

The Auditor-General

Management of Commonwealth
Guarantees, Indemnities and
Letters of Comfort

Australian National Audit Office

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Canberra ACT
23 June 1998

Dear Madam President
Dear Mr Speaker

The Australian National Audit Office has undertaken a performance audit in selected agencies in accordance with the authority contained in the *Auditor-General Act 1997*. I present this report of this audit, and the accompanying brochure, to the Parliament. The report is titled *Management of Commonwealth Guarantees, Indemnities and Letters of Comfort*.

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.

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Contents

Abbreviations	vii
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Part One — Summary and Recommendations

Audit Summary	xi
Background	xi
Audit approach	xii
Accountability	xv
Recommendations	xvi

Part Two — Audit Findings and Conclusions

1. Introduction	3
Background	3
Legislative developments	4
Parliamentary Committees	6
Audit approach	7
Report outline	8
2. Commonwealth Exposure	9
Background	9
Size of the Commonwealth exposure	10
Awareness	13
Privatisation	16
3. Management Framework	20
Background	20
Management and monitoring performance	20
Risk management and control measures	29
Accountability	40
4. Concluding Remarks	43
Commonwealth's exposure	43
Conclusions	46

Part Three — Appendices

Appendix 1	
Parliamentary Committees' Recommendations	51
Appendix 2	
Recommendations and comments from ANAO Audit Report No.6, 1996-97, Commonwealth Guarantees, Indemnities and Letters of Comfort.	53
Appendix 3	
Guarantees, Indemnities and Letters of Comfort as at 30 June 1996 and 1997	57
Appendix 4	
Finance Circular 1997/06 — Potential Liabilities and Losses	74
Index	95
Series Titles	98

Abbreviations

ACT	Australian Capital Territory
AG's	Attorney-General's Department
AIDC	Australian Industry Development Corporation
AN	Australian National Railways Commission
ANAO	Australian National Audit Office
ASC	Australian Submarine Corporation
CAC Act	<i>Commonwealth Authorities and Companies Act 1997</i>
CBA	Commonwealth Bank of Australia
CEIs	Chief Executive Instructions
CFM	Commonwealth Funds Management
CIS	Commonwealth Indemnity Scheme
CRS	Commonwealth Rehabilitation Service
CSS	Commonwealth Superannuation Scheme
DAS	Department of Administrative Services
DEETYA	Department of Employment, Education, Training and Youth Affairs
DEST	Department of the Environment, Sport and Territories
DFAT	Department of Foreign Affairs and Trade
DHFS	Department of Health and Family Services
DHoR	Department of the House of Representatives
DIMA	Department of Immigration and Multicultural Affairs
DIST	Department of Industry, Science and Tourism
DoCA	Department of Communications and the Arts
DoD	Department of Defence
DoE	Department of the Environment
DoF	Department of Finance
DoFA	Department of Finance and Administration
DoS	Department of the Senate
DoTRD	Department of Transport and Regional Development
DPIE	Department of Primary Industries and Energy
DPL	Department of the Parliamentary Library
DPM&C	Department of the Prime Minister and Cabinet
DPRS	Department of the Parliamentary Reporting Staff
DSS	Department of Social Security
DVA	Department of Veterans' Affairs
DWR&SB	Department of Work Relations and Small Business

EFIC	Export Finance and Insurance Corporation
FAC	Federal Airports Corporation
FMA Act	<i>Financial Management and Accountability Act 1997</i>
GBEs	Government Business Enterprises
HLIC	Home Loan Insurance Corporation
HORSCFIPA	House of Representatives Standing Committee on Financial Institutions and Public Administration
JCPA	Joint Committee of Public Accounts
JCPAA	Joint Committee of Public Accounts and Audit
JHD	Joint House Department
MAB/MIAC	Management Advisory Board and its Management Improvement Advisory Committee
OASITO	Office of Asset Sales and IT Outsourcing
PSS	Public Sector Superannuation Scheme
SMA	Statutory Marketing Authority
Tsy	Department of the Treasury

Part One

Summary and Recommendations

Audit Summary

Background

1. In September 1996, the Australian National Audit Office (ANAO) audit report on *Commonwealth Guarantees, Indemnities and Letters of Comfort*, which reported an aggregate of quantifiable exposures as a result of these instruments of some \$222 billion, was tabled in Parliament. The principle purpose in undertaking a performance audit in this field was to establish areas where recommendations could be made regarding the management of the Commonwealth's exposure to guarantees,¹ indemnities² and letters of comfort³ given the risks to the Commonwealth they may involve. Total exposures reported in this report amounted to at least \$214.6 billion as at 30 June 1997. The breakdown by category of instruments with dollar value was loan guarantees of \$10.1 billion; non-loan guarantees of \$201.4 billion; and indemnities of \$3.1 billion.

2. In the 1996 audit report the ANAO concluded that, overall, there needed to be a marked improvement in most agencies' management and administrative practices with regard to off balance sheet risk. There was also a need for greater public accountability at both the agency and whole of government levels through better reporting. The report contained sixteen recommendations which were accepted by the agencies involved. Since the tabling of the audit there have been a number of developments which affect the issuing and management of such instruments including the promulgation of the Department of Finance and Administration Finance Circular 1997/06 which provides revised guidelines on the provision of guarantees, indemnities and letters of comfort.

3. Two Parliamentary Committees inquired into the 1996 audit report, the then Joint Committee of Public Accounts (JCPA)⁴ and the House of Representatives Standing Committee on Financial Institutions and Public Administration (HORSCFIPA). The JCPA, *Report 350, Review of Auditor-*

¹ A guarantee is a promise whereby one party promises to be responsible for the debt of, or performance obligations of, another should this party default in some way.

² An indemnity is a promise whereby a party undertakes to accept the risk of loss or damage another party may suffer.

³ A letter of comfort is essentially an instrument which is used to facilitate an action or transaction but is constructed with the intention of not giving rise to a legal obligation.

⁴ On 1 January 1998, when the *Auditor-General Act 1997* commenced, the JCPA became the Joint Committee of Public Accounts and Audit (JCPAA). The current title and acronym for the Committee is used for the remainder of the report.

General's Reports 1996-97, was released in February 1997 and contained two major recommendations concerning the management of guarantees, indemnities and letters of comfort. The HORSCFIPA released its *Report of the Inquiry into ANAO Audit Report No.6 1996-97 on Commonwealth Guarantees, Indemnities and Letters of Comfort* in September 1997. That Committee made 12 recommendations which canvassed a wide range of measures to improve administrative and risk management procedures in connection with these instruments.

4. A range of contemporary public financial management and public policy measures have been instrumental in reducing some major areas of the Commonwealth's financial exposure to guarantees, indemnities and letters of comfort. In addition, the Government has reduced the access of Government Business Enterprises, Statutory Marketing Authorities and other commercially oriented statutory authorities to explicit Commonwealth loan guarantees, to the point that there now remains few such guarantees in existence, most of which were issued some time ago. Notwithstanding this situation, the most significant factor affecting the composition and size of the Commonwealth's exposure has been the sale of Commonwealth businesses (eg Australian National Line, Australian National Railways and the Australian Industry Development Corporation).

5. Privatisation provides an opportunity to transfer risks formerly carried by the Commonwealth to the private sector. Even in the absence of any explicit Commonwealth guarantee of an entity's operations, the mere fact of Commonwealth ownership represents a commercial advantage to the entity, because of the likelihood that the market will rely on implicit Commonwealth guarantees in its commercial dealings with the entity based on experience to date. There is also a risk to the Commonwealth that, should the entity risk failure, the Commonwealth will be expected to stand behind it, notably by providing additional equity. Commonwealth major asset sales since 1987-88 total some \$31 billion.

Audit approach

6. The major source of information for this audit was a census conducted by the ANAO which canvassed 23 agencies. The objectives of this audit were to assess, with respect to guarantees, indemnities and letters of comfort:

- changes in the size and nature of the Commonwealth's reported exposure since 30 June 1995;
- the extent of improvement in agencies' management and monitoring of the Commonwealth's exposure to these instruments;

- the approach of agencies to effective risk management and control of Commonwealth exposures to these instruments; and
- whether current reporting practices provide a sufficiently comprehensive coverage for public accountability purposes, at both the agency and whole of government levels.

7. The audit criteria addressed the adequacy of agencies' management of guarantees, indemnities and letters of comfort in relation to the size and nature of the Commonwealth's exposure; the nature of agencies' management, reporting and monitoring of the instruments; action taken by agencies in regard to the original audit; the Parliamentary Committees' recommendations; and agencies' approaches to risk management.

Audit Conclusions

8. The ANAO considers that changes in the Commonwealth's financial management arrangements have created a framework which now places greater emphasis on the visibility and effective management of the Commonwealth's guarantees, indemnities and letters of comfort.

Potential size of the Commonwealth's exposure

9. The ANAO found that the overall value of the Commonwealth's exposure to guarantees, indemnities and letters of comfort increased significantly in the first year after the original audit reaching an aggregate of some \$415 billion as at 30 June 1996. This figure reduced to some \$214.6 billion as at 30 June 1997. Both variations were largely due to the changes in the value and reporting of the Commonwealth Bank of Australia guarantee and the reporting of the Commonwealth Superannuation Scheme and Public Sector Superannuation Scheme guarantees. As the Commonwealth Bank of Australia guarantee continues to diminish in size in the next few years, there should be a corresponding material reduction in the size of the Commonwealth's overall financial exposure.

Management and monitoring

10. There has been an overall improvement in the number of agencies implementing registers for their guarantees, indemnities and letters of comfort. However, the ANAO found that relatively few agencies have adopted contract registers as an adjunct to a main or central document registry system for the management of the guarantees, indemnities and letters of comfort. It is not clear whether those agencies, which do not have such registers, have actively considered and rejected the possibility of introducing them. The ANAO considers that transparency of agencies' contractual indemnities and guarantees would be enhanced by the use of contract registers.

11. There continues to be a need for agencies to improve their security arrangements to ensure that they have effective administrative control of their guarantees, indemnities and letters of comfort. The ANAO considers that sound management practice requires that agencies should ensure that all staff are aware of the need to provide appropriate safe custody arrangements for these instruments.

Risk management

12. Commonwealth asset sales over the past decade have generated proceeds of some \$31 billion and the opportunity to effectively transfer to the private sector, significant risks formerly borne by the Commonwealth. Notwithstanding some examples of increased exposures, over time a by-product of Commonwealth asset sales will be a reduction in the Commonwealth's overall exposure as a result of guarantees, indemnities and letters of comfort provided.

13. The ANAO considers that, despite the wide exposure and coverage devoted to the importance of risk management in current financial instructions and guidelines, agencies have not generally placed sufficient emphasis on establishing comprehensive risk management strategies with direct links to the management of their guarantees, indemnities and letters of comfort. Although agencies report a high degree of awareness of the existence of the Department of Finance and Administration Finance Circular 1997/06 that was circulated to all agencies in May 1997, there have not been high levels of compliance with these guidelines particularly in regard to the preparation of the instruments. The ANAO considers that this situation has the potential to expose the Commonwealth to unnecessary risk and warrants further action to raise awareness of the importance of sound procedures in the preparation of guarantees, indemnities and letters of comfort. Such action might include explicit reference to the preparation and management of guarantees, indemnities and letters of comfort in agencies' Chief Executive Instructions.

