The Auditor-General
Audit Report No.22 2004–05
Performance Audit

Investment of Public Funds

Australian National Audit Office

ISSN 1036–7632

ISBN 0 642 80818 X

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Australian National
Audit Office

Canberra ACT
18 January 2005

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit across agencies in accordance with the authority contained in the *Auditor-General Act 1997*. Pursuant to Senate Standing Order 166 relating to the presentation of documents when the Senate is not sitting, I present the report of this audit and the accompanying brochure. The report is titled *Investment of Public Funds.*

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's Homepage—http://www.anao.gov.au.

Yours sincerely

P. J. Barrett
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

The Auditor-General is head of the Australian National Audit Office. The ANAO assists the Auditor-General to carry out his duties under the *Auditor-General Act 1997* to undertake performance audits and financial statement audits of Commonwealth public sector bodies and to provide independent reports and advice for the Parliament, the Government and the community. The aim is to improve Commonwealth public sector administration and accountability.

For further information contact:
The Publications Manager
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Telephone: **(02) 6203 7505**
Fax: **(02) 6203 7519**
Email: **webmaster@anao.gov.au**

ANAO audit reports and information about the ANAO are available at our internet address:

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Audit Team

Nicola Thatcher
Katrina Bevan
Alicia Hall
Brian Boyd

Contents

Abbreviations

ABC	Australian Broadcasting Corporation
AFMA	Australian Fisheries Management Authority
ANAO	Australian National Audit Office
ANMM	Australian National Maritime Museum
ANSTO	Australian Nuclear Science and Technology Organisation
AOFM	Australian Office of Financial Management
APRA	Australian Prudential Regulation Authority
APVMA	Australian Pesticides and Veterinary Medicines Authority
ATSIC	Aboriginal and Torres Strait Islander Commission
ATSIC Act	*Aboriginal and Torres Strait Islander Commission Act 1989*
Audit Act	*Audit Act 1901*
BBSW	Bank Bill SWap rate
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CASA	Civil Aviation Safety Authority
CRF	Consolidated Revenue Fund
DAFF	Department of Agriculture, Fisheries and Forestry
DIMIA	Department of Immigration and Multicultural and Indigenous Affairs
DITR	Department of Industry, Tourism and Resources
DVA	Department of Veterans' Affairs
DSHIS	Defence Service Homes Insurance Scheme
Finance	Department of Finance
FMA Act	*Financial Management and Accountability Act 1997*
GBE	Government Business Enterprise
GRDC	Grains Research and Development Corporation
ITSA	Insolvency and Trustee Service Australia
Land Fund	Land Fund Special Account
NMA	National Museum of Australia

OPA	Official Public Account
SBS	Special Broadcasting Services Corporation
SMA	Statutory Marketing Authority
Treasury	Department of Treasury

Summary and Recommendations

Summary

Introduction

1. Commonwealth entities reported financial investments of some $20.208 billion[1] as at 30 June 2004. For a small number of Commonwealth entities, investment of public funds is part of their core business. However, this is not the case for most investing entities. Nevertheless, in both circumstances, having regard to the attendant risks, it is important that investment of public funds be prudently managed in accordance with the legislative framework.

2. Investment activity involves a trade-off between risk and return.[2] In this context, it is generally considered that the Commonwealth has a low tolerance for financial risk, which limits investment activity to low-risk assets.[3] This is reflected in the legislative framework governing Commonwealth entities' investing activities. In particular:

- not all entities are permitted to invest; and
- for most entities, where investment is permitted, the types of authorised investments are generally very limited.

3. The Department of Finance and Administration (Finance) advised ANAO in November 2004 that, in the case of *Financial Management and Accountability Act 1997* (FMA Act) agencies, the Parliament has authorised each class of investment, whereas for *Commonwealth Authorities and Companies Act 1997* (CAC Act) bodies the Parliament has authorised a limited number of investment classes and given the Treasurer the power to authorise additional investment classes. Finance further advised that the different levels of control exerted by the Parliament over the investments of entities under the FMA and CAC Acts affects the management and reporting of risk, and that responsibility for compliance and proper management under these Acts lies with Chief Executives of FMA Act agencies and directors of CAC Act bodies.

Audit approach and key findings

4. The objective of the audit was to examine the investment of public funds by selected entities, including:

- compliance with relevant legislation, delegations and instructions;

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1 Figures reported as market value of investments.

2 Department of the Treasury (Treasury), *Review of the Commonwealth Government Securities Market: Discussion Paper*, October 2002, p. 89.

3 ibid, p. 90.

- the value for money of investment strategies; and
- reporting of investment activities.

5. Six entities were selected for audit, comprising three FMA Act agencies[4] and three Commonwealth authorities.[5] The six entities had aggregate investments of $1.64 billion as at 30 June 2004 and realised investment earnings of some $80.4 million during 2003–04.

6. In addition to the specific entities selected for their investment activities, Finance and Treasury were included in the audit because of their responsibilities associated with the FMA Act and the CAC Act. ANAO also undertook a desk audit of other Commonwealth statutory authorities' investment activities, relying on the most current financial statement disclosures publicly available at the time of audit fieldwork.

Compliance

7. In general, the types of investments that Commonwealth entities are authorised to acquire are identified in the relevant legislation governing their investing activities. There are three exceptions where enabling legislation for Commonwealth authorities specifically exempts them from the investment restrictions of the CAC Act.[6]

8. The only way authorised investments can be expanded for FMA Act agencies is through legislative change or changes to the regulations made by the Finance Minister under the FMA Act[7]. For Commonwealth authorities, the CAC Act provides the Treasurer[8] with the capacity to approve the investment of surplus moneys in a manner other than those specified in the Act. Although such approvals create additional legal rights for the relevant authority to invest its surplus money, ANAO found that records maintained by Treasury of these approvals were both inaccurate and incomplete. As well, ANAO found that documentation of such approvals was not always readily available from the entities that originally sought the approval.

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4 Namely: the Aboriginal and Torres Strait Islander Commission (ATSIC) (in respect to the Land Fund Special Account); the Department of Veterans' Affairs (DVA) (in respect to the Defence Service Homes Insurance Scheme Special Account); and the Insolvency and Trustee Service Australia (ITSA) (in relation to the Common Investment Fund).

5 Namely: the Special Broadcasting Service Corporation (SBS); the Australian Nuclear Science and Technology Organisation (ANSTO); and the National Museum of Australia (NMA).

6 Namely: the Indigenous Land Corporation (ILC); the Australian National University; and the Coal Mining Industry (Long Service Leave Funding) Corporation.

7 The FMA Regulations are disallowable instruments and, as such, are open to the scrutiny of Parliament.

8 The Financial Framework Legislation Amendment Bill, represented to the Parliament in December 2004, proposes to amend a number of Acts, including the CAC Act, to transfer from the Treasurer to the Finance Minister the power to approve investments not otherwise permitted by legislation.

Identified non-compliance

9. During the course of this performance audit, ANAO identified that, at least 11 entities,[9] and up to 13 entities,[10] have purchased and reported holding investments not authorised by the relevant legislation. In total, more than $566 million in unauthorised investments were identified.

10. There have been two main reasons for the purchase of non-compliant investments, as follows:

- In a number of instances, entities' investment procedures and governance structures demonstrated insufficient regard for legislated investment restrictions. Among other things, this deficiency was reflected in documented investment strategies that included plans to purchase unauthorised investments and inadequate oversight of investment activities.
- Some different views exist on what investments are, and are not, permitted by the CAC Act. For three Commonwealth authorities, these differing views have been informed by legal or financial advice they have obtained. These authorities did not seek the Treasurer's approval under subsection 18(3)(d) of the CAC Act for these investments.

11. In terms of the nature of the non-compliance, Treasury commented to ANAO in November 2004 that the type of investments undertaken by those entities that have not been complying with subsection 18(3) of the CAC Act are of relatively low risk.[11] At the same time, Finance commented to the ANAO as follows:

> The non-compliance, while not acceptable, should be viewed in context. Although there was some non-compliance, the investments were not, in many cases, necessarily of higher risk in comparison to other examples of compliant investments and the report did not identify any circumstances in which money was lost through securities defaulting.

12. It is clearly important that entities comply with restrictions legislated by the Parliament. In addition, where departures by Commonwealth

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[9] The non-compliant entities were identified from ANAO's detailed audit of six entities and a desk audit of all Commonwealth authorities. However, it needs to be recognised that the full extent of non-compliance cannot be identified from a desk audit process because of the limitations in relying on reporting by entities of their investment holdings to identify non-compliance.

[10] There are two entities where, due to differing interpretations of the relevant CAC Act provisions, there is uncertainty about whether some investments were compliant or not. Finance is in discussion with both entities regarding this issue.

[11] For example, Treasury noted that Section 39 of the FMA Act authorises certain entities to invest public money in bank bills of exchange and bank issued negotiable certificates of deposit, indicating that those are regarded by Parliament as an acceptable risk for public money.

authorities are seen as prudent, the legislation provides a means of obtaining appropriate approval from the Treasurer.

13. The non-compliance was particularly significant for two FMA Act agencies involved, as follows:

- Notwithstanding the clear Parliamentary direction that the Fund's investments be limited to those authorised by legislation, and the steps taken to compensate for the possible financial effect of the legislative restrictions, between $415 million and $486 million of the 30 June 2004 investments of the Aboriginal and Torres Strait Islander Land Fund were not in authorised investments. This involved breaches of Sections 39 and 48 of the FMA Act as well as Section 83 of the Constitution.[12]
- The DVA's investment of $56.6 million, as at 30 June 2004, in a managed money market trust was non-compliant in that the trust held investments that were not authorised under the FMA Act. This also reflected breaches of Sections 39 and 48 of the FMA Act and Section 83 of the Constitution.

Governance and reporting

14. At the time of audit, consistently sound governance and reporting processes had yet to be developed and implemented by all audited entities for their investment of public funds, as follows:

- Two of the six audited entities had yet to document an investment strategy. In addition, one of the entities with an investment strategy has not reviewed or updated its strategy in the last nine years, although funds being invested had more than doubled over this period.
- Two of the FMA Act agencies employ an investment adviser or fund manager. Substantial fees have been, and continue to be, paid to each of the firms involved. However, the contracting approaches taken have not provided open and effective competition for these roles.
- The Commonwealth is exposed to credit risk when entities invest public funds. However, in four of the audited entities, there was an absence of defined policies and management procedures for counterparty credit risk.
- Three of the five audited entities that purchase their investments directly had not adopted procedures to maximise the returns on

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[12] Spending money contrary to the purpose of an appropriation, or in excess of the amount appropriated, contravenes Section 83 of the Constitution. In this respect, the Special Appropriations for FMA Act agencies to invest money standing to the credit of a Special Account require that the investments be in authorised investments.

individual investments, for a given level of risk. The sixth audited entity invests through a fund manager. ANAO found little evidence of this agency assessing the ongoing performance of its investment in order to inform the decision to continue this approach, which has been in place for nine years.

Audit conclusion

15. Overall, ANAO found that, for a number of entities, there had been shortcomings in the management of the investment of public funds. Entities require strategies and procedures that both comply with the investment parameters provided by the Parliament and optimise risk-adjusted returns. In this context, the report makes seven recommendations addressing compliance, value for money in investment strategies and financial reporting of the investment of public funds. Implementation of the recommendations should collectively lead to a level of management and focus commensurate with the quantum of public funds under investment.

Agency responses

16. Agencies that responded to the draft report agreed, or agreed in principle, to all recommendations. In addition, a number of agencies provided summary comments on the report, as follows:

Finance

17. Finance notes that investment of entities covered by the audit have occurred under either the CAC Act or the FMA Act. In the case of the FMA Act, the allowable investment choices are low risk in nature and are either set out in the Act itself or the FMA Regulations. In the case of the CAC Act, Commonwealth authorities are limited to specific and conservative classes of investments listed in the Act, with provision for further investment choice to be approved following consideration by the Treasurer.

18. Only 13 FMA Act agencies have investment powers and these investment powers are generally limited to the balances of particular Special Accounts. Finance notes that for entities referred to in the report, the value of investments in some instances is quite significant while in other instances the amounts are much smaller, and can be as low as $1 000. In relation to both FMA Act agencies and CAC Act Commonwealth authorities the report does not identify any entity that has made investments that have defaulted.

19. Finance considers that the report will serve to focus entities' attention on the management of their investment activities and compliance with their legislative parameters. Finance has, in the past, drawn agencies' attention to

the requirements of the framework and will continue to do so, where appropriate, in the future.

Treasury

20. Treasury welcomes the work undertaken by the ANAO to identify and improve compliance with the legal framework for investment activities by relevant Commonwealth entities. Treasury notes that the responsibility to ensure compliance with the legal framework lies with the Board of each agency subject to Section 18(3) of the CAC Act. Treasury supports the recommendations made in the report for helping to achieve this.

21. Treasury notes that the guidance to be issued by central agencies under Recommendation 7(c) will take a generic form, to remind agencies subject to Section 18(3) of the CAC Act of their obligations to adhere to the legislative framework for investments. Treasury also notes that, consistent with the overriding responsibility of Boards, it would not be appropriate for Treasury to undertake an audit role or to review agencies' legislative compliance or financial performance in relation to their investment activities.

DVA

22. DVA agrees with the overall conclusions of this report. DVA acknowledges it needs to enhance its internal governance framework to ensure future legislative compliance and effective management of invested public money.

23. DVA in response to ANAO's findings, has undertaken steps to rectify its existing non-compliance and is in the process of improving its investment management strategies.

ITSA

24. ITSA agrees with those recommendations relevant to its investment responsibilities pursuant to the *Bankruptcy Act 1966*. ITSA notes that it is not a commercially oriented agency and therefore has invested 'surplus public money' conservatively and in accordance with the Bankruptcy Act. ITSA has commenced adoption of appropriate strategies to implement an investment strategy, application of credit risk management policies and, wherever possible, maximisation of investment returns.

ANSTO

25. ANSTO has always endeavoured to maximise the return on investments. The actions taken to increase competitiveness and to update policies and their implementation, will improve those returns and reduce risks.

SBS

26. SBS agrees with the ANAO's overall conclusions that all public entities require strategies and procedures that balance compliance with the investment parameters provided by Parliament and optimises returns for given levels of risks.

27. SBS has always strived in its investments to ensure that legislation requirements are met and the returns are optimised within an appropriate level of risk. It was pleasing to be rated better practice in regards to maximising investment returns.

Recommendations

Recommendation No.1 Para 2.13

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

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

b) conducting an open competitive tender and signing formal contracts for the provision of investment advice and custodial services; and

c) wherever possible, obtaining more than one quote for each proposed investment, and/or comparing quotes to published market rates.

All responding entities agreed, with one agreeing in principle.

Recommendation No.2 Para 2.25

ANAO *recommends* that entities investing public funds document, and regularly review, an investment strategy and approach.

All responding entities agreed, with one agreeing in principle.

Recommendation No.3 Par 2.35

ANAO *recommends* that entities investing public funds manage the risk of counterparty default on their investments by preparing, documenting and implementing credit risk management policies and procedures.

All responding entities agreed, with one agreeing in principle.

Recommendation No.4 Para 2.49

ANAO *recommends* that entities investing public funds:

a) implement procedures that, wherever practicable, maximise competitive processes in the selection of individual investments; and

b) where open and effective competition is not possible, assure themselves that returns are being maximised by comparing the terms of proposed investments to published market rates.

All responding entities agreed, with two agreeing in principle.

Recommendation No.5 Para 2.55

ANAO *recommends* that reporting of interest rate exposures be improved by the Department of Finance and Administration providing guidance to entities on the preferred approach to calculating and reporting weighted average interest rates.

All responding entities agreed, with two agreeing in principle.

Recommendation No.6 Para 3.24

ANAO *recommends* that the Department of the Treasury prepare and maintain a comprehensive and accurate record of all investment approvals provided by the Treasurer, and their current status.

All responding entities agreed, with one agreeing in principle.

Recommendation No.7 Para 3.70

ANAO *recommends* that compliance with legislated restrictions on investing activities be promoted by:

a) Chief Executives/directors ensuring that adequate priority and resources are allocated to achieve compliance with statutory requirements;

b) entities that invest public funds, integrating compliance with legislative restrictions on investing activities with their governance structures and risk management strategies; and

c) where necessary, relevant central agencies issuing guidance to investing entities to explain the legislative framework for investing public funds.

All responding entities agreed, with one agreeing in principle.

Audit Findings and Conclusions

1. Introduction

This chapter outlines the background to the audit and explains the audit approach.

Background

1.1 As at 30 June 2004, Commonwealth entities reported financial investments of some $20.208 billion (see Figure 1.1).[13] The FMA Act and the CAC Act provide the general legislative framework for the investment activities of Commonwealth agencies and most Commonwealth authorities. For some entities, however, their enabling legislation is the source of authority for their investing activities.

