pricing;
- Clinical quality and safety;
- Financial analysis;
- Decision process and timeliness of the option extension assessment;
- Communication with CSL; and
- Agency response to previous review by JCPAA.

Changing nature of the blood products market

- 3.24 Health presented evidence that blood plasma market variables had evolved over the decade that the PFA had been in operation. The

Committee heard that there was now some potential for other suppliers of blood products to enter the Australian market in competition to CSL. Notwithstanding, according to Health the current government policy is to restrict overseas players from entering the market.⁹

- 3.25 The Committee was also told by Health that many OECD¹⁰ countries are switching or have switched to recombinant (or synthetic) product for the treatment of haemophilia, the major user of blood products. Logically therefore, there could also be a switch to similar non-plasma product in Australia in the future.¹¹ If this switch did occur then the nature of the Australian governments' purchases from its blood products provider would change significantly from that anticipated ten years ago and written into the existing PFA.
- 3.26 In Health's view Government policy uncertainty at the time derived from two critical issues:
- The desire for self-sufficiency in the Australian blood derived markets; and
 - The potential for the substitution of blood derived products by recombinant products.
- 3.27 Health advised the Committee that it had regarded its consideration of the extension of the contract as a risk management exercise, given that any extension of the original contract would have locked the Government in until 2009, to supply what many countries regarded as an outmoded product.¹²
- 3.28 Health said that, ultimately, it based its rationale for not extending the previous PFA contract on these uncertainties.¹³

Committee comment

- 3.29 The Committee considers Health's claims that overseas blood market products supply and demand patterns have evolved over the last ten years, to be credible. It is reasonable therefore for Health to regard the nature and use of some of the blood products cited in the (now) decade-old PFA as obsolescent.

9 Department of Health and Ageing (Health), *Transcript, 8 March 2004*, p. 9.

10 Organisation for Economic Co-operation and Development (OECD).

11 Health, *Transcript, 8 March 2004*, p. 9.

12 Health, *Transcript, 8 March 2004*, p. 10.

13 Health, *Transcript, 8 March 2004*, p. 13.

- 3.30 Quite correctly, any projections by Health of Australia's demand for blood products should have taken these global trends into account in determining the nature of blood supplied under any extension of the PFA.

Australian plasma product pricing

- 3.31 The Committee observed that current Australian plasma product prices were substantially less than the corresponding prices on European and other commercial markets – on the face of it, good value-for-money, and a justification for exercising the PFA extension option.
- 3.32 Health claimed, in response, that there was a significant lack of pricing information about alternative products and alternative suppliers.¹⁴ Further, Health cautioned that product price was only one of the many variables that need to be considered in any plasma supply contract.
- 3.33 Health advised that to date Australia has had one only supplier of blood plasma products – CSL. Alternate supply could become available through an overseas supplier or through toll fractionation.¹⁵ Health further advised that if Australia followed the overseas trend and shifted to recombinant products then the scope for alternative sources of supply would increase significantly.
- 3.34 CSL informed the Committee that despite cost increases, currency exchange rate variability and various other factors, it was unlikely that the uncertainty about the PFA extension option directly caused any renegotiation of overseas supplier costs.¹⁶

Committee comment

- 3.35 The Committee accepts Health's argument that assessing the cost of alternative supplies of blood products is difficult. Rather than dismiss this step as being too complex, Health however should have assessed and documented costs and options at a broad level consistent with the Commonwealth Procurement Guidelines (CPG) and in consultation with Finance.
- 3.36 Finance should now encourage agencies involved in complex option negotiations to seek its advice on striking a balance between complying

14 ANAO, *Transcript, 8 March 2004*, p. 19.

15 Toll fractionation – Health advised that 'toll fractionation amounts to Australian plasma being exported for fractionation by a contractor within a protected environment and reimporting the plasma products'.

16 CSL, *Transcript, 8 March 2004*, p. 15.

with the sense of the guidelines, on one hand, and curtailing assessment processes which appear to have reached their limit of cost-effectiveness, on the other.

Clinical quality and safety

- 3.37 The Committee questioned Health about the issue of clinical quality and safety of blood products that could be sourced from suppliers other than CSL.
- 3.38 Health assured the Committee that there were numerous other companies around the world that have the technology to supply blood-based products and these are already supplying recombinant products. Hence, if it came to buying these products overseas;
- ...the question of clinical quality and safety would be very important.¹⁷

Committee comment

- 3.39 The Committee endorses Health's appreciation that blood product quality from whatever source cannot be compromised.

Financial analysis

- 3.40 The CPG were issued under regulation 7 of the *Financial Management and Accountability Regulations 1997* (FMA Regulations) by the Department of Finance and Administration (Finance). Regulation 8 of the FMA Regulations requires officials involved in the procurement of property or services to have regard to the CPG.
- 3.41 The CPG, issued by Finance, provide advice to agencies procuring services and entering contracts. The guidelines require agencies entering or extending contracts to consider each contract for value-for-money on a whole-of-life basis, by considering generic factors such as:
- The procurement method adopted;
 - The relative risk of the proposal;
 - The maturity of the market;

¹⁷ Health, *Transcript*, 8 March 2004, p. 13.

- The performance history of the prospective suppliers;
- Relevant benefits and costs over the procurement cycle;
- Anticipated price; and
- Evaluation of contract options.

3.42 Finance, in evidence, specified to the Committee that :

part of the process of evaluating what value-for-money meant included establishing the criteria to be used to evaluate value-for-money, and then evaluating against those criteria.¹⁸

market conditions and changes in market conditions may not be enough.¹⁹

3.43 Finance added that a logical starting point for any analysis would be to look at whether an existing contract could be negotiated to suit future requirements. ANAO concurred that a proper financial analysis was required on the product purchasing alternatives available to Health for the PFA extension option.²⁰

3.44 The Committee examined the adequacy of Health's attention to the option procurement guidelines, particularly as to whether a benefit-cost analysis was undertaken as part of the decision over the PFA extension option.²¹

3.45 Health advised the Committee that it;

placed great importance on the economic and financial issues around the decision or recommendation not to renew the contract.²²

3.46 Health further advised that it saw its analysis requirement being:

less one of testing the market than one of being aware of developments in the environment.²³

3.47 In Health's view, the market for the manufacturing and supply of blood plasma products is changing continuously.²⁴ This made it difficult to quantify their impact on the future value of the PFA should the extension option be exercised.

18 Department of Finance and Administration (Finance), *Transcript, 8 March 2004*, p. 3.

19 Finance, *Transcript, 8 March 2004*, p. 4.

20 ANAO, *Transcript, 8 March 2004*, p. 14.

21 Finance, *Exhibit No. 1, Procurement Circular PC 03/3, Evaluating Options in Procurement Contracts*.

22 Health, *Transcript, 8 March 2004*, p. 2.

23 Health, *Transcript, 8 March 2004*, p. 3.

24 Health, *Transcript, 8 March 2004*, p. 3.

- 3.48 Health also claimed that it had evaluated the economic and financial benefits of the existing best value of the contract, through its 'scenario analysis'.
- 3.49 ANAO responded that it would have expected greater consideration of what the potential costs of the alternatives were.²⁵ In short, ANAO considered the 'scenario analysis' approach taken by Health not to be sufficiently rigorous in that there was 'a lack of detailed financial analysis'.²⁶ ANAO did concede however, that the analysis did take some possible market changes into account:
- but without measuring that against what else you might be able to get and what the pricing might be in the absence of purchasing such products.²⁷
- 3.50 ANAO advised that the scenario analysis undertaken by Health went along the lines of assuming that the PFA:
- means you cannot give CSL less than the amount in the previous year and that there is some product not now required, hence the product taken will involve an overcharge.²⁸
- 3.51 ANAO concluded that this analysis was quite insufficient to make a recommendation regarding the option extension.
- 3.52 The Committee questioned Health as to the nature and detail of its work undertaken in the face of ANAO's opinion. Health again referred to the 'scenario analysis'.

Committee comment

- 3.53 Taking into account the range of evidence, some of it conflicting, presented by Health, ANAO and Finance, the Committee accepts the ANAO view that Health's financial analysis of the option to extend the PFA contract was inadequate. It concludes that Health did not take sufficient account of the costs of using alternative suppliers and products.
- 3.54 The Committee is reassured that Finance, prompted by these events, published a procurement circular in October 2003 entitled *Evaluation Options in Procurement Contracts*.²⁹ The Circular notes that:

25 ANAO, *Transcript*, 8 March 2004, p. 10.

26 ANAO, *Transcript*, 8 March 2004, p. 14.

27 ANAO, *Transcript*, 8 March 2004, p. 10.

28 ANAO, *Transcript*, 8 March 2004, p. 19.

29 Finance, *Exhibit No. 1, Procurement Circular PC 03/3, Evaluating Options in Procurement Contracts*.

When considering whether or not to exercise an option, officials should conduct a process appropriate to the size, scope and risk profile of the procurement to:

- assess the value of exercising the option and the value of sufficient alternative procurement outcomes to select the outcome that represents best value for the Australian Government; and
- identify and compare, as far as possible, all relevant risks, costs and benefits on a common basis over the whole procurement cycle.³⁰

3.55 The Committee expects Health to take full account of the Commonwealth Procurement Guidelines and associated explanatory circulars when considering whether or not to exercise any future options. It recommends accordingly:

Recommendation 2

3.56 **The Department of Health and Ageing develop staff skills and understanding of the guidelines relating to Competitive Tendering and Contracting set down by the Department of Finance and Administration.**

The National Blood Authority take account of the Commonwealth Procurement Guidelines.

Decision process and timeliness of the option extension assessment

3.57 The Committee reviewed the timeline for the transmission by Health of its recommendation to the Minister for Health and Ageing relating to the extension option. It noted that despite the analysis commencing around December 2001 and the decision to recommend not to exercise the option being reached at a meeting of the Steering Committee on 18 April 2002, the final recommendation was lodged with the Minister only on 20 June 2002, for a Sunday 23 June 2002 deadline.

3.58 Procurement Circular PC 03/3, *Evaluating Options in Procurement Contracts*, issued by Finance after the PFA options process, warns that:

When managing contracts with options, Agencies should ensure that sufficient time is allowed to consult with all relevant parties, gather the information required and conduct an appropriate value-for-money assessment. Where Ministerial involvement is required, Agencies should ensure they provide advice on

30 Finance, Exhibit 1, *Procurement Circular PC 03/3, Evaluating Options in Procurement Contracts*.

exercising options to Ministers giving sufficient time for consultation and consideration of that advice.³¹

- 3.59 Clearly Health's tardy decision-making process had not allowed it sufficient time to gather the information required to complete a cost-benefit analysis, nor give the Minister sufficient time for her own broader consultation.

Committee comment

- 3.60 The Committee considers that this advice relating to 'sufficient time' should be self evident and certainly should have been evident to Health in 2002, particularly for such a significant decision. The Committee is confident, however, that Ministers themselves will ensure that such mistakes are not made twice.
- 3.61 The Committee concludes that Health was tardy in commencing its analysis of the extension option. This tardiness necessitated a down-grading of the analysis process in order for an analysis of sorts to be completed in the very short period then available before the expiry of the option. The late decision process meant that Health gave insufficient time to its Minister to consider Health's recommendation fully. In effect the Minister was compelled to agree with Health because she had insufficient time to do otherwise.³²

Communication with CSL

- 3.62 Despite ANAO's view that there had been insufficient communication between Health and CSL during the extension option considerations, Health maintained, and CSL agreed, that there had been,³³

a very good and productive relationship between Health and CSL as befits commercial partners.³⁴

- 3.63 Health maintained that it took into account ethical issues in determining the extent of its liaison with CSL in the period running up to the deadline for the PFA extension. Indeed these ethical issues were debated within the Steering Committee.³⁵ In the end, Health deliberately did not consult CSL

31 Finance, Exhibit 1, *Procurement Circular PC 03/3, Evaluating Options in Procurement Contracts*, p. 2.

32 ANAO, Audit Report No. 4, 2003-2004, *Management of the Extension Option Review – Plasma Fractionation Agreement*, p. 65.

33 CSL, *Submission No. 3*, p. 2; *Transcript, 8 March 2004*, p. 13.

34 Health, *Transcript, 8 March 2004*, p. 13.

35 Health, *Transcript, 8 March 2004*, p. 10.

because it felt that any such consultation might place CSL in some position of advantage in the context of a new supply contract.

- 3.64 In any event, on the basis that the Stephen Review had recommended that the Commonwealth Government enter into a second PFA with CSL at the expiry of the present agreement (at 30 June 2004), CSL had anticipated that it would be unlikely for the Commonwealth Government to move forward with the option to extend the existing PFA.³⁶ Based on this assumption CSL proceeded to set its commercial and corporate strategies in train.
- 3.65 The Committee asked Health whether, given the changes evident in the blood products market, it should have advised CSL that it was, in effect, looking beyond the blood products specifications written into the PFA.
- 3.66 Health responded that it considered CSL to be a large and sophisticated organisation capable of conducting its own market research and to be in a position to understand market developments and trends.

We have to assume that the private sector is able to address its own interests.³⁷

Committee comment

- 3.67 The Committee finds that there was no requirement for Health to consult with CSL on commercial matters relating to its recommendation to exercise or decline the option.
- 3.68 The Committee commends Health for looking at the ethical issue of maintaining an arms-length relationship with CSL during late stage considerations of the extension option. The Committee also accepts that CSL, as an independent commercial entity, may have been in competition with other potential providers of blood plasma services, and hence it would have been inappropriate for Health to have disclosed, or even hinted at its recommendation to CSL prior to the decision deadline.
- 3.69 However, Health should have acknowledged to CSL that it was considering *all* alternatives with respect to the extension option, especially when the deadline was fast approaching. In any event CSL says that it had anticipated that it would be unlikely for the Commonwealth Government to move forward with the option, and hence was not inconvenienced by the lack of communication.³⁸

36 CSL, *Submission No. 3*, p. 1.

37 Health, *Transcript, 8 March 2004*, p. 11.

38 CSL, *Submission No. 3*, p. 1.

- 3.70 The Committee concludes nevertheless that Health's lack of communication with CSL as the deadline neared, was hardly good practice and not in the best interest of blood plasma supply continuity.

Agency response to previous review by JCPAA

- 3.71 In *Report 378*, the Committee commented that the Department of Health and Aged Care as it was then known had 'some distance to go to achieve satisfactory contract management' in relation to the PFA.³⁹ The Committee also commented on the department's 'lack of appreciation of the size and complexity of the process to be undertaken'⁴⁰. This had led the JCPAA to recommend that:

The Chief Executive Officer of the Department of Health and Aged Care assess the skill base and training needs of its contract managers, and ensure that appropriate legal and technical advice is readily available to them.⁴¹

- 3.72 That recommendation was made in 2000 and still appears to be equally relevant to Health nearly four years later, even though responsibility for managing the PFA now rests with the NBA. Despite the fact that Health no longer has direct responsibility for managing the PFA, the Committee believes that the comments by the ANAO in two performance audits and by the JCPAA in *Report 378* do not seem to have been absorbed by Health.

Committee comment

- 3.73 The Committee is disappointed that despite ANAO's early warning in 1999 and the Committee's signalling its concern as far back as 2000 with regard to timeliness,⁴² Health still struggled to have its decision signed off by its Minister before the last working day (21 June 2002) prior to the expiry of the extension option on Sunday 23 June 2002.

39 JCPAA, *Report 378, Review of Auditor-General's Reports 1999-2000, Second Quarter*, p. 46.

40 JCPAA, *Report 378, Review of Auditor-General's Reports 1999-2000, Second Quarter*, p. 45.

41 JCPAA, *Report 378, Review of Auditor-General's Reports 1999-2000, Second Quarter*, p. 46.

42 ANAO, *Audit Report No. 4, 2003-2004, Management of the Extension Option Review - Plasma Fractionation Agreement*, p. 84; Health noted that a 'timely' audit should mean 'well timed or appropriately timed and not simply rapid'.