14. The Non-Insurance Review instigated by Department of Finance and Administration in 1997 considered not only the risk management issues relating to Commonwealth guarantees, indemnities and letters of comfort but also addressed the wider risks faced by the Commonwealth including assessing options for appropriately managing those risks. The implementation of the managed fund (*Comcover*) policy from 1 July 1998, should provide an effective means of managing all of the Commonwealth's normal insurable risks.

Accountability

15. There has also been a marked improvement in the guidance provided to agencies regarding the disclosure and reporting of the Commonwealth's guarantees, indemnities and letters of comfort. The ANAO considers that the Department of Finance and Administration has effectively pursued the intent of the 1996 audit report recommendations concerning the need to improve disclosure, reporting and accountability arrangements for Commonwealth guarantees, indemnities and letters of comfort. The improvements made to these arrangements since 1996 have continued to enhance the transparency of material Commonwealth contingent liabilities.

Recommendations

Set out below are the ANAO's recommendations. The ANAO considers that agencies should give priority to Recommendations 1,4,5 and 6.

Recommendation No. 1
Para. 3.9 The ANAO recommends that all agencies with guarantees, indemnities and letters of comfort maintain an adequate and accessible register of these instruments.

Agree: AG's, DEETYA, DFAT, DHFS, DIMA, DIST, DoCA, DoD, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.

Recommendation No. 2
Para. 3.17 The ANAO recommends that agencies actively consider the implementation of a contract register system, which among other benefits would be an aid to effective records management of their guarantees, indemnities and letters of comfort.

Agree: AG's, DEETYA, DFAT, DHFS, DHoR, DIMA, DIST, DoCA, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.

Agree with qualification: DoD.

Recommendation No. 3
Para. 3.27 The ANAO recommends that agencies review their physical security measures with a view to establishing appropriate safe custody arrangements for the documents associated with Commonwealth guarantees, indemnities and letters of comfort.

Agree: AG's, DEETYA, DFAT, DHFS, DIMA, DIST, DoCA, DoD, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.

Recommendation No. 4
Para. 3.41 The ANAO recommends that, in developing corporate risk management strategies, agencies ensure that an explicit link is established between the agency's corporate risk management plan and their strategies for the management of guarantees, indemnities and letters of comfort.

Agree: AG's, DEETYA, DFAT, DHFS, DHoR, DIMA, DIST, DoCA, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.

Agree with qualification: DoD.

Recommendation No. 5
Para. 3.48 The ANAO recommends that agencies establish procedures to ensure effective review and evaluation of their financial exposures as a result of Commonwealth guarantees, indemnities and letters of comfort.

Agree: AG's, DEETYA, DFAT, DHFS, DIMA, DIST, DoCA, DoD, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD and Tsy.

Agree with qualification: OASITO.

Recommendation No. 6
Para. 3.56 The ANAO recommends that, where appropriate and commercially practical, agencies ensure that time limits, termination clauses, subrogation clauses, and financial limits on liability are incorporated into guarantees, indemnities and letters of comfort they issue.

Agree: AG's, DEETYA, DFAT, DHFS, DIMA, DIST, DoCA, DoD, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.

Part Two

Audit Findings and Conclusions

1. Introduction

The chapter outlines the background and approach of the audit.

Background

1.1 In September 1996, ANAO Audit Report No.6, 1996-97, *Commonwealth Guarantees, Indemnities and Letters of Comfort*, was tabled in Parliament. The principal purpose in undertaking a performance audit in this field was to establish areas where recommendations could be made regarding the management of the Commonwealth's exposure to guarantees, indemnities and letters of comfort⁵ given the risks to the Commonwealth they may involve. In order to do this, the audit sought to identify the nature and size of the Commonwealth's exposure to these instruments and assess agencies' management, monitoring and reporting of them. The audit found that achievement of each of these goals, to the extent that they could be achieved, required far more extensive effort, both on the part of the ANAO and the agencies involved, than was either anticipated by the ANAO or prudent administration would dictate.

1.2 Guarantees, indemnities and letters of comfort are instruments which perform an effective role in facilitating the operations of the Government, much as they do the commercial operations of the private sector. However, they involve the assumption of contingent (potential) liabilities and accordingly, carry with them risks and obligations which may be called on in the future. They are not necessarily costless and need to be carefully used. Equally, it is important that the exposures they represent are adequately monitored over the life of the instruments. Audit Report No.6, 1996-97 reported the Commonwealth's gross exposure arising from these instruments was at least \$222 billion as at 30 June 1995.

1.3 In the 1996 audit report, the ANAO concluded that, overall, there needed to be a marked improvement in most agencies' management and administrative practices with regard to off-balance sheet risk. There was also a need for greater public accountability at both the agency and whole of government levels through better reporting. The report contained sixteen recommendations which were accepted by the agencies involved. Since the tabling of the audit in September 1996, there has been a number of developments which affect the issuing, management and reporting of these instruments.

⁵ Definitions, op. cit., p. xi.

Legislative developments

1.4 The *Financial Management and Accountability Act 1997* (FMA Act), the *Commonwealth Authorities and Companies Act 1997* (CAC Act) and the *Auditor-General Act 1997*⁶ came into effect on 1 January 1998 in replacement of the *Audit Act 1901*. Under the FMA Act, Chief Executives (including departmental secretaries) are required to manage the affairs of their agency in a way which promotes proper use of Commonwealth resources for which the Chief Executive is responsible.⁷ To assist Chief Executives in meeting their responsibility, the FMA Regulations⁸ authorise Chief Executive Officers to issue instructions (Chief Executive Instructions - CEIs) to officials in their agencies regarding matters covered by the FMA Act. The Department of Finance and Administration (DoFA) developed and released to agencies model instructions intended to assist agencies in the development of their own CEIs. DoFA's model CEIs included guidance on the management of contingent liabilities.

1.5 An outline of the legislative and policy framework that currently affects Commonwealth guarantees,⁹ indemnities and letters of comfort is contained in Exhibit 1.1. The framework includes, in addition to the new legislative package, finance circulars and other policy guidelines. The most significant is Finance Circular 1997/06 *Potential Liabilities and Losses* (discussed further in Chapter 2) which replaced Finance Circular 1989/11 *Guidelines for the Issuing of Commonwealth Indemnities*.

1.6 Guarantees, indemnities and letters of comfort, which do not explicitly involve the Commonwealth in a legal obligation, were not within the scope of the previous audit and are again not covered in this audit because they do not directly constitute legal contingent liabilities of the Commonwealth.¹⁰

⁶ The main purpose of the *Financial Management and Accountability Act 1997* is to establish a framework for the proper management of public money and public property. The *Commonwealth Authorities and Companies Act 1997* contains reporting, accountability and other rules for Commonwealth authorities and Commonwealth companies. The *Auditor-General Act 1997* establishes the Office of the Auditor-General and sets out the functions of the Auditor-General.

⁷ Section 44, *Financial Management and Accountability Act 1997*.

⁸ Regulation 6, *Financial Management and Accountability Regulations*.

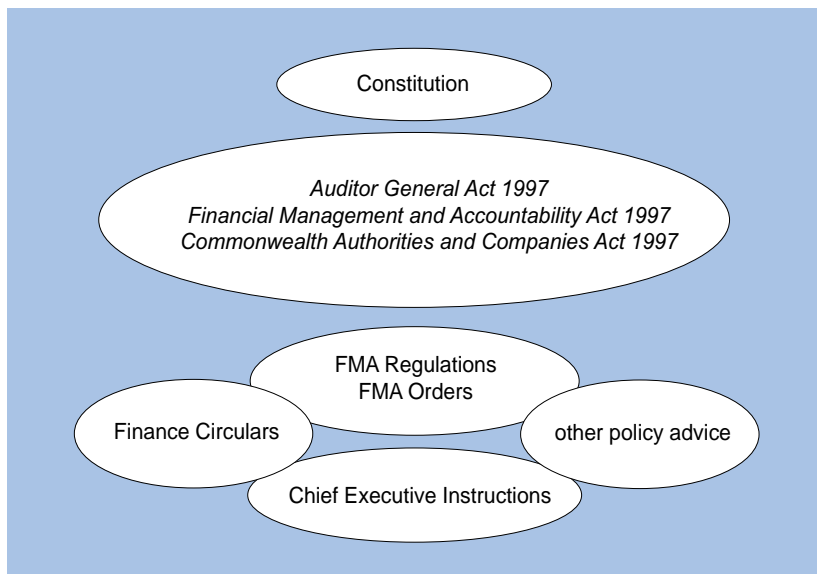
⁹ Until 31 December 1997, Section 70B of the *Audit Act 1901* prohibited the issuing of a loan guarantee by or on behalf of the Commonwealth unless expressly authorised by an act. The prohibition of the giving of loan guarantees in the absence of legislative authorisation does not remain under the new FMA legislation. Under Regulation 14 of the FMA Regulations persons (including Ministers or Chief Executives) may give a loan guarantee on behalf of the Commonwealth if a proposal to spend public money for the guarantee has been approved under Regulation 9 or 10 and the giving of the guarantee has been authorised by the Finance Minister, or another person authorised by the Finance Minister for the purpose.

¹⁰ Excluded from the audit were other contingent liabilities such as uncalled capital subscriptions for multilateral financial institutions (\$7108 million), and instruments issued by Statutory Marketing Authorities and Government Business Enterprises that did not explicitly involve the Commonwealth in a legal obligation.

1.7 The CAC Act provides the underlying legislative basis for the reporting and accountability framework applying to all statutory authorities and Commonwealth controlled companies, including Statutory Marketing Authorities (SMAs) and Government Business Enterprises (GBEs). Although the CAC Act does not explicitly address guarantees, indemnities and letters of comfort, the requirements of the Act, particularly those relating to audited financial statements, include the objective of ensuring that relevant ministers, as well as the Minister for Finance and Administration, have access to regular information on the status of authorities' liabilities, including contingent liabilities.

Exhibit 1.1

Legislative and policy framework



Source: ANAO

1.8 In June 1997, following the *Review of GBE Governance Arrangements*,¹¹ the Government issued revised governance arrangements for GBEs. These revised governance arrangements¹² have also enhanced the management framework for Commonwealth risk in that they require GBEs to include in

¹¹ Following a request from the Prime Minister for a review of GBE governance arrangements, the Minister for Finance announced on 23 December 1996 the appointment of Mr Richard Humphry AO, Managing Director of the Australian Stock Exchange to undertake the review. The report completed in March 1997 was entitled *Review of GBE Governance Arrangements*.

¹² *Governance Arrangements for Commonwealth Government Business Enterprises*.

their corporate plans analysis of any factors likely to create significant financial risk for the GBE and /or the Commonwealth; provide for regular financial reports to the Shareholder Ministers; outline the risk management obligations of GBE directors; provide that, in normal circumstances, a GBE should only use derivative financial instruments for the purpose of hedging exposures; and advise that, as a general rule, the Government will not provide formal guarantees of GBEs liabilities.