Figure 1.1

Commonwealth entities investment activities as at 30 June 2004

Investing power		Number of entities investing	Investment Balance ($m)
FMA Act [A]	Finance Minister's delegation	7 [B]	1,647 [C]
	Treasurer's delegation for the management of Commonwealth debt	1	14,850
CAC Act [D]		51	2,388
Other legislation [E]		12	1,323
TOTAL		**71**	**20,208**

Notes

[A] See Appendix 2 for details.

[B] This figure only includes entities with reported investment holdings.

[C] Of this amount, some $1.52 billion (92 per cent) is contained in the two ATSIC Special Accounts, namely the Land Fund and the Aboriginal Benefits Account.

[D] See Appendix 3 for details.

[E] See Appendix 4 for details.

Source: ANAO analysis of entity financial data and reporting

Financial framework legislation

1.2 The Department of Finance and Administration (Finance) is responsible for developing and maintaining the financial framework for the

[13] This audit focused on financial investments. Consequently, this amount does not include the Commonwealth's shareholder interest in Commonwealth authorities and companies or joint ventures. The audit scope also did not include the monetary policy investments of the Reserve Bank of Australia.

Commonwealth public sector.[14] As at September 2004, that framework covered 85 agencies that were subject to the FMA Act, and 107 entities that were subject to the CAC Act.[15]

1.3 Section 39 of the FMA Act addresses the investment of public money[16] by Commonwealth agencies. Under Section 39, the Finance Minister is provided with a general power to invest public money in any authorised investment. This investment power can be exercised specifically in relation to amounts credited to Special Accounts[17], or in relation to the Consolidated Revenue Fund (CRF) as a whole. Section 39 also provides that the Treasurer may invest public money in authorised investments for debt management purposes.

1.4 Under the FMA Act[18], the Finance Minister and the Treasurer can delegate their investment powers to officials.[19] The Finance Minister has delegated his investment power to 11 Chief Executives in respect to the balances of 12 Special Accounts.[20] In terms of debt management investments, the Treasurer has delegated his investment power to officials of the Australian Office of Financial Management (AOFM). Section 53 of the FMA Act enables agency Chief Executives to delegate their functions and powers under the Act to an official in any agency. This includes delegated investment powers.

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14 *Portfolio Budget Statements 2003–04: Finance and Administration Portfolio*, Budget Related Paper No. 1.9, p. 35.

15 At the time of this audit, an additional three entities, although not Commonwealth authorities for the purposes of the CAC Act, were subject to certain CAC Act provisions, including Section 18, namely the Australian National Training Authority, NEPC Service Corporation, and National Transport Commission.

16 Section 5 of the FMA Act defines public money as:

(a) money in the custody or under the control of the Commonwealth; or

(b) money in the custody or under the control of any person acting for or on behalf of the Commonwealth in respect of the custody or control of the money; and

including such money that is held on trust for, or otherwise for the benefit of, a person other than the Commonwealth.

17 A Special Account is a mechanism used to record amounts in the CRF that are set aside for specified purposes. See ANAO Audit Report No.24 2003–04, *Agency Management of Special Accounts*, Canberra, 30 January 2004.

18 Sections 62 and 62A respectively.

19 In this context, the Office of the Australian Government Solicitor (AGS) advised Finance in June 2002 that any person (including employees or officers or an outsourced investment services provider) who performs a task involving the commitment or spending of public money, or the management and control of public money, is an official for the purposes of the FMA Act.

20 The number of Special Accounts over which a Section 39 delegation has been made was significantly reduced in October 2003, following a review by Finance.

1.5 The CAC Act applies to Commonwealth authorities and companies.[21] Sections 18 and 19 of the CAC Act provide for surplus funds to be invested: on deposit with a bank; or in securities of the Commonwealth or State or Territory; or in securities guaranteed by the Commonwealth, a State or Territory[22]. Section 18 also provides the authority for CAC bodies to invest in any other manner as approved by the Treasurer. In comparison, Section 19 provides the authority for Government Business Enterprises (GBEs) and Statutory Marketing Authorities (SMAs) to invest surplus funds in any other manner that is consistent with sound commercial practice.[23] This audit focused on the operation of Section 18, as the ANAO has limited powers to undertake performance audits of GBEs[24] and there is, at present, only one SMA.[25] Like private sector companies, the investment activities of Commonwealth companies are governed by their constitutional documents and corporations legislation (Commonwealth companies were not included in the audit).

Other legislative authority

1.6 The investment activities of some Commonwealth entities are governed by provisions made in other legislation specific to the activity or entity concerned. As at September 2004, nine Acts other than the FMA and CAC Acts provided investment powers to Commonwealth entities. These are outlined in Appendix 4.

Audit approach

1.7 The objective of the audit was to examine the investment of public funds by selected entities, including:

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[21] Prior to the commencement of the CAC Act, the accountability requirements for Commonwealth authorities and companies were dispersed through numerous enabling Acts, company memorandum and articles. The CAC Act aimed to draw these together, and provide a core set of reporting and accountability requirements, including banking and investment activities. Source: Joint Committee of Public Accounts, *Report 33*1, *An Advisory Report on the Financial Management and Accountability Bill 1994, the Commonwealth Authorities and Companies Bill 1994 and the Auditor-General Bill 1994, and on a Proposal to Establish an Audit Committee of* Parliament, September 1994, paras 3.5 and 3.6.

[22] Surplus money is defined in the CAC Act as being 'money of the authority that is not immediately required for the purposes of the authority.'

[23] Although they are neither GBEs nor SMAs, the enabling legislation for the Export Finance and Insurance Corporation and the Australian Industry Development Corporation provides these corporations power to invest under Section 19 of the CAC Act, rather than Section 18 (see Section 11 of *Export Finance and Insurance Corporation Act 1991* and Section 26 of the *Australian Industry Development Corporation Act 1970).*The Wheat Export Authority also had the power to invest under Section 19 of the CAC Act, until its enabling legislation (specifically, Section 11 of the *Wheat Marketing Act 1989)* was amended, on 23 July 2003, to refer to Section 18 of the CAC Act.

[24] Unless requested by the Finance Minister, the responsible Minister, or by the Joint Committee of Public Accounts and Audit, ANAO cannot conduct a performance audit of a GBE.

[25] The Australian Wine and Brandy Corporation is the only authority currently prescribed as an SMA under Regulation 5 of the *Commonwealth Authorities and Companies Regulations 1997*.

- compliance with relevant legislation, delegations and instructions;
- the value for money of investment strategies; and
- reporting of investment activities.

1.8 The entities selected for inclusion in the audit held aggregate investments with a market value of $1.64 billion as at 30 June 2004. The purchase price of these investments was $1.55 billion. They had realised investment earnings of some $80.4 million during 2003–04. Figure 1.2 outlines the six entities that were audited in detail and the total amount paid to acquire investments held at 30 June 2004.

Figure 1.2

Audited entities' investments as at 30 June 2004: Cost of acquisition

Entity	Purchase price for investments ($m)
Audited entities investing under the authority of the FMA Act	
▪ Aboriginal and Torres Strait Islander Commission (ATSIC)–Land Fund Special Account (Land Fund)[26]	1332.1
▪ Department of Veterans' Affairs–Defence Service Homes Insurance Scheme (DSHIS) Special Account	53.0
Audited entities investing under the authority of the CAC Act	
▪ Australian Nuclear Science and Technology Organisation (ANSTO)	55.7
▪ National Museum of Australia (NMA)	26.7
▪ Special Broadcasting Service Corporation (SBS)	63.7
Audited entities investing under the authority of legislation other than the FMA and CAC Acts	
▪ Insolvency and Trustee Service Australia (ITSA)–Common Investment Fund (Common Fund)	15.5
Total amount paid to acquire investments	**1546.7**

Source: ANAO analysis of entity financial data and reporting

1.9 In addition to the entities selected for their investment activities, Finance and Treasury were included in the audit because of their responsibilities associated with the FMA Act and the CAC Act. As a result of the non-compliance with legislative restrictions on authorised investment instruments initially detected in the three audited entities investing under the

[26] Since 1 July 2003, the Aboriginal Torres Strait Islander Service (ATSIS) has been responsible for the day-to-day activities associated with the Land Fund. The Land Fund remained the responsibility of ATSIC.

authority of the CAC Act, ANAO also undertook a desk audit of other Commonwealth statutory authorities' investment activities, relying on financial statement disclosures.

1.10 Audit fieldwork was conducted between March 2004 and June 2004. In June and July 2004, Issues Papers were provided to the five entities audited in detail, where issues relating to compliance with the legislative framework had been identified. Subsequent fieldwork was undertaken between July and September 2004. Issues were also raised and resolved with some entities as part of the finalisation of the ANAO audit of their 2003–04 financial statements.

1.11 A Discussion Paper was provided to relevant entities in October 2004. ANAO also offered exit interviews to all entities that were provided with a copy of the Discussion Paper. Of the six entities audited in detail, both ATSIC and DVA chose not to have an exit interview to discuss the issues raised in the Paper. ATSIC also advised the ANAO that it had no written comments to make on the Discussion Paper.

1.12 The audit methodology included the appointment of Applied Financial Diagnostics to assist ANAO in assessing individual agencies' overall approach to investment of public funds. The consultant also developed a system to enable ANAO to compare the risk-adjusted investment performance of the audited agencies. The consultant was selected following a competitive tender.

1.13 The audit was conducted in accordance with ANAO auditing standards and cost the ANAO approximately $370 000.

2. Governance and Reporting

This chapter examines the investment strategies of the selected entities and related controls and procedures. It also examines reporting associated with the entities' investment activities.

Investment strategies

ATSIC—Land Fund

2.1 The *Land Fund and Indigenous Land Corporation (ATSIC Amendment) Act 1995* amended the *Aboriginal and Torres Strait Islander Commission Act 1989* (ATSIC Act) to establish the Aboriginal and Torres Strait Islander Land Fund Special Account (Land Fund)[27] and the Indigenous Land Corporation (ILC).[28] The purpose of the Land Fund is to provide a secure and ongoing source of funds to the ILC to provide economic, environmental, social and cultural benefits for Aboriginal people and Torres Strait Islanders, by assisting in the acquisition and management of an Indigenous land base.[29]

2.2 The legislation provided for the Land Fund to be built up to become a self-sustaining capital fund by 30 June 2004.[30] For the period 1995–96 to 2003–04, a Special Appropriation under Section 193 of the ATSIC Act provided for amounts to be credited to the Land Fund[31]. If, as at 30 June 2004, the actual balance of the Fund (calculated in the manner specified by the Act) were less than the 30 June 2004 target balance (also calculated in the manner specified by the Act)[32], the Act provided a Special Appropriation to bring the actual balance up to the target amount.

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27 The *Aboriginal and Torres Strait Islander Commission Amendment Bill 2004*, if passed by the Parliament, will implement the Government's decision to abolish the Aboriginal and Torres Strait Islander Commission. It will not abolish the Land Fund Special Account; affect the related Special Appropriations; nor change the legislated investment framework. Finance advised the ANAO in November 2004 that the Land Fund and Aboriginal Benefits Special Accounts, related Special Appropriations, and the legislated investment framework, will be administered by the Department of Immigration and Multicultural and Indigenous Affairs.

28 The ILC is a statutory authority with responsibility for the acquisition and management of newly acquired Indigenous land and for existing Indigenous held land in all States and Territories.

29 Aboriginal and Torres Strait Islander Commission (ATSIC), *Annual Report 2002–03*, p. 325.

30 ibid.

31 For the period 1995–96 to 2003–04, Section 193(1) of the ATSIC Act provides for a payment of $121 million (indexed to 1994 values) to be appropriated, on the first business day of each financial year, to the Fund. The annual payments were to be indexed in accordance with the methodology specified in Section 193D of the Act.

32 The target amount of the Fund (as defined by sub-sections 193AA(2) and (3) of the ATSIC Act) was indexed on an annual basis, using the same factor (the Indexation Factor) as that used for the annual Special Appropriation payment into the Fund.

2.3 Approximately 63 per cent of the amounts credited to the Land Fund has been invested, under Section 39 of the FMA Act, in order to build its capital base up to the target level. The remaining 37 per cent is paid to the ILC for its statutory land acquisition and management responsibilities, and associated costs.[33]

2.4 The ATSIC Act[34] requires a Consultative Forum on investment policy of the Land Fund to be convened by the Minister for Immigration and Multicultural and Indigenous Affairs. This Forum is to meet at least twice each financial year for the purpose of discussing the investment policy of the Land Fund.[35]

2.5 Due to concerns raised by the Consultative Forum regarding the ability of the Land Fund to achieve the 30 June 2004 target balance, quotations were sought from three firms for the provision of a business plan for the Land Fund and to provide further assistance in promoting the business plan to the Finance Minister. A firm of international investment consultants was initially contracted by ATSIC in December 1995 to meet this requirement. Since 1995, the same firm has been contracted, without competitive tender, to provide ongoing half-yearly performance reviews and assist in the formulation of annual investment strategies and other advice. Total fees paid since 1995 have amounted to some $655 200.[36] In relation to this arrangement, ANAO found as follows.

- ATSIC records state that the arrangement was intended to be an ongoing consultancy. However, the 1995 contract stated that the consultancy was to be completed by the end of December 1995. No contract extension, or option, was included in the contract. Also, ATSIC's records did not indicate that the same firm would be appointed for at least the first 10 years of the Land Fund. Furthermore, the ongoing consultancies were for the provision of strategic reviews, reinvestment program advice, and investment reporting, for the Land

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33 op.cit., *Annual Report 2002–03*.

34 Section 193G.

35 At the time of audit, the Consultative Forum consisted of two Indigenous Land Corporation Directors and the Chief Finance Officer of ATSIC (who had sub-delegated investment powers under Section 39 of the FMA Act for the purposes of investing the Land Fund).

36 ATSIC's website notes that the Senate Order for Departmental and Agency Contracts, as amended, requires Commonwealth agencies subject to the FMA Act to publish details of certain contracts, assessable via their website homepage. The website reports the following.

> No contracts have been entered into with any other party by ATSIC in relation to the Land Fund or the ABA. Any contracts in relation to these accounts were executed under the provisions of the CAC Act. It follows that there are no contracts reportable by ATSIC.

While the contract is between ATSIC and the consultant, the Land Fund pays the contracted fees. These costs are reported in both the 2002–03 and 2003–04 Land Fund financial statements.

Fund, rather than a business plan as required under the original 1995 contract.

- Subsequent contracts refer to a proposal and quotation dated 20 June 1997, submitted by the consultant, that outlines the work to be performed.[37] Proposals were not sought from other possible providers. The quotation involved an annual fee of 0.01% of the value of the Fund as at the start of each year of the contract. It also noted that the fee would be reviewed every year with some reduction in the rate as the size of the Fund increased. However, the fee rate has not been reduced, despite the Fund's value increasing from $396 million in 1997 to $1.29 billion[38] as of June 2003.

2.6 The long-term investment strategy for the Land Fund has been revised on a number of occasions. The stated strategy at the time of ANAO's audit work included the following features:

- An investment objective of reaching the 30 June 2004 target balance.
- Management of risk was to be achieved through diversification and the application of strict investment policies. The best returns possible are to be sought given the particular level of risk. To this end, government, or bank, securities with an overall credit rating of no less than 'A-' are to be included in the portfolio in order to obtain possible capital gains over the longer term.
- There are no limits on investments in Commonwealth and semi-government bonds or semi-government promissory notes. However, bank issued subordinated debt and other bank issued securities were subject to a limit of between five and 20 per cent of the aggregate portfolio.

2.7 Separate to the firm engaged to provide investment advice, most of ATSIC's Land Fund investments are undertaken with the assistance of the institutional banking division of a large Australian bank. This institution undertakes three distinct tasks for the Land Fund, as follows.

- the provision of investment advice;
- the purchase and sale of securities and provision of cash accounts; and
- custodial services with respect to securities.

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[37] Up until, and including, 2001, ATSIC signed a contract each year with the investment consultants. In late 2002, a contract for a two year period was signed.

[38] As noted earlier, from 1995–96 until 2003–04, the Fund was appropriated $121 million (indexed to 1994 values) on the first business day of each financial year. The Fund's value also increased as a result of investment earnings throughout the year.

2.8 In the seven years this arrangement has been in place, ATSIC has never tendered any of these roles. In addition, competitive quotes from other possible providers have not been obtained by ATSIC during this period. Nor has ATSIC signed a contract with the institution concerned. There is also an absence of performance benchmarks and no transparent cost structure on the margins being charged on investment transactions.[39]

2.9 Expert advice obtained by ANAO during the course of this audit was that combining all three functions in the one institution reduces transparency. In addition, there is no independent benchmark against which to verify the prices and rates being offered[40]. The approach taken for the Land Fund also increases the risk of unidentified errors occurring.

Achievement of the target balance

2.10 On 30 September 2004, based on advice from Finance, the Finance Minister formed the view that value of the Land Fund as at 30 June 2004 was $1.34 billion.[41] This amount was marginally greater than the target amount of $1.33 billion. As a result, no top-up payment was necessary.