Recommendation 3

- 3.74 The Secretary of the Department of Health and Ageing ensure that improvements occur in contract management, and that contract management staff comply with the Commonwealth's Procurement Guidelines and circulars as well as any related Chief Executive's Instructions.**

Audit Report No. 6, 2003-2004

APRA's Prudential Supervision of Superannuation Entities

Introduction

Background

- 4.1 The regulatory function of the Australian Prudential Regulation Authority (APRA) of Approved Trustees¹ and of funds registered under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) was audited by the Australian National Audit Office (ANAO) during June – September 2002.
- 4.2 Superannuation funds are regulated primarily by the SIS Act. To become a regulated superannuation fund and qualify for concessional tax treatment, a superannuation fund has to elect to be regulated under s. 19 of the SIS Act. The Australian Securities and Investments Commission (ASIC) is responsible for regulating disclosure, consumer protection and member complaint provisions under the SIS Act.

¹ Australian National Audit Office (ANAO), Report No. 6, 2003-2004, *APRA's Prudential Supervision of Superannuation Entities*; p. 7; **Approved Trustee** – A corporation licensed by APRA under the SIS Act to act as the trustees of an approved deposit fund, a public offer superannuation fund, a small APRA fund (a fund with less than five members) or a pooled superannuation trust.

- 4.3 Responsibility for supervising superannuation funds is shared by APRA and the Australian Taxation Office (ATO):
- APRA supervises 160 Approved Trustees and 12 429 funds registered under the SIS Act, with member total assets of \$328 billion (at 30 June 2002); and
 - ATO supervises 231 000 small, self-managed superannuation funds (SMSF's) (95% by number of all funds) with assets totalling \$100 billion.
- 4.4 Supervisory techniques employed by APRA and ATO include checking compulsory returns, undertaking trend analyses, benchmarking with organisations of similar size, reviewing asset concentrations, checking risk management statements and meeting minutes, and holding discussions with key fund officials and fund auditors.
- 4.5 In August 1999, APRA (which was established on 1 July 1998) restructured its supervisory functions into two divisions:
- the *Specialised Institutions Division* (SID) which supervises institutions involved in deposit-taking, insurance or superannuation, and those that operate mainly in Australia; and
 - the *Diversified Institutions Division* (DID) which is responsible for supervising groups that operate in more than one APRA regulated sector, and those with international links. An example of a diversified group is the National Australia Bank (NAB) which is not a superannuation fund entity itself, but has superannuation funds that APRA would supervise.²
- 4.6 Each division is responsible for supervising financial entities in each of the deposit-taking, insurance and superannuation sectors. Under the restructured arrangements, these two frontline divisions are supported by specialist units from the Policy Research and Consulting Division, which conduct onsite visits to institutions in conjunction with SID and DID supervisors.
- 4.7 Prior to arranging an onsite visit, APRA conducts offsite preparatory work including requesting a fund to answer a preliminary questionnaire. Matters addressed during an onsite visit include reviewing operational risk and market risk, and impacts of particular instruments and processes. Discussions may be held with board management and auditors. An onsite visit may last several hours or extend over a few days. Normally notice of

2 Australian Prudential Regulation Authority (APRA), *Transcript*, 29 March 2004, p. 5.

intention to visit is served on a fund by APRA, but if assets are deemed to be at risk an onsite visit can take place without warning.

- 4.8 In April 2000, APRA started transferring the records of some 180 000 self-managed superannuation funds (SMSF) to the supervision of ATO, and the Government Actuary's Office moved to the Department of the Treasury (Treasury). More recently, there have been a number of changes in senior APRA staff in the wake of the HIH Royal Commission. The APRA Board and Chief Executive Officer were replaced in July 2003 with an executive of three APRA members (the Executive Group) appointed by the Treasurer.
- 4.9 In addition to the supervisory teams within DID and SID, the Consulting Services and the Statistics Units of Policy Research and Consulting Division also have direct roles in supervising the superannuation sector. As risk experts, the primary role of the Consulting Services Unit is to conduct onsite visits and assist the DID and SID personnel in their supervision of institutions. The Statistics Unit processes financial and other returns and produces a series of reports that are used by supervisors to monitor the institutions for which they are responsible.
- 4.10 The current prudential regime for superannuation has remained largely intact since the SIS Act was introduced, and is generally sound and effective.³ Nonetheless, in late 2002 the Government announced a package of reforms intended to:
- Improve fund governance and trustee competence;
 - Empower more proactive and preventative action by APRA; and
 - Improve disclosure of information, particularly to fund members.⁴

The audit

- 4.11 The ANAO audit focused on APRA's prudential supervision of Approved Trustees and superannuation funds registered under the SIS Act. The audit paid particular attention to the work of APRA's supervisory divisions.
- 4.12 The Department of the Treasury was also included in the scope of the audit because of its responsibilities for providing advice on the legislative framework for APRA's prudential supervision, monitoring developments

3 APRA, *Transcript*, 29 March 2004, p. 3.

4 ANAO, Audit Report No 6, 2002-2003, *APRA's Prudential Supervision of Superannuation Entities*, p. 11.

in the financial sector and advising on the policy implications of those developments. ATO was consulted during the course of APRA's audit because of its responsibility for receiving fund registrations and maintaining the publicly available register of complying superannuation funds. The audit, however, did not examine ATO's supervision of its superannuation funds.

Audit findings

- 4.13 ANAO found that APRA's inspection of superannuation funds and Approved Trustees has been affected by re-organisation, relocation, and changes to case selection and auditing methodologies. A risk-based supervisory approach had yet to be consistently and comprehensively applied in relation to all superannuation funds regulated by APRA. Some two-thirds of the superannuation funds supervised by APRA had not been allocated a risk rating. Risk rating methods are defined below (paragraph 4.62).
- 4.14 Supervisory action within APRA was found to vary significantly depending upon which of APRA's supervisory divisions was responsible for a particular fund or Approved Trustee:
- The **Specialised Institutions Division (SID)** supervisory approach balanced efficiency with risk. This approach was effective in identifying exposures and underlying prudential risks and applying enforcement options. SID consistently applies a documented methodology for supervising superannuation funds. Also, SID formalised a more *systematic approach* to escalating supervision and undertaking enforcement actions.
 - The **Diversified Institutions Division (DID)** did not have a documented separate methodology for reviewing superannuation entities within financial conglomerates. The DID approach to escalating supervision and undertaking enforcement actions was *informal and consultative*.
- 4.15 ANAO concluded that there was a series of administrative improvements that APRA could initiate to enhance its prudential supervision of Approved Trustees and superannuation funds.
- 4.16 The Audit made five recommendations, all of which were agreed to by APRA. One recommendation addressed the administration of APRA's regulatory framework, and four recommendations addressed APRA's supervision methodologies.

The Committee's review

4.17 On 29 March 2004 the Committee held a public hearing to review the progress made against the ANAO audit's recommendations. The public hearing was attended by:

- Australian National Audit Office;
- Australian Taxation Office; and
- Australian Prudential Regulation Authority.

4.18 The Committee took evidence on the following issues:

- APRA's supervision framework project;
- Onsite reviews by APRA of superannuation entities;
- Taxation compliance by superannuation funds;
- Capital adequacy of superannuation funds;
- Prudential standards;
- APRA's risk rating system;
- Codification of superannuation prudential standards;
- Lost and lazy funds; and
- Tax advantages to superannuation funds.

APRA's supervision framework project

4.19 APRA advised the Committee that the APRA supervision framework project currently being developed was aimed at achieving consistency in the supervisory methodology adopted by both SID and DID. Measures taken to improve the consistency of approach by SID and DID included:

- Creating a documented APRA supervision framework;
- Setting specific industry-based procedures;
- Issuing work instructions; and
- Providing resource materials including templates.⁵

⁵ APRA, *Transcript, 29 March 2004*, pp. 4-5.

4.20 APRA further claimed that although there had been significant differences in the past between SID's and DID's cultures and documented practices, these had not translated to differences in the quality of supervision. Rather, the style of supervision had varied according to the nature of the organisation being looked at and the different means of achieving the outcomes.⁶

4.21 By way of clarification APRA noted that it is more difficult to identify and analyse the management processes used in the diversified institutions. APRA conceded that it was moving towards cross-divisional consistency in supervision but had yet to achieve its objective completely. With regard to the complementary activity of enforcement, APRA emphasised that:

We are extremely consistent in our enforcement action regardless of which division it came out of.⁷

Committee comment

4.22 The Committee concurs with APRA's appreciation of the nature of its supervisory function – characterised by complexity, size and diversity among the funds that it supervises – and is satisfied that APRA is taking the necessary steps, and with sufficient urgency, to consolidate a consistent approach to supervision across the organisation's divisions. The Committee notes that APRA has already achieved cross-divisional consistency in its enforcement activity.

Onsite reviews by APRA of superannuation entities

4.23 The ANAO audit found that APRA did not conduct enough onsite reviews.

4.24 In response, APRA explained that its approach had been to target certain categories of funds as part of its onsite review program rather than merely to seek to reduce the number of funds for which onsite reviews were outstanding:

...we are looking at a better process to make sure we get good coverage of those smaller funds that sit underneath an Approved Trustee.⁸

6 APRA, *Transcript, 29 March 2004*, p. 4.

7 APRA, *Transcript, 29 March 2004*, p. 23.

8 APRA, *Transcript, 29 March 2004*, p. 4.

- 4.25 APRA advised that it also generated onsite visits as part of its risk assessment activities including:
- Operational risk visits;
 - Credit risk visits; and
 - Actuarial evaluation processes.
- 4.26 APRA explained to the Committee that it now had better data systems tracking fund activities at its disposal and these enabled a greater degree of risk assessment to take place offsite. Its approach was to use the better data to identify the small number of funds which warranted visits, thereby reducing the number of site visits in absolute terms, and possibly their duration, but not their overall effectiveness.

Committee comment

- 4.27 The Committee notes that APRA is developing a reputation for precision within the superannuation industry through its policy of refining its onsite visits program, with particular attention being directed at small funds. Through the use of superior data systems and good responses by funds to its questionnaires, APRA is able to target funds that warrant onsite investigation.
- 4.28 APRA is to be commended for developing a targeted approach to its onsite visits program particularly with regard to risk assessment. The outcome is that the effectiveness of the onsite visits program is enhanced without necessarily increasing the number of visits.

Taxation compliance by superannuation funds

- 4.29 ATO advised that it monitored those superannuation funds that had opted to be supervised by it, in regard to:
- Tax compliance status targeting large funds in the large business law context; and
 - Regulatory compliance status, confined to about the 270 000 funds Self Managed Superannuation Funds (SMSF) which are non-APRA funds.⁹
- 4.30 These funds, it should be noted, were not the subject of the ANAO audit.

9 Australian Taxation Office (ATO), *Transcript, 29 March 2004*, p. 6.

- 4.31 ATO gave the Committee an assurance that it has systems in place to identify any risk that an SMSF would not be able to meet its promises to its beneficiaries.
- 4.32 ATO elaborated on the education campaign that it had undertaken since the 1999 transition by the SMSFs to ATO supervision. The purpose of the campaign was to educate the fund managers about their taxation compliance responsibilities.

That education campaign has borne quite significant fruit. We conducted some benchmarking work on the 2001-02 financial year returns and found that for those who had been the subject of the education work the compliance was quite high both in income tax and regulatory responsibilities.¹⁰

For those funds...established prior to that process, the compliance status was not so high, and we have since moved to ramp up our compliance activities including lodgement enforcement and field audits.¹¹

- 4.33 Since 2002-2003 however, ATO has been moving from an educative program targeting SMSFs towards a campaign of audit and lodgement compliance. In support of its new campaign, ATO has initiated:
- Taxation audits of 1 000 SMSFs;
 - Follow-up of qualifications by external auditors for 5 000 funds;
 - Enforced lodgement for between 30 000 and 40 000 funds; and
 - Lodgement programs for 20 000 funds.¹²

Committee comment

- 4.34 The Committee is cognizant that ATO's taxation compliance activity is not an APRA function. It is, nevertheless, satisfied on the evidence presented that ATO has an efficient broad-based compliance program underway, covering both income tax and regulatory regimes for SMSFs.

10 ATO, *Transcript, 29 March 2004*, p. 6.

11 ATO, *Transcript, 29 March 2004*, p. 6.

12 ATO, *Transcript, 29 March 2004*, p. 6.

Tax advantages to superannuation funds

- 4.35 Superannuation funds enjoy considerable tax advantages as a form of savings. Superannuation is taxed concessionally relative to other marginal rates applicable to taxpayers. Consequently the concessional treatment of monies accumulated through the compulsory superannuation system represents encouragement for members of funds to save for retirement. Voluntary savings in superannuation also attract these concessions.¹³
- 4.36 The Committee asked whether the responsibilities between APRA and ATO had been sufficiently regulated, to monitor effectively the tax returns of any delinquent funds (*i.e.*, lost and lazy funds)¹⁴.
- 4.37 ATO advised that its supervision of superannuation fund tax return lodgements followed the normal practice of self assessment by the lodging entity (whether a superannuation fund or any other entity) followed by an ATO compliance risk assessment. ATO conceded that there was no special attention being directed at these funds because it had not emerged from ATO analysis to date that that group of funds was less reliable taxation lodgers than others.¹⁵
- 4.38 ANAO, however, reminded the Committee that APRA had concluded to the contrary as it had advised ANAO that:

...a significant proportion of the lost funds had not been lodging taxation returns with ATO.¹⁶

Committee comment

- 4.39 A degree of uncertainty emerged from the evidence presented to the Committee by APRA, ANAO and ATO respectively, relating to the taxation return lodgement patterns of the group of funds that have switched from APRA to ATO supervision.¹⁷ A definitive analysis of lodgement patterns by these funds is required to detect if any are aberrant, or inconsistent with the patterns displayed by other taxpayers. The Committee recommends accordingly.

13 APRA, *Submission No. 4*, p. 2.

14 APRA, *Submission No. 6*, p.2; **Lost funds** are those that, having elected to be regulated by APRA prior to July 2000, did not lodge returns after that date and were unable to be traced by APRA easily; **Lazy funds** are those that APRA could trace, but only submitted returns under threat of prosecution.

15 ATO, *Transcript, 29 March 2004*, p. 15.

16 ANAO, *Transcript, 29 March 2004*, p. 14.

17 ANAO, *Transcript, 29 March 2004*, p. 14; ATO, *Transcript, 29 March 2004*, p. 15

Recommendation 4

- 4.40 **The Australian Taxation Office review those superannuation funds that have switched from Australian Prudential Regulation Authority supervision to Australian Taxation Office supervision, to ensure that all have lodged taxation returns appropriately.**

Capital adequacy of superannuation funds

- 4.41 APRA detailed the capital requirements of superannuation entities in a submission to the inquiry. An Approved Trustee of a *public offer superannuation entity* must:
- Maintain no less than \$5 million in net tangible assets; or
 - Be entitled to the benefit of a \$5 million approved guarantee; or
 - Have a combination of net tangible assets and an approved guarantee totalling \$5 million; or
 - Comply with written requirements regarding the custody of assets. As well, APRA requires holdings of both eligible assets and liquid assets to be at least \$100 000, respectively.¹⁸
- 4.42 APRA further submitted that although a public offer superannuation entity is not required to maintain capital reserves under the SIS Act, it may do so for other reasons. In such cases, APRA will review the fund's management of its capital reserves.
- 4.43 A trustee of a *non-public offer superannuation fund* is not required by the SIS Act or APRA to maintain a capital reserve, although it has the right to be indemnified out of fund assets for liabilities incurred when acting as a fund trustee.¹⁹
- 4.44 To complement the measures taken to tighten capital supervision by both public offer and non-public offer funds, the Government has placed its reliance on the 2002 package of reforms (see paragraph 4.10). The reforms include trustee licensing (by APRA) and the requirement for preparation of a risk management plan by each trustee to cover concerns about operational risk. If these are shown to be ineffective in protecting fund

¹⁸ APRA, *Submission No. 4*, p. 1.