Parliamentary Committees

1.9 Two Parliamentary Committees inquired into the 1996 audit report, the then Joint Committee of Public Accounts (JCPA)¹³ and the House of Representatives Standing Committee on Financial Institutions and Public Administration (HORSCFIPA). The recommendations made by each of the Parliamentary Committees are set out in Appendix 1. The Government responded to JCPA *Report 350, Review of Auditor-General's Reports 1996-97* on 17 September 1997 in light of comments from 18 agencies. The Government responded to the HORSCFIPA Report on 7 May 1998.

1.10 The JCPA's Report 350 was released in February 1997 and contained two major recommendations concerning the management of guarantees, indemnities and letters of comfort. The first of these was that all Commonwealth agencies be required to provide progress statements on the steps taken to address the recommendations of Audit Report No.6, 1996-97. The second was that it be mandatory that agencies include full statements of off-balance sheet contingent liabilities in their annual financial statements. The JCPA report also noted that:

*... responsibility for managing the Commonwealth's risk related to guarantees, indemnities and letters of comfort lies with individual agencies. It is a responsibility which most Chief Executive Officers have been neglecting. This state of affairs cannot be allowed to continue. The recommendations in the audit report designed to improve agency awareness and management of the Commonwealth's exposure are important. They warrant serious and urgent attention from Finance and all agency heads.*¹⁴

1.11 The HORSCFIPA released its *Report of the Inquiry into ANAO Audit Report No.6, 1996-97 on Commonwealth Guarantees, Indemnities and Letters of Comfort* in September 1997. The Committee made 12 recommendations which canvassed a wide range of measures to improve administrative and

¹³ Definitions, op. cit., p. xi.

¹⁴ JCPA *Report No.350*, op. cit., pp. 25-26.

risk management procedures in connection with these instruments. The Chairman of the Committee noted that:

*... the ANAO report revealed a disturbing picture of inadequate management of these instruments which potentially could expose the Commonwealth to losses. The Commonwealth had not been informed of potential losses that might arise, guarantees and indemnities were rarely recorded and in too many cases not managed at all.*¹⁵

Audit approach

1.12 This audit commenced in August 1997 with the development of a questionnaire which included a census of all explicit Commonwealth guarantees, indemnities and letters of comfort on issue. Field work was conducted between September 1997 and February 1998. Initial data for the audit was assembled by way of a census of 23 agencies.¹⁶ The census data was then used as a guide to gather detailed information from selected agencies by way of interviews, file review and exchange of correspondence.

1.13 The objectives of the follow up audit were to assess, with respect to guarantees, indemnities and letters of comfort:

- changes in the size and nature of the Commonwealth's reported exposure since 30 June 1995;
- the extent of improvement in agencies' management and monitoring of the Commonwealth's exposure to these instruments;
- the approach of agencies to effective risk management and control of Commonwealth exposures to these instruments; and
- whether current reporting practices provide a sufficiently comprehensive coverage for public accountability purposes, at both the agency and whole of government levels.

1.14 The ANAO developed criteria which addressed the adequacy of agencies' management of guarantees, indemnities and letters of comfort in relation to the size and nature of the Commonwealth's exposure; the nature of agencies' administrative management, reporting and monitoring of the instruments; action taken by agencies in regard to the original audit; the Parliamentary Committees' recommendations; and agencies' approaches to risk management.

¹⁵ David Hawker MP, Chairman of the House of Representatives Standing Committee on Financial Institutions and Public Administration, Media News, *Management of Risk by Government Agencies*, 29 September 1997.

¹⁶ Comprising 17 portfolio departments, the five Parliamentary Departments and the Office of Asset Sales and IT Outsourcing.

1.15 Excluded from the audit were instruments issued by SMAs and GBEs that did not explicitly involve the Commonwealth in a legal obligation and the Commonwealth's exposure from guarantees relating to financial derivatives. The Office of Asset Sales and IT Outsourcing (OASITO) advised the ANAO that there:

... appears to be a pervasive GBE practice of writing onerous change of ownership and/or confidentiality conditions into commercial agreements, including debt and lease arrangements, with the effect that any move to full or partial privatisation has the effect of applying a de facto Commonwealth guarantee to the relevant liability.

1.16 In light of the advice from OASITO, it is incumbent on portfolio departments to ascertain the position of Commonwealth bodies regarding material contingent liabilities. This is consistent with the guiding principles of the 1997 GBE Governance Arrangements that require the timely disclosure of information which may have a material effect on the shareholder value of the Commonwealth body.

1.17 The recommendations and agency responses from the original report are set out in Appendix 2. This report addresses the recommendations from the original report with an assessment of action to date.

1.18 The cost of the audit was approximately \$165 000. The audit was conducted in accordance with the ANAO auditing standards.

Report outline

1.19 The following two chapters of the audit report discuss, in turn, the size and nature of the Commonwealth's exposure to explicit Commonwealth guarantees, indemnities and letters of comfort, including the implications of privatisation for the Commonwealth's exposure to these instruments; and the management framework for them. A concluding chapter provides an overview of the identified issues and the overall conclusions of the audit.

2. Commonwealth Exposure

This chapter discusses the size and nature of the Commonwealth exposure to guarantees, indemnities and letters of comfort and the implications of privatisations for the Commonwealth's exposure to these instruments.

Background

2.1 The 1996 audit set out to capture all explicit guarantees, indemnities and letters of comfort provided by the Commonwealth under legislation, deeds, contracts and correspondence as at 30 June 1995. Excluded from the audit were other instruments such as those issued by SMAs and GBEs that did not explicitly involve the Commonwealth in a legal obligation, indemnification of Commonwealth employees (for example, the indemnification of Commonwealth officers serving on statutory authority boards) and uncalled capital subscriptions for multilateral financial institutions.

2.2 The ANAO found in the 1996 audit that agencies did not have an adequate awareness of the management requirements for guarantees, indemnities and letters of comfort and that few agencies met the then Finance Direction 21/3 requirement of establishing and maintaining an accurate register for these instruments.¹⁷ As a result, the ANAO was not confident that the contingent liabilities reported in the census of guarantees, indemnities and letters of comfort undertaken for the 1996 audit was a complete list of the Commonwealth's exposure to these instruments as at 30 June 1995.

2.3 In addition, many instruments reported to the ANAO had no dollar value attributed to them. In almost all cases, these instruments were either indemnities or letters of comfort. It is a simple matter to aggregate the maximum exposure represented by loan guarantees and non-loan guarantees since these usually relate to specified sums for loans or other financial obligations. It is similarly straight forward to make the same calculation where instruments include a cap on the maximum liability accepted under the instrument. Many indemnities and one letter of comfort reported to the ANAO for the 1996 audit included such caps on liability. However, many other indemnities and all other letters of comfort reported in both audits do not have caps on liability. Nevertheless, if called upon,

¹⁷ The guidance on recording guarantees, indemnities and letters of comfort in a central register is now contained in DoFA's model CEIs.

these instruments have the potential to commit the Commonwealth to significant outlays as was the case with payments made under indemnification arrangements for the blood supply system which saw outlays by the Commonwealth of some \$28.6 million between 1989 and 1995.¹⁸ Another example can be found in the Commonwealth indemnity to the Australian Submarine Corporation where 46 claims were made by December 1996 (23 of these were denied).¹⁹ Accordingly, all of the aggregate figures reported in both the 1996 audit and this follow up audit do not include the instruments with no dollar value ascribed to them. A full list of guarantees, indemnities and letters of comfort existing at 30 June 1996 and 1997 is included at Appendix 3.²⁰

Size of the Commonwealth exposure

2.4 The ANAO established in the 1996 audit that the reported Commonwealth exposures as a result of the issue of explicit guarantees, indemnities and letters of comfort amounted to at least \$222 billion, comprising contingent loan guarantees of \$13 billion; non loan guarantees of \$206.8 billion (including \$43.4 billion for the Commonwealth Superannuation Scheme (CSS) and Public Sector Superannuation Scheme (PSS) guarantees); indemnities of \$1.7 billion and letters of comfort of \$180 million.

2.5 As with the original audit, the major data collection exercise for the follow up audit was an agency survey which included a census of explicit Commonwealth guarantees, indemnities and letters of comfort. Carried out in September 1997, the follow up census requested data from agencies relating to the same subset of Commonwealth contingent liabilities as examined by the 1996 audit in order to determine the nature and amount of these instruments on issue as at 30 June 1996 and 30 June 1997. This provided a basis for comparison with the results of the original audit. The ANAO sought to identify from this data any trends in the nature and size of the Commonwealth's exposure and also any improvements to the agencies' management of these instruments.

¹⁸ ANAO Audit Report No.6, 1996-97, p. 5.

¹⁹ ANAO Audit Report No.34, 1997-98, *New Submarine Project*, p. 33.

²⁰ The instruments which have been reported as having no specified dollar value are nearly all either indemnities or letters of comfort and range from indemnification of the Department of Defence's new submarine project and the Civil Aviation Safety Authority's air safety functions to letters of comfort provided for the Qantas Trade Sale.

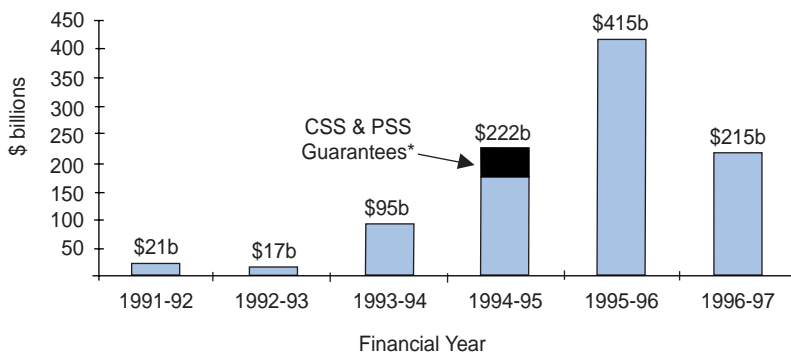
2.6 Finding: Total quantifiable exposures reported in the census amounted to at least \$214.6 billion as at 30 June 1997. The breakdown by category of instruments with dollar values included:

- loan guarantees of \$10.1 billion;
- non-loan guarantees of \$201.4 billion; and
- indemnities of \$3.1 billion.

2.7 The total Commonwealth exposure to contingent liabilities over the period 1991-92 to 1996-97²¹ is outlined in Exhibit 2.1. It was not practical for the ANAO to verify all figures returned in the census although, where the ANAO was aware of different figures to those reported to it, clarification was sought from the relevant agency.

Exhibit 2.1

Reported value of guarantees, indemnities and letters of comfort 1991-92 to 1996-97



* Note: This aggregate figure includes CSS and PSS guarantees which amounted to \$43.4 billion. Subsequent figures do not include these guarantees and therefore it is more accurate to compare the 1995-96 and 1996-97 figures of \$415 billion and \$215 billion respectively, with an amended 1994-95 aggregate of \$178.6 billion.

Source: Minister for Finance's Aggregate Financial Statement – 1991-92, 1992-93, 1993-94 and ANAO analysis based on information from 1995 and 1997 agency surveys.