2.11 In this context, the Land Fund achieved its investment objective for the first 10 years. This was the result of a number of factors, not least of which was the fall in interest rates that occurred over the 10-year period. As a significant number of the Land Fund's investments involved fixed coupon securities, falling interest rates significantly increased the market value of the investments, thereby increasing the 30 June 2004 value of the Land Fund.

2.12 Although the Land Fund achieved its target balance, investing procedures do not provide assurance that returns were maximised for the level of risk taken. In this context, in the absence of competitive quotes being obtained by ATSIC at the time of investing, ANAO attempted to benchmark the pricing obtained by ATSIC on a sample of investment transactions. However, more than half of investments sampled were insufficiently liquid to

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[39] The *Commonwealth Procurement Guidelines* (CPGs) establish the core procurement policy framework and articulate the expectations placed upon all departments and agencies subject to the FMA Act and their officials, when performing duties in relation to procurement. The principle of value for money underpins the framework and often entails a competitive procurement process with logical, clearly articulated, comprehensive and relevant evaluation criteria which in turn enables the proper identification, assessment and comparison of the costs and benefits of all potential suppliers on a fair and common basis over the whole procurement cycle. Source: *Commonwealth Procurement Guidelines*, July 2004, para 1.2 and 4.3.

[40] While the 20 June 1997 Proposal and Quotation provided the requirement for the investment consultant to monitor the prices at which securities were purchased and sold, and generally provide input to ATSIC on the effectiveness with which the bank carried out its assignment, there was no evidence that ATSIC actually obtained such advice.

[41] This comprised $673,004,061 in book value of fixed-interest investments and $668,858,957 in market value of investments other than fixed-interest investments.

have published prices that ANAO could use for comparative purposes.[42] For those investments where analysis was possible, Applied Financial Diagnostics advised ANAO that, on the debt instruments, the margins appeared reasonable. However, ANAO was also advised that the margin being charged on bank bill investments appeared higher than would usually be expected for transactions with the Australian Government (see paragraphs 2.42 to 2.44 and Figure 2.1 for more information).

Recommendation No.1

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

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

(b) conducting an open competitive tender and signing formal contracts for the provision of investment advice and custodial services; and

(c) wherever possible, obtaining more than one quote for each proposed investment, and/or comparing quotes to published market rates.

Agency responses

2.14 Agreed: ATSIC, Australian Broadcasting Corporation (ABC) and Department of Industry, Tourism and Resources (DITR).

2.15 Agreed in principle: Australian National Maritime Museum (ANMM).

2.16 Some respondents also made comments on the recommendation, as follows:

- ATSIC commented as follows:

  ATSIC agrees that ideally there should be a segregation of roles between the investment adviser and the security custodian. However, the report seems to infer that ATSIC was non-compliant with the Commonwealth Procurement Guidelines. However, these guidelines relate to agencies subject to the FMA Act. ATSIC is a body subject to the CAC Act and as such the Procurement Guidelines are not applicable.

  For the future, it is recognised that these arrangements will need to be reviewed as part of the transition of the Land Fund to the Department of Immigration and Multicultural and Indigenous Affairs (DIMIA), as DIMIA's arrangements are under the FMA Act.

[42] There are also inherent limitations in attempting to undertake this type of analysis after a substantial period of time elapsed since the transactions occurred.

- DIMIA commented as follows:

  Currently, responsibility for the administration of the Land Fund rests with ATSIS and under Section 193 of the ATSIC Act, investment performance and management is performed in conjunction with the Consultative Forum. DIMIA will be performing its own due diligence checks on the management of the Land Fund in anticipation of the passing of the ATSIC Amendment Bill. Any issues that come out of the due diligence checks will be discussed with the Consultative Forum at that stage.

  DIMIA notes that the Land Fund is currently managed by a CAC Act body. Any changes to the governance framework associated with the transfer of the Land Fund to an FMA Act Department will be addressed as part of the due diligence review.

ANAO comment

2.17 Under Regulation 5 of the FMA Regulations, ATSIC is an FMA Agency in regard to public money that it holds. The amounts standing to the credit of the Land Fund are public money (see Figure 1.2). Accordingly, ANAO's understanding is that the Commonwealth Procurement Guidelines (CPGs) applied to ATSIC in respect to its administration of the Land Fund. In addition, the *Finance Minister's (CAC Act Procurement) Directions 2004* require relevant CAC Act bodies, from 1 January 2005, to have regard to the new CPGs when procuring property or services and to comply with the mandatory procurement procedures in all circumstances for covered procurements.

DVA—DSHIS

2.18 The DSHIS is a self-funding scheme that operates through a Special Account established by Section 40 of the *Defence Service Homes Act 1918* (DSH Act). DSHIS provides building insurance to eligible veterans and their dependants, as well as, contents insurance through an agency arrangement.

2.19 In addition to an official operating account held with the Reserve Bank of Australia, the DSHIS had two forms of investment activity, as follows:

- a call account that involves the acquisition of an interest in certificates of deposit issued. DSHIS aims to keep a working balance of some $2 million in this account ($1.5 million as at 30 June 2004); and
- a managed money market trust with a market value of some $56.64 million as at 30 June 2004.

2.20 Day-to-day cash requirements for meeting claims and other expenses for the DSHIS are generally met from cash (premiums) flowing into the operating account. Withdrawals from the call account are made on occasions where the balance of the operating account is insufficient to meet expenses. If

the operating account shows a surplus to requirements, a deposit is made into the call account.

2.21 The current investment strategy was developed in 1995. At this time, the investment portfolio was valued at $22 million. While the value of funds invested has increased significantly, the investment strategy has not been revisited or updated in the last nine years.

Entities investing surplus funds

2.22 Section 18(3) of the CAC Act permits Commonwealth authorities to invest 'surplus money'. In this context, Section 18(5) of the CAC Act provides that 'surplus money' means 'money of the authority that is not immediately required for the purposes of the authority'. Each of the three CAC Act entities audited in detail was investing surplus funds, as follows.

- The NMA has accumulated surplus funds in relation to funding for depreciation and employee provisions.
- ANSTO has accumulated a surplus in operational cash levels, due primarily to setting aside reserves associated with the delivery of the replacement nuclear reactor at Lucas Heights.
- SBS invests surplus funds from two sources, as follows:
  - As part of the social bonus associated with the second sale of Telstra shares, SBS was provided in April 2000 with $70 million to meet the costs of extending analogue transmission services to certain areas of Australia.[43] Funds that are not immediately required for payment in relation to the provision of these services have been invested.[44]
  - SBS also has operational funding that is surplus to its immediate needs.

2.23 In addition to the three audited CAC Act entities, ITSA, which is governed by the FMA Act, invests available trust moneys. These trust moneys are held in the Common Fund established under Section 20B of the *Bankruptcy Act 1966*. All moneys received from bankruptcies administered by the Official Trustee under the Bankruptcy Act are held in the Common Fund.[45] The

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[43] Analogue transmission services were to be extended to areas of Australia with a population of over 10,000 that did not receive the signal.

[44] Contracts have been let for a 12-year period for the provision of these services. The contracts included the required capital work and an ongoing service fee. The cash-flow requirements associated with these contracts are known, except for annual CPI increases that are to be calculated as specified in the contracts.

[45] Interest earned from the investment of money in the Common Fund is paid to the Commonwealth. Source: ITSA *Annual Report 2002–03*, 8 October 2003, p. 30.

Bankruptcy Act requires that funds in the Common Fund not immediately required for the purposes of the Act be invested.

2.24 In terms of the investment strategies for the four audited entities that were investing funds that are not immediately required, ANAO found the following:

- In relation to SBS's analogue extension funds, an investment strategy was developed and subsequently agreed to by the SBS Board in August 2000.[46] This strategy was updated in December 2002, with the approval of the SBS Audit and Finance Committee.[47] At the time of audit, no documented investment strategy existed for other SBS investments. SBS advised ANAO, in November 2004, that it would document a strategy which reflects the practices that have been long established in SBS for investments.
- The NMA's Audit and Finance Committee endorsed an investment policy and procedures in 2001. The policy outlines the key investment principles governing the NMA's investment activities.
- ITSA's Chief Executive Instruction 4: 'Care, Custody and Management of Public Money' documents the control structures surrounding its banking and investment activities. ITSA advised ANAO in November that the CEI itself outlines ITSA's general investment strategy and the investment approach to be used. However, ANAO found that this instruction, whilst outlining the overall context of ITSA's investment activities and detailed controls, did not sufficiently explain ITSA's investment strategy.
- ANSTO has a Policy and Procedures Manual that includes a section addressing Treasury Management. This document includes procedures to minimise treasury risks (credit risk, interest rate risk, and liquidity risk). However, it does not include an investment strategy.

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[46] The Minutes of the August 2000 SBS Board meeting reflected that decisions would need to be made in the future on whether to keep the investment duration short (for the balance) or to fix the sum at any later stage. The Board was advised that parameters had been established as risk management triggers when such decisions had to be made. Board minutes also noted that reports on investment activities were to be made to the Audit and Finance Committee, which is a sub-committee of the SBS Board.

[47] The Committee decided that it would be prudent to obtain quotations to fix the balance of funds to meet ongoing commitments up to 2012 (excluding the CPI increases) and thereby limit future risk from interest rate movements. It was considered that the downside risk of the existing short term investment approach was too great in light of SBS's main priority of ensuring it could meet its obligations as they fell due. Any residual funds were to be used as a buffer against the annual CPI increases associated with the contract milestone payments by investing them in short term instruments (negotiable certificates of deposit).

Recommendation No.2

2.25 ANAO *recommends* that entities investing public funds document, and regularly review, an investment strategy and approach.

Agency responses

2.26 Agreed: ABC, Australian Fisheries Management Authority (AFMA), ANSTO, Australian Prudential Regulation Authority (APRA), Australian Pesticides and Veterinary Medicines Authority (APVMA), ATSIC, Civil Aviation Safety Authority (CASA), Australian Customs Service (Customs), Department of Agriculture, Fisheries and Forestry (DAFF), DCITA, DITR, DVA, Finance, Grains Research and Development Corporation (GRDC), ITSA, NMA, SBS.

2.27 Agreed in principle: ANMM.

2.28 Some respondents also made comments on the recommendation, as follows:

- ANSTO commented that its investment strategy has been reviewed and documented.
- ATSIC commented that this was already being undertaken as part of the ATSIC Act Consultative Forum arrangements.
- The NMA stated that the investment strategy for the NMA was endorsed in 2001 and is continually reviewed.
- SBS commented that, as noted in the audit report it has a long established strategy and approach to investing its funds. The major investments for SBS are in relation to its analogue funds and the strategies for these investments are extensively documented. The same strategies are followed for its smaller investments and this will be formally documented to reflect the current practices.
- CASA commented that it has reviewed its investment strategy since gaining the Treasurer's approval on 16 July 2004 to invest in a wider range of products. The strategy will be documented and endorsed as a Policy Notice forming part of CASA's internal governance arrangements, to be reviewed annually.

Credit risk

2.29 Credit risk is the risk that a counterparty may default on its obligations leading to a financial loss for the Commonwealth.[48] Credit risk also includes the rating of a counterparty and the potential for loss on an investment in an instrument where the counterparty's rating is downgraded. The Commonwealth is exposed to credit risk when it invests public funds.[49]

2.30 ANAO recognises that, for many entities, legislated restrictions on the nature of their authorised investments reduces their exposure to credit risk. Nevertheless, even where entities invest in deposits with an authorised deposit-taking institution such as a regulated bank, credit risk remains. This is because Australia does not have any deposit guarantee arrangements.[50] Instead, the *Banking Act 1959* provides that the assets of a bank shall be available to meet deposit liabilities prior to all other liabilities of the bank.[51] Finance advised ANAO in December 2004 that, consistent with international requirements, prudential regulation in Australia also requires deposit-taking institutions to keep a minimum level of capital calculated on factors such as risk-weighted assets and off-balance sheet business. In other words, banks are required to hold a minimum amount of capital against the risk of loss associated with their business operations.

2.31 In this context, it is important that investing entities develop credit risk management policies and procedures that effectively address both the probability, and economic consequences, of counterparty default or downgrading. Such policies are particularly important for entities with significant investment portfolios. For example, ATSIC's management of the Land Fund, as an FMA Act agency, involves an investment portfolio of more than $1.4 billion.

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[48] ANAO Audit Report No.14 1999–2000, *Commonwealth Debt Management*, Canberra, 12 October 1999, p. 46.

[49] The Grape and Wine Research and Development Corporation advised ANAO in December 2004 that:

Research and Development Corporations, such as themselves, exist under both the CAC Act and the *Primary Industry and Energy Research and Development Act 1989* and, as such, represent corporate structures for both the Australian Government and industry. In this partnership, the Australian Government contribution is only provided for contracted project payments. Because of this feature, only money provided by industry as levies is available for financial investments, further diminishing the risk to the Australian Government. This comment is made to provide supplementary information, not to diminish or alter the Corporation's obligations for management and compliance.

[50] Financial System Inquiry, *Final Report*, March 1997, p. 354.

[51] In May 2004, the Government released a Discussion Paper seeking input to assist it make an in-principle decision on whether to implement a financial system guarantee scheme and, if so, to determine appropriate design parameters. Source: The Treasury, *Government Discussion Paper on Financial System Guarantees*, May 2004, p. iv.

2.32 Also in this context, ANAO has previously identified that the AOFM's approach to managing credit risk reflects good practice.[52] In particular, the AOFM's Credit Risk Policy provides that AOFM may only undertake transactions with counterparties that have a high credit rating. In addition, counterparty credit limits are assigned for those parties that meet the minimum standard. The counterparty credit limits are scaled according to the counterparty's credit rating; the more highly rated the counterparty, the larger is the credit limit.

2.33 Of the six audited entities, ANAO found that ATSIC and NMA had addressed credit risk in their overarching policy and procedures documents. Each had given explicit consideration to the credit ratings of institutions with which they will invest. ATSIC and NMA also have documented counterparty credit limits. However, while NMA has complied with its credit risk policy, ATSIC has not. In particular, the stated policy for the Land Fund is to invest in securities that have a credit rating of A- or higher, whereas the fund included a number of BBB and BBB+ rated investments. As of 30 June 2004, there were investments totalling $28.7 million (market value) that had a credit rating of BBB or BBB+.

2.34 In terms of the other entities audited in detail, ANAO found as follows:

- SBS does not have any overarching policies or procedures addressing credit risk for investments. However, issues relating to credit concentration were addressed when SBS tendered in 2000 for providers of annuity investments. Similarly, in developing an investment strategy for surplus funds relating to the analogue extension project, SBS stated its desire to optimise returns within acceptable risk parameters. SBS advised ANAO in November 2004 that it follows long established credit risk practices in determining all its investments. Further, a formal policy will be prepared to document these long established procedures.
- ANSTO's Treasury Management Policy and Procedures includes a section on credit risk. However, this relates to the supply of goods and services to customers. The only mention made of credit risk for investments is a requirement that 90 day bank bills must bear an AAA rating[53] and be endorsed by a bank.
- DVA does not have any current credit risk policy and procedures in relation to its DSHIS investments. However, the current investment strategy (developed in 1995) proposed an investment approach that

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[52] ANAO Audit Report No.14 1999–2000, op. cit., p. 95.

[53] This rating actually relates to long-term investments rather than short-term securities such as 90 day bank bills.

was to minimise risk and ensure adequate liquidity while seeking to maximise returns. With a concentration in low risk investments, it was considered that the advantages of diversification across fund managers would be less important than obtaining quality advice and service from a manager responsible for the whole portfolio.

- While ITSA's investment approach has resulted in low credit risk, credit risk and its management are not specifically addressed in ITSA's Chief Executive Instructions.

Recommendation No.3

2.35 ANAO *recommends* that entities investing public funds manage the risk of counterparty default on their investments by preparing, documenting and implementing credit risk management policies and procedures.

Agency responses

2.36 Agreed: ABC, AFMA, ANSTO, APVMA, ATSIC, CASA, Customs, DAFF, DITR, DVA, Finance, GRDC, ITSA, NMA, SBS.

2.37 Agreed in principle: ANMM.

2.38 Some respondents also made comments on the recommendation, as follows:

- ANSTO commented that credit risk management is now included in ANSTO's policy manual and was already implemented.
- ATSIC commented that it complies with these arrangements.[54]
- Finance commented that the policies and procedures should have regard for the nature and scale of the type of investments allowed. In this context, Finance notes that FMA Act agencies are limited to low risk investments.
- The NMA stated that credit risk and counterparty credit limits form part of its investment strategy.
- SBS commented that, as in Recommendation No.2, the credit risk policy for SBS was determined when determining its investment strategy for the major investment activity relating to the analogue fund investments. This policy is followed for all investments and SBS agrees to formally document its long established procedures to encompass all investment activity.

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[54] However, as outlined in paragraph 2.33, ANAO found that, while ATSIC has documented counterparty credit ratings, it has not consistently complied with them.

- CASA commented that in the recent review of its investment strategy, CASA has considered credit risk and this will be documented in the final policy.
- DCITA notes that the legislated restrictions on the types of investments limits investments to very low risk securities of or guaranteed by governments or deposits with banks. In this context, there appears to be minimal need for extensive risk management policies.