¹⁹ APRA, *Submission No. 4*, p. 1.

assets, it is understood that the Government will consider reviewing the capital requirements for funds.²⁰

- 4.45 In any event, capital requirements changed on 1 July 2004 upon commencement of the new superannuation licensing scheme:

The *Superannuation Safety Amendment Act 2004* (SSAA), which [came] into force on 1 July 2004, provides for a more comprehensive approach to prudential supervision of superannuation trustees by APRA. Following the implementation of the SSAA, the superannuation industry will come into line with other institutions operating in the financial sector in that all trustees accepting superannuation contributions will have to be licensed by APRA. APRA worked closely with the Treasury in developing the legislative provisions contained in the SSAA.²¹

- 4.46 APRA explained that the structure of a superannuation fund may have no capital itself.²² While a fund may manage millions of dollars on behalf of its clients, it may not have any substantial amount of capital in its own name²³ A vexing question exists therefore, as to who should hold the capital.

- 4.47 To clarify its approach to regulatory and capital management methods, APRA advised that it looks at robustness of the treatment of each superannuation fund's capital.²⁴

Given that our capital adequacy internal targets are... what Basel or the statutory minima would dictate, we do take into account... robustness.²⁵

- 4.48 APRA noted too that the proposed Basel Capital Accord²⁶, which is due for introduction on 1 January 2007 and which will affect all deposit taking

20 APRA, *Submission No. 4*, p. 2.

21 APRA, *Submission No. 4*, p. 2.

22 APRA, *Submission No. 6*, p. 1; Superannuation funds by their trust structure operate as mutuals and do not easily admit provision of external capital that could cushion foreseen and other risks in return for appropriate reward. Even where owners of trustees provide capital these have to be remunerated through a reduction in crediting rates.

23 APRA, *Transcript, 29 March 2004*, p. 12.

24 APRA, *Submission No. 6*, p. 1; Robustness – means the strength or certainty that the superannuation entity's financial promises to its beneficiaries will be met.

25 APRA, *Transcript, 29 March 2004*, p. 16.

26 The Basel Capital Accord was produced by the Basel Committee on Banking Supervision. This committee does not possess any formal supranational supervisory authority and its conclusions do not have legal force. Rather, it formulates broad supervisory standards and guidelines and recommends statements of best practice to encourage convergence towards common approaches and common standards. Its capital measurement system provides for the

institutions in Australia, is based on consistent approach to capital requirements across the superannuation sector.²⁷

- 4.49 If APRA has concerns about a fund being undercapitalised and at risk of collapsing and thus threatening the security of client deposits, it increases the capital requirements of the fund.²⁸ In assessing capital adequacy, APRA takes into account an entity's capitalised costs by deducting any such capitalised costs from the stated capital so as to present a conservative picture.²⁹ Further APRA has issued guidelines to authorised deposit takers as to how they should treat capitalised costs. APRA's advice to the Committee was that:

capitalised expenses should not be counted as assets that are available for prudential regulation and capital purposes, and they should be written out for prudential regulation.³⁰

Committee comment

- 4.50 The Committee expresses its concern regarding capital adequacy of funds. It notes that the new statutory provisions introduced on 1 July 2004 will provide measures that APRA can use to tighten up the capital requirements of funds, and in so doing are expected to reduce risk of fund failure substantially. In recognising that the new provisions have yet to be tested in a practical sense for their effectiveness against their goals, the Committee is prepared to allow time for the measures to take effect. It recommends accordingly.

Recommendation 5

- 4.51 **The Australian Prudential Regulation Authority conduct a review of the effectiveness of the new prudential provisions with respect to capital adequacy of superannuation funds registered under the *Superannuation Industry (Supervision) Act 1993* and implement corrective action targeting funds deemed still to be at high risk due to inadequate capital bases.**

implementation of a credit risk measurement framework, and includes minimum capital requirements, supervisory review of an institution's internal assessment process and capital adequacy, and effective use of disclosure to strengthen market discipline as a complement to supervisory efforts. Source: Bank for International Settlements, *The Basel Committee on Banking Supervision*, <http://www.bis.org/bcbs/aboutbcbs.htm>, accessed 5 August 2004.

27 APRA, *Submission No. 4*, p. 4.

28 APRA, *Transcript, 29 March 2004*, p. 16.

29 APRA, *Submission No. 6*, p. 1.

30 APRA, *Transcript, 29 March 2004*, p. 17.

Prudential standards

4.52 APRA does not stipulate the accounting treatment to be used by funds. According to APRA, that function is adequately covered by appropriate accounting standards.³¹ APRA confirmed, however, that there are differences between accounting standards and prudential standards.³²

The prudential treatment of capital, or any other accounting treatment, need not fully align with what the accountants or auditors would require...

The difference between what a prudential regulator wants and what an accountant may want... [is a]... reflection of different objectives.³³

4.53 Under the *Superannuation Safety Amendment Act 2004* there are a number of new prudential requirements that must be met by funds in order to obtain a licence including:

- A risk management strategy;
- Access to adequate financial, technical and human resources for their operations;
- Outsourcing requirements between Trustee and service provider, in writing and reviewed periodically;
- Clearly articulated net tangible asset requirements;
- Determination by APRA of approved guarantee requirements where required; and
- Issue to by APRA of new certification to a Trustee where required.³⁴

4.54 The Basel Committee's global project for harmonisation of accounting standards has provided APRA with an opportunity to consult with the accounting, life insurance, actuary professionals to clarify acceptable prudential standards for superannuation funds.³⁵

4.55 APRA was queried as to its view on the acceptability of accounting practices, and responded that where there are divergences, it advises its funds to:

31 APRA, *Transcript, 29 March 2004*, p. 16.

32 APRA, *Transcript, 29 March 2004*, p. 17.

33 APRA, *Transcript, 29 March 2004*, p. 17.

34 APRA, *Submission No. 4*, p. 3.

35 APRA, *Transcript, 29 March 2004*, p. 17.

Produce its returns on prudential bases, have them audited, have the fund board attest to them, and lodge them according to prudential rather than accounting requirements.³⁶

Committee comment

- 4.56 The Committee notes that currently there are divergences between accounting standards and prudential standards. APRA is aware of these divergences and is ensuring its requirements are met by instructing its supervised funds to lodge their returns against APRA prudential standards. The Committee endorses the additional attention being directed at prudential standard-setting, especially with respect to propriety of trustees through the imminent licencing and recertification process. The Committee urges APRA to continue liaising with other accounting bodies to encourage harmonisation of the two sets of standards.

APRA risk rating system

- 4.57 APRA described the APRA-wide risk rating system that it had developed over the last 18 months.³⁷ It noted that, as at June 2002,

Less than one per cent of the almost \$3 billion in superannuation under APRA's supervision was accounted for by the small APRA funds, or SAFs. With respect to these SAFs (which have fewer than five members) the focus is on the Approved Trustee, and every Approved Trustee has been risk rated.³⁸

- 4.58 Expanding on this observation, APRA said that rather than rate each individual SAF and continue re-rating them endlessly, it focusses on risk rating all the responsible Approved Trustees complemented by sample testing of the SAFs. If risk ratings of a SAF and its Approved Trustee were at odds, APRA would review and re-rate as appropriate.³⁹
- 4.59 APRA acknowledged that it is currently developing a more structured framework for rating its SAFs via the Approved Trustee route so that it is more confident that its ratings are correct.⁴⁰

36 APRA, *Transcript, 29 March 2004*, p. 19.

37 APRA, *Transcript, 29 March 2004*, p. 3.

38 APRA, *Transcript, 29 March 2004*, p. 3.

39 APRA, *Transcript, 29 March 2004*, p. 3.

40 APRA, *Transcript, 29 March 2004*, pp. 3-5.

- 4.60 APRA advised too that it has completed a significant amount of work on developing a rating template for SID and DID to use when working on the non-small APRA funds.
- 4.61 The risk rating model employed is broadly based on assessing the probability of financial failure of an entity as well as taking into account the size of the entity, and it is aimed at being proactive.⁴¹ APRA collects information about regulated entities through returns, market intelligence, prudential reviews and entity-generated requests for dispensation. It maps the information into identified risk categories.⁴² The risk rating so assigned to an entity is used to determine APRA's supervisory stance. The system comprises three phases:
- Risk type identification, which could relate to:
 - ⇒ Operations;
 - ⇒ Markets and trading;
 - ⇒ Credit;
 - ⇒ Governance;
 - ⇒ Legal and regulatory aspects, and
 - ⇒ Compliance.
 - Risk mitigation methods including:
 - ⇒ Checks on fund senior management;
 - ⇒ Audit;
 - ⇒ Actuary work;
 - ⇒ Internal audit work;
 - ⇒ Checks on the board; and
 - ⇒ Governance aspects.
 - Capital checks including:
 - ⇒ Continued availability of capital; and
 - ⇒ The quality of the earnings stream.⁴³
- 4.62 APRA's risk rating technique rates entities on two basic parameters – potential impact of failure and probability of default – taking into account the above information.⁴⁴ The model is known by APRA as the Probability

41 APRA, *Transcript, 29 March 2004*, p. 7.

42 APRA, *Submission No. 6*, p. 1.

43 APRA, *Transcript, 29 March 2004*, p. 7.

44 APRA, *Transcript, 29 March 2004*, p. 8.

and Impact Rating System (PAIRS).⁴⁵ From this, entities are categorised using a four-tier 'supervisory stance':

- Normal supervision;
- More oversight;
- Mandated improvement; or
- Restructure.⁴⁶

- 4.63 The next stage in the process involves peer review sessions within APRA at which all risk assessments are 'put to proof' prior to the agreed risk assessments being formally accepted signed off by the APRA Executive Group. A PAIRS assessment is not limited to an annual event. The assessment frequency is increased for any fund that experiences a substantial change in its affairs, for example when it acquires a new business.
- 4.64 The PAIRS framework links into the Supervisory Oversight and Response System (SOARS) which determines APRA's propensity to intervene once the PAIRS Supervisory Attention Index is established.⁴⁷ Together PAIRS and SOARS are APRA's new and improved supervisory methodology.⁴⁸
- 4.65 Entities designated to be in the two lower supervisory levels – normal supervision and more oversight – are inspected on site by APRA supervisors. Control of a superannuation entity rated within the mandated improvement tier may still rest with its approved trustee, but an entity at restructure level would be subjected to some APRA enforcement, such as replacing trustees, imposing enforceable undertakings, with the most severe sanction being disqualification of trustees.⁴⁹
- 4.66 Some five per cent of the APRA portfolio sits in the two high intensity tiers (*ie*, those requiring APRA intervention) and this proportion of the total has been found over time to be relatively static. As an indication of the scale of its intervention activity, APRA advised that during the period July 2003 to April 2004, fifteen individuals had been excluded under the

45 ANAO, Audit Report No. 6, 2003-2004, *APRA's Prudential Supervision of Superannuation Entities*, p. 49.

46 APRA, *Transcript, 29 March 2004*, p. 8 & p. 21.

47 APRA, *Submission No. 2*, p. 2.

48 APRA, *Transcript, 29 March 2004*, pp. 20-21.

49 APRA, *Transcript, 29 March 2004*, p. 8

SIS Act (comprising twelve involuntary disqualifications and three enforceable undertakings).⁵⁰

- 4.67 PAIRS delivers other advantages to APRA by reinforcing any suspicions relating, say, to particular administrators of a superannuation fund, and providing a logical and accountable basis for resource allocation.⁵¹

Committee comment

- 4.68 The Committee endorses APRA's approach to risk-rating its SAFs as cost-efficient and is satisfied that APRA's risk rating methodology and management have been upgraded to a level sufficiently sensitive to identify any questionable fund management practices. APRA's remedial responses involve taking appropriate action. Where more drastic action has been found necessary, the penalties available to and imposed by APRA appear to be effective in encouraging recalcitrant funds to observe the required standards.

Lost and lazy funds

- 4.69 The Committee heard evidence from APRA and ATO relating to the identification and status of APRA's lost and lazy funds following the rationalisation of supervisory responsibilities in 2001.⁵²
- 4.70 There had been a sizable transfer of funds between the two agencies, resulting in a net stream of some 4 000 funds to ATO. ATO advised the Committee that its self-managed funds were growing at about 2 500 per month, so the introduction of 4 000 new funds from APRA's area was not of consequence in the overall scheme.
- 4.71 Cost was the principal determinant driving fund movements between the two agencies. Some funds preferred to reside within the lower-cost ATO administration, however the offset was that those funds had to administer themselves.⁵³

50 APRA, *Submission No. 4*, p. 1.

51 APRA, *Transcript, 29 March 2004*, p 22.

52 APRA, *Submission No. 6*, p.2; **Lost funds** are those that, having elected to be regulated by APRA prior to July 2000, did not lodge returns after that date and were unable to be traced by APRA easily; **Lazy funds** are those that APRA could trace, but only submitted returns under threat of prosecution.

53 ATO, *Transcript, 29 March, 2004*, p. 12.

- 4.72 APRA advised the Committee that, after an extensive advertising campaign, all of its lost and lazy funds have now been traced, as of late March 2004. Most, in fact, had been wound up by their trustees without APRA having been advised, some had never started and some others had moved to ATO as SMSFs.

Committee comment

- 4.73 The Committee commends APRA for tracking down and reconciling all of its lost and lazy funds.

Audit Report No. 11, 2003-2004

Annual Performance Reporting

Introduction

Background

5.1 All Australian Public Service (APS) agencies are required to prepare an annual report that is tabled in Parliament. In accordance with ss. 63(2) and 70(2) of the *Public Service Act 1999* (PSA), annual reports must comply with requirements that have been approved by the Joint Committee of Public Accounts and Audit (JCPAA). This document, *Requirements for Annual Reports*, is published by the Department of the Prime Minister and Cabinet (PM&C), and states:

The primary purpose of annual reports of departments is accountability in particular to the Parliament.¹

5.2 Performance reporting is a specific requirement of annual reporting.² Annual reports should inform parliamentarians and other stakeholders about the performance of the agency and act as a key reference document.

1 The Department of the Prime Minister and Cabinet (PM&C), *Requirements for Annual Reports*, p. 3, www.pmc.gov.au/pdfs/annual_report_requirements.pdf, accessed 5 August 2004.

2 PM&C, *Requirements for Annual Reports*, p. 5, www.pmc.gov.au/pdfs/annual_report_requirements.pdf, accessed 5 August 2004.

5.3 The *Requirements for Annual Reports* state that annual reports must include:

a review of how the department has performed during the year in relation to the efficiency of the department's outputs and their effectiveness in terms of achieving the planned outcomes.

Descriptions of processes and activities should be avoided. Rather, reporting should be aimed at providing an assessment of how far the agency has progressed towards outcomes.³

The audit

5.4 The objectives of Audit Report No. 11, 2003-2004, *Annual Performance Reporting* were to determine whether agencies had:

- Established a sound annual reporting performance information framework;
- Developed arrangements to ensure performance information is accurate and coherent; and
- Appropriately analysed performance information in their annual reports.

5.5 The ANAO audit focused on whether overall characteristics were demonstrated in the annual reports of five agencies, to make them appropriate instruments of accountability. The annual reports of the following agencies were examined:

- Australian Customs Service;
- Department of Communications, Information Technology and the Arts;
- Department of Education, Science and Training;
- Department of Employment and Workplace Relations; and
- Department of Immigration and Multicultural and Indigenous Affairs.

3 PM&C, *Requirements for Annual Reports*, p. 6, www.pmc.gov.au/pdfs/annual_report_requirements.pdf, accessed 5 August 2004.

Audit findings

- 5.6 ANAO concluded that outcomes, agency outputs and administered item outputs were well specified in most instances. In order, however, to provide accountability and transparency to parliamentarians and other stakeholders, agencies' annual reporting frameworks needed to be improved, particularly in relation to:
- The specification of agencies' influence on, and contribution to, shared outcomes;
 - Performance measures relating to quality and effectiveness/impact;
 - The efficiency of agency operations and the cost effectiveness of outputs delivered; and
 - Targets or other bases for comparison.
- 5.7 Particular issues concerned the need for annual reports to:
- Provide an analysis of performance, rather than list activities;
 - Assess performance against targets or other bases for comparison;
 - Provide and review trends in non-financial and financial performance; and
 - Use the results of evaluations where appropriate to provide performance information on quality and effectiveness.
- 5.8 In these circumstances, the annual reports did not fully meet their primary purpose of accountability, particularly to Parliament.
- 5.9 Agencies have developed arrangements to provide performance information in their annual reports that is accurate, coherent and consistent. Agencies would be assisted, however, in maintaining the quality of this performance information through the establishment and monitoring of agency data quality standards, improvement in documentation of costing approaches, and a review by particular agencies of the correlation between their internal and external reporting frameworks.