²¹ It should be noted that because of deficiencies in the past in some agencies' records management and judgements that were applied by agencies regarding both disclosure in their annual financial statements and reporting to DoFA, these figures can only be taken as a guide to the full exposure of the Commonwealth. For example, the figures from 1991-92 to 1994-95 are sourced from the Minister for Finance's Annual Aggregate Financial Statements. At the time, these statements were the most comprehensive single source of information about the Commonwealth's exposure to contingent liabilities but they did not purport to be a complete record of these instruments.

2.8 The total quantifiable exposure reported as at 30 June 1997 of \$214.6 billion was some \$200 billion less than the figure of \$415 billion reported for 30 June 1996. Changes in the value of the total exposure can be expected as old agreements lapse over time and new ones are issued. There were also some variations because agencies changed the category and/or value of instruments previously reported. However, the most significant explanation for the large difference in the aggregate figures as at 30 June 1995 and 30 June 1996, lies in the changing value and reporting of the guarantee for the Commonwealth Bank of Australia (CBA) and the reporting of the CSS and PSS liabilities.

2.9 The value reported by the Department of the Treasury for the CBA guarantee rose from \$91.3 billion as at 30 June 1995 to \$324.2 billion as at 30 June 1996 because of the inclusion in the 1996 figure of the off-balance sheet exposure of the Bank. Following the sale of the final tranche of CBA in July 1996, the legislative guarantee of the CBA changed, reflecting the completion of the Bank's transition to full private sector ownership. By 30 June 1997, the amount outstanding under the guarantee had already reduced to \$104 billion, and the Commonwealth aggregate exposure was also, accordingly, significantly reduced. The CBA guarantee will continue to reduce rapidly in the next few years tapering off to a point where the guarantee is expected to reduce to approximately \$1.7 billion by the year 2006-07.

2.10 In addition, DoFA did not report the CSS and PSS guarantees in the 1997 survey. The obligations involved are now recognised as liabilities in DoFA's annual financial statement. Accordingly, the 30 June 1995 base line figure has been reduced by \$43.4 billion. In this circumstance, it is more accurate to compare the 30 June 1997 survey aggregate of \$214.6 billion to an amended 30 June 1995 survey aggregate of \$178.6 billion.

2.11 A comparison between the 30 June 1995, 1996 and 1997 aggregate values of exposure by instruments and agency is set out in Exhibit 2.2. In the original report, the overwhelming proportion of exposures by value occurred in the Departments of the Treasury and Finance and Administration (DoFA). However as the CSS and PSS guarantees are no longer in the DOFA aggregate, the Department of the Treasury now accounts for some 87 per cent of the total exposure, most of which is the result of the CBA guarantee which, as discussed above, is diminishing rapidly year by year.

2.12 Finding: The ANAO found that the overall value of the Commonwealth's exposure to guarantees, indemnities and letters of comfort increased significantly in the first year after the original audit reaching an aggregate of some \$415 billion as at 30 June 1996. This figure reduced to some \$214.6 billion as at 30 June 1997. Both changes were largely due to the changes in the value and reporting of the CBA guarantee and the reporting of the CSS and PSS guarantees. As the CBA guarantee continues to diminish in size in the next few years, there should be a corresponding material reduction in the size of the Commonwealth's overall financial exposure.

Awareness

2.13 The 1996 audit found that, overall, agencies did not have a sound understanding of the management requirements for Commonwealth guarantees, indemnities and letters of comfort. The guidelines on contingent liabilities provided by the DoFA at the time were contained in the Finance Directions and in Finance Circular 1989/11 *Guidelines for the Issuing of Commonwealth Indemnities*. Finance Circular 1989/11 attached policy guidelines for the issuing of indemnities but did not discuss guarantees and/or letters of comfort.

2.14 In the 1996 audit the ANAO also reported that the guidelines on indemnities provided in the Finance Circular did not address issues such as subrogation.²² As well, while the Finance Directions provided some guidance to agencies on the recording and reporting of guarantees and indemnities, they did not specifically discuss letters of comfort. As a consequence, agencies' awareness of these instruments and the risks associated with them was deficient. Accordingly, the ANAO recommended that the Department of Finance and Administration initiate, in consultation with other agencies, an awareness program concerning risk management of off-balance sheet exposures, notably those relating to indemnities and letters of comfort.²³

²² Subrogation is a concept and practice which arises in insurance law and involves the right of an insurer to assume the position of the insured in a claim made against the insured, or to assume the legal rights of the insured against third parties.

²³ ANAO Audit Report No.6, 1996-97, *Commonwealth Guarantees, Indemnities and Letters of Comfort*, Recommendation No.2, p. 27.

Exhibit 2.2

Comparison of portfolio departments' guarantees, indemnities and letters of comfort as at 30 June 1995, 1996 and 1997

Portfolio Departments	1995 \$m	1996 \$m	1997 \$m
Loan Guarantees			
Communications and the Arts	940.3	683.1	624.2
Defence	313.5	343.5	246.0
Employment, Education, Training and Youth Affairs	560.6	829.6	996.9
Environment ⁽¹⁾	403.9	237.1	197.8
Industry, Science and Tourism	6 577.0	6 207.3	6 153.5
Primary Industries and Energy	3 252.7	1 239.2	813.4
Prime Minister and Cabinet	0.7	0.6	0.7
Transport and Regional Development ⁽²⁾	918.7	1 088.5	1 052.9
Treasury	12.1	0.0	0.0
Sub-total	12 979.5	10 628.9	10 085.4
Non-Loan Guarantees			
Communications and the Arts	947.0	1 036.0	1 060.2
Finance and Administration	43 400.0	4.1	3.9
Foreign Affairs and Trade	192.4	209.0	145.4
Health and Family Services	0.0	0.0	uv
Industry, Science and Tourism	3 772.0	4 734.5	5 233.1
Treasury	158 476.4	396 227.5	194 994.2
Sub-total	206 787.8	402 211.1	201 436.8
Indemnities			
Attorney-General's	5.4*	uv	uv
Communications and the Arts	745.1	862.5	59.7
Defence	45.0*	185.1*	1 039.9*
Employment, Education, Training and Youth Affairs	uv	uv	uv
Environment	0.0	1.5	1.5
Finance and Administration	uv	0.0	54.8*
Health and Family Services	888.0*	uv	uv
Immigration and Multicultural Affairs	0.0	0.0	4.3
Industry, Science and Tourism	uv	uv	uv
Primary Industries and Energy	uv	1 077.4*	1 871.4*
Transport and Regional Development	uv	uv	uv
Veteran's Affairs	9.5	14.9	21.6
Sub-total	1 693.0	2 141.4	3 053.2
Letters of Comfort			
Finance and Administration	uv	uv	uv
Transport and Regional Development	180.0*	uv	uv
Sub-total	180.0	uv	uv
Total	221 640.3	414 981.4	214 575.4

uv Unspecified value instruments reported.

* Specified value and unspecified value instruments reported.

(1) Northern Territory Loan Guarantees from the then DEST (as from October 1997 with DoTRD).

(2) Includes instruments relating to maritime function from DoTRD (as from October 1997 with DWR&SB).

Source: ANAO analysis based on agencies 1995 and 1997 survey returns.

2.15 In response to the audit, DoFA in consultation with the Attorney-General's Department and the ANAO, issued Finance Circular 1997/06 *Potential Liabilities and Losses* (see Appendix 4) to replace the previous guidelines. This document, which was distributed to all Commonwealth agencies in April 1997, is not limited to consideration of indemnities but also includes advice on guarantees and letters of comfort. DoFA also attached to Finance Circular 1997/06 the *Better Practice Principles* which were included in the ANAO 1996 audit report. In addition, DoFA highlighted to agencies in the Finance Circular that both the JCPAA and HORSCFIPA had inquired into the ANAO's report.

2.16 Finance Circular 1997/06 includes advice for agencies regarding:

- definitions of the instruments and their uses;
- the types of risks covered by indemnities and guarantees;
- the importance of the instruments in the context of risk management;
- the basis of authority for issuing guarantees and indemnities;
- the difference between issuing these instruments and spending public money;
- the importance of seeking appropriate authority for contracts which contain indemnities as well as spending proposals;
- the means of protecting the Commonwealth's interests;
- the need to seek legal advice on relevant instruments;
- the need to record all contingent liabilities in agency registers; and
- the need to monitor, report and review all contingent liabilities.

2.17 Finance Circular 1997/06 was issued prior to the commencement on 1 January 1998 of revised Commonwealth financial management arrangements established under the new legislative package comprised of the Auditor-General Act, the FMA Act and the CAC Act. DoFA ensured that the guidance included in the circular was drafted to accommodate the changing legislative framework.

2.18 Under the new arrangements, the detailed guidance on financial management to an agency's officers is contained in the CEIs issued by the agency's Chief Executive. To assist agencies in developing their own CEIs, DoFA issued to all agencies model CEIs. Chapter 8 of these model instructions addresses (among other things) risk management, Commonwealth insurance and the management of indemnities. Most agencies report that they have put their own CEIs in place. The ANAO examined a sample of agencies' CEIs all of which made reference, either directly or indirectly, to the management of contingent liabilities.

2.19 Another initiative by DoFA which has enhanced agencies' awareness regarding indemnities, guarantees and letters of comfort was the promulgation in June 1997 of revised financial statement guidelines which incorporate improved guidelines regarding the reporting of contingencies. This has been further complemented by the 1997 review of the Commonwealth's policy of non-insurance. DoFA, in cooperation with other Commonwealth agencies, undertook the "Non-insurance Review" which re-examined this Commonwealth policy. The review was completed in September 1997. The details of this review are discussed later in this report.

2.20 Finding: The recommendation relating to the need for an awareness program has been implemented by the Department of Finance and Administration via a number of measures including the promulgation of: Finance Circular 1997/06; model CEIs; and revised financial statement guidelines.

Privatisation

2.21 A range of contemporary public financial management and public policy measures have been instrumental in reducing some major areas of the Commonwealth's financial exposure to guarantees, indemnities and letters of comfort. In addition, the Government has reduced the access of GBEs,²⁴ SMAs and other commercially oriented statutory authorities to explicit Commonwealth loan guarantees, to the point that there now remain few such guarantees in existence, most of which were issued some time ago. Notwithstanding this situation, the most significant factor affecting the composition and size of the Commonwealth's exposure has been the sale of Commonwealth businesses (eg Australian National Line, Australian National Railways and the Australian Industry Development Corporation).

2.22 Privatisation provides an opportunity to transfer risks formerly carried by the Commonwealth to the private sector. Even in the absence of any explicit Commonwealth guarantee of an entity's operations, the mere fact of Commonwealth ownership represents a commercial advantage to the entity, because of the likelihood that the market will rely on implicit Commonwealth guarantees in its commercial dealings with the entity. There

²⁴ The Office of Asset Sales and IT Outsourcing advised the ANAO that: *Under the umbrella of the Commonwealth guarantee, GBEs have adopted a number of practices that might warrant disclosure. These have included lease financing arrangements with idiosyncratic conditions and benefits. More significantly, they have included guarantees on continuing arrangements that cannot be readily extinguished in a privatisation, giving rise to the risk that a Commonwealth guarantee-de facto or de jure-may persist following a sale, including exposure to some risk arising out of the use of guaranteed leased assets in the post-privatised business.*

is also a risk to the Commonwealth that, should the entity risk failure, the Commonwealth will be expected to stand behind it, notably by providing additional equity. Commonwealth major asset sales since 1987-88 total some \$31 billion.²⁵ A list of Commonwealth major asset sales is set out in Exhibit 2.3.