Maximising returns

2.39 There are a number of different approaches that entities can adopt to maximise investment returns, for a given level of risk. These include the following:

- quotes can be sought from a number of institutions;
- in selecting a provider of investment and other financial services, entities can include as part of the selection process explicit consideration of rates and margins that will be offered on products; and/or
- entities can compare quoted rates with published market rates.

2.40 ANAO found significant variability in the approach adopted by the audited entities in making individual investments. Better practice was observed in two entities, as follows:

- The NMA obtains quotes for interest rates on two nominated products from up to seven financial institutions. This informs its decision on the type and duration of its investment activity.
- SBS also sought competitive quotes in relation to its fixed term annuity investments. For other investments, SBS validates the quotes against published market figures.

2.41 The procedures of a third entity, ANSTO, require it to check the interest rates being offered by the major banks for short-term and fixed term deposits. However, ANAO found that ANSTO was not implementing this procedure. Instead, ANSTO deals only with its transactional banker. ANSTO was not taking any steps to assure itself that the quoted rate was competitive or whether different investment periods may have offered improved returns. In response to the issues raised by the ANAO, ANSTO advised, in November 2004, that it had implemented, from 1 July 2004, the comparison of the interest rate offered by its institutional banker with published market rates.

2.42 In terms of the Land Fund and ITSA[55], procedures to maximise returns for individual investments are not in place. This is reflected in ANAO's analysis of the returns being achieved by each entity. In particular, ANAO undertook an assessment of entities' short-term investments against the Bank Bill Swap Rate (BBSW)[56] as a benchmark.[57] DSHIS was not included in this analysis, as it primarily invests in a managed money market trust.

2.43 Figure 2.1 illustrates that only the two entities with procedures in place to obtain competitive quotes had achieved average returns above the BBSW benchmark.[58] Both entities had consistently invested in instruments providing interest rates higher than the market average, represented by the BBSW. The remaining three agencies had obtained interest rates lower than the market average.

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[55] ITSA does obtain a quotation from its transactional banker for three periods but does not compare these rates to an independent source prior to investing.

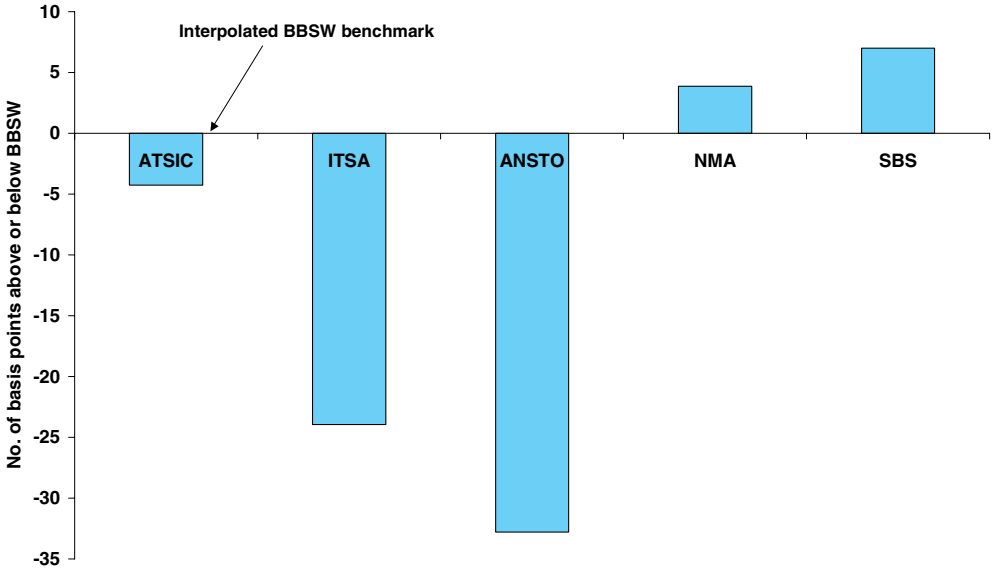
[56] The BBSW is an adjusted average of a range of bank bill rates at a specific time each day. BBSW's are published by most authorised deposit-taking institutions in respect to bank bills with maturities of one, two, three, four, five, six, nine and 12 months. An average of these rates, published by the Australian Financial Markets Association, can be used as an indicator that an entity has obtained a consistently higher, or lower, rate of return than the market over time.

[57] As entities often purchase securities with maturity dates greater or less than the maturities associated with the BBSW, ANAO used linear interpolation in order to compare the interest rate obtained by the audited entities, versus the interpolated BBSW rate. Investments less than 30 days were not included in the analysis, nor were those greater than 150 days.

[58] Financial advice provided to the ANAO indicates that entities should be able to purchase bank bills at a margin to BBSW of 1 to 2 basis points to allow the selling bank a bid/offer spread.

Figure 2.1

Average performance above or below interpolated BBSW over the 2000–01 to 2003–04 Financial Years



Source: ANAO analysis of entity and other data.
Note to figure: There are 100 basis points in 1 per cent.

2.44 ANAO has estimated that the interest foregone during the period from 2000–01 to 2003–04 by the three entities obtaining rates of return lower than the BBSW was just over $428 000.

DVA—DSHIS

2.45 DSHIS, as an insurance provider, requires ready access to funds to meet insurance claims and related expenses. Accordingly, the investment strategy for the DSHIS was based on the need to minimise risk and provide adequate liquidity while seeking to maximise returns.

2.46 The 1995 investment strategy included a decision to purchase units in a managed money market trust. Previously, investments had been made directly in long-term bonds, bank bills and at call accounts. The stated reason for this changed investment strategy was that DSHIS National Office staff had limited time to monitor the markets and be fully involved in the management of the portfolio.

2.47 In relation to the investment returns of the DSHIS, ANAO found that, in recent times, the interest rate being paid on the operating account with the

Reserve Bank had been greater than the call account held with a financial institution. At the time of audit, no steps had been taken within DVA to assess, in this context, the continuing merits of maintaining a call account separate to the operating account. In November 2004, DVA advised that it had reviewed the need for continuing to operate the call account and has concluded that it is no longer required. DVA advised it is currently in the process of closing this account.

2.48 In terms of the managed money market trust, where the significant majority of the DSHIS funds are invested, there has been limited action on DVA's part to assess the ongoing performance of this investment. While the fund manager provides monthly reports, there was no evidence of DVA examining these reports in order to inform the apparently implicit decision to continue to invest with the trust. In this context, ANAO noted the following:

- The trust allows next day access to funds. However, the most DVA has required at any one time in the past two years has been $2 million. This ready access, when funds are not so readily required, may be adversely impacting on the potential rate of return that could be paid to DVA for the amount of funds invested.
- As of 31 August 2004, the return since the inception of the trust in 1998 was reported as 5.15 per cent. This is below the benchmark of 5.25 per cent.
- Between 2001–02 and 2003–04, fees of some $325 680 were paid to the fund manager. DVA records did not enable ANAO to identify the fees paid prior to 2001–02.[59]

[59] Based on the amounts invested and the documented fees agreed with DVA, ANAO estimated that fees exceeding $1 million had been paid to the fund manager since the investment commenced in 1995. (This is almost double what the Land Fund has paid its professional investment adviser for a fund 23 times larger).

Recommendation No.4

2.49 ANAO *recommends* that entities investing public funds:

(a) implement procedures that, wherever practicable, maximise competitive processes in the selection of individual investments; and

(b) where open and effective competition is not possible, assure themselves that returns are being maximised by comparing the terms of proposed investments to published market rates.

Agency responses

2.50 Agreed: ABC, AFMA, ANSTO, APRA, APVMA, ATSIC, CASA, DAFF, DCITA, DIMIA, DVA, Finance, GRDC, DITR, ITSA, NMA, SBS.

2.51 Agreed in principle: ANMM and Customs.

2.52 Some respondents also made comments on the recommendation, as follows:

- ANSTO commented that it has implemented the recommendation from 1 July 2004. Interest rates offered by its transactional banker are now compared with published market rates to ensure competitiveness. The bank has been advised of this policy and has responded positively.
- ATSIC commented that this is already being done as part of the ATSIC Act Consultative Forum arrangements.[60]
- The NMA commented that a number of quotes are received for each investment decision made.
- SBS commented that its current procedures reflect this recommendation and SBS was rated as better practice by the ANAO in this area.
- DIMIA commented that when responsibility of the Land Fund passes to DIMIA, it will be seeking to ensure that returns are maximised.
- CASA commented that, in the past, it adopted a policy similar to that identified in the better practice entities, by seeking quotes from between four and six institutions before investing funds. The current review of investment strategy endorsed this practice, but will further propose that quotes are evaluated on a risk-adjusted basis.

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[60] However, as outlined in paragraphs 2.8, 2.9 and 2.42 and Figure 2.1, ANAO found that ATSIC's current approach does not maximise returns. In addition, it is important to recognise that the Consultative Forum's role is to discuss the investment strategy of the Land Fund, not to select individual investments. It is the ATSIC Chief Executive, not the Consultative Forum, that has the Finance Minister's delegation to purchase authorised investments.

- DCITA agreed but in the environment of limited investment options.
- ILC commented that it retains an independent investment adviser that provides quarterly reports of the performance of the ILC fund managers and investments against set benchmarks and the market.
- Customs commented that it may not be feasible, however, to regularly vary investments during the course of the investment as a result of short-term returns. The most appropriate approach is considered as part of the risk versus return versus liquidity requirements of the fund at the time of investment.

Reporting interest rate exposures

2.53 Commonwealth entities are required to report information about their exposure to interest rate risk. This includes, where applicable, effective interest rates or the weighted average effective interest rate.[61] Interest rate information is required to be disclosed as it affects the amount, timing and certainty of an entity's future cash flows relating to financial instruments. While there is the requirement to report such interest rates, neither the applicable Australian Accounting Standard nor the Finance Minister's Orders[62] provide explicit guidance on how these rates should be calculated.[63]

2.54 ANAO examined the reporting undertaken by five of the six audited entities. (There is no requirement for ITSA to report the weighted average interest rate regarding invested trust moneys). ANAO found significant variations in the approach taken to calculating and reporting interest rate exposures (see Figure 2.2). Particularly significant was that some entities reported a weighted average rate of return, although they had not actually calculated a weighted average, as follows.

- The figure reported by ANSTO as the weighted average (prior to 2003–04) was actually the rate of return prevailing on current investments as at 30 June. ANSTO volume weighted its interest rate calculation for 2003–04.

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61 AAS33 and AASB1033: *Presentation and Disclosure of Financial Instruments,* Interest rate risk exposures 5.4(b).

62 Department of Finance and Administration Accounting Policy Branch, *Finance Minister's Orders 2003–2004 onwards: Requirements and Guidance for the preparation of Financial Statements*.

63 AAS33 and AASB1033 are to be replaced with effect 1 January 2005 with AASB132, *Financial Instruments: Disclosure and Presentation*. An additional standard, AASB139 *Financial Instruments: Recognition and Measurement,* also commences on 1 January 2005. ANAO analysis of these new standards found no information on how to calculate weighted averages for disclosure purposes.

- DVA calculated its reported rate for the DSHIS using the amount of interest received during the year over a straight arithmetic average balance of its investments. As such, there is no weighted average.

Figure 2.2

Weighted average interest rate calculation methodologies: 2000–01 to 2003–04

Entity	Volume-weighted?	Time-weighted?	Timing of figures used?
ATSIC–Land Fund	Yes	No	As at 30 June
DVA–DSHIS	No	No	Whole financial year
ANSTO[64]	No	No	As at 30 June
NMA	No	Yes	Whole financial year
SBS	Yes	No	As at 30 June

Source: ANAO analysis of entity financial data and reporting

Recommendation No.5

2.55 ANAO *recommends* that reporting of interest rate exposures be improved by the Department of Finance and Administration providing guidance to entities on the preferred approach to calculating and reporting weighted average interest rates.

Agency responses

2.56 Agreed: ABC, AFMA, APVMA, CASA, Customs, DAFF, DCITA, DVA, GRDC, DITR, NMA, SBS.

2.57 Agreed in principle: ANMM and Finance.

2.58 Some respondents also made comments on the recommendation, as follows:

- Finance considered that the Accounting Standard on the presentation and disclosure of financial instruments clearly sets out the disclosure requirements in regard to interest rate exposure and considers that the issue lies more with agency compliance. However, Finance is consulting with the ANAO with the view to clarifying ANAO's understanding of the Standard. If discussions with the ANAO resolve that further clarification of the disclosure requirement is necessary, that clarification will be provided through the *Finance Minister's Orders (Financial Reporting)*.

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[64] ANSTO has volume weighted its interest rate calculation from financial year 2003–04 but not for 2000–2001 to 2002–2003.

- The NMA commented that guidance on the preferred approach to calculating and reporting the rate of interest returns would assist agencies in delivering consistent reporting on investment performance.
- SBS commented that it currently meets all legislative and accounting standards requirements for the reporting of its weighted average of its investments. The current reporting of investment returns under the accounting standards is considered appropriate.
- CASA commented that any guidance that leads to standardisation of reporting investing returns amongst entities is to be welcomed.
- Customs commented that guidelines such as those proposed would be beneficial for investments.

Investment risk

2.59 The ANAO considers that there is a significant disadvantage in the use of weighted average rates of return, as it does not take investment risk into account. As a general principle, the riskier the investment, the higher the interest rate.[65] If risk is not disclosed and/or taken into account in the calculation of investment returns, entities may be biased towards investing in riskier assets. ANAO considers that there is advantage in agencies using mechanisms to manage the risk associated with their investment portfolios. However, none of the entities examined as part of this audit had established risk-weighted performance measures for their portfolios, or reported risk-weighted returns either internally or as part of their external accountability documents.

2.60 In this context, Applied Financial Diagnostics prepared a portfolio return system to enable ANAO to compare the risk-adjusted investment performance of the six audited agencies. The system calculated the weighted average[66] of portfolio returns on all invested funds for the period between each cash flow. Returns were adjusted for the amount of any credit risk spread.[67] This resulted in reported portfolio returns that were adjusted back to the risk-free benchmark[68] for all investments. The results are shown in Figure 2.3.

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65 Interest rates are also affected by other factors, such as the amounts invested, and the time to maturity of the investment. Entities with more money to invest may therefore expect to achieve better average rates than entities investing less.

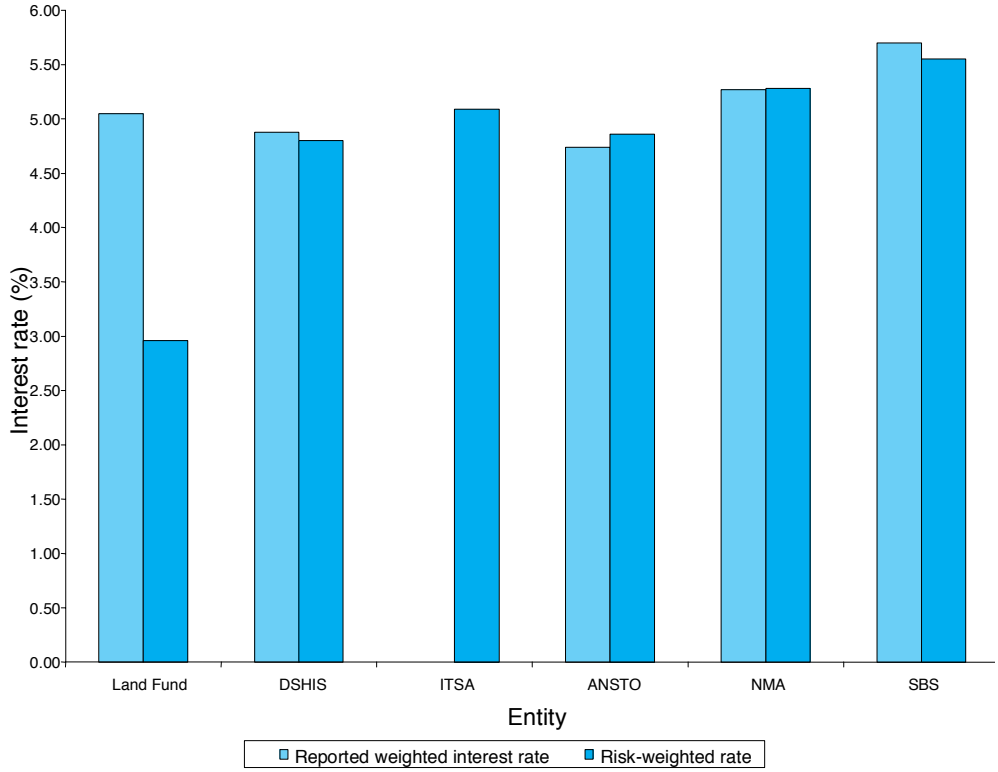
66 The weighting used is the ratio of the relevant cash flow period to the total investment period.

67 Credit 'spreads' are the difference in yield (effective rate of interest) between investments of different credit quality.