The Committee's review

- 5.10 On 24 May 2004 the Committee held a public hearing to review the progress made against the recommendations of Audit Report No. 11. The public hearing was attended by:
- Australian National Audit Office;
 - Australian Customs Service;
 - Department of Communications, Information Technology and the Arts;
 - Department of Education, Science and Training;
 - Department of Employment and Workplace Relations; and
 - Department of Immigration and Multicultural and Indigenous Affairs.
- 5.11 The Committee took evidence on the following issues:
- ANAO's *Better practice guide*;
 - Changing performance indicators;
 - Reporting on unmet targets;
 - Insufficient funding;
 - Cost-benefit analysis; and
 - Shared outcomes.

ANAO's *Better practice guide*

- 5.12 The Committee was interested in how agencies had responded to the ANAO Better Practice Guide titled *Better Practice in Annual Performance Reporting (Better practice guide)*.
- 5.13 This guide, released in April 2004, was prepared jointly by ANAO and the Department of Finance and Administration (Finance) as a practical tool to help Commonwealth agencies improve the quality of performance reporting in annual reports.⁴

4 Australian National Audit Office (ANAO), *Better Practice Guide: Better Practice in Annual Performance Reporting*, April 2004, p. v.

5.14 The guide aims to address a conclusion of the Committee Report 388, *Review of the Accrual Budget Documentation*. That report stated:

It is the Committee's view that agencies still have some way to go in improving performance information. The Committee encourages Finance and the ANAO to publish better practice guides in relation to measuring, assessing and reporting agency performance.⁵

5.15 The *Better practice guide* was developed concurrently with Audit Report No. 11, and includes better practice approaches identified in the course of the audit.⁶

5.16 The *Better practice guide* provides the following features:

- Practical examples of better practice;
- Suggestions about the foundations of good performance reporting;
- Tips for better data measurement and management; and
- Useful reference sources.⁷

5.17 The Australian Customs Service (Customs) and the Department of Education, Science and Training (DEST) referred to the *Better practice guide* in their responses to Audit Report No. 11, stating that they welcomed the guidance that it would provide. The Department of Immigration and Multicultural and Indigenous Affairs (DIMIA) had found ANAO's efforts to be:

very useful in clarifying and articulating better practice and providing a standard to which we can aspire and also providing specific comments to guide our improvement process.⁸

5.18 DIMIA had recently completed a thorough review of its performance indicators. This review was reflected in its 2004-05 Portfolio Budget Statement (PBS). The *Better practice guide*, along with ANAO's audit and report, had acted as a catalyst to the review process, which had been under consideration for some time.⁹

5 ANAO, *Better Practice Guide: Better Practice in Annual Performance Reporting*, April 2004, p. v; Joint Committee of Public Accounts and Audit (JCPAA), Report 388: *Review of the Accrual Budget Documentation*, June 2002, p. 84.

6 ANAO, Audit Report No. 11, 2003-2004, *Annual Performance Reporting*, p. 23.

7 ANAO, *Better Practice Guide: Better Practice in Annual Performance Reporting*, April 2004, p. v

8 ANAO, Audit Report No. 11, 2003-2004, *Annual Performance Reporting*, pp. 36-7; Department of Immigration and Multicultural Affairs (DIMIA), *Transcript, 24 May 2004*, p. 3.

9 DIMIA, *Transcript, 24 May 2004*, p. 4.

- 5.19 Customs had not yet made any changes to its outcomes and outputs because:

It is a massive task for us to do. We have been making endeavours to do that. We could not do it in the time frame [of the 2004-05 PBS]. Our performance indicators are quite detailed.... So to change everything we would need to go through a whole big system change, which we have not been able to do...¹⁰

- 5.20 Customs, however, was examining its annual reporting performance information framework, and reviewing its performance measures so that they focused on measuring performance rather than indicating workload or activity.¹¹

Committee Comment

- 5.21 The Committee is pleased to note agencies' ready acceptance of the ANAO *Better practice guide* and the resulting changes to their performance reporting practices.
- 5.22 The Committee acknowledges that implementation of the suggestions of the *Better practice guide* requires significant time and resources for some agencies. However, the Committee views performance reporting improvement as an ongoing process, and expects agencies to continue to improve their performance reporting practices.

Changing performance indicators

- 5.23 The Committee was interested in the changes that agencies had made to their performance reporting as a result of the ANAO audit.
- 5.24 A number of DIMIA's outputs were aspirational statements, like "Appreciation of cultural diversity", which are difficult to measure quantitatively. DIMIA will now break these indicators down into sub-indicators that are measurable.¹²
- 5.25 The Department of Communications, Information Technology and the Arts (DCITA) had also made changes to their outputs that would affect their performance indicators. Before the audit, their outputs had been generically defined. They had since moved to identify more specific

10 Australian Customs Service (Customs), *Transcript*, 24 May 2004, p. 3.

11 Customs, *Transcript*, 24 May 2004, pp. 3-4.

12 DIMIA, *Transcript*, 24 May 2004, p. 4.

outputs in the telecoms market, the broadcasting market, the Information and Communication Technology (ICT) market and the postal market. DEST too had made iterative changes to its performance reporting in response to the audit.¹³

- 5.26 ANAO argued that the way that performance indicators are expressed can often influence performance reporting. It is important that agencies choose the right statements or phrases in their performance indicators to ensure complete and accurate reporting.¹⁴

Committee comment

- 5.27 The Committee is satisfied with moves towards specific, measurable outputs by the agencies questioned, and is confident that these changes will result in better performance reporting. However, the Committee would have hoped that all agencies, after several years of performance reporting, are aware of the need for measurable outputs and for performance indicators that make it possible to assess whether the outputs have been achieved.

Reporting on unmet targets

- 5.28 The Committee was concerned that agencies were reporting in greater detail on targets that they had met, but in less detail on unmet targets. The ANAO stated that, where it was obvious that performance had not met expectations, agencies generally only reported on positives and did not discuss areas where performance had not met expectations or strategies to improve performance.¹⁵
- 5.29 The Committee was sympathetic to agencies' need to present a positive image to the public and their ministers. Parliament, however, expects complete, balanced and accurate reporting. The Committee was interested in how agencies achieve balance between these two concerns.
- 5.30 Agencies stated that they did report on unmet targets. They see performance reporting as an opportunity not only to highlight positive achievements, but also to provide an explanation of the environment and

13 Department of Communications, Information Technology and the Arts (DCITA), Department of Education, Science and Training (DEST), *Transcript, 24 May 2004*, p. 6.

14 ANAO, *Transcript, 24 May 2004*, p. 5.

15 ANAO, Audit Report No. 11, 2003-2004, *Annual Performance Reporting*, p. 48.

any reasons for unmet targets. Agencies want to be seen in a positive light, but also want annual reporting to be a transparent process.¹⁶

- 5.31 Customs noted that failing to meet a target did not indicate a failure of government activity, as some targets are beyond Customs' influence. For example, Customs sets a citizenship target in its PBS that is based on its ability to process that number of applications. If fewer applications are received, then Customs cannot meet its target. In cases like these, explanatory notes are important in explaining circumstances where it is not the fault of the agency when targets have not been met.¹⁷
- 5.32 ANAO stated that performance reporting provides agencies with opportunities to provide accountability back to their stakeholders and capture areas for improvement. The audit has shown that while agencies find it difficult to report against performance measures, they do at least describe the factors that have made it difficult to meet their particular objectives. ANAO has not observed any agency putting excessive emphasis on putting itself or any other agency in a good light.¹⁸

Committee comment

- 5.33 Reporting on unmet targets is important because it shows where improvements can be made and allows agencies to explain why targets have not been met. As the Committee has commented in the past, the open recognition of shortcomings and an indication of remedial action are preferable to subsequent revelations of cover-ups or incomplete reporting.¹⁹

Insufficient funding

- 5.34 The Committee was concerned that agencies were not reporting cases where they were unable to meet their targets due to insufficient funding. While this situation must occur from time to time, it is not mentioned in annual reports.

16 Department of Employment and Workplace Relations (DEWR), DCITA, DIMIA, DEST, *Transcript, 24 May 2004*, pp. 7, 9.

17 Customs, *Transcript, 24 May 2004*, p. 8.

18 ANAO, *Transcript, 24 May 2004*, pp. 17-18.

19 JCPAA, Report 399: *Inquiry into the Management and Integrity of Electronic Information in the Commonwealth*, March 2004, p. vii; Department of the House of Representatives, *Hansard Transcript, 1 April 2004*, p. 28025.

- 5.35 Customs told the Committee that statements in its most recent annual report implied that its activities were constrained by limited funding. The annual report's review by the Chief Executive Officer states:

Customs meets the challenge of balancing urgent Government priorities while continuing to deliver day-to-day business requirements, through a robust strategic and risk planning framework.²⁰

- 5.36 DEST and DCITA set targets that are achievable within available funding:

we have a range of priorities and during our [internal] planning processes we plan what we are going to do for the forthcoming year...

you work out what the processes are going forward, you broadly know what your budget is going forward and you do set your priorities. So, in a sense, if there is any trading off, that is done within those priorities.²¹

- 5.37 The Department of Employment and Workplace Relations (DEWR) explained that, in the hypothetical situation where funding constraints did not allow them to meet their targets, the Secretary would speak to the Minister to determine the Government's priorities.²²

Committee comment

- 5.38 The Committee is satisfied that agencies are well aware of their funding restraints and operate accordingly.

Cost-benefit analysis

- 5.39 The Committee was interested to know whether agencies were using cost-benefit analysis in their performance reporting. This would assist agencies in obtaining the funding and resources to achieve their targets.
- 5.40 All agencies told the Committee that they do engage in cost-benefit analysis, although they do not include it in their performance reporting. Instead, cost-benefit analysis is used for internal processes such as program delivery, investment and policy proposal.²³

20 Customs, *Transcript, 24 May 2004*, p. 10; Customs, *Annual Report 2002-03*, p. 6.

21 DEST, DCITA, *Transcript, 24 May 2004*, p. 10.

22 DEWR, *Transcript, 24 May 2004*, p. 11.

23 DEWR, DCITA, DEST, DIMIA, Customs, *Transcript, 24 May 2004*, pp. 11-12, 14.

- 5.41 In the process of performing the audit, ANAO had determined that agencies had done a number of evaluations of program effectiveness over a period of time, but that this information did not appear in their annual reports. ANAO felt that agencies could be making better use of this body of work.²⁴

Committee comment

- 5.42 The Committee was disappointed at the low utilisation of cost-benefit analysis in performance reporting, and expects that cost-benefit analysis could be a fundamental part of overall performance evaluation.
- 5.43 The Committee agrees with ANAO that agencies could be making better use of cost-benefit analyses and evaluations of effectiveness.

Shared outcomes

- 5.44 The Committee was concerned about the reporting of shared outcomes. Over the past decade there has been increased emphasis on monitoring achievements on a whole-of-government basis. Outcomes are frequently broad and their achievement is dependant on contributions of other agencies, including other tiers of government. In such situations, it is necessary to develop a broad framework of performance information to specify the respective contributions of all agencies towards achieving the outcome and responsibilities for reporting on performance.²⁵
- 5.45 Annual reports acknowledge where the achievement of outcomes depends on a range of stakeholders. However, the reports included little or no performance information that related to their individual contribution to the achievement of the shared outcomes.²⁶
- 5.46 The ANAO recommended (Recommendation No. 1, (a)) that agencies use intermediate outcomes and explanatory text to better specify their contribution to broadly stated or shared outcomes.²⁷

24 ANAO, *Transcript*, 24 May 2004, p. 12.

25 ANAO, Audit Report No. 11, 2003-2004, *Annual Performance Reporting*, p. 30.

26 ANAO, Audit Report No. 11, 2003-2004, *Annual Performance Reporting*, p. 30.

27 ANAO, Audit Report No. 11, 2003-2004, *Annual Performance Reporting*, p. 36.

- 5.47 DEST's response to this recommendation pointed out that reporting against shared outcomes was difficult:

The segregation of clear elements of responsibility, for example where this is shared between the Commonwealth and the states, is challenging and the subsequent measurements of the performance of these sub-elements in a meaningful way represents a major hurdle to progress in this regard.²⁸

- 5.48 The ANAO *Better practice guide* does advise on reporting against broad or shared outcomes:

The key challenge is to identify the agency's area of influence, and be aware of the influence of other players, in other Australian Government agencies, or at other levels of government.²⁹

- 5.49 ANAO explained that agencies were adequately describing where they were involved in a whole-of-government approach or an approach across jurisdictions. However, agencies need a way of measuring individual contributions to these broader outcomes. Agencies would be able to articulate performance measures for broader outcomes if they clearly identified their roles and responsibilities to these outcomes. ANAO understands that this is a challenging task, especially where outcomes cross jurisdictions.³⁰

- 5.50 Customs and DCITA had acted on ANAO advice, and had identified the whole-of-government outcomes to which they contribute. From this, they had changed their shared outcomes to reflect their roles in achieving each outcome.³¹

- 5.51 DCITA also pointed out that the marketplace often contributes to its shared outcomes, which makes it difficult to determine what its actual contribution was.³²

- 5.52 DEST told the Committee of several improvements to performance reporting of shared outcomes in its 2003-04 annual report. These included better analysis through the use of tables, graphs and explanatory text; specifying the Government's contribution to each outcome; and the use of benchmarks. These improvements will be transferred to the 2004-05 PBS.

28 ANAO, Audit Report No. 11, 2003-2004, *Annual Performance Reporting*, p. 36.

29 ANAO, *Better Practice Guide: Better Practice in Annual Performance Reporting*, April 2004, p. 10.

30 ANAO, *Transcript*, 24 May 2004, p. 13.

31 Customs, DCITA, *Transcript*, 24 May 2004, pp. 3-4, & 6.

32 DCITA, *Transcript*, 24 May 2004, p. 14.

DEST conceded that further improvement is needed, and the *Better practice guide* will help.³³

- 5.53 Customs and DIMIA pointed out the problem of working with a large number of agencies at different levels. Customs suggested a solution to this problem: appointing an agency to take an overview of each shared outcome. This agency would be responsible for measuring the overall progress against the outcome and determining each agency's contribution to this progress, and then reporting this information.³⁴

Committee comment

- 5.54 The Committee acknowledges the difficulties of reporting against shared outcomes, and notes that the *Better practice guide* does include advice on reporting on shared outcomes. Agencies need to identify clearly their contribution to a shared outcome and report on that contribution — while also recognising the contribution of other agencies or levels of government.
- 5.55 The Committee will note the quality of performance reporting on shared outcomes in future annual reports as whole-of-government approaches to issues — such as security or environmental management — will be increasingly prominent features of public policy in Australia.