Exhibit 2.3

Major Commonwealth Asset Sales 1987-88 to 1997-98

Sale Year	Sale Transaction ⁽¹⁾	Financial Consideration (2) (3) (\$m)
1987-88	• Commonwealth Accommodation and Catering Services	15
1988-89	• Defence Service House Corporation Loan Portfolio	1 516
1989-90	• Lease of Avalon Airfield	70
1990-91	• Australian Defence Force Home Loan Franchise	42
	• Commonwealth Housing Loan Assistance Schemes in the ACT. Portfolio of residential mortgages	47
1991-92	• First Tranche Sale of the Commonwealth Bank of Australia (CBA) ⁽⁴⁾	1 300
	• Sale of Aussat Pty Ltd	800
	• 25% of Qantas (trade sale to British Airways)	667
1993-94	• Second Tranche Sale of the CBA	1 700
	• Hollywood Repatriation General Hospital	36
	• Greenslopes Repatriation General Hospital	47
	• CSL Ltd (public share offer)	299
	• Moomba-Sydney Gas Pipeline System	534
1994-95	• ASTA	40
1995-96	• 75% Qantas (public share offer)	1 450
1996-97	• Third Tranche Sale of the CBA	5 145
	• Commonwealth Funds Management (CFM)	62
1997-98	• Brisbane, Melbourne and Perth Airports	3 312
	• Department of Administrative Services Business Units	436
	• Australian National	95
	• One third sale of Telstra Corporation (public share offer)	14 241
	• Housing Loans Insurance Corporation	108
	• AIDC Ltd	200

(1) Does not include less material asset sales such as Snowy Mountain Engineering Corporation of \$1.5 million in 1993-94, nor property sales such as overseas embassy sites.

(2) Rounded to the nearest million.

(3) Excluded are debts assumed by the Commonwealth.

(4) Funds raised were applied to increase the Bank's share capital.

(5) 1997-98 sale figures were to April 1998 for completed sales.

Source: Office of Asset Sales and IT Outsourcing and ANAO analysis.

²⁵ The First Tranche Sale of CBA which raised \$1.3 billion was applied to increase the Bank's share capital and is not included in this figure.

2.23 The sale of the Moomba to Sydney Gas Pipeline in June 1994 was an example of how the Commonwealth divested itself of all significant obligations relating to the pipeline after the sale. In the course of selling Commonwealth assets, it is common practice for a range of warranties and indemnities to be provided to bidders to facilitate the sale process. The 1997 sale of Brisbane, Melbourne and Perth airports by the Office of Asset Sales and IT Outsourcing generated proceeds of \$3.3 billion and was concluded without the need for indemnities for bidders, also warranties provided to bidders were limited and for a nominal amount.²⁶ However, the Government also decided that, in order to facilitate the sale of the Federal Airports Corporations' (FAC's) airports the Commonwealth would assume the majority of the FAC's debt as at 30 June 1997. This involved the assumption by the Commonwealth of the obligation to service and repay debt with a notional value of some \$688 million.

2.24 It is not always feasible for the Commonwealth to remove itself from all contingent liabilities associated with a business previously owned by the Commonwealth at the time of the sale. For example, the Commonwealth's guarantee of the CBA extends beyond the sale of the final tranche of the Bank in July 1996. To facilitate the sale of the final tranche, the *Commonwealth Bank Sale Act 1995* was passed by the Parliament in December 1995. The Act provided, among other things, for detailed transitional arrangements for the Commonwealth's guarantee of the liabilities of the CBA, the Commonwealth Bank Officers' Superannuation Corporation and an ongoing Commonwealth guarantee of the then Commonwealth Development Bank. Accordingly, even though the amount guaranteed by the Act will reduce in the next few years, the Commonwealth retains residual contingent liabilities following the sale of the CBA.

2.25 The sales in late 1997 of HLIC Limited and AIDC Limited will lead to further reductions over time in the Commonwealth's exposure arising from guarantees. As at 30 June 1995, the Department of the Treasury reported that the total value of housing loans insurance provided by the then Housing Loans Insurance Corporation (now HLIC Limited) which was underpinned by statutory Commonwealth guarantee was \$36 billion. By 30 June 1997, this had grown to \$44.5 billion. Following the sale of HLIC Limited, the Commonwealth guarantee remains for policies issued prior to the sale date but does not apply to any new policies issued by the privatised business. Accordingly, over time the value of this guarantee will diminish as the relevant housing loans are repaid or otherwise turned over.

²⁶ ANAO Audit Report No.38, 1997-98, *Sale of Brisbane, Melbourne and Perth Airports*.

The sale of AIDC Limited will also lead to substantial reductions in the aggregate value of Commonwealth guarantees. As at 30 June 1997 AIDC had Commonwealth guaranteed loans totalling \$3 billion and non-loan guarantees amounting to \$811 million. Not included in these figures are any derivative transactions entered into by AIDC which attracted Commonwealth guarantee.

2.26 Notwithstanding the opportunity which privatisation of a Commonwealth business presents for the transfer of risk from the Commonwealth to the private sector, it has not always been the case. In Audit Report No.14, 1995-96, *The Sale of CSL*, the ANAO reported that, through the issuing of various indemnities, the Commonwealth had retained much of the risk associated with CSL's blood supply business. Since this report was tabled, the Department of Health and Family Services has advised the JCPAA that some limited insurance cover has been obtained from private insurers to reduce the scope of the Commonwealth's risks incurred under these indemnities.

2.27 It is also customary practice in Commonwealth asset sales to indemnify certain individuals involved in asset sales. The original audit found some 12 indemnities reported which had been issued for the purpose of protecting individuals from exposure to a level of risk of litigation as a result of their involvement in asset sales. Increased outsourcing, including in the conduct of asset sales, is likely to generate an increase in the number of indemnities for individuals who are members of companies, statutory boards or advisory panels. Although this audit sought to determine whether there was a change in the incidence of such indemnities the 1997 census reported only a small increase in the number of indemnities of this type from 12 to 15.

2.28 Finding: Commonwealth asset sales over the past decade have generated proceeds of some \$31 billion and have generally provided the Commonwealth with the opportunity to effectively transfer significant risks formerly borne by the Commonwealth to the private sector.

3. Management Framework

This chapter discusses the financial governance framework for guarantees, indemnities and letters of comfort including agencies' management and monitoring performance; risk control measures; and accountability issues.

Background

3.1 Notwithstanding the magnitude of the Commonwealth's overall exposure to guarantees, indemnities and letters of comfort, there were only two reported pay-outs as a result of such instruments, which were made in relation to two Department of Defence indemnities. The first of these was a payment of \$9.3 million to Boeing Australia Limited pursuant to indemnities associated with the sale of shares in ASTA (see Exhibit 2.3). The second payment of \$1.5 million was paid against indemnities associated with the New Submarine Project Prime Contract.²⁷ Although these indemnities were in existence when the ANAO undertook its 1995 census of instruments, they were not reported to the ANAO at that time.

3.2 In comparison to the size of the Commonwealth's aggregate exposure to guarantees, indemnities and letters of comfort, the two pay-outs reported to the ANAO relate to relatively small sums. The relative infrequency of calls on agencies to make payments pursuant to these instruments may be seen as indicative of a low level of risk associated with their issue. However, the ANAO considers that the sheer size of some of the individual exposures and the Commonwealth's aggregate exposure means that one set of adverse circumstances in relation to any one of a number of high value instruments could result in a considerable payout by the Commonwealth. The ANAO considers that this possibility alone warrants vigilance in the management of these instruments.

Management and monitoring performance

3.3 In the 1996 audit, the ANAO found significant deficiencies in agencies' compliance with DoFA guidelines and directions which the ANAO considered impaired agencies' capacity to manage and monitor the risks associated with exposure to guarantees, indemnities and letters of comfort. The ANAO recommended that all relevant agencies review their records to ensure that they had a complete register of all Commonwealth

²⁷ The payouts were in relation to two separate berthing incidents in November 1994 and June 1995.

guarantees, indemnities and letters of comfort on issue within their portfolio.²⁸ The ANAO also recommended the establishment of contract registers²⁹ and improvements in physical security measures³⁰ for safe keeping of documents associated with these instruments in order to enhance agencies' records management of their contingent liabilities.

Document register

3.4 Following the repeal of the *Audit Act 1901* and its subordinate legislation, it is no longer mandatory for agencies to have registers for guarantees and contingent liabilities.³¹ Notwithstanding this, the DoFA model CEIs and Finance Circular 1997/06 strongly encourage their use. In the case of Finance Circular 1997/06, this advice is on the basis that prudence and efficient management clearly dictates the need to maintain such registers in order to provide the information for the purposes of audit and financial reporting.

3.5 There has been a general improvement in agencies' record keeping performances. In the previous audit, the ANAO found that the majority of portfolio departments, which reported having guarantees, indemnities and letters of comfort, did not have them recorded in a formal register. The characteristics of a sound document register include the effective capture and recording of information; compliance with legislative and policy requirements; appropriate security classification of documents; accessibility; and secure storage. In the 1997 census, nine of the fourteen agencies with these instruments reported having a register. An example of a register system that provides a good basis for recording these instruments is provided by the DoFA register (see Exhibit 3.1).

3.6 The ANAO noted that some agencies, in carrying out the review of their records, uncovered instruments that should have been reported in the previous audit. During the course of this audit, the ANAO found that seven agencies had inaccuracies in their reported exposures ranging from omissions of minor instruments to material inaccuracies in the value reported for particular exposures.

²⁸ ANAO Audit Report No.6, 1996-97, *Guarantees, Indemnities and Letters of Comfort*, Recommendation No.1, p. 11.

²⁹ Ibid, Recommendation No.8, p. 41.

³⁰ Ibid, Recommendation No.9, p. 43.

³¹ Previously pursuant to Section 23C and 23D of Finance Directions.

Exhibit 3.1

Department of Finance and Administration register of contingent liabilities

Group:

Contact Officer:

Type of Contingency:

Name of Guaranteed/Indemnified Organisation:

Organisation to which the Contingency was given:
(if applicable)

Title of Contingency:

Purpose of Contingency:

GUARANTEE ONLY

Type of Financial Instrument:

Total Principal Amount:

Interest Payment Arrangements:

Outstanding Balance:

Period of Financial Instrument FROM: TO:

INDEMNITY, LETTER OF COMFORT & UNDERTAKING ONLY

Amount of Contingent Liability arising from Indemnity,
Letter of Comfort or Undertaking:

INDEMNITY ONLY

Subrogation Clause: Details:

Legislative Authority:

Who approved the arrangement:

Date of Issue (Extension Date):

Date of Termination:

Registry Files:

Other Details:

Source: Department of Finance and Administration

3.7 The Department of Defence, in particular, has improved its registry system markedly and has reported a comprehensive range of instruments to this audit compared to those listed in the original report. For example, in the original census the Department reported a total quantified exposure of \$358.5 million. This figure included a guarantee of Defence Housing Authority loans totalling \$313.5 million and \$45 million in respect of a range of indemnities including a total of 26 separately named instruments or categories of instruments.³² In the 1997 census, the Department reported a total of 115 separately named instruments as current at 30 June 1997 with an aggregate value of some \$1.3 billion. All of the instruments reported by the Department as current as at 30 June 1997 were indemnities and of these 51 did not have caps on liability.