68 Commonwealth Government bonds are the risk-free benchmark.

Figure 2.3

Audited entities' risk-adjusted returns: 2003–04



Source: ANAO analysis of entity financial data and reporting
Note to figure: No reported weighted interest rate is included for ITSA as investment returns on trust money are not required to be externally reported.

2.61 In this context Finance advised the ANAO, in November 2004, that it does not support the introduction of risk-weighted performance measures in the public sector. Finance is of the view that the use of risk-weighted performance measures should be sensitive to the materiality of the entity's investments and the costs and risks involved.

2.62 However, ANAO notes that, should entities wish to include risk-weighted performance measures as part of their internal governance structures, ANAO's contract arrangements enable it to make available the model developed for the purposes of this audit.

3. Legislative Framework

The chapter outlines the legislative framework governing Commonwealth entities' investment activities within the scope of this audit, and examines entity compliance with the legislative requirements.

Authorised investments

3.1 The types of investments that Commonwealth entities are authorised to acquire are identified in the legislation governing their investing activities.

Entities subject to FMA and CAC Acts

3.2 The FMA and CAC Acts (together with the *Auditor-General Act 1997)* replaced the *Audit Act 1901* (Audit Act) with effect from 1 January 1998. During the development of those Acts, the Parliament re-assessed the types of investments it considered appropriate for the different nature of Commonwealth entities. It was concluded that, with the exception of GBEs and SMAs, entities should be required to invest public funds conservatively.[69] Indeed, the FMA Act does not allow some forms of investment previously permitted under the Audit Act. However, this change was not universally recognised by agencies that invest public money.[70]

3.3 Figure 3.1 summarises the types of investments authorised under the FMA Act and Section 18 of the CAC Act.

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[69] The September 1994 Joint Committee of Public Accounts report accepted that GBEs and SMAs should be at arms length from day-to-day government oversight. The Committee also concluded that: 'Commonwealth authorities that are not GBEs or SMAs are not so commercially orientated and should be required to invest surplus public money conservatively. This appears prudent, particularly in light of the recent poor investment records of some state public entities.' Source: JCPA Report No.331, op. cit., paragraph 3.107.

[70] For example, the Land Fund's investment activities commenced in 1995 when the Fund was established. Records show that ATSIC advised the Joint Committee of Native Title and Aboriginal Torres Strait Islander Land Fund that: '...there have been no practical administrative or investment implications arising from the legislative change that took effect on 1 January 1998'. Source: Joint Committee of Native Title and Aboriginal Torres Strait Islander Land Fund, Fourteenth Report: *Explanation of Annual Reports for 1997–98 in fulfilment of the Committee's duties pursuant to s.206(c) of the Native Title Act 1993,* paragraph 3.20.

Figure 3.1

Authorised investments under the FMA and CAC Acts[71]

Authorised investment	Applies to:
Section 39(10) of the FMA Act and Regulation 22 of the FMA Act (i) securities of the Commonwealth or of a State or Territory; (ii) securities guaranteed by the Commonwealth, a State or a Territory; (iii) a deposit with a bank, including a deposit evidenced by a certificate of deposit; (iv) a bill of exchange accepted or endorsed only by a bank; and (v) a professionally managed money market trust if the Finance Minister or the Treasurer is satisfied that: (i) the only investments managed by the trust are securities of, or guaranteed by, the Commonwealth, a State or a Territory; or a bill of exchange accepted or endorsed only by a bank; and (ii) a charge over trust assets does not support any borrowings by the trust.	Finance Minister or delegate
Section 18(3) of the CAC Act The authority may invest surplus money: (a) on deposit with a bank; or (b) in securities of the Commonwealth or of a State or Territory; or (c) in securities guaranteed by the Commonwealth, a State or a Territory; or (d) in any other manner approved by the Treasurer.[A] where *surplus money* means money of the authority that is not immediately required for the purposes of the authority.	a Commonwealth authority that is not a GBE or SMA
Note to figure: [A] Audit (Transitional and Miscellaneous) Regulation 32 states: An approval by the Treasurer under Section 63E (1) (c) of the Audit Act, or under a law relating to a Commonwealth authority that is not a GBE or SMA, and given before 1 January 1998, continues to have effect after 1 January 1998 as if it were an approval under Section 18(3)(d) of the CAC Act.	

Source: Extracts from the FMA Act and Regulations, and the CAC Act as at the time of audit

3.4 Figure 3.1 illustrates that the authorised investments for FMA Act agencies (to which investment powers have been delegated) is broader than those permitted for Commonwealth authorities subject to Section 18 of the CAC Act. However, as the figure also shows, individual CAC Act authorities are able to broaden the scope of investments available to them by obtaining the Treasurer's approval.

3.5 Rather than require approval from the Treasurer for additional manners as noted in Figure 3.1, Section 19 of the CAC Act allows GBEs and

[71] This figure excludes authorised investments only available to the Treasurer in the management of public debt.

SMAs to invest surplus money in any other manner that is consistent with sound commercial practice.

3.6 In its March 2000 review of the FMA and CAC Acts, the Joint Committee of Public Accounts and Audit (JCPAA) did not recommend any changes to the investment provisions of either Act. In addition, in response to a submission from one Commonwealth authority seeking greater investment flexibility, the JCPAA stated that it had not changed its view that authorities, which are not as commercially oriented as GBEs or SMAs, should be required to invest money conservatively.[72]

Other entities

3.7 Diversity exists in the types of investments that are permitted where entities invest under the authority of legislation other than the FMA Act and Section 18 of the CAC Act. As outlined in Appendix 4, many entities that invest under such legislation are subject to restrictions similar to those set out in Section 18 of the CAC Act. However, ANAO's examination of legislation also identified three instances where enabling legislation for Commonwealth authorities specifically exempts them from the investment restrictions of the CAC Act.[73] For those entities, such issues are left to the entities' own internal governance arrangements.

Capacity to expand authorised investments

3.8 The only way authorised investments can be expanded for FMA Act agencies is through legislative change or changes to the regulations made under the FMA Act (FMA Regulations). However, under subsection 18(3)(d) of the CAC Act, the Treasurer has the authority to approve CAC Act authorities (other than GBEs or SMAs) investing surplus moneys in a manner other than that specified in the Act. Such approvals could previously be provided under subsection 63E(1)(c) of the Audit Act as well as some entities' enabling legislation. There are still a number of instances where entities' enabling legislation provides the Treasurer with the power to approve investment activities not specifically provided for in their legislation.

3.9 In order to obtain the Treasurer's approval to invest in additional instruments, an entity is required to submit a business case to Treasury explaining why the approval is sought. In this context, Treasury advised ANAO in August 2004, as follows:

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[72] Joint Committee of Public Accounts and Audit, *Report 374*, *Review of the Financial Management and Accountability Act 1997 and the Commonwealth Authorities and Companies Act 1997*, AGPS, Canberra, 2000, paragraph 2.73.

[73] The relevant entities are: the Indigenous Land Corporation; the Australian National University; and the Coal Mining Industry (Long Service Leave Funding) Corporation.

The Treasury's responsibilities involve advising the Treasurer with respect to his power to approve investments by CAC bodies under Section 18(3)(d) of the Act. Consistent with the responsibilities of CAC Boards, Treasury does not monitor the investments made by CAC bodies nor undertake an audit function to ensure compliance with the Act itself.

Extent and nature of approvals

3.10 In September 2004, Treasury advised ANAO that it had reviewed its archives and collated a list of 40 valid approvals for 32 entities made by Treasury Ministers under the CAC Act, Audit Act, and a range of enabling legislation. However, ANAO found that this list was both inaccurate and incomplete, as follows.

- A total of 26 approvals were valid approvals for which Treasury held a copy of the relevant Treasurer approval.[74]
- In nine instances, Treasury did not hold a copy of the Treasurer approval, only correspondence referring to the approval. It is the approval itself that would need to be recorded on the Federal Register of Legislative Instruments.
- Eight of the 'approvals' were not valid investment approvals. Five related to the opening of bank accounts[75]; one was a borrowing approval; one related to correspondence from Treasury referring to an earlier approval; and one related to a request for approval but where no signatures were evident on either the approval documents or on correspondence addressed to the entity.
- An approval granted to the NMA in August 2004 was not included in the Treasury list. The list also did not include a 1991 approval granted to the Dairy Research and Development Corporation.

3.11 ANAO concluded that, at the time of audit fieldwork, Treasury did not have a comprehensive and accurate record of all current investment approvals provided by the Treasurer and his delegates for the purposes of investing

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[74] Treasury provided ANAO with National Library of Australia approval documentation on 11 October 2004. This document was not on Treasury files during fieldwork.

[75] Treasury listed approvals in 1994 for the Civil Aviation Authority (CAA) and the Civil Aviation Safety Authority (CASA) separately. However, CASA was established in 1995, replacing the CAA, and, as such, there could not have been approvals given to both entities in 1994.

public funds. ANAO found that documentation of such approvals was also not always readily available from the entities that originally sought the approval.[76]

3.12 ANAO considers that the absence of complete and accurate records regarding the investment approvals which have been provided over time is of concern for three reasons. Firstly, under Audit (Transitional and Miscellaneous) Regulation 32, all such approvals continue to have effect, including those provided prior to the commencement of the CAC Act on 1 January 1998.

3.13 Secondly, in July 2004, Treasury was advised by AGS that a subsection 18(3)(d) approval given in writing is a legislative instrument for the purposes of the *Legislative Instruments Act 2003*. This Act establishes a comprehensive regime for the registration, tabling, Parliamentary scrutiny and automatic repeal of legislative instruments.[77] To remain in effect, legislative instruments made before 1 January 2005 must be registered on the Federal Register of Legislative Instruments within the timeframes specified by the Act.[78]

3.14 Thirdly, the directors of CAC Act entities are accountable for the organisation's activities and safeguarding its assets, including maintaining proper records.

3.15 ANAO analysis of Treasury records also revealed a number of issues relating to the investment approvals that had been recommended to Treasury Ministers by the Department. In particular, in a number of cases, entities sought approval to invest in a specific instrument, but Treasury recommended to the Minister that approval be given to the entities to invest in a broader range of instruments. In regard to this issue, Treasury advised ANAO in September 2004 as follows:

> [*ANAO*] expressed concern about the approach taken by Treasury in the past to recommend approval of a broader range of instruments than what was requested by entities. We note that our approach reflected the view that entities should be given flexibility to invest in any of a range of products which were regarded by us as comparable to those historically approved by the Treasurer. This approach allowed the entities to adjust their investment

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[76] For example, in the course of the audit, ANAO identified that all of ANSTO's investments were held in instruments not allowed by the CAC Act without the Treasurer's approval. ANAO raised this issue with ANSTO in June 2004. The authority subsequently sought approval from the Treasurer to invest in those instruments, as it was not aware of an existing approval. In late July 2004, Treasury located a copy of a July 1994 Treasurer's approval for ANSTO to invest in the additional instruments, which had been given under subsection 27(4) of the ANSTO Act. ANSTO's lack of awareness of the existing approval was reflected in ANSTO's Policy and Procedural Manual as, at the time of ANAO's audit fieldwork, this Manual did not reflect the broader investment approval provided by the Treasurer in 1994.

[77] AGS, *Legal Briefing: Legislative Instruments Act 2003*, Number 69, 18 December 2003, p. 1.

[78] ibid, pp. 5–8.

portfolios to achieve appropriate returns without the administrative costs associated with seeking additional approvals.

3.16 Treasury's approach may have reduced the need for entities to possibly seek approval to use additional investment products should they have subsequently required it. However, by providing the approval for entities to invest in products such as debt securities and floating rate notes issued by an approved bank, Treasury has not limited investments to capital-secure products, even though this was the basis for the recommended approval. For example, the documentation for a number of floating rate note[79] investments, examined by ANAO as part of this audit, state that the notes are subject to investment risks that include the possible loss of the principal invested.

3.17 Other entities have been provided with approval to invest through an intermediary when they did not seek to adopt this approach. For example, Forest and Wood Products Research and Development Corporation (FWPRDC) sought approval in March of 1998 to invest directly in short term bank bills. ANAO found that Treasury advised the FWPRDC twice on the matter, one by facsimile dated 27 April 1998 and a letter dated 3 June 1998. The facsimile attached the 'standard' list of approved investments by authorities under the CAC Act with the message 'I anticipate the Treasurer will write to you shortly confirming this list of appropriate investments'. While the subsequent letter referred to the FWPRDC's request to invest in bank bills, it advised that approval had been provided for the FWPRDC to invest temporary surplus funds in any professionally managed money market trust.[80] Treasury advised the ANAO in September 2004 that:

> We have reviewed the documentation in question and formed the view that an error was made in the drafting of the letter to the Corporation. The Corporation has been advised that a strict reading of the approval does not allow it to acquire bank bills directly and the Corporation has undertaken to consider whether to re-apply for the approval to have the issue corrected.

3.18 ANAO also noted that approval was provided under subsection 18(3)(d) of the CAC Act for an entity to enter into financial derivatives through a professionally managed money market trust. Although, prior to recommending this approval, Treasury sought legal advice on the residual risk to the Commonwealth of these investments, it did not examine whether

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[79] Floating rate note is a generic term applied to physical debt instruments bearing an interest rate that is tied to an interest rate standard such as a Bank Bill Swap Rate or the London Inter-bank Offer Rate. They have diverse terms, conditions and issuers (including government and semi-government authorities, deposit-taking institutions and commercial enterprises). Source: Australian Prudential Regulation Authority, *Practice Notes—Liquidity Ratios: Inclusion of Floating Rate Notes*, Practice Note 01/98, 16 January 1998.

[80] Rather than seek approval from the Treasurer in accordance with the Corporation's request, the approval documentation provided to, and subsequently approved by, the Treasurer was only for the entity to invest in a professionally managed money market trust.

Section 18 of the CAC Act provides the necessary authority to approve use of financial derivatives. In this context, ANAO noted legal advice, provided to Finance by the Attorney-General's Department in November 1995, on a statutory authority's capacity to enter into financial derivative contracts was that:

> In the case of a statutory authority, if the enabling legislation specifically authorises the application of moneys for dealing in futures contracts or other forms of derivatives, then the situation is clear and those transactions which are authorised can be entered into for the purposes of the authority's functions.
>
> If the enabling legislation contains a general power of investment only and does not refer specifically to the power to enter into derivative transactions, our advice is that derivative financial transactions should be avoided as they could be held to be invalid.

3.19 In November 2004, Treasury advised ANAO that, in response to the above concern, it had obtained legal advice from AGS which 'indicates that the provision does allow the Treasurer to approve investment in this manner'. Specifically, the legal advice from AGS stated:

> In our view, the Treasurer may give approval for an authority to 'invest' surplus money using derivatives contracts as part of an investment strategy where the purpose of the strategy is to obtain a return on the authority's surplus money. We do not consider that the fact that the use of the derivatives may assist to manage/reduce the investment risk prevents the purpose from being one of 'investment'. In our view, the Treasurer could not under subsection 18(3) approve the use of surplus money in a derivative transaction where the sole purpose was as a form of insurance or risk minimisation and not as part of a larger investment strategy.
>
> It is a separate question whether or not a particular statutory authority would have the capacity to enter into a derivatives transaction for hedging purposes. Clearly, where the authority has the express power to do so, there can be no doubt. In other cases, a power to enter into such contracts may be held to come within the general power of a body to do all things necessary or convenient for the performance of its functions. For example, where a body has commercial functions, a power to enter into hedging contracts or other forms of derivatives may be more readily implied. Indeed, in some circumstances, a failure on the part of an authority to hedge against currency or interest rate fluctuations might be criticised as imprudent.

Transfer of approval responsibilities

3.20 The Financial Framework Legislation Amendment Bill 2004, presented to the Parliament in August 2004[81], proposed to amend a number of Acts,

[81] Subsequently represented to Parliament in December 2004.

including the CAC Act, to transfer from the Treasurer to the Finance Minister the power to approve certain types of investments of surplus money not otherwise permitted by legislation.[82]

3.21 One of the benefits expected to arise from the transfer of approval powers is that it will co-locate in one central portfolio the powers relating to the financial oversight of Commonwealth and other entities, particularly Budget-dependent entities.[83] However, ANAO notes that, in addition to the 25 Acts included in the Bill for amendment, there are a further three Acts that also currently provide the Treasurer with the power to approve additional types of investments. These are the *Pipeline Authority Act 1973*, the *Construction Industry Reform and Development Act 1992* and the *Native Title Act 1993* (Native Title Act).

3.22 The entities that were empowered to invest under the first two of these Acts are no longer in existence. However, investment activities continue to occur under the Native Title Act. Accordingly, ANAO considers that there would be merit in Finance seeking to have all relevant investment approval powers transferred to the Finance Minister.

3.23 In November 2004, Finance advised the ANAO that it was liaising with DIMIA regarding an amendment to the Native Title Act being included in a future bill to transfer the approval power from the Treasurer to the Finance Minister. Finance stated that consultation with Treasury will also be required.

Recommendation No.6

3.24 ANAO *recommends* that the Department of the Treasury prepare and maintain a comprehensive and accurate record of all investment approvals provided by the Treasurer, and their current status.