33 DEST, *Transcript*, 24 May 2004, p. 13.

34 Customs, *Transcript*, 24 May 2004, p. 15; DIMIA, *Transcript*, 24 May 2004, p. 16.

Audit Report No. 21, 2003-2004

Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)

Introduction

Background

- 6.1 On 12 and 14 September 2001, the boards of directors of various Ansett companies resolved that the companies were or likely to be insolvent. The companies were immediately placed in the hands of administrators who ceased airline operations and stood down most of Ansett's 15 000 employees.
- 6.2 The Prime Minister announced on 14 September 2001 that a Special Employee Entitlements Scheme for Ansett group employees (SEESA) would be established. SEESA was to provide a safety net for Ansett staff terminated on or after 12 September 2001 owing to their employer's insolvency. SEESA payments were to cover unpaid entitlements:
- Wages;
 - Accrued annual leave;
 - Long service leave;

- Pay in lieu of notice; and
 - Up to eight weeks redundancy payments.¹
- 6.3 The Department of Employment and Workplace Relations (DEWR) was responsible for administering SEESA. To implement SEESA, DEWR selected a private company by tender, Bentleys MRI Sydney Pty Ltd, which created a special-purpose company, SEES Pty Ltd, to undertake the distribution of the assessed entitlements. Ansett had no cash and the administrators estimated that asset realisations would take 2-3 years to complete.² SEES Pty Ltd obtained a loan facility for up to \$350 million from the Commonwealth Bank of Australia (CBA) in order to expedite entitlements estimated at the time to be around \$700 million.
- 6.4 To meet the cost of the scheme a special Air Passenger Ticket Levy was placed on airline tickets purchased on or after 1 October 2001 until 30 June 2003, through the *Air Passenger Ticket Levy (Collection) Act 2001* (Collection Act). The levy was administered by the Department of Transport and Regional Services (DOTARS). From the outset, the Government made it clear that it would pursue recovery of the levy from the Ansett administrators.
- 6.5 The Government's objectives for SEESA were to achieve both early payment of unpaid entitlements (up to the community standard) and to 'stand in the shoes of the employees' to recover from Ansett's assets the funds advanced under the scheme. SEESA used a private company to administer payments to minimise the impact on the Commonwealth budget, especially the underlying cash balance.
- 6.6 On 9 October 2001, the Minister for Employment, Workplace Relations and Small Business made a formal determination specifying the companies and entitlements to be covered by SEESA and the terms on which payments were to be made.
- 6.7 The Collection Act provided a special appropriation capped at \$500 million for SEESA.³
- 6.8 SEESA payments could not flow until the Government and the Ansett Administrators had agreed, by a deed (SEESA Deed) on 14 December 2001. The Commonwealth needed to invoke the provisions of s 560 of the
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1 Department of Finance and Administration (Finance), Report to the Commonwealth made under s. 24 of the *Air Passenger Ticket Levy (Collection) Act 2001* for the period 1 April 2002 to 31 March 2003, p. 2.

2 Australian National Audit Office (ANAO), Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, p. 33.

3 Department of Employment and Workplace Relations (DEWR), *Transcript*, 31 May 2004, p. 7.

Corporations Act 2001 to secure the Government's priority position equal to the former employees regarding the repayment of SEESA advances effectively made to Ansett.⁴

- 6.9 The process of negotiation delayed SEESA payments to Ansett employees, many of whom had been stood down in September 2001. For the Government to have agreed to the Ansett Administrators' proposals, however, would have required it to compromise its other primary objective of securing legal priority.
- 6.10 On 1 June 2004, the scheme's financial standing was that \$341 million had been paid to every one of the 12 998 employees for 100% of their assessed entitlements,⁵ the loan for SEES Pty Ltd had been paid out on 15 April 2004,⁶ an estimated \$288 million was raised by the ticket levy (as at 31 January 2004), SEES Pty Ltd had recovered \$163 million with \$49 million still to come,⁷ and the Commonwealth had incurred costs associated with payments of \$7.8 million to date in compensating unintended tax consequences.⁸

The Audit

- 6.11 The Australian National Audit Office (ANAO) performance audit was conducted during 2003. The audit took place during the latter part of SEESA's operation, and set out to determine the efficiency and effectiveness of the management of two key elements of the distribution of assessed entitlements to ex-Ansett employees. ANAO's objectives were to assess DEWR's management of SEESA and DOTARS' management of the air ticket levy.⁹

ANAO findings

- 6.12 In summary, ANAO found that SEESA was managed well by DEWR and was effective in delivering some \$341 million in employee entitlements to former Ansett group employees terminated through their employer's insolvency. The arrangements for delivering these payments were put in

4 SEES Pty Ltd, *Exhibit No. 5*, pp. 6-7.

5 DEWR, *Transcript, 31 May 2004*, p. 15.

6 SEES Pty Ltd, *Transcript, 31 May 2004*, p. 15.

7 Department of Transport and Regional Services (DOTARS), SEES Pty Ltd, *Transcript, 31 May 2004*, p. 16.

8 DEWR, *Transcript, 31 May 2004*, p. 11.

9 ANAO, Audit Report No. 21, 2003-2003, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, pp. 28-9.

place in a very tight timeframe, and despite some modest delays, SEESA generally met the Government's requirement for early payment of unpaid entitlements.

- 6.13 ANAO considered that three particular risks that arose during the implementation of the scheme could have been managed more effectively by DEWR:
- The incidence of tax;
 - The repayment of the loan; and
 - The interaction between SEESA and other Commonwealth payment programs.
- 6.14 Despite SEESA being effective, ANAO concluded that there were areas where DEWR could have been more efficient in its administration of SEESA, notwithstanding the tight timeframe.¹⁰ In line with this view ANAO made one recommendation. It especially directed this recommendation at agencies that might have to implement a SEESA-type scheme in the future. Key characteristics were the short timeline and the considerable public interest.¹¹
- 6.15 In summary, ANAO recommended that for schemes like SEESA, any agency responsible should especially resolve all tax issues before commencement, and allocate risk between agency and outsourced provider before the contract is signed.¹²
- 6.16 DEWR agreed to this recommendation with qualification. It claimed that the recommendation was too broad and did not provide the necessary flexibility to address situations encountered during the implementation of SEESA.
- 6.17 DEWR also felt that the risks associated with possible tax implications for SEESA were effectively managed. It stated that ANAO's finding that the realised tax risk resulted in only a small increase in overall costs supports DEWR's judgement and repudiates suggestions that major risks were not managed effectively.
- 6.18 ANAO expressed the view on 22 December 2003 that the final distribution of Ansett resources remained subject to a range of other contingencies,
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10 ANAO, Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, 2003-2004, p. 20.

11 ANAO, Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, 2003-2004, p. 21.

12 ANAO, Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, 2003-2004, p. 21.

including legal disputes, so that the effectiveness of the overall recovery strategy could not be finally assessed until completion of all action.

Committee considerations

6.19 JCPAA considered the precursor to SEESA, the Employee Entitlements Support Schemes (EESS), in *Report 396, Review of Auditor-General's Reports 2002-2003 First, Second & Third Quarters*, tabled September 2003. EESS was established in January 2000 to provide a safety net for employees who had lost their jobs as a result of their employer's insolvency or bankruptcy. The JCPAA recommended in its 2003 report that:

The Department of Employment and Workplace Relations examine ways in which it can:

- improve claimants' awareness of the scheme, their eligibility for benefits under the scheme, and changes in the interpretation of the operational arrangements; and
- monitor interactions between insolvency practitioners and individual claimants for the quality and accuracy of information provided to claimants.

6.20 In an Executive Minute dated 5 April 2004, DEWR supported the recommendation.

Committee review

6.21 The Committee held a public hearing on 31 May 2004 to take evidence from the following entities on issues related to SEESA:

- Australian National Audit Office;
- Australian Taxation Office;
- Department of Transport and Regional Affairs;
- Centrelink;
- Department of Employment and Workplace Relations; and
- SEES Pty Ltd.

6.22 The following issues were examined by the Committee:

- Tax risk;
- Outsourcing;
- Loan repayment;
- Performance measures;

- Agency liaison; and
- Management of the air ticket levy.

Tax risk

- 6.23 DEWR advised the Committee that it took the Australian Government Solicitor's (AGS) advice when it was setting up the SEESA scheme in September 2001, to check if there was a significant tax risk attaching to the payments to SEES Pty Ltd.
- 6.24 DEWR arranged a meeting with the Australian Taxation Office (ATO) for 29 November 2001 and forwarded meeting agenda papers on 27 November 2001 scoping fringe benefits tax, capital gains tax, goods and services tax (GST), and income tax.
- 6.25 At that meeting ATO officials (only GST specialists and *not* income tax specialists were present because ATO was unsuccessful in arranging for the latter to attend) advised DEWR that there was no income tax liability. ATO cautioned DEWR, however, not to rely on that opinion because the matter should be addressed thoroughly through a private binding ruling.¹³
- 6.26 Despite receiving advice that there was no significant risk of a negative tax implication,¹⁴ DEWR embraced caution by inserting appropriate risk management controls into the contract which it signed with SEES Pty Ltd on 17 December 2001. Shortly after DEWR applied to ATO for a private binding ruling on the tax liability matter.¹⁵ ANAO noted that DEWR had recognised the seriousness of the tax risk. It had commented in its application that a negative tax ruling might prevent implementation of the scheme in the way the Government intended.¹⁶ DEWR delivered the application by hand to ATO security on 3 January 2003. DEWR received no response for some eight weeks. Over that period SEES Pty Ltd communicated with DEWR four times expressing its concern.¹⁷ Finally DEWR queried ATO about its application and it emerged that it had been lost by ATO security staff. The Commissioner of Taxation ruled in April

13 DEWR, *Transcript, 31 May 2004*, pp. 13-14.

14 DEWR, *Transcript, 31 May 2004*, p. 3.

15 DEWR, *Transcript, 31 May 2004*, p. 3.

16 ANAO, Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, p. 60.

17 SEES Pty Ltd, *Submission No. 10*, p. 1.

2002, that the payments by DEWR to SEES Pty Ltd were assessable income in the hands of SEES Pty Ltd.

- 6.27 DEWR advised the Committee that it had signed the contract with the private sector provider prior to obtaining the tax ruling to ensure that as many terminated Ansett employees as possible could receive their SEESA payments before Christmas 2001. SEES Pty Ltd was able to make its initial payments under SEESA on 18 and 19 December 2001.¹⁸ ANAO suggested that a better approach would have been for DEWR to have advised its Minister of the tax risk before executing the contract on 17 December 2001.
- 6.28 In the light of the Tax Commissioner's ruling that the payments by DEWR to SEES Pty Ltd were assessable income, SEES Pty Ltd sought its own counsel's opinion on the tax risk liability issue.
- 6.29 The outcome was conflicting views.
- 6.30 SEES Pty Ltd's counsel was of the view that there was no liability:
the payments into and out of the separate account are capital payments, and not on revenue account: they are neither assessable income nor allowable deductions.¹⁹
- 6.31 ATO's counsel held that there was a liability:
the payments which the Commonwealth make[s] to SEES...are income in the hands of SEES....the monthly instalments of \$8 million are not only made in consideration of the Services to be rendered by SEES pursuant to the DEWR contract, but they are received by SEES in the context of a business operation consisting of the provision of those Services.²⁰
- 6.32 In regard to the two legal opinions, SEES Pty Ltd advised the Committee:
We still cannot reconcile the differences.²¹
- 6.33 SEES Pty Ltd further advised that, in its Queens Counsel's view:
The moneys were held separately and were always repayable to the Commonwealth. The ability of SEES Pty Ltd to derive any income from this arrangement was limited to the fees and services of the contract, to which the tax office paid no regard.²²

18 ANAO, Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, p. 58.

19 SEES Pty Ltd, *Exhibit No. 5*, p. 22.

20 Australian Taxation Office (ATO), *Exhibit No. 4*, p. 13.

21 SEES Pty Ltd, *Transcript, 31 May 2004*, p. 8.

22 SEES Pty Ltd, *Transcript, 31 May 2004*, p. 9.

- 6.34 DEWR explained to the Committee that reimbursement provisions in the contract between SEES Pty Ltd and the Commonwealth required the Commonwealth to reimburse SEES Pty Ltd from consolidated revenue for any unintended tax levy paid by SEES Pty Ltd. DEWR explained that the reimbursements were budget neutral:

The budget neutral nature of the payment from consolidated revenue to SEES Pty Ltd to the consolidated revenue has no direct impact...It must be taken into account, [however] when considering the legislated cap of \$500 million to be spent on SEESA.²³

- 6.35 The Commonwealth's reimbursement of SEES Pty Ltd, however, created the possibility of a tax liability on the tax reimbursement.

- 6.36 SEES Pty Ltd noted that the scope of its brief for a private ruling on tax liability did not extend to the tax on the tax reimbursement.²⁴ SEES Pty Ltd agreed that it could be:

taxed on tax on tax on tax.²⁵

The question as to whether there is tax on the tax reimbursement itself was not the subject of the private ruling. It is an unresolved question.²⁶

- 6.37 Also of concern to the Committee were costs to the Government deriving from the income tax issue. Administrative costs involved in the circular payment from consolidated revenue to SEES Pty Ltd to tax to consolidated revenue were mounting.²⁷

It would be neutral on SEES Pty Ltd eventually but it is going to cost some departments some money.²⁸

- 6.38 In addition, ANAO advised that SEES Pty Ltd would enjoy the benefits of franking credits that arose from the payment of the income tax and this represented an additional cost to the Commonwealth.²⁹

23 DEWR, *Transcript, 31 May 2004*, p. 7.

24 SEES Pty Ltd, *Transcript, 31 May 2004*, p. 10.

25 SEES Pty Ltd, *Transcript, 31 May 2004*, p. 10.

26 SEES Pty Ltd, *Transcript, 31 May 2004*, p. 10.

27 DEWR, *Transcript, 31 May 2004*, p. 10.

28 DEWR, *Transcript, 31 May 2004*, p. 10.

29 ANAO, Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, p. 61.

Committee comment

- 6.39 It is clear to the Committee that a major shortcoming of the administration of SEEA derived from the income tax liability of the payments made by DEWR to SEES Pty Ltd to fund the assessed employee entitlements.
- 6.40 The Committee believes, however, that the income tax liability problems could have been avoided if Centrelink had been used as the administrator in place of SEES Pty Ltd. ATO confirms this.³⁰
- 6.41 Given the Government's decision to outsource the administration, the Committee concludes that DEWR managed the implementation of SEESA efficiently despite the tight time constraints placed on it. DEWR faced a dilemma. It needed to resolve the tax risk issue. At the same time it had to sign a contract with SEES Pty Ltd in order to begin distributing at least some of the Ansett employee entitlements before Christmas 2001. DEWR managed the tax risk by inserting an indemnity clause into the contract it signed with Bentleys MRI Sydney Pty Ltd.
- 6.42 DEWR balanced well the tasks of assessing and prioritising the contract negotiations in the short time available. The Committee, however, agrees with ANAO that DEWR should have advised its Minister of the tax risk before executing the contract in December 2001.
- 6.43 The Committee regrets that the misplacement of the taxation private binding ruling application, claimed to have been lodged by DEWR with ATO security staff, compromised the work put in place by DEWR in setting up the management structure of the entitlements payments scheme. The Committee expects that ATO will have taken account of the need to have appropriate tax specialists attend urgent meetings requested by other agencies, and that its document receipts system will have improved.
- 6.44 It is clear to the Committee that the problems relating to the handling of the tax liability issue could not have been resolved in the short time that DEWR had to put the SEESA scheme in place. Indeed the problems have still not been resolved to the satisfaction of all parties.
- 6.45 The Committee concludes that the SEESA model for distributing assessed employee entitlements possesses certain advantages including the ability to expedite payments to eligible employees. But it is also flawed.
- 6.46 The Department of the Treasury (Treasury) and DEWR must work together to design a method that avoids the costly reimbursement of

30 ATO, *Transcript*, 31 May 2004, p. 5.

income tax payments to the private administrator of the scheme. Circular payments of tax on tax must be avoided. No future employee entitlement scheme that may adopt the SEESA model should have to revisit the tax liability issue. The Committee recommends accordingly:

Recommendation 6

- 6.47 The Department of the Treasury, in conjunction with the Department of Employment and Workplace Relations, resolve the income tax uncertainty experienced by the private sector administrator of the Special Employee Entitlements Scheme for Ansett Group Employees (SEESA) prior to any future use of the SEESA model.**

Outsourcing

- 6.48 The Committee assessed whether the outsourcing process involving two private contractors to deliver SEESA was, on balance, efficient and effective. The functions that were outsourced were:
- The administration of SEESA by SEES Pty Ltd; and
 - The financing of the \$350 million loan by the CBA.
- 6.49 DEWR advised the Committee that an interdepartmental committee had initially assessed several SEESA administration options. One option was to use Centrelink as the administrator and another was to use an out-sourced provider. The interdepartmental committee eventually recommended the out-sourcing option. It selected Bentleys MRI Sydney Pty Ltd from a list of ten invited tenderers not including Centrelink, supplied by the Department of Finance and Administration (seven of the ten accounting firms invited to tender withdrew because of conflicts). Bentleys MRI Sydney Pty Ltd subsequently set up SEES Pty Ltd to distribute SEESA payments.³¹
- 6.50 The decision on the winning tender:
- was informed by an interdepartmental task force that reported to Cabinet.³²

31 DEWR, Transcript, 31 May 2004, p. 17.

32 DEWR, *Transcript, 31 May 2004*, p. 7.

- 6.51 The Committee questioned Centrelink as to whether it would have had the capacity to distribute SEESA payments. Centrelink advised the Committee that:

We certainly would have the skills. In terms of resources, it would have been over and above the government's ask of Centrelink at the time, so obviously there would have been some additional cost incurred.