3.8 Finding: There has been a general improvement in agencies' record keeping performances and there has been some improvement in the number of agencies with document registers for their guarantees, indemnities and letters of comfort. However, there are still agencies with these instruments on issue which report that they do not have a register.

Recommendation No.1

3.9 The ANAO *recommends* that all agencies with guarantees, indemnities and letters of comfort maintain an adequate and accessible register of these instruments.

3.10 Agencies responded to the recommendation as follows:

- *Agree:* AG's, DEETYA, DFAT, DHFS, DIMA, DIST, DoCA, DoD, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.

3.11 Specific comments by agencies are set out below.

- *DoD response:* Agree. Defence's extant register already meets this recommendation.
- *DoFA response:* Agree. The Department supports this recommendation and maintains a register.

³² Routine indemnities issued in place of public liability insurance to shopping centres or similar venues for recruitment or training activities were not included in both the Department of Defence's 1995 and 1997 census responses. In addition, of the 24 specific instruments reported in 1995 only 8 included caps on liability and, accordingly, had no dollar value attached to them.

- **DIMA response:** Agree. DIMA agrees with the intent of the six recommendations and has already taken steps to convert its Departmental Consultation Register into a comprehensive Contracts Register as suggested by Recommendations 1 and 2.
- **DPIE response:** Agree. This Department maintains a central register with the ANAO considering that DPIE's administrative practice is sound.

Contracts register

3.12 In the previous audit, the ANAO noted that agencies would be assisted in enhancing their capture of off-balance sheet exposures if they maintained a contracts register which were regularly monitored and included details of any guarantees, indemnities or letters of comfort attaching to agreements. Accordingly, the ANAO recommended that agencies consider introducing such contract registers.³³

3.13 Contract registers are also not a mandatory requirement. In response to the 1997 survey, only a small minority of agencies reported having a contract register, with only the Department of Transport and Regional Development claiming that there was a link between its contract register and its register for contingent liabilities. Many agencies reported to the ANAO that they consider that contract registers are not necessarily an efficient adjunct to a main or central register in the context of managing these instruments. The Department of Defence advised the ANAO that with over 50 000 contracts awarded annually it considered that a contracts register was not a practical arrangement in this context, and to a degree, that it would duplicate information already on the register for guarantees, indemnities and letters of comfort.³⁴

3.14 Notwithstanding this view, the Department of Defence also advised the ANAO that:

Program Coordinators have been advised on the necessity to record such instruments in contracts. [The] preferred option is to record only those where the potential liability is above a threshold value, ... [and] instead of maintaining this information as a subset of the contract register, it would be administratively more appropriate to record the indemnities or guarantees attached to contracts within the indemnities register.

³³ op. cit., ANAO Audit Report No.6, Recommendation No.8, p. 41.

³⁴ Defence agreed in principle with the recommendation in the original report, however, was concerned that with over 50 000 contracts per annum with a value greater than \$2000, the identification of every contract containing indemnities or guarantees would impose an inappropriate resource burden on Defence. However, Defence was prepared to consider establishing a register applying to contracts over \$5 million which would reduce the number to some 120 contracts and still capture a significant part of the total value. Source: ANAO Audit Report No.6, 1996-97 *Commonwealth Guarantees, Indemnities and Letters of Comfort* p. 42.

3.15 The problems associated with maintaining both a register for guarantees, indemnities and letters of comfort, and a contracts register, are addressed in Finance Circular 1997/06, which advises that it is for managers of agencies to judge the scope and form of contract registers best suited to their respective agencies circumstances, consistent with meeting their responsibilities for the effective, efficient and ethical use of public money.³⁵

3.16 Finding: The ANAO found that relatively few agencies have adopted contract registers as an adjunct to a main or central document registry system for the management of the Commonwealth's guarantees, indemnities and letters of comfort. It is not clear whether those agencies which do not have such registers have actively considered and rejected the possibility of introducing them. The ANAO considers that transparency of agencies' contractual indemnities and guarantees would be enhanced by the use of contract registers.

Recommendation No.2

3.17 The ANAO *recommends* that agencies actively consider the implementation of a contract register system, which among other benefits would be an aid to effective records management of their guarantees, indemnities and letters of comfort.

3.18 Agencies responded to the recommendation as follows:

- *Agree:* AG's, DEETYA, DFAT, DHFS, DHoR, DIMA, DIST, DoCA, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.
- *Agree with qualification:* DoD.

3.19 Specific comments by agencies are set out below.

- **DoD response:** Agree with qualification. Defence has considered the implementation of a contract register system, but considers its extant procedures, as already advised to the ANAO and included at para 3.14 of this report, are sufficient to record the Department's contingent liabilities under contract and therefore negate the need to introduce a separate contracts register.

³⁵ Section 4 of *The Commonwealth Procurement Guidelines* requires that an agency agreement or Commonwealth contract valued at \$2000 or more must be notified in the *Gazette* within six weeks of entering into the agreement. The ANAO considers that this requirement would be a useful point of reference for capturing contingent liabilities associated with such agreements or contracts.

- **ANAO comment:** The ANAO is advised that the Department of Defence proposes to record all contingent liabilities in contracts valued at over \$5 million in their central recording system on the basis that this represents an appropriate balance between risk management/ reporting requirements and administrative efficiency. The ANAO considers that the materiality of the threshold level for recording contracts will need to recognise the administrative costs and benefits involved.
- **DoFA response:** Agree. The Department agrees with the recommendation where there is benefit in maintaining such a register. In view of the low volume of indemnities issued by DoFA and taking into consideration the cost-benefit of creating a separate register, it is considered that a central register of guarantees, indemnities and letters of comfort is appropriate to meet the Department's requirements with respect to these contingent liabilities.
- **DIMA response:** Agree. (see comments on Recommendation No 1, para 3.1)
- **DPIE response:** Agree. The Department's program areas maintain contract registers which have been developed to meet external reporting requirements. These are periodically reviewed in accordance with corporate reporting, audit and risk assessment requirements.
- **DPL response:** Agree. In supporting recommendations 1 and 2 DPL notes both that it has a contract register and that such a register should cover both recommendations.
- **DSS response:** Agree. A contract register system was in place in DSS prior to the creation of Centrelink. Centrelink has maintained this register, with the new DSS contributing as appropriate. DSS has recently advised Centrelink that it will commence to manage its own register.

Document security

3.20 In the 1996 audit, the ANAO found instances where the loss, destruction or misplacing of financial documentation placed the Commonwealth at a disadvantage. In addition, many of the instruments considered in the report were found to have ongoing importance, for example, some indemnities needed to be retained for evidentiary reasons in case of possible claims and/or future litigation long after the period of indemnification had lapsed.³⁶ The ANAO recognises that over classification is administratively inefficient and should be avoided. Nevertheless, the audit found that on balance agencies' security practice at the time in relation

³⁶ Where an indemnity is used in place of insurance for public liability or other loss or damage, it is necessary to retain the indemnity at least until the relevant statute of limitations has lapsed.

to these instruments tended to err on the side of too little, rather than too much control. Accordingly, the ANAO recommended that agencies review their physical security measures with a view to establishing appropriate safe custody arrangements for the documents associated with Commonwealth guarantees, indemnities and letters of comfort.³⁷

3.21 The ANAO found that document security arrangements had not changed significantly since the previous audit, with most agencies continuing to store their guarantees, indemnities and letters of comfort under routine arrangements. The need for special security (outside normal document security requirements for a given classification) when dealing with these instruments is not a mandatory requirement³⁸ and only a small number of agencies reported having more secure arrangements for their documents.

3.22 The ANAO considers that the use of routine storage arrangements in most instances does not necessarily pose an unacceptable security risk. However, in some circumstances, if an instrument is misplaced or lost the Commonwealth will face a higher level of risk if not actual loss as was the case in some instances identified in the previous audit. For example, in one case some years ago, an agency was not aware of an instrument which had been issued to a party and when the instrument was produced in the course of an asset sale the Commonwealth was obliged to make a substantial payment to extinguish that party's rights. In another example, a party, which had to be indemnified against unauthorised presentation of these instruments when it was discovered that the agency concerned had misplaced them.

3.23 The ANAO considers that transactions which may be extant for considerable periods of time; that expose the Commonwealth to risks having the potential to result in significant outlays if called upon; or which may be needed for evidentiary purposes in future litigation, should be accorded special attention to ensure their continued visibility and accessibility.

3.24 The ANAO considers that the characteristics of a sound document security system include that it:

- fits into the context of the overall records management strategy;
- accounts for the long term and/or indefinite nature of some of the obligations;

³⁷ op. cit., ANAO Audit Report No.6, Recommendation No.9, para 5, p. 43.

³⁸ It is addressed briefly in the DoFA model *Chief Executives Instructions*, Chap 8, para 17.

- embodies the characteristics of a sound document register; and
- considers the use of special security storage such as the Commonwealth Security System provided by the Attorney-General's Department for valuable, long term or otherwise significant instruments.

3.25 The ANAO identified an example of sound practice which exemplifies the characteristics outlined above in the Department of Communications and the Arts' document security system for the indemnities which it issues to facilitate, among other things, high value art exhibitions. The Department's indemnities are stored either in safe custody with the Attorney-General's Department; with their own legal contracts branch; or in a receiver of public monies safe in the Department depending on the level of security required. Such arrangements are a practical example that sound document security systems need not involve onerous administrative arrangements and (as is customary) can vary according to the relative importance of the documents concerned.

3.26 Finding: There continues to be a need for agencies to improve their security arrangements to ensure that they have effective administrative control of their guarantees, indemnities and letters of comfort. The ANAO considers that sound management practice would dictate that agencies should ensure that staff are aware of the need to provide appropriate safe custody arrangements for these instruments.

Recommendation No.3

3.27 The ANAO *recommends* that agencies review their physical security measures with a view to establishing appropriate safe custody arrangements for the documents associated with Commonwealth guarantees, indemnities and letters of comfort.

3.28 Agencies responded to the recommendation as follows:

- *Agree:* AG's, DEETYA, DFAT, DHFS, DIMA, DIST, DoCA, DoD, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.

3.29 Specific comments by agencies are set out below.

- ***DoD response:*** Agree. Defence considers its extant procedures provide satisfactory security measures. Defence's CEI Part 1, Chapter 4 *Indemnities and Insurance* (para 435) clearly advises personnel to ensure physical security of these instruments as loss or damage of an indemnity could place the Commonwealth at a disadvantage when dealing with the other party.