Agency responses

3.25 Agreed: Treasury, ABC, AFMA, CASA, DAFF, DITR, GRDC.

3.26 Agreed in principle: ANMM.

Legislative compliance

3.27 A fundamental requirement of a sound control environment is an effective system for monitoring compliance with legislative obligations, particularly those that govern financial management and accountability.[84]

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[82] The Bill also proposed to provide the Finance Minister with the power to delegate this function to officials.

[83] Explanatory Memorandum, *Financial Framework Legislation Amendment Bill 2004*, pp. 88–89.

[84] ANAO, *Better Practice Guide to Effective Control: Controlling Performance and Outcomes*, 1997, p. 46.

Achieving legislative compliance is dependent upon the development and implementation of policies and procedures that are consistent with relevant laws and regulations.[85]

3.28 Commonwealth entities are only authorised to invest public funds within the terms prescribed by the FMA Act, CAC Act or other relevant legislation. For FMA Act agencies, the terms of the Finance Minister's delegations have provided that delegates must ensure that investment activities are consistent with the requirements of Section 39 of that Act, including being limited to the authorised investments set out in subsection 39(10). In relation to the legal effect of Section 39, AGS advised ANAO, in July 2004, as follows:

> In the absence of Section 39, the Commonwealth (or a person acting on behalf of the Commonwealth) would have been able to invest money in exercise of the executive power of the Commonwealth, without the restrictions contained in Section 39. Although Section 39 does not explicitly abrogate the executive power in this respect, we consider that it evinces a clear intention that money should only be invested in accordance with that section. We do not therefore consider that the Commonwealth, or someone acting on behalf of the Commonwealth, has a power to invest outside the terms of Section 39 (or specific powers of investment contained in other legislation or some legislative instrument that can validly authorise the investment of public money[86]).

3.29 Unless their enabling legislation provides otherwise, Commonwealth authorities are permitted to invest any surplus money. However, in this context, AGS advised the ANAO in August 2004 that:

> It seems clear to us that Section 18 confers a limited power of investment on CAC Act authorities, and this power of investment exists in relation to surplus money only. If the money is surplus, it must be invested in accordance with Section 18. If the money is not surplus money, then the CAC Act authority may not invest it, because it has not been conferred with any power to do so.

3.30 Two of the six entities examined as part of this audit, DVA and ATSIC, were investing, using a Section 39 delegation from the Finance Minister. ITSA, an FMA Act agency, was investing under the provisions of the Bankruptcy Act. The remaining three entities were required to invest within the terms of the CAC Act. As part of this audit, ANAO assessed the level of compliance by the six audited entities with the relevant legislative restrictions on their permitted investments.

3.31 ANAO found that two of the FMA Act agencies (DVA and ATSIC) had purchased unauthorised investments. In relation to the three Commonwealth

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[85] ibid.

[86] 'For example, we think that a determination establishing a special account under s.20 of the FMA Act can allow amounts to be debited from the account for the purposes of investment' (AGS quotation).

authorities audited in detail, NMA was found to have purchased unauthorised investments. Due to differing interpretations of the relevant CAC Act provisions, there is uncertainty about whether the negotiable certificate of deposit (NCD)[87] investments of SBS were compliant or not. This issue is examined further later in this chapter. Table 3.2 summarises ANAO's assessment of compliance by the six entities audited in detail with legislative limitations on their authorised investments.

Table 3.2

Compliance of entities audited in detail as at 30 June 2004

Entity	Reported value of investments ($)[A]	Percentage compliant (%)	Percentage non-compliant (%)	Percentage unresolved (%)[B]
Subject to FMA Act				
ATSIC–Land Fund	1 417 836 351	65.72	29.31	4.97
DVA–DSHIS[C]	58 144 507	2.58	97.42	00.00
ITSA[D]	15 500 000	100.00	00.00	00.00
Sub total	**1 491 480 858**	**63.62**	**31.66**	**4.73**
Subject to CAC Act				
ANSTO	55 690 000	100.00[E]	00.00	00.00
NMA[F]	26 734 050	52.72	47.28	00.00
SBS	63 732 065	84.47	00.00	15.53
Sub total	**146 156 115**	**84.58**	**8.65**	**6.77**
OVERALL TOTAL	**1 637 636 973**	**65.49**	**29.61**	**4.91**

Notes:

[A] Value is the reported revaluation (or purchase price in the case of short term investments) of investment holdings. Investments include cash invested in 11am Call Accounts, which in some cases is reported separately as cash in the entities' financial statements.

[B] Unresolved due to insufficient data or clarification of status.

[C] As DSHIS holds units in a professionally managed money market trust, if any underlying investment of the trust is non-compliant, the total unit holdings are non-compliant.

[D] ITSA's investment holdings are included in its reported Common Investment Fund balance. The $15.5 million is calculated from ITSA's records.

[E] ANSTO's investments were initially assessed as being non-compliant with subsection 18(3) of the CAC Act as it was investing in bills of exchange without apparent approval from the Treasurer. A 1994 approval was later located by Treasury.

[F] NMA's investment policy, approved in February 2001 by its Audit and Finance Committee, permitted it to invest in a number of instruments including NCDs and bills of exchange, which are not permitted investments for authorities unless the entity has obtained the Treasurer's approval. In August 2004, NMA sought and was granted permission from the Treasurer to invest in certificates of deposit and bank bills.

Source: ANAO analysis of entity and supplementary information

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[87] An NCD is a short-term money market security issued by a bank at a discount to its face value (a discount security). The certificate is for a predetermined period, typically up to 180 days, and at a specified interest rate. Unlike term deposits, if cash is required, the certificate may be traded in the financial markets. The holder of the certificate is paid the face value at maturity date.

3.32 Initially all three CAC Act entities being audited were assessed as purchasing unauthorised investments.[88] In this context, to assess whether non-compliance with Section 18 of the CAC Act was, as the initial audit sample results had suggested, a widespread issue, ANAO undertook a desk audit of the 2002–03 published financial statements of all Commonwealth authorities' (other than GBEs and SMAs).[89]

3.33 Based on the investments reported in their financial statements, ANAO identified a further 13 CAC Act entities that appeared to be investing in instruments not permitted by Section 18 without the Treasurer's approval. Following discussions with Treasury, ANAO provided details of these 13 entities and their reported investments to the Department in July 2004. Shortly thereafter, Treasury contacted those entities for which it had no record of any Treasurer approval for the relevant investments. Treasury drew entities' attention to Section 18 of the CAC Act and advised them that, in the absence of an existing Treasurer approval, they would need to provide a business case to Treasury in order to obtain the Treasurer's approval.

3.34 The individual instances identified by ANAO, and the outcome of Treasury's investigations, are presented in Appendix 5. In addition, Table 3.3 provides details of all entities identified during the course of this audit as having purchased unauthorised investments, or where there are doubts about whether certain investments are authorised. Table 3.3 also provides details of these investments and information on corrective action, if any, taken by the relevant entities.

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[88] Following further audit work, it was revealed that ANSTO had a pre-existing approval from the Treasurer for its investing activities. Differing views exist on whether or not SBS's NCD investments comply with the CAC Act.

[89] These financial statements were the most current at the time of audit fieldwork and analysis and included 2001–02 comparators.

Table 3.3

ANAO compliance findings as at time of audit

Non-complying entities	Amount non-compliant ($)[A]	Non-compliant instruments held	Status as at November 2004
ATSIC–Land Fund	415,540,684	Floating rate notes, capital indexed bonds and nominal bonds.	Entity trading out of unauthorised investments
ATSIC–Aboriginal Benefits Account	at least 40,000,000	Floating rate notes and nominal bonds	Entity trading out of unauthorised investments
DVA–Defence Service Homes Insurance Scheme	56,644,000	Money market trust investing in certificates of deposit	Trust now compliant with FMA Regulation 22
National Museum of Australia	14,095,481	Negotiable certificates of deposit and bills of exchange	Approval sought and obtained from the Treasurer
Australian Film Commission	nil	Bills of exchange	Non-compliant instruments matured in 2002–03
Australian Institute of Family Studies	1,734,611	Bills of exchange	Entity currently invests in complying instruments
National Gallery of Australia	6,079,245	Bill of exchange and negotiable certificate of deposit	Entity currently invests in complying instruments
National Standards Commission	2,023,296	Bills of exchange and negotiable certificates of deposit	Entity ceased being a statutory authority on 30 June 2004
Australian Pesticides and Veterinary Medicines Authority	9,500,000	Floating rate notes	Approval sought and obtained from the Treasurer (see also para 3.65)
Civil Aviation Safety Authority	14,100,000	Bank bills and negotiable certificates of deposit	Approval sought and obtained from the Treasurer
Forest and Wood Products Research and Development Corporation	6,300,000	Bank bills	Investments have been converted to complying instruments (see also para 3.17)
Subtotal	**$566,017,317**		
Status unclear			
Indigenous Business Australia	5,013,111	Floating rate notes	Discussions underway with Finance (see also paras 3.66)
Special Broadcasting Services Corporation	9,896,604	Negotiable certificates of deposit	Discussions underway with Finance (see also para 3.65)
Subtotal	**$14,909,715**		

Notes to table

[A] For entities covered by the ANAO desk audit, figures are as at 30 June 2003.

Source: ANAO analysis of entity financial data and reporting

3.35 It needs to be recognised that the full extent of non-compliance cannot be identified from a desk audit process, because of the limitations in relying on financial statement reporting by entities of their investment holdings. Two contributing factors for that are:

- the Australian Accounting Standards enable entities to report short-term investments (less than three months) within their cash figures and there is no requirement for disaggregation of these investments[90]; and
- entities have mis-reported the nature of their investments. For example, both the NMA and ANSTO held bills of exchange and/or negotiable certificates of deposit, but had reported these holdings as term deposits and fixed term investments in their respective 2002–03 financial statements.

3.36 In this context, it cannot be concluded that the only Commonwealth authorities that have purchased unauthorised investments are those identified during the course of this audit. For this reason, when providing details of apparent non-compliance to Treasury in July 2004, ANAO advised the Department that relying on financial statement reporting of investment holdings would not identify all entities that may not be complying with Section 18 of the CAC Act. However, to date, Treasury has not taken any action to satisfy itself about the overall level of compliance with Section 18. Treasury considers that it would be inconsistent with CAC Boards' responsibilities for it to have an ongoing monitoring and compliance role.

Implications of non-compliance by FMA Act entities

3.37 Section 83 of the Constitution provides that money shall not be drawn from the Consolidated Revenue Fund (CRF) except under appropriation made by law. Accordingly, contravention of Section 83 occurs where money has been drawn from the Treasury for purposes not supported by a valid appropriation.

3.38 Section 48 of the FMA Act, together with Order 2.3 of the Finance Minister's Orders, require that the accounts and records of each agency properly record and explain the agency's transactions and financial position. Without limiting the generality of this obligation, agency Chief Executives are required to ensure that moneys are only expended for the purposes for which they are appropriated and that the limit on any appropriation is not exceeded.

3.39 Where investment is specified as one of the purposes of a Special Account, the FMA Act provides a Special Appropriation to allow the drawing

[90] Source: Finance advice to the ANAO in November 2004.

of money from the CRF for the purposes of the investment activities.[91] Alternatively, where investments are undertaken under the authority of a Section 39 delegation, subsection 39(9) of the FMA Act provides a Special Appropriation for the investment activity. In this respect, in relation to the two Special Accounts over which ATSIC holds a Section 39 delegation, ANAO has received the following legal advice:

> An investment of moneys properly standing to the credit of the [*Special Account*] in an investment that is not authorised by Section 39 will breach Section 83 of the Constitution because it is not supported by the appropriation in either Section 21(1) or Section 39(9) of the FMA Act.
>
> This in turn means that there will also have been a breach of Section 48 of the FMA Act which, through the Finance Ministers Orders, requires that a Chief Executive must ensure that the accounts and records of their Agency are such as to ensure that moneys are only expended for the purpose for which they are appropriated.

3.40 Section 48 of the FMA Act will also be breached where entities have not maintained proper records in respect to their investment activities, irrespective of whether or not the individual investments are in authorised instruments. In particular, ANAO was advised by AGS in July 2004 that, in order to meet their Section 48 obligations when investing, agency Chief Executives should ensure that:

- approvals of proposals to invest public money in particular investments were recorded in writing, as required by FMA Regulation 12, and that these records were retained;
- documentation detailing the nature and conditions of particular investments (such as information memoranda and term sheets) were obtained prior to the investment being made, and retained;
- documentation setting out the particular circumstances of investments made (such as security confirmations) were obtained and retained; and
- communications between the agency and the investment adviser or bank surrounding the circumstances of particular investments were recorded and these records retained.

3.41 ANAO found that both ATSIC and DVA had breached Section 83 of the Constitution and Section 48 of the FMA Act in relation to the purchase of unauthorised investments. Further breaches of Section 48 also existed in each

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[91] By definition, Commonwealth authorities are separate legal entities and hold money on their own account (Section 7 of the CAC Act). As a result, non-compliance with the investments authorised by Section 18 of the CAC Act does not raise appropriation issues as it does for FMA Act agencies.

entity due to deficiencies in the accounts and records held in respect to their investment transactions.

ATSIC—Land Fund

3.42 During the development of legislation to establish the Land Fund, submissions were made by the Northern Land Council, an international investment bank, and the then Leader of the Australian Democrats to the then Government, that higher returns could be earned if the Land Fund were not subject to the investment restrictions of the Audit Act or the then proposed FMA Act.[92] The then Government recognised that higher returns may well be available from investments that involved greater risk. However, the higher risk factor would endanger the flow of funds to the ILC and impact on its ability to regularly commit to land purchases and management.[93]

3.43 Accordingly, instead of providing the Land Fund with wider investment powers, the legislation presented to, and passed by, the Parliament addressed the possibility of reduced investment returns that may have resulted from the emphasis on investment security with the following measures:

- an extra $100 million was allocated to the capital of the Land Fund; and
- an additional clause was included in the legislation providing that the Land Fund would be topped-up at the end of the first 10 years if it did not reach the target balance.

3.44 Nevertheless, following concerns expressed by the Land Fund Consultative Forum about the inability of the Fund to achieve the target balance, ATSIC forwarded a submission to the Finance Minister in May 1996 raising concerns about the legislated restrictions on authorised investments.[94] After considering the concerns raised, Finance concluded that any adverse financial implications from the legislative restrictions had been significantly overstated.[95] Finance further concluded that there was no urgency for change and, unless the existing top-up provision was to be removed, offered little support for wider investment powers.[96]

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92 Senate, *Hansard*, 18 October 1994, *ATSIC Amendment (Indigenous Land Corporation and Land Fund) Bill 1994: Second Reading debate*, pp. 1929 and 1953.

93 ibid.

94 ATSIC, *Annual Report 1997–98*, 28 October 1998, p. 211, and ATSIC, *Annual Report 1998–99*, 15 October 1999, p. 225.

95 ibid.

96 ibid.

3.45 ATSIC has reported[97] that, as a result of this outcome, it developed investment strategies that have attempted to achieve the target balance whilst still working within the legislative constraints. However, ANAO found that insufficient attention was paid to legislative compliance in developing and implementing the Land Fund's investment strategies.

Investment strategies

3.46 In its 1998–99 Annual Report, ATSIC stated that, following Finance's advice that it would not support wider investment powers, a revised investment strategy was implemented in May 1999 with the stated intention of working within the constraints of the FMA Act.[98] However, the stated strategy included investments in bank issued subordinated debt[99], which is not an authorised investment under Section 39 of the FMA Act.

3.47 In addition, ANAO found that the Land Fund's current documented Risk Management Strategy also includes a number of securities that are not permitted by the FMA Act. In particular, the Risk Management Strategy states that bank issued bonds and bank issued floating rate notes (both senior and subordinated debt) are permissible investments, but the FMA Act does not permit their purchase.

Investing procedures

3.48 At the time of audit fieldwork, ATSIC's internal processes required approval from an authorised delegate for each investment. Each request for approval examined by ANAO was accompanied by supporting documentation explaining what was to be sold and/or purchased. As the trade usually arose from a written recommendation by ATSIC's external investment manager (the institutional banking area of a major bank), that documentation was also attached to the submission to the delegate.

3.49 In mid-2003, the external investment manager introduced a requirement for the FMA Act delegate to sign a transaction acknowledgement along with the authorisation to undertake each trade, which stated as follows:

> The Aboriginal and Torres Strait Islander Services confirms that:
>
> - This transaction is within the investment powers of the Aboriginal and Torres Strait Islander Land Fund Account as previously advised to [*the investment manager*].
> - The Aboriginal and Torres Strait Islander Services fully understands the nature of this investment and any risks associated with it, and has

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97 ibid.

98 ibid.

99 ibid.

received all the information necessary to make its investment decision in the light of its own needs and circumstances.

- The decision to enter into this transaction has been made by the Aboriginal and Torres Strait Islander Services in its sole and absolute discretion, and the Aboriginal and Torres Strait Islander Services has not received investment advice from [*the investment manager*] in connection with this transaction.