Based on an assessment of entitlement, given a set of rules, it is the core work that Centrelink does.³³

- 6.52 The Committee heard that the income tax liability problems had arisen because of the outsourcing of SEESA administration and could have been avoided if a government agency had been nominated to deliver the assistance to the Ansett employees.

The company was a private company and it received those payments from the Commonwealth in its own right...which was critical for income tax purposes. Had it received those payments from the Commonwealth and passed them on...to such as Centrelink, there would not have been income tax consequences. The ATO ruled that the payments of approximately \$8 million per month were fully taxable.³⁴

- 6.53 The second outsourcing decision related to the selection of the private bank to finance a \$350 million loan facility.
- 6.54 DEWR advised the Committee that under the terms of the contract SEES Pty Ltd was required to approach four financial institutions, analyse their offers and present the findings to the Commonwealth. The CBA was the successful tenderer.
- 6.55 DEWR conceded that a critical set of meeting minutes documenting the decision to select the CBA had been lost.³⁵ In ANAO's view, DEWR's inability to provide a formal record of the decision to select CBA to provide the finance was unsatisfactory from an accountability viewpoint.

Committee comment

- 6.56 The Committee considers that it is not in a position to judge whether the Government should have used Centrelink rather than the private sector provider to administer SEESA.

33 Centrelink, *Transcript*, 31 May 2004, pp. 7-8.

34 ATO, *Transcript*, 31 May 2004, p. 5.

35 DEWR, *Transcript*, 31 May 2004, p. 16.

- 6.57 The Committee is satisfied, notwithstanding, that the Government's decision to outsource SEESA administration was, on balance, effective. The Committee notes that the awarding of the successful tender to Bentleys MRI Sydney Pty Ltd followed a logical and transparent process supervised by an interdepartmental committee.
- 6.58 The Committee notes that by outsourcing the finance to fund early payments of entitlements, the Government achieved its aim of minimising the impact of the SEESA package on the Commonwealth budget.
- 6.59 The Committee is disappointed that the record of the discussions and decisions leading to the appointment of the CBA as the lender of \$350 million to SEES Pty Ltd, is incomplete. Accountability clearly suffered. The Committee, however, relies on ANAO's view that sufficient records of discussions are available to enable it to conclude that due process was followed in this appointment.

Loan repayment

- 6.60 Monthly repayments of the loan were set at an early stage at \$8 million per month. Despite DOTARS' ongoing accurate forecasts of greater levy collection than initially anticipated, DEWR was slow to increase repayments, thereby incurring greater loan interest charges than was necessary.
- 6.61 In ANAO's view DEWR could have undertaken the necessary financial analysis early in 2002 that would have assisted it to manage better the funds available to it under the \$500 million appropriation in the Collection Act.
- 6.62 ANAO advised that since the levy raised revenue at a substantially higher rate than was originally expected, this should have allowed DEWR to set a higher monthly rate of repayment of the SEESA loan facility and hence reduce the interest paid.³⁶
- 6.63 SEES Pty Ltd advised ANAO that the additional interest paid to mid-September 2003 was \$3.6 million, which was substantially more than the cost of payments made in the establishment and operation of the Scheme, which, from 1 October 2001 to 31 March 2003, was reported as \$1.98 million.

36 ANAO, Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, p. 129.

Committee comment

- 6.64 The Committee accepts that there were good reasons for DEWR initially to adopt a conservative loan repayment schedule. DOTARS' levy receipt data, however, showed that receipts were running higher than expected. DEWR should have reassessed its repayment schedule earlier. Higher monthly repayments of loan principal would have reduced the overall interest bill.
- 6.65 The Committee agrees with ANAO that this late response by DEWR to effecting amendment of its loan repayments schedule, caused avoidable additional loan costs to the Commonwealth, but of a marginal level.

Agency liaison

- 6.66 According to ANAO, DEWR did not recognise until March 2002 that there would be an impact from the scheme on Centrelink and other Commonwealth payment programs to former Ansett employees until well after the program was under way and substantial advances had already been made. DEWR then found it difficult to make suitable arrangements to obtain personal data from SEES Pty Ltd, because of privacy considerations and because it had raised this requirement belatedly.
- 6.67 While this was overcome when Centrelink approached the Ansett Administrators directly, the data Centrelink obtained in this way proved inadequate for Centrelink to use in its compliance work. If any overpayments to former Ansett employees were to be detected through *post hoc* compliance strategies, the recovery costs would be greater than would have been possible had DEWR made arrangements to provide prompt and full advice at the time payment was made. The costs to the Commonwealth could be determined only if, and when, such overpayments were detected.³⁷

Performance measurement

- 6.68 ANAO noted that standard performance measures to monitor SEESA's performance were not put in place at an early stage by DEWR.

37 ANAO, Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, pp. 77-79.

- 6.69 ANAO found that DEWR had stated its expectations of SEES Pty Ltd under the contract in terms that made the major tasks clear. Initially, however, DEWR had not clarified the level of assurance being provided by SEES Pty Ltd. The fact that DEWR had to refer to SEES Pty Ltd for such clarification reinforces the view that insufficient attention was given to this aspect of accountability. This was not sound contract management practice as it could have placed at risk DEWR's ability to control a main objective of the Scheme, i.e., to ensure required performance.
- 6.70 SEESA delivered employee entitlement payments to nearly 13 000 former Ansett employees much more quickly than would have occurred if those employees had had to await the distribution of funds from the assets of the Ansett group. DEWR neither specified any target for timeliness of payment of former Ansett employees nor collected any data on how promptly it had been able to effect payment.

Management of the air ticket levy

- 6.71 DOTARS administration of the collection of the air ticket levy was efficient. ANAO acknowledged that DOTARS:

Performed well by preparing for the implementation of the ticket levy in only two weeks.³⁸

- 6.72 DOTARS consulted with industry participants and devised four procedural documents. It maintained an accurate estimate of the levy receipts for levy duration and amount of periodic loan repayment purposes.

Committee comment

- 6.73 The Committee is satisfied with DOTARS' implementation and management of the air ticket levy.

38 ANAO, Audit Report No. 21, 2003-2004, *Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)*, p. 129.

Audit Report No. 24, 2003-2004

Agency Management of Special Accounts

Introduction

Background

- 7.1 The Australian Constitution creates a Consolidated Revenue Fund (CRF), formed from all revenues and moneys raised or received by the Government.¹ Section 83 of the Constitution stipulates that payments from The Treasury of the Commonwealth must be authorised by an appropriation by law.²
- 7.2 A Special Account is a ledger account recording a right to draw money from the CRF for specified purposes – it does not physically hold cash. Special appropriations under ss. 20 and 21 of the *Financial Management and Accountability Act 1997* (FMA Act) appropriate funds for the purposes of Special Accounts up to the balance of each account.³
- 7.3 Special Accounts and their associated appropriations under the FMA Act are a method of delivering programs that are funded by indirect taxes or other compulsory imposts, contributions by other governments, money
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1 Australian National Audit Office (ANAO), Report No. 24, 2003-2004, *Agency Management of Special Accounts*, p. 11.

2 *The Australian Constitution*, ss. 81 and 83.

3 Appropriations for Special Accounts cover approximately 8 per cent of all special appropriations.

appropriated by the Parliament for crediting to a Special Account or contributions by members of the community.⁴

- 7.4 A Special Account can be established by a determination by the Minister for Finance and Administration as prescribed in s. 20 of the FMA Act. A written determination may do all or any of the following:
- Establish a Special Account;
 - Allow or require amounts to be credited to a Special Account; and
 - Specify the purposes of a Special Account.
- 7.5 Section 20 Determinations (with Explanatory Statements) must be tabled in Parliament for five sitting days and are subject to disallowance by both Houses of Parliament.
- 7.6 A Special Account may also be established by legislation under s. 21 of the FMA Act.
- 7.7 The Determination or legislation establishing a Special Account may outline the source of funds that must or may be credited to the Special Account. Legislation may also require certain amounts to be credited to a Special Account, so that crediting occurs by operation of law *without* needing an appropriation or administrative action.
- 7.8 Amounts standing to the credit of a Special Account may only be debited strictly in accordance with the Account's purpose, except to correct a clerical error or where there has been a fundamental mistake made in the management of the Account.
- 7.9 Having an appropriation available is not, in itself, sufficient for such money to be spent. For agencies subject to the FMA Act, a valid Drawing Right is required to have been issued by the Minister for Finance and Administration, before payments of public monies can be made from, and debits recorded against, appropriations.
- 7.10 Under the FMA Act responsibility for keeping accounting records for Special Accounts has been delegated to the respective agencies.⁵
- 7.11 The FMA Act also requires agencies to keep accounts and records in such a manner that ensures the limit on any appropriation is not exceeded (s. 48). As appropriations authorise only the drawing and spending of public monies, a Special Account balance should not, by definition, be negative. Should this occur, then the standing appropriation provided by
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4 2004-05 Budget Paper No. 4, *Agency Resourcing 2004-05*, p. 3.

5 ANAO, *Transcript, 21 June 2004*, p. 6.

the FMA Act in each of these instances would have been exceeded, and the overdrawn funds spent without appropriation under law.

- 7.12 According to legal advice obtained by the Australian National Audit Office (ANAO), s. 83 of the Constitution is not breached where payments purportedly made from a non-existent Special Account could have been legitimately recorded against another, valid, appropriation.⁶

The audit

- 7.13 The ANAO audit was undertaken between April 2003 and December 2003.

- 7.14 The scope of the audit included a review of all Special Accounts (and their predecessors) that have existed since the FMA Act commenced operation on 1 January 1998. The audit objectives were to:

- Identify all Special Accounts that have existed;
- Assess the efficiency and effectiveness of the establishment, management and abolition of these Special Accounts; and
- Assess compliance with legislative requirements, including those of the FMA Act and the Finance Minister's Orders promulgated under that Act.

Audit findings

- 7.15 The ANAO audit identified deficiencies in the management of 12 of the 19 Special Accounts examined in detail. Deficiencies included Special Accounts not being credited with amounts that legislation required to be credited and debits being recorded against Special Accounts that were outside the specified expenditure purposes of the Account. Inaccuracies in the reported balance of seven Special Account appropriations were one consequence of the deficiencies identified during the course of the audit.

- 7.16 The audit demonstrated that there was significant scope for agencies to improve their financial management and reporting practices in respect of their Special Accounts. The improvements to Special Account disclosure requirements, and the development and publication in October 2003 of Special Account Guidelines by Finance have provided a stronger platform for enhancing the financial management, reporting and transparency of Special Accounts.⁷ Further improvements in administration must also

⁶ ANAO, *Transcript, 21 June, 2004*, p. 10.

⁷ ANAO, Report No. 24, 2003-2004, *Agency Management of Special Accounts*, Appendix 2, Finance Guidelines for the Management of Special Accounts, p. 66.

occur, however. Improvement will come from greater understanding of, and increased care and attention to, legislative requirements and appropriation management practices by agencies responsible for the management of individual Special Accounts.

7.17 ANAO framed 13 recommendations. In summary these were:

- Recommendation 1 – Agencies responsible for Special Accounts to ensure that they accord with all relevant legal requirements, and policy and best practice procedures;
- Recommendation 2 - Agencies regularly review the continuing need for individual Special Accounts and abolish Accounts that are no longer required;
- Recommendation 3 - The Department of Finance and Administration (Finance) maintain a comprehensive and accurate register of all Special Accounts;
- Recommendation 4 - Agencies present to the Parliament timely annual reports where required by legislation;
- Recommendation 5 - Agencies establish a ledger record for all current Special Accounts for which they are responsible;
- Recommendation 6 – Agencies operate Special Accounts as transparently as possible;
- Recommendation 7 - Agencies develop and implement procedures that ensure full compliance with any legislation requiring amounts to be credited to Special Accounts;
- Recommendation 8 – Agencies ensure Special Account appropriations are debited for the purposes of the appropriate Special Account;
- Recommendation 9 - Agencies maintain an accurate daily record of the transactions and balances on each Special Account;
- Recommendation 10 – Finance resolve whether an appropriation is needed for the expenditure of money held in trust, and inform agencies accordingly;
- Recommendation 11 – Agencies ensure a valid appropriation exists before seeking to draw funds from the Treasury of the Commonwealth;
- Recommendation 12 – Agencies ensure that valid Drawing Rights exist for all public money payments and appropriation ledger debits;

- Recommendation 13 - Agencies ensure that the limits on Special Account appropriations are not exceeded.

The Committee's review

7.18 The Joint Committee of Public Accounts and Audit (JCPAA) considered Special Accounts as part of its *Inquiry into the Draft Financial Framework Legislation Amendment Bill* which was tabled in August 2003.⁸ JCPAA made five recommendations. Recommendations 1, 2 and 3 are relevant to the present ANAO review and are summarised below:

- Recommendation 1 - A determination of the Finance Minister establishing a Special Account should include a reference to amounts that are allowed or required to be debited from a Special Account and this reference should be linked to the reference to the purposes of the Special Account;
- Recommendation 2 - Replace references to 'Special Account' with references to 'Designated Purpose Account' in the FMA Act; and
- Recommendation 3 - The annual Appropriation Acts should not authorise the crediting of appropriated amounts to a Special Account if the Act or the Finance Minister's determination that establishes the Special Account does not specifically provide for appropriated amounts to be credited to the Special Account.

7.19 The Minister for Finance and Administration submitted to the Committee in the Government Response to its *Inquiry into the Draft Financial Framework Legislation Amendment Bill*, that the Government had agreed, *inter alia*, to recommendations 1 and 3. The Minister rejected recommendation 2 because, wishing to avoid changes that did not contribute to improving the financial framework.⁹

7.20 At the public hearing on 21 June 2004, the committee heard from witnesses representing the following agencies:

- Australian National Audit Office;
- Department of Finance and Administration;

8 Joint Committee of Public Accounts and Audit, Report No. 395, *Inquiry into the Draft Financial Framework Legislation Amendment Bill*, tabled August 2003.

9 Minister for Finance and Administration, Government response to recommendations of the JCPAA *Inquiry into the Draft Financial Framework Legislation Amendment Bill* (Report No. 395), 26 June 2004, www.aph.gov.au/house/committee/jpaa/financial_bill/gr395.pdf, accessed 5 August 2004.

- Department of Transport and Regional Services;
 - Department of Communications, Information Technology and the Arts;
 - Department of the Environment and Heritage;
 - Department of Agriculture, Fisheries and Forestry; and
 - Department of the Treasury.
- 7.21 The Committee initially questioned witnesses at the public hearing in general terms on the nature and rationale behind the creation of Special Accounts and it took evidence on ANAO's census of Special Accounts.
- 7.22 The Committee then focussed on a selection of management flaws relating to Special Accounts that had been identified during the ANAO audit:
- Reporting;
 - Negative account balances;
 - Double Funding;
 - Abolishing an account with money still in it;
 - Compliance with legislative requirements;
 - Enabling legislation;
 - Payments from non-existing Special Accounts;
 - Drawing Rights; and
 - Debit outside the purpose of the account.