- **DoFA response:** Agree. The Department's centralised register has provision for the recording of the location of the documentation associated with a contingent liability. The ex DoFA register has recently been reviewed and all the documents were sighted and the location of the supporting documents recorded in the register. A review is currently being undertaken of the indemnities etc issued by ex DAS and as part of the review a similar process will occur in respect of those documents.
- **DPIE response:** Agree. The Department is currently undertaking a review of its physical security measures.

Risk management and control measures

3.30 The 1996 audit sought to determine the extent of risk management that was applied to Commonwealth guarantees, indemnities and letters of comfort. The ANAO found there were shortcomings in the overall planning and coordination of risk management strategies by central agencies and that the risk controls applied by agencies was generally inadequate, thus exposing the Commonwealth to unnecessary risk as a result of issuing these instruments.

3.31 The ANAO considered that the deficiencies identified in the 1996 audit in the overall management of guarantees, indemnities and letters of comfort was partly due to a lack of central coordination and the absence of an explicit overarching strategy to manage the Commonwealth's overall risk. Accordingly, the ANAO recommended that the DoFA prepare an explicit strategy to manage the Commonwealth's overall risk associated with guarantees, indemnities and letters of comfort.³⁹

3.32 DoFA has to date not produced an explicit strategy regarding the management of guarantees, indemnities and letters of comfort, but progress regarding this recommendation has occurred in other ways. For example, some coordination of agencies' risk management approaches to this issue is facilitated by Finance Circular No 1997/06 which addresses risk management in some detail and advises the need for an integrated "top down" approach to the issue. This circular also refers readers to the comprehensive *Guidelines for Managing Risk in the Australian Public Service* which were produced by the Management Advisory Board and its Management Improvement Advisory Committee (MAB/MIAC).⁴⁰

³⁹ op. cit., ANAO Audit Report No.6, Recommendation No.12, p. 47.

⁴⁰ MAB/MIAC *Guidelines for Managing Risk in the Australian Public Service*, Exposure Draft July 1995.

3.33 The DoFA model set of CEIs which were released in May 1997 address the broad issues of managing risk (implicit under section 44(1) of the FMA Act) and also include a section on the Commonwealth's current policy in regard to insurance and indemnities.⁴¹ Samples of agencies' CEIs were examined and most were found to have either direct or indirect reference to risk management.

Agency risk management planning

3.34 Sound risk planning is fundamental to the effective management of exposures as a result of the issue of guarantees, indemnities and letters of comfort. The ANAO considers that a sound risk management system would be one that could clearly demonstrate links between the overall corporate risk management strategy and the risk management applied to the management of these instruments.

3.35 In the 1996 audit, the ANAO found that portfolio departments' risk management practices in regard to guarantees, indemnities and letters of comfort were not generally part of a comprehensive corporate risk strategy. Of the departments which reported in 1995⁴² having these instruments, only a small minority reported having a corporate risk strategy, and fewer still claimed there was a link between this strategy and the management of contingent liabilities. Many of the risk management strategies reported in the original audit were in fact fraud control plans which had a narrower focus than the broad strategies referred to here. The ANAO recommended that, where applicable, agencies develop a risk management plan for the management of off-balance sheet liabilities; and, that there be an explicit link between the risk management plan for off-balance sheet liabilities and their corporate risk management plan⁴³ to ensure effective and consistent management of Commonwealth guarantees, indemnities and letters of comfort.⁴⁴

3.36 The importance of linking an agency's risk management plan with the management of guarantees, indemnities and letters of comfort is discussed in the DoFA Finance Circular 1997/06 in the context of the broader issues of risk management in relation to these instruments. The circular advises that:

It is essential that risks associated with contingent liabilities be examined together with other risks faced by an agency. In terms of their impact on

⁴¹ DoFA Model Chief Executive Instructions, Chap 8, December 1997.

⁴² The census for the 1996 Audit Report was undertaken in late 1995.

⁴³ There is no mandatory requirement for agencies to have either corporate risk management plans or risk management plans for the management of their off-balance sheet liabilities. However, sound management practice incorporates appropriate risk management planning.

⁴⁴ Recommendation No.4, p. 32.

*program outcomes, risks which involve contingent liabilities cannot be assessed in isolation from strategies to manage other risks ... which depending on their success, may reduce or exacerbate potential losses related to indemnities or guarantees.*⁴⁵

3.37 The importance of sound risk management strategies is also addressed in DoFA's model CEIs.⁴⁶ A sample of agencies' CEIs examined during field work for this audit revealed that, apart from indirect reference to Finance Circular 1997/06 and the MAB/MIAC guidelines for managing risk, few agencies' CEIs dealt with the issue of risk management of contingent liabilities in any detail.

3.38 The 1997 agency census revealed that the introduction of formal risk management in regard to contingent liabilities had not advanced significantly since the previous audit. Of the agencies that reported having these instruments, a small minority also reported having a corporate risk management plan and only one agency reported that there was an explicit link between this plan and the management of their guarantees, indemnities and letters of comfort. However, the agency survey also revealed that more agencies are in the process of developing their corporate risk management plans.⁴⁷

3.39 In light of the magnitude of some of the potential liabilities involved, the ANAO considers that agencies need to link their overall risk management strategy to the management of their guarantees, indemnities and letters of comfort. The ANAO considers that there is now sufficient guidance available to agencies on the elements of good risk management practice, and the benefits to be derived from its implementation, to expect that such arrangements would be the norm.

3.40 Finding: The ANAO considers that despite the wide coverage devoted to the importance of risk management in current instructions and guidelines, agencies have not generally placed sufficient emphasis on establishing comprehensive risk management strategies with links to the management of their guarantees, indemnities and letters of comfort.

⁴⁵ Finance Circular 1997/06, *Potential Liabilities and Losses*, p. 4.

⁴⁶ DoFA *Model Chief Executive Instructions*, Chap 8, December 1997.

⁴⁷ For example the Department of Primary Industries and Energy is in the process of implementing a system of assessing business risk. The objective of the project is to develop risk management policies, procedures and practices appropriate to the evolving business environment.

Recommendation No.4

3.41 The ANAO *recommends* that, in developing corporate risk management strategies, agencies ensure that an explicit link is established between the agency's corporate risk management plan and their strategies for the management of guarantees, indemnities and letters of comfort.

3.42 Agencies responded to the recommendation as follows:

- *Agree*: AG's, DEETYA, DFAT, DHFS, DHoR, DIMA, DIST, DoCA, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.
- *Agree with qualification*: DoD.

3.43 Specific comments by agencies are set out below.

- **DoD response**: Agree with qualification. As previously advised, in major capital acquisition (ie acquisitions greater than \$20m) Defence has a very defined equipment acquisition strategy which identifies the major risks and develops an appropriate risk management plan. Details on development of the plan, including insurance and indemnification, are provided in Defence's Capital Equipment Procurement Manual.
- **DoFA response**: Agree. The Department agrees with the recommendation where the contingent liabilities are significant. The Department is currently undertaking a risk assessment of the Department's programs and this will form the basis of the Departmental Risk Management Plan and will include risks associated with off-balance sheet liabilities.
- **DPIE response**: Agree. The Departmental Corporate Fraud Control Plan, Part 1, approved by the Commonwealth Law Enforcement Board, is based on risk assessment of program and core business activities. The Department will progressively develop the linkage of off-balance sheet liabilities with existing risk assessment practices in conjunction with the implementation of resource management reforms.
- **DPM&C response**: Agree. But only if a significant element.
- **DSS response**: Agree. DSS has recently commenced the development of its own risk management and audit strategies. Strategies for the management of guarantees, indemnities and letters of comfort will be incorporated into the risk management plan.

Review and evaluation

3.44 The ANAO considers that it is important that instruments are reviewed on a periodic basis to ensure that circumstances have not changed in a material way as to expose the Commonwealth to greater risk. The ANAO found in the 1996 audit that less than half of the instruments had

been subject to some form of periodic review. In addition, the ANAO considers that the appropriateness of instruments, and whether they are effective in achieving the purpose for which they were issued in the first place, should be evaluated. This will assist in limiting any tendency to issue such instruments without due consideration of alternative measures.

3.45 In the 1996 audit, the ANAO found that guarantees, indemnities and letters of comfort were not always reviewed and/or evaluated as part of normal agency practice. Accordingly, the ANAO recommended that agencies establish well documented procedures to ensure the effective review and evaluation of their financial exposures as a result of Commonwealth guarantees, indemnities and letters of comfort.⁴⁸

3.46 Finance Circular 1997/06 also advises agencies that indemnities and guarantees need to be reviewed periodically to ensure they are still the most appropriate means of achieving the benefits they were intended to deliver. The ANAO found that, of the agencies that reported having guarantees, indemnities and/or letters of comfort in response to the 1997 survey, only two claimed they had procedures in place to ensure that such periodic review and evaluation occurs. The Commonwealth may be unnecessarily exposed to risk if agencies do not institute adequate review and evaluation arrangements.

3.47 Finding: Notwithstanding the ANAO's recommendation in Report No.6 1996-97, and the advice provided in Finance Circular 1997/06, only two agencies reported having established procedures to ensure review and evaluation of their financial exposures as a result of Commonwealth guarantees, indemnities and letters of comfort. The ANAO considers review and evaluation is an important management practice which is linked directly to sound risk management and that it should be routine practice in the management of these Commonwealth exposures, at the very least for accountability purposes. As well, such practices provide a greater level of assurance to the various stakeholders at a justifiable cost.

Recommendation No.5

3.48 The ANAO *recommends* that agencies establish procedures to ensure effective review and evaluation of their financial exposures as a result of Commonwealth guarantees, indemnities and letters of comfort.

⁴⁸ op. cit., ANAO Audit Report No.6, Recommendation No.11, p. 45.

3.49 Agencies responded to the recommendation as follows:

- *Agree*: AG's, DEETYA, DFAT, DHFS, DIMA, DIST, DoCA, DoD, DoFA, DoTRD, DPIE, DPL, DPM&C, DPRS, DSS, DVA, DWR&SB, JHD and Tsy.
- *Agree with qualification*: OASITO.

3.50 Specific comments by agencies are set out below.

- **DoD response**: Agree. Defence's CEI Part 1, Chapter 4 *Indemnities and Insurance* (para 426) already advises Defence personnel of the need to review indemnities periodically to ensure they are still the most appropriate means of achieving the particular benefits they were intended to deliver.
- **DoFA response**: Agree. Details of the Departmental register are circulated to managers periodically to ensure the records are correct and appropriate prior to reporting in the Department's financial statements. During this process the information is submitted to the Department's Financial and Audit Committee as part of the processes for approving the Department's financial statements. The response to Recommendation No 4 is also relevant here.
- **DPIE response**: Agree. This Department has received favourable comment from the ANAO on its sound administrative practices, which includes effective review of risk exposures. Notwithstanding ANAO's observation, the Department regularly reviews its accounting procedures and will schedule a review of its Chief Executive Officers Instructions as soon as possible.
- **OASITO response**: Agree with qualification. OASITO considers that what is most important is the review and evaluation, rather than the establishment of procedures. OASITO is concerned about a focus on procedures rather than substance. In addition, OASITO would qualify this recommendation with explicit considerations of cost-effectiveness.