3.50 In this respect, AGS advised ANAO in July 2004 that:

> This appears to be an attempt by the bank to reduce the risk of liability in relation to investment of funds on behalf of an authority which has limited investment powers, and would appear to be a legitimate risk mitigation strategy from the perspective of the bank. We suggest that any agency responding to such a request should provide specific information about the types of investments which are permitted, and those investments which are not. We suggest that agencies that are involved in making investments on a regular basis should, regardless of any specific request, ensure that their investment advisers are properly and regularly briefed on what forms of investment are authorised under the FMA Act and Regulations.

3.51 ATSIC does not take these steps when investing. ANAO also found that ATSIC did not obtain and retain Information Memorandum and Final Term Sheets[100] relating to a number of Land Fund investments.

3.52 The failure to obtain and retain sufficient information to properly inform investment decisions, combined with the development of investment strategies that permitted the purchase of unauthorised investments, led to at least $415.5 million of the Land Fund's 30 June 2004 investments being non-compliant with Section 39 of the FMA Act. In addition, due to the absence of proper accounts and records in respect of many investments, there are doubts about the compliance of a further $70.5 million of Land Fund investments.

3.53 In June 2004, ATSIC agreed with the ANAO that there were a number of investments that were not authorised by the FMA Act. ATSIC further advised that:

> We are now very aware of this issue for future purchases and are in fact taking the opportunity to actively trade out of these existing holdings in the portfolio as the opportunity to take profits arise.

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[100] Information Memorandum and Final Term Sheets explain the terms and conditions of the securities to be purchased, including its legal status such as a deposit liability or subordinated debt. These documents also refer to additional information sources that form part of the terms and conditions of the security.

3.54 ATSIC's 2003–04 financial statements included disclosures that:

- the discrepancy in the calculation of amounts to be credited to the Land Fund[101] had resulted in excess appropriations being transferred to the Land Fund, within the CRF, and on-paid to the ILC or ATSIC in breach of the Land Fund's administering legislation, Section 83 of the Constitution, and Section 48 of the FMA Act; and
- the Land Fund holds unauthorised investments in breach of Section 39 of the FMA Act, which also resulted in a breach of Section 83 of the Constitution, and Section 48 of the FMA Act.

Aboriginal Benefits Account

3.55 In addition to the Land Fund, ATSIC is responsible for the management of another Special Account with an investment delegation, namely the Aboriginal Benefits Account. Accordingly, having regard to the findings in relation to the Land Fund, further performance audit work was undertaken contemporaneous with the 2003–04 financial statement audit of the Aboriginal Benefits Account. This work revealed that:

- of the $92 million in investments held by the Account as at 30 June 2004, more than $40 million was in instruments not authorised by Section 39 of the FMA Act, thereby breaching Section 83 of the Constitution; and
- similar to the Land Fund, insufficient records had been obtained and retained regarding the detail of investment activities, thereby breaching Section 48 of the FMA Act.

DVA—DSHIS

3.56 Significant non-compliance issues were identified in relation to DVA's investment in a professionally managed money market trust. FMA Regulation 22 stipulates that a professionally managed money market trust is an authorised investment, if the Finance Minister or the Treasurer (or his/her delegate) is satisfied that the only investments managed by the trust are in:

- securities of, or guaranteed by, the Commonwealth, a State or a Territory; or
- a bill of exchange accepted or endorsed only by a bank.

3.57 ANAO found that a significant proportion of the managed money market trust investments reported to DVA by the trust manager was not in accordance with those requirements. Instead, investments had been reportedly

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[101] ANAO Audit Report No.15 2004–05, *Financial Management of Special Appropriations*.

made in bank backed corporate securities and certificates of deposit. Corporate securities have never been permitted as either direct investments under Section 39 of the FMA Act or as indirect investments through a money market trust.[102] Despite provision, DVA had never queried the reported holdings, nor obtained the necessary records to satisfy itself as to the nature of the investments being made on its behalf by the trust. This latter shortcoming, represents a breach of Section 48 of the FMA Act.

3.58 Initially, FMA Regulation 22 allowed for a professionally managed money market trust to invest in deposits with a bank, including those evidenced by a certificate of deposit. Following amendment of the Regulation in July 1999, bank deposits were no longer an authorised investment for a trust. As the Explanatory Statement for the amendment provided no explanation for reducing the investment options for such trusts in this manner, ANAO raised the issue with Finance to determine whether the amendment may have been an anomaly. In August 2004, Finance advised ANAO that the amendment had unintentionally omitted bank deposits from Regulation 22, and that instructions had been issued to the Office of Legislative Drafting to amend the Regulation to reinsert bank deposits as a permitted investment for a professionally managed money market trust. In November 2004, Finance advised the ANAO that it will provide the ANAO with details of the revised Regulation 22, once it has been finalised. Finance advised the ANAO, in December 2004, that FMA Regulation 22 has been amended to include a reference to 'on deposit with a bank, including a deposit evidenced by a certificate of deposit'.

3.59 Whilst the removal from Regulation 22 of bank deposits as a permissible investment was unintended, had there been sound controls over DSHIS's investment activities, this error should have been identified by DVA soon after it occurred some five years ago. That it was not, evidences that DVA has not had proper procedures in place to monitor any changes in its legislated investment mandate, and take action accordingly.

3.60 In response to ANAO's findings, DVA has taken steps to rectify its existing non-compliance and reduce the likelihood of future non-compliance. In particular, DVA has obtained the agreement of the money market trust manager to:

- restructure the portfolio;
- provide the Department with a monthly security holding list along with the monthly DSHIS investment report; and

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[102] These investments were reported in monthly reports provided to DSHIS by the trust manager. ANAO analysis of the underlying instruments found that they were, in fact, transferable certificates of deposit.

- amend the trust's internal investment policy, and inform DSHIS formally before, rather than after, any variation to investment policy is made by the trust manager.

3.61 ANAO considers that these changes would assist in promoting future compliance by DVA with the requirements of the FMA Act and Regulations. However, ANAO considers that it would have been preferable for the requirements of the FMA Act and Regulations to have been reflected in a separate constitution document for the trust.

3.62 In regard to amending the constitution document for the managed money market trust, DVA advised ANAO in November 2004 that:

> DVA has pursued the option of amending the constitution document with [fund manager] and has concluded that it is not a viable option (given that [fund manager] has a constitution that covers a number of trusts) nor would it necessarily provide a guarantee of future compliance. On this basis, DVA has concluded that the implementation of processes including regular reporting and review will be adequate to mitigate the risk of future legislative non-compliance in relation to the investments.

Commonwealth authorities

3.63 The underlying purpose of the CAC Act was to replace the diverse accountability requirements of Commonwealth authorities and companies with a single set of core requirements.[103] In this context, to provide an effective control over investing activities, there needs to be a shared understanding of legislative restrictions between central agencies that administer the Commonwealth's financial framework and those entities that are investing public funds. Finance considers that this understanding must, however, be on the basis that the directors of the Commonwealth authorities retain clear responsibility for ensuring compliance with the CAC Act. In this regard, Finance noted that, where doubt exists, Commonwealth authorities could obtain clarity over compliance of investment choices through seeking an approval from the Treasurer under subsection 18(3)(d) of the CAC Act.

3.64 ANAO found that different views exist among Commonwealth authorities, and between some Commonwealth authorities and central agencies, of the term 'on deposit with a bank' (subsection 18(3)(a) of the CAC Act). This is particularly the case in relation to NCDs. Advice provided to ANAO by AGS in July 2004 was that, for Commonwealth authorities, 'on deposit with a bank' does not include NCDs. ANAO provided this advice to Finance, which commented in August 2004 as follows.

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[103] House of Representatives, *Hansard*, 12 December 1996, *Commonwealth Authorities and Companies Bill 1996: Second Reading Speech*, The Hon John Fahey MP, p. 8347.

> Finance has provided a couple of entities with its policy views regarding the requirements of subsection 39(10) of the FMA Act or subsection 18(3) of the CAC Act, but Finance has always suggested that these entities should seek legal advice to confirm that any intended investments are consistent with the relevant Act. On the few occasions over recent years that Finance has expressed these views, they have been consistent with the interpretations contained in your legal advice.

3.65 However, two CAC Act entities have been advised that the CAC Act permits them to purchase NCDs without the Treasurer's approval, as follows.

- In response to ANAO's concern that its NCD investments were non-compliant, SBS obtained a series of legal advices to the effect that the CAC Act should be interpreted to include NCDs as 'on deposit with a bank'. ANAO understands that SBS and Finance are discussing this issue.
- Similarly, APVMA advised ANAO in November 2004 that, until August 2004, it had understood the term 'on deposit with a bank' to include bank products such as NCDs and Floating Rate Notes. In support of the inclusion of NCDs, APVMA provided ANAO with a copy of financial advice it had obtained in preparing its investment strategy. It indicated that similar advice had been obtained, but was not documented, in relation to Floating Rate Notes. APVMA has advised ANAO that it is now seeking legal advice on the matter.

3.66 The audit process also revealed that Indigenous Business Australia (IBA) has been investing in Floating Rate Notes based on its interpretation of the term 'surplus funds', without a specific approval from the Treasurer under subsection 18(3)(d) of the CAC Act. This issue was raised by IBA in 1999 in response to Finance seeking comments from entities on the FMA Act and the CAC Act. Finance did not directly respond to IBA but specifically addressed the issue in its submission to the JCPAA in its 1999–2000 review of the FMA Act and CAC Act. In recent discussions between Finance and IBA, it has been agreed that IBA is best placed to obtain clarity over its ability to invest in Floating Rate Notes through seeking an approval from the Treasurer under subsection 18(3)(d) of the CAC Act.

3.67 In response to the Discussion Paper, the Australian Film Commission advised ANAO in November 2004 as follows:

> In the absence of any policy guidelines from central agencies such as DoFA [Finance] and Treasury on what constitutes 'on deposit with a bank', the interpretation was left to individual entities. Upon receipt of the policy guidance on what 'on deposit with a bank' encompasses, which was only provided to the ANAO by AGS in recent weeks, the AFC has ceased investing in bank bills and will be seeking the Treasurer's approval to invest in bank bills and NCDs in the future.

3.68 In this context, and having regard to the accepted instances of non-compliance identified by this audit, ANAO considers there is a role for relevant central agencies in promoting a shared understanding of limits in the financial framework legislation on Commonwealth entities' investment activities. On this issue Treasury commented to ANAO as follows in November 2004.

> Treasury is strongly of the view that compliance with Section 18 of the CAC Act lies firmly with the directors of CAC Boards and that the Treasury does not perform a compliance audit function.

3.69 With a view to assisting Commonwealth authorities in consistently interpreting CAC Act requirements, Finance advised ANAO that it will be initiating action to clarify the definition of 'on deposit with a bank' in relation to the issue of 'certificates of deposit', taking into account the legislative history on this issue. While this initiative will assist Commonwealth authorities with the issue of certificates of deposit, it will not assist authorities where they have invested in other investments, such as bank bills of exchange, which clearly do not fall within the class of assets allowed under subsections 18(3)(a) to (c) of the CAC Act.

Recommendation No.7

3.70 ANAO *recommends* that compliance with legislated restrictions on investing activities be promoted by:

(a) Chief Executives/directors ensuring that adequate priority and resources are allocated to achieve compliance with statutory requirements;

(b) entities that invest public funds, integrating compliance with legislative restrictions on investing activities with their governance structures and risk management strategies; and

(c) where necessary, relevant central agencies issuing guidance to investing entities to explain the legislative framework for investing public funds.

Agency responses

3.71 Agreed in full: ABC, AFMA, ANSTO, APVMA, CASA, Customs, DAFF, DCITA, DITR, DVA, Finance, GRDC, ITSA, NMA, SBS.

3.72 Agreed 7(a): APRA, DIMIA.

3.73 Agreed 7(b): APRA.

3.74 Agreed 7(c): Treasury, DIMIA.

3.75 Agreed in principle: ANMM.

3.76 Some respondents also made comments on the recommendation, as follows:

- Finance noted that the responsibility for compliance with statutory obligations lies with investing entities. Finance acknowledged that, where there is a lack of clarity associated with an element of the framework, central agencies can assist entities to understand the requirements by issuing guidance, where required.
- ANSTO commented that it has adequate resources to achieve compliance, and compliance processes are in place through governance and risk management strategies including improved reporting to governing bodies and management.
- The NMA commented that greater guidance on legislative restrictions with respect to investments may have prevented the misinterpretation of what constituted an eligible investment.
- SBS commented that it has integrated compliance with legislative requirements into its governance structure and risk management strategies. Further, it would welcome central agency issued guidance in respect to Government agencies investing funds. SBS hopes that such central agency issued guidance would not lead to a situation where authorities have less freedom than FMA Act agencies in selecting the type of investment they can make.
- DCITA supports the need for guidance to be provided on the legislative framework for investing public funds especially for those agencies whose investment activities are only incidental to their normal functions or who have only an ad hoc or short term need to invest. DCITA agrees that resources appropriate to the scale of investment activity and the potential impact on the Commonwealth's finances should be allocated to the investment activity. DCITA supports the concept that for relevant entities management of investment activity should be incorporated into entity governance structures such as detailed Chief Executive Instructions (CEIs) and/or procedures accompanying CEIs and subject to appropriate internal review.
- ATSIC commented that:

  The Land Fund's investment banker (a major Australian Bank) does not agree with the findings of the Report that certain of the investments held by the Land Fund are noncompliant debt investments. The bank considers that the correct interpretation of these investments is that they are a deposit with a bank and therefore comply with the legislative restrictions on investing activities. If this interpretation is correct, a significant proportion of these investment are not then in breach of either the FMA Act or the Constitution.

ATSIC and its investment banker are prepared to work with the ANAO to determine the appropriate classification of these investments.

There is obvious uncertainty surrounding whether certain investments (such as Floating Rate Notes) are authorised investments. Indeed it appears that some are while others are not. Against this background, the Consultative Forum established under the ATSIC Act was given the task of achieving a target balance in the Land Fund over a ten year period of $1.373B. This was achieved by the due date of 30 June 2004. All investments undertaken by ATSIC were with the major banks and while the ANAO report has found that they were unauthorised investments it is not the view of ATSIC that they were inappropriate investments.

Given the inherent uncertainty surrounding certain investments and considering that this is potentially an issue across government and therefore for reasons of efficiency of effort, ATSIC believes that there should be an additional recommendation as follows: "Finance should maintain a list of investment types the are compliant with the FMA Act and agencies should only invest in accordance with the Finance list."

- DIMIA commented that:

  While DIMIA broadly agrees with the recommendation, it has concerns about the wording of point (a). DIMIA understands that ATSIC and ATSIS did not intentionally purchase unauthorised investments. Floating Rate Notes were considered to be deposits with banks and therefore allowable investments under the Financial Management and Accountability Act. The difference between a deposit with a bank and a debt with a bank may not be readily apparent to all agencies. To have each agency interpreting legislation and the legalities of each class of investment in such a detailed way may not be the most efficient and effective use of government resources.

  DIMIA would therefore suggest that the recommendation be reworded to reflect this, for example: "Finance should maintain a list of investments that are compliant with the FMA Act and agencies should only invest in accordance with the Finance list".

ANAO Comment

3.77 ANAO does not agree with ATSIC's and DIMIA's suggestion that there is merit in Finance maintaining a list of compliant investments. Effective internal controls over investing activities requires that the governing documentation for each investment be obtained and examined by the investing entity to assess legislative compliance, prior to a decision being taken to invest public funds. It also needs to be emphasised that, as the delegation from the Finance Minister empowers delegates to purchase only authorised investments, it is the Section 39 delegate's responsibility to be satisfied that instruments being invested in are in accordance with the legislation and, if in doubt, seek guidance prior to investing. ANAO also considers it would be

impractical for Finance to develop and maintain a list of all compliant investments.

3.78 In terms of the compliance status of the Land Fund's investments, in June 2004, ANAO formally advised ATSIC that a detailed audit analysis of the investment portfolio as at 29 March 2004 had revealed that a significant number of unauthorised investments were held by the Land Fund. In June 2004, ATSIC advised ANAO that it agreed there were a number of unauthorised investments (see paragraph 3.53). In July 2004, ANAO provided ATSIC with an updated assessment, following the receipt of further documentation from ATSIC. At no time, between July 2004 and ATSIC's 17 December 2004 response to the draft ANAO report, did ATSIC seek to discuss the issue further with ANAO. Furthermore, in Note 13 and Note 24D of its 2003–04 Financial Statements, ATSIC acknowledged that the Land Fund holds investments that do not meet the definition of an authorised investment under Section 39 of the FMA Act.

Canberra ACT
18 January 2005

P. J. Barrett
Auditor-General

Appendices

Appendix 1: Responses to the audit

Albury-Wodonga Development Corporation

The Albury-Wodonga Development Corporation was provided with an update to the written guidelines by an officer of the Treasury in November 2003 in respect of the types of the investments that can be made.

As a consequence, the Corporation Board issued a new written policy to document a number of internal control procedures on investment activities and to formalise this list of authorised investments.