Special Accounts

- 7.23 ANAO identified widespread mismanagement (non-reporting, non-compliance and deficiencies)¹⁰ of Special Accounts by agencies during its audit. In this context, the Committee asked Finance to explain the nature and purpose of a Special Account and to comment on whether there was a credible alternative facility to a Special Account to achieve the same end.
- 7.24 Finance advised that the creation of a Special Account provided a facility for a government to account for funds allocated for a specific purpose, and that it was essentially an account number:

10 ANAO, Audit Report No. 24, 2003-2004, *Agency Management of Special Accounts*, p. 18.

A Special Account does not have to be matched by cash. It is an appropriation authorisation rather than a matching of cash¹¹

- 7.25 Finance further advised that a Special Account is established as an hypothecation of the CRF.¹² It provides a mechanism by which money can be set aside for particular purposes within very tight constraints. Finance emphasised that, in its view, it is particularly important for governments in situations where funding falls across financial years or across jurisdictions to be able to demonstrate that funds are being set aside for a particular purpose and not being used for any other purpose.¹³
- 7.26 Finance referred, as an example, to the instance where the states as well as the Commonwealth contribute funds for a particular program. Such monies are then hypothecated in a Special Account.

The mechanism gives the states some confidence that they are paying the funds to the Commonwealth [and] that those funds are going to be used for that purpose and are not going to be diverted...¹⁴

Committee comment

- 7.27 The Committee is satisfied that the establishment of Special Accounts is an appropriate and necessary mechanism to enable governments to demonstrate transparency in the management and deployment of special purpose public finance.

Census of Special Accounts

- 7.28 ANAO conducted a census of all Commonwealth agencies to identify all Special Accounts that had existed. It located 297 Special Accounts.¹⁵
- 7.29 The Committee questioned the five representative agencies present at the public hearing as to whether there had been any improvement in their management of their respective Special Accounts, since the ANAO audit. All responded in the affirmative.

11 Department of Finance and Administration (Finance), *Transcript, 21 June 2004*, p. 5.

12 Finance, *Transcript, 21 June 2004*, p. 16.

13 Finance, *Transcript, 21 June 2004*, p. 4.

14 Finance, *Transcript, 21 June 2004*, p. 5.

15 ANAO, Audit Report No. 24, 2003-2004, *Agency Management of Special Accounts*, p. 38.

- 7.30 The Department of Agriculture, Fisheries and Forestry (AFFA) reported that it had instituted a centralised departmental bidding process. Should any part of the organisation believe it needed a Special Account all alternative mechanisms were to be considered first. If a Special Account was considered appropriate then an application was made to Finance under s. 20 of the FMA Act or under specific legislation.¹⁶
- 7.31 The Department of the Environment and Heritage advised that the majority of its accounts were set up by legislation, with the largest item being the Natural Heritage Trust. It had investigated its procedures, tightened its Chief Executive's Instructions (CEI) and reviewed its financial statement and annual reporting procedures.¹⁷
- 7.32 The Department of Transport and Regional Services (DOTARS) responded that most of its Special Accounts were created under special appropriations. One only was set up under the FMA Act. Some small technical problems in its Special Accounts had been corrected and identified in the last financial statements.¹⁸
- 7.33 The Treasury reported that it had centralised management of its Special Accounts, updated its CEI to be in line with the ANAO Audit requirements and all staff made aware of their responsibilities.¹⁹
- 7.34 The Department of Communications, Information Technology and the Arts (DCITA) advised that it had updated its CEI in consultation with Finance, established a Special Accounts register as well as separate ledgers for each account. It now conducted internal monthly reconciliations of its Special Accounts.²⁰
- 7.35 Referring to the agencies' comments, ANAO confirmed that:
- Most agencies were very responsive.²¹
- 7.36 Finance advised that the prime responsibility for maintaining Special Accounts' records still rested with agencies - as provided in the FMA Act. Finance, nevertheless, maintained the financial framework around Special Accounts and it made sure that agencies understood and implemented the framework. Additional measures by Finance to strengthen the framework included:
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16 Department of Agriculture, Fisheries and Forestry (AFFA), *Transcript, 21 June 2004*, p. 3.

17 Department of the Environment and Heritage (DEH), *Transcript, 21 June 2004*, p. 3.

18 Department of Transport and Regional Services (DOTARS), *Transcript, 21 June 2004*, p. 3.

19 The Department of the Treasury (Treasury), *Transcript, 21 June 2004*, p. 4.

20 Department of Communications, Information Technology and the Arts (DCITA), *Transcript, 21 June 2004*, p. 4.

21 ANAO, *Transcript, 21 June 2004*, p. 4.

- Promulgating comprehensive guidelines;
- Including Special Accounts into consolidated financial statements; and
- Requiring agencies to report their Special Accounts in their portfolio budget statements.²²

Committee comment

- 7.37 The Committee is reassured by the positive responses by agencies to ANAO's Special Accounts audit findings and ANAO's confirmation that agency management of their Special Accounts has, by and large, improved. It endorses the information campaign and expanded reporting requirements introduced by Finance.
- 7.38 The Committee notes, however, that the flaws in agency management of Special Accounts are numerous and variable. A selection of flaws are analysed below.

Special Account management flaws

- 7.39 The Committee selected a cross section of Special Account management flaws identified by ANAO for further examination at the public hearing. These are discussed below.

Reporting

- 7.40 The ANAO audit found that there had been widespread non-reporting by agencies of Special Accounts.²³ Indeed in 2001-02, 41 per cent of Special Accounts had not been recorded nor reported in agency financial statements. Where there had been reporting of Special Accounts, ANAO found significant inaccuracies in the financial disclosures on some of those accounts. Further, appropriation management procedures and timeliness were found to be inadequate in a number of agencies.²⁴
- 7.41 Finance then identified the agencies with Special Accounts which had failed to report. This process resulted in a significant improvement in disclosures in 2002-03 financial statements.
- 7.42 ANAO undertook a more detailed examination of the management of 19 Special Accounts administered by six agencies, including consideration of

22 Finance, *Transcript, 21 June 2004*, p. 8.

23 ANAO, Audit Report No. 24, 2003-2004, *Agency Management of Special Accounts*, p. 18

24 ANAO, Audit Report No. 24, 2003-2004, *Agency Management of Special Accounts*, pp. 13, 49.

the accuracy of reporting of these Accounts. Errors were found to exist in the reported balance of seven of these accounts, totalling some \$575 million. The major cause of these errors was that agencies had not recorded and reported cumulative credits over a number of years to various accounts totalling \$544 million. All errors were corrected in the 2002-03 financial statements.²⁵

- 7.43 Finance advised that some underreporting of account ledger balances had occurred for the following reason:

There was not necessarily any financial transaction that took place to record it. All there was to record it was a law or a piece of legislation that said an amount would be credited... That law was not recorded administratively correctly in the ledger. There was no flow of financial money there to record.²⁶

Negative account balances

- 7.44 ANAO noted that in five instances amounts reported as being debited from Special Accounts had exceeded the amounts available for payment. Thus the standing appropriation had been exceeded, and the overdrawn funds had been spent without appropriation under law.²⁷
- 7.45 The Committee then queried DCITA about a negative balance in one of its Special Accounts. DCITA advised that the situation had arisen when payments were made to a contracted service provider prior to receipts from telecommunications carriers. It had responded by adjusting the service provider's contract to legitimise payments only after receipt of monies from carriers.²⁸

Double funding

- 7.46 The Committee examined the duplication of substantial funding to the Natural Heritage Trust of Australia (NHT) Special Account.
- 7.47 The *Natural Heritage Trust of Australia Act 1997* (NHT Act) required the first \$250 million of the Telstra 2 sale proceeds to be credited to the NHT Special Account in 1999. However, the Department of Environment and Heritage (DEH), which administered the NHT Special Account, had not realised that this amount had been automatically deposited and credited the account with an equivalent amount funded through annual

25 ANAO, Audit Report No. 24, 2003-2004, *Agency Management of Special Accounts*, p. 15

26 Finance, *Transcript*, 21 June 2004, p. 6.

27 ANAO, Audit Report No. 24, 2003-2004, *Agency Management of Special Accounts*, p. 88.

28 DCITA, *Transcript*, 21 June 2004, pp. 12-13.

appropriation. This second credit by appropriation amounted to a duplication of the first credit.

- 7.48 DEH conceded that it was ANAO, rather than DEH which had discovered the double crediting. After the discovery, DEH debited the account for the second \$250 million provided by annual appropriation and reassured the Committee that:

In terms of actual cash, there was no impact on that trust account...²⁹

- 7.49 DEH pointed out that, while the incident of double crediting was in error, it was not illegal:

Parliament approved the annual appropriation through the budget process. The earlier amount was self-executing, so it was there since the original legislation.³⁰

DEH affirmed [that it could have, quite legally with the permission of the parliament, spent the monies twice].³¹

- 7.50 A further complication arose out of the NHT double funding issue. As well as crediting the NHT with funds from Telstra 2 sale, the NHT Act also appropriates an amount equivalent to eight per cent of the uninvested 30 June balance of the NHT Account to the account each year. DEH, however, had again drawn an annual appropriation to fund the interest deposit. In essence, two amounts of interest were being credited each year to the Account.

- 7.51 The \$250 million appropriation, that should not have been in the NHT Account, attracted interest that likewise should not have been in the NHT Account. It was a case that ANAO described as being the “fruit of the poison tree”.

- 7.52 The provisions of the NHT Act exacerbated the double interest problem because, unlike the \$250 million appropriation which could be reversed back to the CRF, the second lot of interest could not be taken out of the account.

The legal advice to the department was that...the amount [of interest] could not be taken out. Therefore, had none of the mistakes ever been made, the actual balance that can now be spent

29 DEH, *Transcript*, 21 June 2004, p. 9.

30 DEH, *Transcript*, 21 June 2004, p. 9.

31 DEH, *Transcript*, 21 June 2004, p. 9.

on the NHT would have been \$37 million less than now can be spent.³²

Committee comment

7.53 The Committee is surprised that an error of the magnitude of \$250 million went undiscovered for such a period of time.

Abolition of Special Account with money still in it

7.54 DEH also described an instance where money was lodged in a Special Account for the Cockatoo Island decontamination project. The Government decided to fund the project through other processes and sought to take back the funds lodged in the Special Account. The Special Account money, however, could not be legally refunded and its repatriation to the Consolidated Revenue Fund could only take place by closing the Special Account first.³³

We were actually asked to return the money to consolidated revenue, which we did. We debited that from the account. We were then told that is not within the purpose of the act, so we restored the money. We have \$30 million sitting there at the moment. When the Special Account is closed, that will then be returned to consolidated revenue.³⁴

Compliance with legislative requirements

7.55 The ANAO found that there had been non-compliance with a number of provisions of the FMA Act (and subordinate legislation) relating to:

- the management of appropriations;
- the keeping of proper accounts and records; and
- the reporting of all Special Accounts.

7.56 There had also been inadequate understanding within agencies of, and non-compliance with, aspects of the legislation that had established particular Special Accounts. This included where legislation required amounts to be credited to a Special Account.

7.57 One example involved the Rural Transactions Centres Account. The relevant legislation required \$70 million in social bonus funds from Telstra 2 to be credited in 1999 to this Account. However, only \$61.7 million was

32 ANAO, *Transcript, 21 June 2004*, pp. 13-14.

33 DEH, *Transcript 21 June 2004*, pp. 14-15.

34 DEH, *Transcript 21 June 2004*, p. 15.

recorded and reported against the Account in 1999–2000. The non-compliance with the legislative requirements was corrected by the administering agency in 2002–03, when the balance of the Account was increased by \$8.3 million.³⁵

Enabling legislation

- 7.58 The Committee queried AFFA on the circumstances surrounding the Strategic Ballast Water Research and Development Account.
- 7.59 AFFA responded that the account had collected levies but the operation of the Special Account had been repealed accidentally as an unintended consequence of the legislation when the levy balance reached the account limit.
- 7.60 AFFA had since checked all its Special Accounts to ensure that valid enabling legislation remains in place.³⁶

Payments from non-existing Special Accounts

- 7.61 The Committee was informed that payments in and out of the Court Litigants Trust Account at the time of the audit were being made on the basis of Court Orders, not appropriation.³⁷ ANAO was uncertain as to whether Special Account appropriation rather than Court Order was required prior to the expenditure of these funds.
- 7.62 Finance explained that the trustees of the Federal Magistrate Service Court Litigants Trust Account had operated on the basis that these trust monies were not part of the Consolidated Revenue Fund (CRF) and therefore expenditure did not require an appropriation.
- 7.63 This had led ANAO to question whether monies held by the Commonwealth in trust were, in fact, part of the CRF. Finance informed the Committee that it had taken legal advice in September 2003 on whether this was the case:

There was a view that trust money was not part of the consolidated revenue of the Commonwealth and therefore the expenditure of trust money did not require an appropriation because it was never part of the Treasury of the Commonwealth, which is what is required by s. 83.³⁸

35 ANAO, Audit Report No. 24, 2003-2004, *Agency Management of Special Accounts*, p. 16.

36 AFFA, Transcript, 21 June 2004, p. 11.

37 ANAO, Audit Report No. 24, *Agency Management of Special Accounts*, p. 81.

38 Finance, Transcript 21 June 2004, p. 10.

We have come to the conclusion that ...we should treat as it as if it were part of consolidated revenue. Essentially all money received by the Commonwealth does go into consolidated revenue. Therefore an appropriation is required.³⁹

- 7.64 To clarify the legal status of the Federal Magistrate Service Litigants Trust, new Special Accounts are being created to put the matter beyond any doubt.⁴⁰
- 7.65 Finance confirmed to the Committee that it is taking a conservative approach to the treatment of monies held by the Commonwealth in trust by treating such monies as part of the CRF and therefore require appropriation properly authorised by Parliament.⁴¹

Drawing rights

- 7.66 Witnesses were questioned about who was given authority within agencies to draw on Special Accounts. Finance advised that the nomination of personnel holding drawing rights on Special Accounts had been delegated to agencies under the FMA Act.⁴² In Finance's view, there was no need for any central register of the holders of drawing rights, nor was a central register practical.
- 7.67 ANAO advised the Committee that it had found during its audit that the Department of Defence had not issued drawing rights.

[The Department of Defence is] working with the Australian Government Solicitor to try and fix them up.⁴³

Debit outside the purpose of the account

- 7.68 ANAO reported finding four Special Accounts for of which debits had been reportedly made for purposes other than those specified in the establishing legislation or Determination.⁴⁴
- 7.69 The Committee notes that these actions contravene s. 20 of the FMA Act.

Committee comment

- 7.70 The Committee was concerned at the wide range of shortcomings in Special Accounts management identified by ANAO. At least agencies

39 Finance, *Transcript 21 June 2004*, p. 11.

40 Finance, *Transcript, 21 June 2004*, pp. 10-11.

41 Finance, *Transcript, 21 June 2004*, p. 11.

42 Finance, *Transcript, 21 June 2004*, p. 12.

43 ANAO, *Transcript, 21 June 2004*, p. 17.

44 ANAO, Audit Report No. 24, 2003-2004, *Agency Management of Special Accounts*, p. 17.

appear to have responded positively to the ANAO report and reviewed their Special Accounts and the way they are administered.

- 7.71 While the ANAO review may have prompted agencies to examine and rectify mistakes in the management of their Special Accounts, the Committee does not want this to be a one off event.
- 7.72 The Committee accepts that the FMA Act largely delegates the financial management responsibilities for Special Accounts to agencies. The Committee believes, however, that Finance has a continuing role to provide advice to agencies on management of Special Accounts. Indeed, Finance's initiatives, including its introduction of a Special Accounts register and the issuing of the *Finance Guidelines for the Management of Special Accounts* to agencies, have made positive impacts. Notwithstanding, the degree of centralised supervision by Finance is still at inadequate levels and this may lead to instances of poor administration of their Special Accounts by agencies in the future.
- 7.73 From the evidence before it, the Committee sees a need for agencies to undertake annual reviews to ensure that their Special Accounts are being administered appropriately. The reviews should be against a checklist or range of criteria determined by Finance. This information should be reported annually to Finance so that there can be some basic centralised assurance that Special Accounts are, in fact, being administered in compliance with *all* aspects of their enabling legislation or Finance Minister's determinations.
- 7.74 As a minimum, the Committee believes agencies administering Special Accounts should be able to report that they have:
- A Register of all Special Accounts they administer and the basis for their establishment;
 - Confirmed the adequacy of enabling legislation, where appropriate, for the establishment, management and closure of each Special Account;
 - Ensured the existence of valid drawing rights, and maintain a record of agency delegates who hold drawing rights;
 - Checked that there are current references to Special Accounts in Chief Executives Instructions; and
 - Provided appropriate training to agency personnel managing Special Accounts.
- 7.75 The Committee recommends accordingly.

Recommendation 7

7.76 The Department of Finance and Administration raise the level of agency accountability for their Special Accounts by developing appropriate Special Account management standards to complement the *Finance Guidelines for the Management of Special Accounts*.

For each Special Account they administer, agencies be required to report annually to the Department of Finance and Administration that they have complied with these standards.

**Bob Charles MP
Chairman**



Appendix A — Conduct of the Committee's Review

Selection of Audit Reports

The Committee considered seven audit reports tabled in the first quarter of 2003-2004, fourteen audit reports tabled in the second quarter of 2003-2004 and three audit reports tabled in the third quarter of 2003-2004. These were:

- No. 1 Performance Audit
Administration of Three Key Components of the Agriculture -
Advancing Australia (AAA) Package
Across Agency
- No. 2 Audit Activity Report
Audit Activity Report: January to June 2003
Across Agency
- No. 3 Business Support Process Audit
Management of Risk and Insurance
Across Agency
- No. 4 Performance Audit
Management of the Extension Option Review - Plasma Fractionation
Agreement
Department of Health and Ageing
- No. 5 Business Support Process Audit
The Senate Order for Departmental and Agency Contracts (Autumn
2003)
Across Agency

- No.6 Performance Audit
APRA's Prudential Supervision of Superannuation Entities
Australian Prudential Regulation Authority
- No. 7 Business Support Process Audit
Recordkeeping in Large Commonwealth Organisations
Across Agency
- No. 8 Performance Audit
Commonwealth Management of the Great Barrier Reef Follow-up
Audit
Great Barrier Reef Marine Park Authority
- No. 9 Performance Audit
Business Continuity Management and Emergency Management in
Centrelink
Centrelink
- No. 10 Performance Audit
Australian Defence Force Recruiting Contract
Department of Defence
- No. 11 Performance Audit
Annual Performance Reporting
Across Agency
- No. 12 Performance Audit
The Administration of Telecommunications Grants
Department of Communications Information Technology and the Arts
- No. 13 Performance Audit
ATSI Law and Justice Program
Aboriginal and Torres Strait Islander Services
- No. 14 Performance Audit
Survey of Fraud Control Arrangements in APS Agencies
Across Agency (all FMA agencies and CAC bodies)
- No. 15 Performance Audit
Administration of Staff Employed Under the Members of Parliament
(Staff) Act 1984
Department of Finance and Administration
- No. 16 Performance Audit
Administration of Consular Services Follow-Up Audit
Department of Foreign Affairs and Trade

- No. 17 Performance Audit
AQIS Cost-recovery Systems Follow-up Audit
Australian Quarantine and Inspection Service
- No. 18 Performance Audit
The Australian Taxation Office's Use of AUSTRAC Data Follow-up Audit
Australian Taxation Office
- No. 19 Business Support Process Audit
Property Management
Across Agency
- No. 20 Performance Audit
Aid to East Timor
Australian Agency for International Development
- No. 21 Performance Audit
Special Employee Entitlements Scheme for Ansett Group Employees (SEESA)
Department of Employment and Workplace Relations, Department of Transport and Regional Services
- No. 22 Financial Statement Audit
Audits of the Financial Statements of Australian Government Entities for the Period Ended 30 June 2003
Across Agency
- No. 23 Performance Audit
The Australian Taxation Office's Management of Aggressive Tax Planning
Australian Taxation Office
- No. 24 Performance Audit
Agency Management of Special Accounts
Across Agency

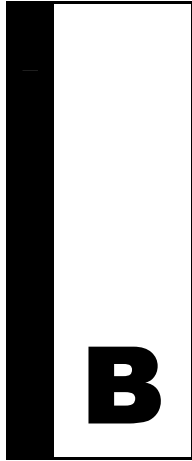
The Joint Committee of Public Accounts and Audit discussed the above audit reports and considered whether the issues and findings in the reports warranted further examination at a public hearing. In making this assessment the Committee considered, in relation to each audit report:

- 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.

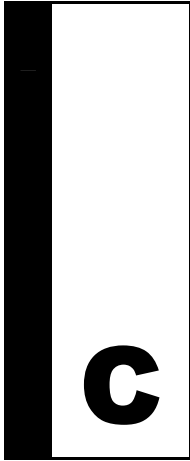
Following this consideration, the Committee decided to take evidence at public hearings on the following audit reports:

- No. 1 Performance Audit
Administration of Three Key Components of the Agriculture -
Advancing Australia (AAA) Package
Across Agency
- No. 4 Performance Audit
Management of the Extension Option Review - Plasma Fractionation
Agreement
Department of Health and Ageing
- No. 6 Performance Audit
APRA's Prudential Supervision of Superannuation Entities
Australian Prudential Regulation Authority
- No. 11 Performance Audit
Annual Performance Reporting
Across Agency
- No. 21 Performance Audit
Special Employee Entitlements Scheme for Ansett Group Employees
(SEESA)
Department of Employment and Workplace Relations, Department of
Transport and Regional Services
- No. 24 Performance Audit
Agency Management of Special Accounts
Across Agency



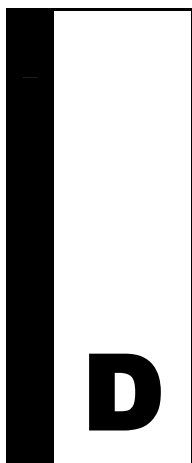
Appendix B — Submissions

1. Australian Taxation Office
2. Australian Prudential Regulation Authority
3. CSL Limited, BioPlasma
4. Australian Prudential Regulation Authority
5. Department of Education, Science and Training
6. Australian Prudential Regulation Authority
7. Department of Finance and Administration
8. Australian Customs Service
9. Department of Employment and Workplace Relations
10. Bentleys MRI Sydney Pty Ltd



Appendix C — Exhibits

1. Department of Finance and Administration, *Procurement Circular, PC 03/3, Evaluating Options in Procurement Contracts*
2. Australian Taxation Office, *Special Employee Entitlements Scheme for Ansett Group Employees - Minute Paper*
3. Australian Taxation Office, *Application for Private Ruling Authorisation Number 13442*
4. Australian Taxation Office, *The Commissioner of Taxation re SEES Pty Ltd and the Department of Employment and Workplace Relations and in the matter of The Income Tax Assessments Acts 1936 and 1997, Further Advice by Australian Government Solicitor*
5. Bentleys MRI Sydney Pty Ltd, *SEES Pty Ltd and the Commonwealth, Payments under the special Employee Entitlements Scheme for Ansett Workers, Opinion by A.H Slater QC*
6. ANAO, *List of Special Accounts Not Disclosed in 2002-03 Financial Statements*



Appendix D — Witnesses Appearing at Public Hearings

Monday, 16 February 2004

Australian National Audit Office

Mr John Emil Meert, Group Executive Director, Performance Audit Services Group

Mr Alan Greenslade, Executive Director, Performance Audit Services Group

Mr Szymon Duniec, Consultant, Managing Director, Orima Research

Australian Taxation Office

Ms Jennifer Anne Granger, Second Commissioner

Mr Mark Konza, Deputy Commissioner, Small Business

Mr Brett Peterson, Assistant Commissioner, Small Business

Centrelink

Mr Graham Bashford, Deputy Chief Executive Officer

Mr Robin Salvage, National Manager, Business, Rural and Rent Assistance

Mr Robert Mugford, Business Manager, Rural Services

Department of Agriculture, Fisheries and Forestry

Mr Thomas Aldred, General Manager, Rural Support and Adjustment

Mr Craig Bradley, Manager, Farm Business Management Unit

Ms Anne McGovern, Manager, Welfare, Adjustment and Regional Programs

Monday, 8 March 2004**Australian National Audit Office**

Mr Warren John Cochrane, Group Executive Director, Performance Audit Services Group

Ms Frances Holbert, Executive Director, Performance Audit Services Group

CSL Ltd

Mr Paul Bordonaro, General Manager Bioplasma

Department of Finance and Administration

Mr Michael Loudon, Assistant Secretary, Manager, Procurement Branch

Department of Health and Ageing

Mr Philip Davies, Deputy Secretary

Dr Louise Morauta, First Assistant Secretary, Acute Care Division

Monday, 29 March 2004**Australian National Audit Office**

Mr Warren Cochrane, Group Executive Director, Performance Audit Services Group

Mr Brian Boyd, Executive Director, Performance Audit Services Group

Mr Kim Bond, Performance Audit Services Group

Ms Alicia Hall, Performance Audit Services Group

Australian Prudential Regulation Authority

Mr Ross Jones, Deputy Chairman

Mr Keith Chapman, General Manager, Diversified Institutions Division

Mr Stephen Glenfield, General Manager, South-West Region

Mr Ramani Venkatramani, General Manager, Diversified Institutions Division

Australian Taxation Office

Ms Jennifer Granger, Second Commissioner

Mr Mark Jackson, Deputy Commissioner, Superannuation

Monday, 24 May 2004**Australian National Audit Office**

Mr Steven Lack, Acting Group Executive Director, Performance Audit Services Group

Ms Ann Thurley, Senior Director, Performance Audit Services Group

Ms Corrine Horton, Performance Analyst, Performance Audit Services Group

Australian Customs Service

Ms Christine Marsden-Smedley, National Manager, Planning and International Branch

Mr Peter Naylor, National Manager, Information Management Branch

Department of Communications, Information Technology and the Arts

Ms Fay Holthuyzen, Deputy Secretary, Communications

Mr Frank Nicholas, Chief Operating Officer, Corporate and Business

Ms Cheryl Watson, Manager, Corporate Governance and Divisional Coordination

Department of Education, Science and Training

Mr Ewen McDonald, Group Manager, Corporate Strategy Group

Ms Susan Smith, Branch Manager, Business Performance Improvement Branch

Department of Employment and Workplace Relations

Ms Malisa Golightly, Chief Financial Officer

Mr Craig Symon, General Manager, Corporate

Mr Finn Pratt, Group Manager, Intensive Support

Ms Janet Lever, Team Leader, Coordination and Project Management Team

Department of Immigration and Multicultural and Indigenous Affairs

Mr John Moorhouse, First Assistant Secretary, Corporate Governance Division

Mr Peter Vardos, First Assistant Secretary, Citizenship and Multicultural Affairs Division

Monday, 31 May 2004**Australian National Audit Office**

Mr Steven Lack, Acting Group Executive Director, Performance Audit Services Group

Mr David Rowlands, Senior Director, Performance Audit Services Group

Ms Rebecca Collareda, Performance Analyst, Performance Audit Services Group

Australian Taxation Office

Ms Louise Clarke, Acting Senior Tax Counsel

Centrelink

Ms Carolyn Hogg, General Manager, Service Integration Shop

Mr Tony Hedditch, National Program Manager, Participation Payments

Department of Employment and Workplace Relations

Ms Jenet Connell, Group Manager, Workplace Relations Services Group

Mr Michael Maynard, Assistant Secretary, Workplace Relations Implementation Group

Mr Henry Carr, Principal Government Lawyer, Corporate Legal Team

Department of Transport and Regional Services

Mrs Joan Armitage, Assistant Secretary, Transport Programmes North and West

Mrs Maureen Ellis, Director

SEES Pty Ltd

Mr Geoffrey Ellison, Director

Mr Robert Ryn, Director

Mr Brett Cox, Tax Advisor

Monday, 21 June 2004**Australian National Audit Office**

Mr Warren Cochrane, Group Executive Director, Performance Audit Services Group

Mr Brian Boyd, Executive Director, Performance Audit Services Group

Mr Darren Box, Executive Director, Research and Development

Department of Agriculture, Fisheries and Forestry

Mr Allan Gaukroger, Chief Financial Officer

Mr Peter Cook, Chief Financial Officer, Australian Quarantine and Inspection Service

Department of Communications, Information Technology & the Arts

Ms Fay Holthuyzen, Deputy Secretary, Communications

Ms Karen Gosling, Special Advisor, Arts and Sport Division

Department of the Environment and Heritage

Mr David Anderson, First Assistant Secretary, Corporate Strategies Division

Department of Finance and Administration

Mr Jonathan Hutson, Division Manager, Financial Framework Division

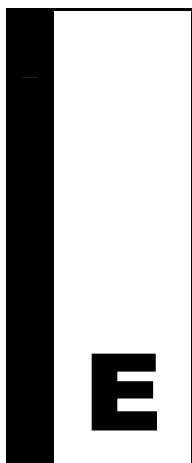
Mr Michael Culhane, Branch Manager, Finance and Banking Branch, Financial Management Group

Department of Transport and Regional Services

Mr Jeremy Chandler, First Assistant Secretary, Corporate Group

Department of the Treasury

Mr Tony Murcutt, Chief Financial Officer



Appendix E — The National Blood Authority

Introduction

The National Blood Authority is a Commonwealth agency established under the *National Blood Authority Act 2003* to improve and enhance the management of the Australian blood banking and plasma product sector at a national level.

The National Blood Authority came into effect from 1 July 2003, and is a key part of new reforms to the blood sector, which have been agreed to by all States and Territories. These are set out in the National Blood Agreement.

The establishment of the National Blood Authority represents the culmination of consideration and cooperation by all governments through the Australian Health Ministers' Conference in responding to needs for reforms identified in the 2001 Review of the Australian Blood Banking and Plasma Product Sector (the Stephen Review).¹

The role of the National Blood Authority

The role of the National Blood Authority is to ensure that Australia's blood supply is safe, secure, adequate and affordable. It does this by:

- Coordinating demand and supply planning for blood and blood products from suppliers on behalf of all States and Territories;
- Negotiating and managing national contracts with suppliers of blood and blood products;

¹ National Blood Authority (NBA), *About the National Blood Authority*, www.nba.gov.au/, accessed 5 August 2004.

- Working with all governments to ensure that they get the blood and blood products they require, according to an agreed single national pricing schedule;
- Undertaking research to support policy development and operations within the blood sector through transparent evidence-based processes;
- Developing and implementing national strategies to encourage better use of blood and blood products;
- Promoting adherence to national safety and quality standards; and
- Taking responsibility for national contingency planning.

Stakeholder responsibilities

There are three main stakeholders in the blood sector: the States and Territories; the Department of Health and Ageing; and the Therapeutic Goods Administration. They have the following responsibilities:

- States and Territories
 - ⇒ fostering the development and implementation of best practice planning and management systems to promote efficiency in the use and minimisation of wastage;
 - ⇒ ensuring the flow of information and advice to the National Blood Authority in relation to demand for blood and blood products; and
 - ⇒ managing local issues such as those involving clinical practice.
- Department of Health and Ageing
 - ⇒ managing the Commonwealth's policy and financial participation in the National Blood Authority;
 - ⇒ managing the National Cord Blood Program, the Bleeding Disorder Registry and the Bone Marrow Transplant Program;
 - ⇒ handling contracts with the Haemophilia Foundation of Australia and the Australian Haemophilia Centre Directors' Organisation; and
 - ⇒ taking responsibility for quarantine as it may affect the blood supply.
- Therapeutic Goods Administration
 - ⇒ auditing Good Manufacturing Practice;
 - ⇒ initiating product recalls;
 - ⇒ implementing modifications to safety standards; and
 - ⇒ issuing directives regarding such things as donor deferrals.²

2 NBA, *About the National Blood Authority*, www.nba.gov.au/, accessed 5 August 2004.