Whilst the investment of surplus funds is only a minor adjunct to the core business activities of the Corporation, it is recognised that the principles of sound corporate governance and risk management must be applied to this process as well.

Therefore I am pleased to advise that essentially the investment activities carried out by the Corporation already comply with the recommendations numbered 1 to 7, which are applicable to our activities.

Australian Broadcasting Corporation

We should note that the ABC is compliant in all regards and has had best practice procedures and policies in place for many years. The ABC agrees with each recommendation contained in the Audit Report and believes these are important developments that will support better practice in the management of public monies.

Australian Customs Service

Progress in implementing recommendations which impact on Customs will be reported, as usual, through the Audit Committee which the ANAO attends.

The audit of Investment of Public Funds has been beneficial and the opportunity to comment, both consultatively throughout the audit and with this draft reporting phase is appreciated.

Australian Fisheries Management Authority

We support your proposed recommendations as far as they are relevant to AFMA.

Australian National Maritime Museum

Although the Australian National Maritime Museum was not involved in the audit, I note the key findings and agree in principle with the seven recommendations as they are directed at all Commonwealth organisations.

Australian National University

The University believes that Recommendations listed are all consistent with sound investment management practices.

Australian Nuclear Science and Technology Organisation

In response to the ANAO letter (and report) ANSTO advised that its policy and procedures included treasury associated risks but did not have a statement on Investment Strategy. The policy document now includes an Investment Strategy.

As stated in your report, interest rates offered by our institutional banker are now compared with published market rates to ensure competitiveness. The bank has been advised of this policy and has responded positively.

Credit risk mentioned in our policy and procedures related primarily to supply of goods and services. Credit risk is now included in the policy document.

Australian Pesticides and Veterinary Medicines Authority

The APVMA notes and accepts the recommendations in the report that relate to its operations. It is noteworthy however that prior to the recent AGS opinion which now provides guidance on what bank products fall within the scope of the term 'on deposit with a bank' there were no official guidelines or policies issued by central agencies such as Treasury or Finance on the issue. The APVMA acted in accordance with its interpretation of the legislation at the time, and in the absence of guidelines and policy advice.

The APVMA's investment of funds complies with Section 18(3) of the CAC Act and the Treasurer's investment authority of 25 August 2004.

Australian Prudential Regulation Authority

We are permitted by Section 54 of the *Australian Prudential Regulation Authority Act 1998* to hold investments in accordance with Section 18 of the CAC Act. This in practice means that we invest surplus money on deposit with the Reserve Bank of Australia and in securities guaranteed by the Commonwealth and States of Australia.

You have recorded our investments at $1000 as at 30 June 2004. This represents the minimum balance that we would hold during the year having liquidated all investments pending the payment of new levies into the CRF and the drawdown by APRA after the Treasurer's determination for funding Australian Securities and Investments Commission and the Australian Taxation Office has been met. We may therefore achieve much higher balances of cash during the year typically in the range of $15 to $50 million. This is

invested according to our policy on the investment of surplus funds set by the prior Board.

Australian Sports Commission

While the ASC was not involved in the audit, we welcome the opportunity to review the draft extracts prior to their tabling in Parliament. We offer no additional comments on the substance of the document. Indeed, ASC practice is aligned with the recommendations proposed.

Australian Wheat Export

The Wheat Export Authority will review its investment policy to ensure that it complies with legislation taking into account issues raised in your audit findings.

Australian Wine and Brandy Corporation

The investment of funds is not a core activity of the Australian Wine and Brandy Corporation but in accordance with prudent fiscal practice, funds surplus to day-to-day requirements are invested in order to generate additional interest revenue. The Corporation has a documented Investment Policy that requires surplus funds to be invested in very low-risk, short-term products such as call accounts, term deposits and commercial bills.

As the Corporation is constantly transferring funds to and from such investments as daily cash flow requirements dictate, surplus funds are most invariably invested with products offered by the Corporation's banker.

We would suggest that your Recommendation No.4—that the selection of individual investments be subject to competitive processes 'wherever possible'—be eased a little to 'wherever practicable'. In our situation it is possible for us to shop around for better investment terms but it is not practicable to do so.

Cotton Research and Development Corporation

The Cotton Research and Development Corporation (CRDC) is a CAC Act body and we note in your report there are differing views, obtained from legal or financial advice, on what investments are, and are not, permitted by the CAC Act. CRDC would therefore like to recommend the government prepare guidelines for interpreting Section 18(3) of the CAC Act for distribution to all CAC bodies.

Department of Agriculture, Fisheries and Forestry

The Department notes the findings in the draft report and agrees with the ANAO recommendations.

Department of Industry Tourism and Resources

DITR agrees with the seven recommendations put forward in the report. Briefly, DITR invests moneys paid to it by Energy Resources Australia (ERA) on their behalf for the eventual rehabilitation of the ranger uranium mine. This is undertaken in consultation with the ERA and their instruction. The moneys are currently invested in Negotiable Certificates of Deposit (NCD) with the Westpac Banking Corporation and, on maturity, are reinvested in NCD's, including the interest earned. That is, all money standing to the credit of the Special Account is invested. Accordingly, the balance of the funds as at 30 June 2004 was $39 025 639 being all money available for reinvestment.

Grape and Wine Research and Development Corporation

The overall analysis presented by the ANAO and the resulting recommendations are clear, and a clear reminder for those entrusted with management of public funds as to their duties and obligations when making financial investments.

Health Insurance Commission

The HIC advises it agrees with overall thrust of the extract of the report received and the recommendations of the report.

Northern Land Council

The Northern Land Council (NLC)'s investment of funds is restricted to 11am cash management accounts and term deposits with institutions such as Wetspac and TIO [Territory Insurance Office]. These have been examined by the ANAO during our annual audits. The NLC does not engage in any investment activities that would present shortcomings in the management of the investment of public funds.

The seven recommendations made by the report are valid in addressing risks associated with the investment of public funds and the NLC would be in support of their implementation in so far as they apply to activities of the Council.

Appendix 2: Investments under Section 39 of the FMA Act: 30 June 2004

Entity	Special Accounts	30 June 2004 Investment Balance ($)
Aboriginal and Torres Strait Islander Commission	Aboriginal and Torres Strait Islander Land Fund Account	1,417,836,351
	Aboriginal Benefits Account	102,758,004
Australian Customs Service	Industry Related Systems Development Account	2,784,784
Department of Agriculture, Fisheries and Forestry	National Residue Survey Account	13,500,000
Department of Communications, Information Technology and the Arts	Television Account	12,027,158
Department of Education, Science and Training	National Science and Technology Centre Special Account	600,000
Department of Industry, Tourism and Resources	Ranger Rehabilitation Account	39,025,639
Department of Veterans' Affairs	Defence Service Homes Insurance Account	58,144,000
	Subtotal	**1,646,675,936**
Australian Office of Financial Management	Not applicable	14,850,000,000
TOTAL		**16,496,675,936**

Note:
Those Special Accounts that had a delegation to invest public monies but held no investments in the period are excluded from the table. The Australia-Japan Foundation, Federal Court of Australia, Federal Magistrates Court and the Family Court of Australia also have Section 39 investment powers.

Source: ANAO analysis of Finance and entity data

Appendix 3: Investments under Sections 18 and 19 of the CAC Act, excluding those of GBEs: 30 June 2004[104]

Entity	Investment Balance ($)
Anindilyakwa Land Council	181,004
Australia Council	5,927,000
Australian Accounting Standards Board	3,027,191
Australian Broadcasting Authority	1,037,127
Australian Broadcasting Corporation	35,753,000
Australian Communications Authority	13,807,000
Australian Film Commission	16,239,101
Australian Fisheries Management Authority	17,200,000
Australian Hearing Services	15,132,000
Australian Industry Development Corporation [D]	756,892,000
Australian Institute of Aboriginal and Torres Strait Islander Studies	5,407,000
Australian Institute of Criminology	850,000
Australian Institute of Family Studies	622,543
Australian Institute of Health and Welfare	5,168,000
Australian Institute of Marine Science	16,909,000
Australian Maritime College	13,586,000
Australian Maritime Safety Authority	16,681,000
Australian National Maritime Museum	5,855,000
Australian Nuclear Science and Technology Organisation	55,690,000
Australian Pesticides and Veterinary Medicines Authority	7,655,694
Australian Prudential Regulation Authority	1,000
Australian Securities and Investments Commission	3,418,000
Australian Sports Commission	26,541,000
Australian Sports Drug Agency	1,414,560
Australian Tourist Commission	10,053,000
Australian Trade Commission	27,255,000[A]
Australian War Memorial	27,898,047
Australian Wine and Brandy Corporation [C]	2,559,768[B]
Civil Aviation Safety Authority	18,425,000
Comcare	18,403,000

[104] List excludes the reported cash on hand figures in the financial statements but includes cash held in call accounts and on deposit with a bank, where reported separately. Includes only those entities subject to Sections 18 and 19 of the CAC Act, other then GBEs.

Entity	Investment Balance ($)
Commonwealth Scientific and Industrial Research Organisation	150,000,000
Cotton Research and Development Corporation	10,939,515
Criminology Research Council	850,000
Export Finance and Insurance Corporation [D]	728,800,000
Forest and Wood Products Research and Development Corporation	5,700,000
Grains Research and Development Corporation	127,746,000
Grape and Wine Research and Development Corporation	3,500,000
Great Barrier Reef Marine Park Authority	2,268,644
Health Insurance Commission	89,000,000
Indigenous Business Australia	1,000,400
Land and Water Australia	8,671,586
National Gallery of Australia	9,900,000
National Library of Australia	14,007,000
National Museum of Australia	26,734,051
NEPC Service Corporation [E]	500,000
Northern Land Council	3,589,263
Private Health Insurance Ombudsman	300,000
Rural Industries Research and Development Corporation	5,527,835
Special Broadcasting Service Corporation	63,732,000
Sugar Research and Development Corporation	4,589,195
Wheat Export Authority	905,000
TOTALS	**2,387,848,524**

Notes:

[A] Cash and cash equivalents including bank bills.

[B] This figure includes an amount reported as cash, but that reportedly also includes bank bills or commercial bills.

[C] The Australian Wine and Brandy Corporation is a CAC Act Statutory Marketing Authority (SMA). Its power to invest is therefore provided under Section 19 of the CAC Act.

[D] Although the Australian Industry Development Corporation and the Export Finance and Insurance Corporation are neither a GBE nor an SMA, their enabling Acts provide that Section 19, not Section 18, of the CAC Act gives the corporations power to invest their surplus money.

[E] Under its enabling legislation, the NEPC Service Corporation is not a Commonwealth Authority for the purposes of the CAC Act. However, it is subject to Section 18 of the CAC Act.

Source: ANAO analysis of entity financial data and reporting

Appendix 4:Investment under legislation other than the FMA and CAC Acts: 30 June 2004[105]

Authorised Investment	Legislation	Entity	Investment Balance ($)
In public securities; or In a loan the repayment of which is guaranteed by the Commonwealth, a State or a Territory; or In a loan to a municipal corporation or other local governing body in Australia; or In a loan to, or on deposit with, an ADI; or In bank bills accepted or endorsed by an ADI.	*Bankruptcy Act 1966*	Insolvency and Trustee Service Australia	15,500,000 [A]
On deposit with an approved bank or ADI; In Commonwealth securities; or In any other manner approved by the Treasurer.	*Albury-Wodonga Development Act 1973*	Albury-Wodonga Development Corporation	26,857,000
	High Court of Australia Act 1979	High Court of Australia	No reported investments
On deposit with a bank; or In securities of the Commonwealth or of a State or Territory; or In securities guaranteed by the Commonwealth, a State or Territory; or In any other manner approved by the Treasurer in writing.	*Native Title Act 1993*	North Queensland Land Council Native Title Representative Body	498,937 [B]
		Yamatji Marlpa Barna Baba Maaja Aboriginal Corporation	50,000 [B]
In securities of the Commonwealth; On deposit with a bank/the RBA; or In any other manner for the time being allowed by any Act or State Act for the investment of trust funds.	*Royal Australian Air Force Veterans' Residences Act 1953*	Royal Australian Air Force Veterans' Residences Trust Fund	1,012,000
	Services Trust Funds Act 1947	Australian Military Forces Relief Trust Fund	2,009,270

[105] The audit scope did not include the monetary policy investments of the RBA and, as such, the *Reserve Bank Act 1959* is excluded from this list. There are also two other Acts, the *Pipeline Authority Act 1973* and the *Construction Industry Reform and Development Act 1992*, which provide investment powers for entities that are no longer in existence. These Acts have therefore also been excluded from this list.

Authorised Investment	Legislation	Entity	Investment Balance ($)
		Royal Australian Air Force Welfare Trust Fund	1,211,316
		Royal Australian Navy Relief Trust Fund	217,083
No specified restrictions on types of investments that may be undertaken	*Aboriginal and Torres Strait Islander Commission Act 1989*	Indigenous Land Corporation	236,475,022
	Australian National University Act 1991	Australian National University	715,796,000 [C]
	Coal Mining Industry (Long Service Leave Funding) Act 1992	Coal Mining Industry (Long Service Leave Funding) Corporation	323,542,000
		TOTAL	**1,323,168,628**

Notes:

[A] Although ITSA does not report investment activity for the Common Investment Fund, internal records show investments amounting to $15.5 million as at 30 June 2004.

[B] 2003–04 figures unavailable at the time of audit.

[C] ANU figures relate to the 2003 calendar year. 2004 data not available at the time of audit.

Source: ANAO analysis of entity financial data and reporting

Appendix 5:Results of desk audit of entities investing under Section 18 of the CAC Act: 30 June 2003

Entity	Financial reporting	Outcome of Treasury Investigations
Three authorities in breach of Section 18 but have now changed their practices:		
Australian Film Commission	Reported term deposits and bank bills in the same line item, unable to separate from disclosure note.	No approval was located. Entity advised ANAO in November 2004 that upon receipt of recent guidance by AGS on what 'on deposit with a bank' encompasses, the AFC has ceased investing in bank bills and will be seeking the Treasurer's approval to invest in bank bills and NCDs in the future.
Australian Institute of Family Studies	Held bills of exchange.	No approval was located. Entity advised Treasury on 5 August 2004 that, as at 30 June 2004, it invested only in bank term deposits; that in future it would only invest in authorised products; and that it would carefully consider the need to seek approval to expand its financial products to include bills of exchange.
National Gallery of Australia	Held commercial bills.	No approval was located. Entity advised Treasury on 6 August 2004 that: it had mistakenly believed it had the authority to invest in Commercial Bills; upon maturity of the currently held Bill, investments have been restricted to those authorised by the CAC Act. NGA is considering seeking the Treasurer's approval to broaden its investment powers.
Two authorities in breach of Section 18 but have now obtained the Treasurer's approval:		
Australian Pesticides and Veterinary Medicines Authority	Held floating rate notes.	Approval given on 25 August 2004.
Civil Aviation Safety Authority	Held bank bills and negotiable certificates of deposit.	Approval given on 7 July 2004.

Entity	Financial reporting	Outcome of Treasury Investigations
One authority had approval to invest through a managed trust, but not for their current investing activities thereby being in breach of Section 18:		
Forest and Wood Products Research and Development Corporation	Held bank bills.	FWPRDC sought approval to invest in bank bills but approval to invest through a professionally managed market trust was given on 8 May 1998 instead. In August 2004, Treasury advised entity that the approval does not allow direct investment. Bank bills held have since been converted to bank fixed term deposits.
One authority not contacted by Treasury:		
National Standards Commission	Held term deposits and bank bills/NCDs, unable to separate.	On 30 June 2004, the Commission ceased to exist as a separate statutory authority and its operations were transferred to the National Measurement Institute, a unit within the Department of Industry, Tourism and Resources.
Four authorities with pre-existing approvals such that were not in breach of Section 18:		
Australian Trade Commission	Cash holdings included bank bills.	Approval given on 15 July 1986, and extended on 18 June 1990. Approval documentation provided to Treasury by entity on 11 August 2004.
Australian Broadcasting Corporation	Held bills of exchange.	Approval given on 6 January 1989. Approval documentation provided to Treasury by entity on 4 August 2004.
Australian Maritime College	Invests in a managed investment fund.	Approval given on 20 December 2000. Approval documentation provided to Treasury by entity on 3 August 2004.
Grains Research and Development Corporation	Held negotiable certificates of deposit and floating rate notes.	Treasury held three documented approvals on file. Initial approval on 5 March 1992 to invest directly. Approval to invest through professionally managed money market trust given on 17 August 1998. Approval for managed trust to invest in financial derivatives given on 5 July 2000.
One authority incorrectly reported nature of investments with actual investments not breaching Section 18:		
Grape and Wine Research and Development Corporation	Cash holdings include commercial bills, unable to separate.	No approval was located. Entity advised Treasury on 3 August 2004 that it does not invest in Commercial Bills, and used the term in error instead of 'Term Deposits'.
Status unclear:		
Indigenous Business Australia	Held floating rate notes.	See paras 3.66

Source: ANAO analysis

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