Agency risk controls

3.51 The 1996 audit found that the Commonwealth may be exposed to unnecessary risk because agencies regularly issued instruments without setting financial limits, inserting termination clauses and /or imposing time limits. The ANAO recommended that, where appropriate and commercially practical, agencies ensure that these things were stipulated when issuing Commonwealth guarantees, indemnities and letters of comfort.⁴⁹ In

⁴⁹ op. cit., ANAO Audit Report No.6, Recommendation No.6, p. 36.

addition, the ANAO considered that agencies should include subrogation⁵⁰ clauses in indemnities as a means of managing and controlling the Commonwealth's financial exposure.⁵¹ Contract vetting was another measure recommended in the original audit as a means of reducing the Commonwealth's exposure to risk.⁵² An additional improvement to agencies' risk control measures recommended by the ANAO was that agencies review their authorisation arrangements, particularly those relating to officers' authorisation to bind the Commonwealth to contractual arrangements pertaining to the issue of Commonwealth indemnities.⁵³

3.52 In response to these four recommendations, DoFA included in Finance Circular 1997/06 explicit guidance to agencies on the use of subrogation clauses; contract vetting; the importance of time limits; termination clauses and financial limits; and authorisation arrangements. In addition, some agencies now have explicit references to these risk controls in their CEIs with the Department of Industry Science and Tourism being an example of sound practice.

3.53 In regard to each specific element of the recommendations the ANAO found the following:

- ***Subrogation.*** Of the agencies which reported having indemnities, only a very small minority indicated that they had instructions regarding the use of subrogation clauses in the preparation of these instruments. An example of good practice identified by the audit is the Department of Defence's standard draft indemnity clause which addresses subrogation. In addition, the concept is also explicitly mentioned in the Department's CEIs.
- ***Time limits, financial limits and termination clauses.*** Of the agencies which reported having guarantees, indemnities, and/or letters of comfort, approximately a half reported that they did not have formal instructions for the preparation of these instruments regarding the use of time limits, financial limits and termination clauses.
- ***Authorisation arrangements.*** Of the agencies reporting having indemnities, approximately a half also reported having formal authorisation instructions to officers pertaining to the issue of Commonwealth indemnities. For example, the Department of Defence's

⁵⁰ Subrogation is a concept and practice which arises in insurance law and involves the right of an insurer to assume the position of the insured in a claim made against the insured, or to assume the legal rights of the insured against third parties.

⁵¹ op. cit., ANAO Audit Report No.6, Recommendation No.5, pp. 34-35.

⁵² op. cit., ANAO Audit Report No.6, Recommendation No.14, p. 54.

⁵³ op. cit., ANAO Audit Report No.6, Recommendation No.7, p. 38.

CEIs specify by position, those officers authorised by the Chief Executive Officer to bind the Commonwealth through indemnification, and include, where practical, financial limits on this authorisation.

- **Contract vetting.** Of the agencies reporting having these instruments, most also reported having a process of contract vetting in regard to written commercial arrangements to minimise the exposure of the Commonwealth to risk. However, the methods varied considerably between agencies. The ANAO considers that the characteristics of a sound contract vetting system include sound contract drafting for routine instruments; effective capture of agreements which need extra scrutiny; authoritative scrutiny of agreements; and effective correction of any deficiencies identified. The Department of Industry, Science and Tourism has a contract vetting process which embodies these characteristics and a description of the Department's system is presented in Exhibit 3.1.

Exhibit 3.1

Example of good practice – contract vetting

Contract Vetting — Department of Industry, Science and Tourism

- The legal service section has the task of vetting all departmental grants and contracts - including amendments - with a value of \$2000 or more. The vetting process requires contracting officers to confirm that the necessary approval has been obtained.
- The legal services section has lawyers with experience in Commonwealth contracting. Where necessary, the section obtains specialist legal advice from law firms. Advice provided by the section is recorded and filed. A record of advice from law firms is also kept.
- The legal services section maintains a data base of the department's contracts and a registry which contains the department's originals of its grants and contracts. The section seeks to ensure that all departmental grants and contracts are properly executed before the original documents are stored in its registry.

Source: ANAO analysis of information provided by the Department of Industry, Science and Tourism.

3.54 The ANAO examined a sample of indemnities raised since the original audit and found that these control measures generally were followed where practical. The ANAO considers that application of appropriate risk control measures is an administrative matter which, if carried out diligently, would contribute significantly to protecting the Commonwealth interests.

3.55 Finding: The issues of contract vetting, authorisation, subrogation, time limits, financial limits and termination clauses are adequately addressed in the Department of Finance and Administration Finance Circular 1997/06 that was circulated to all agencies in May 1997. Although agencies report a high degree of awareness of the existence of this circular, there have not been high levels of compliance with the guidelines. The ANAO considers that this situation has the potential to expose the Commonwealth to unnecessary risk and warrants further action to raise awareness of the importance of sound procedures in the preparation of these instruments. Such action might include explicit reference to the preparation and management of guarantees, indemnities and letters of comfort in agencies' CEIs.

Recommendation No.6

3.56 The ANAO *recommends* that, where appropriate and commercially practical, agencies ensure that time limits, termination clauses, subrogation clauses, and financial limits on liability are incorporated into guarantees, indemnities and letters of comfort they issue.

3.57 Agencies responded to the recommendation as follows:

- *Agree:* AG's, DEETYA, DFAT, DHFS, DIMA, DIST, DoCA, DoD, DoFA, DoTRD, DPIE, DPL, DPRS, DSS, DVA, DWR&SB, JHD, OASITO and Tsy.

3.58 Specific comments by agencies are set out below.

- **DoD response:** Agree. Defence's CEI Part 1, Chapter 4 *Indemnities and Insurance* (paras 421-428) already recommends the inclusion of each of these attributes as appropriate as well as recommending the inclusion of clauses specifying a requirement to notify the Commonwealth of any impending disputes or claims (including those from third parties).
- **DoFA response:** Agree. As these instruments are developed by legal counsel, these matters are covered as a matter of course. In addition, as a check that these matters are addressed, the Department's Register of Guarantees, Indemnities and Letters of Comfort, require these aspects to be recorded in the Register by the issuer of such instruments.
- **DPIE response:** Agree. This Department is where possible, including the recommended limitations when issuing Commonwealth guarantees, indemnities or letters of comfort.

Risk pricing and risk transfer

3.59 In the 1996 report, the ANAO discussed options for dealing with Commonwealth risk exposures from guarantees, indemnities and letters of comfort within a commercial framework of risk management and control.

The options canvassed included risk transfer through privatisation; risk prevention strategies (such as contract vetting); risk pricing; and outsourcing of risk.

3.60 The Commonwealth has to date maintained a general policy of self insurance which has limited the incentive for agencies to actively consider the benefits and cost of risk retention versus risk transfer options. The lack of any risk pricing mechanism for the various risks facing agencies has also reduced the incentives and disciplines for them to actively manage their risks.

3.61 In contrast, the ANAO noted in the 1996 report that some State Governments have adopted a more commercially oriented approach to the management of broad risk exposures that governments usually face. For example, the New South Wales and Victorian Governments have introduced systematic risk management programs that incorporate the management of contingent liabilities. This is achieved through the operation of managed insurance fund arrangements. The Victorian Government Managed Insurance Fund operates to cover a range of eventualities from relatively low level risks (retained as self insurance in the form of a normal deductible or excess) to catastrophic low frequency events which are covered by commercial reinsurance.

3.62 The ANAO recommended in the 1996 report that DoFA, in consultation with the Attorney-General's Department and other relevant agencies, review the merits of the Commonwealth carrying all the risk associated with guarantees, indemnities and letters of comfort, given that there may be commercial options for cost effective transfer of risk to other parties.⁵⁴

3.63 DoFA's response to this recommendation was to undertake the 1997 Review of the Commonwealth's Non-Insurance Policy which examined risk pricing and transference options that might be available to agencies to replace the Commonwealth's existing non-insurance policy.⁵⁵ In this circumstance, the review was not limited to canvassing the scope for risk pricing and transference with respect to guarantees, indemnities and letters of comfort but rather considered the Commonwealth's risks in their totality in order to identify:

- the range of risks that would be covered by the replacement Commonwealth policy;

⁵⁴ op. cit., ANAO Audit Report No.6, Recommendation No.16, p. 61.

⁵⁵ Final Report of the Steering Committee of the Non-Insurance Review, *Terms of Reference for the Review of the Commonwealth's Non-Insurance Policy*, Attachment A.

- the potential efficiency gains from any new arrangement, having regard to any additional administrative and other costs not incurred under the non-insurance policy; and
- benefits in terms of incentives, resource allocation and measurement, ie allocation of costs to outputs.

3.64 The Non-Insurance Review Steering Committee included members from DOFA, the Attorney-General's Department, the Australian Government Actuary and the ANAO. The Steering Committee's final report was issued in August 1997 and its key findings included that:

- the current non-insurance policy was found to be deficient in that there is limited and varied incentive for managers to manage their risks (risks exposures of agencies are not generally identified, loss experience is not generally recorded and agencies are not generally required to pay any significant losses);
- managed funds/captives have been (or are being) established by a number of state and territory Governments and are commonly used by major corporations both in Australia and overseas;
- most of the work involved in operating a managed fund could be contracted out; and
- all agencies and entities within the General Government Sector should be required to participate in the new arrangements, unless exempted by the Minister for Finance and Administration.⁵⁶

3.65 Subsequently, the Government has decided to implement the Steering Committee's recommendation to replace the Commonwealth's non-insurance policy with a managed fund called *Comcover* from 1 July 1998.

3.66 Finding: The Non-Insurance Review instigated by DoFA in 1997 considered not only the risk management issues relating to Commonwealth guarantees, indemnities and letters of comfort but also addressed the wider risks faced by the Commonwealth including assessing options for appropriately managing those risks. The implementation of the managed fund policy from 1 July 1998 should provide an effective means of managing all of the Commonwealth's normal insurable risks.

⁵⁶ Final Report of the Steering Committee of the Non-Insurance Review, *Terms of Reference for the Review of the Commonwealth's Non-Insurance Policy*, Attachment A.

⁵⁷ As with commercial insurance policies the funds coverage does not cover (among other things) losses arising from guarantees or indemnities. The ANAO sees this as a disincentive to issue these instruments which should help reduce exposures overall.

Accountability

3.67 In the 1996 audit the ANAO found that, despite there being a requirement under the then Finance Directions for departments to maintain accurate records of their guarantees and contingent liabilities and report them annually to DoFA, there were significant deficiencies in agencies' practice. Furthermore, the disclosure and reporting requirements that applied to these instruments required judgements as to which instruments were presented in portfolio departments annual reports and in the Minister for Finance's *Aggregate Financial Statements*. These reporting arrangements resulted in only partial presentation of information regarding off-balance sheet liabilities.

3.68 Accordingly, the ANAO recommended that DoFA, in consultation with agencies, review the disclosure and reporting requirements of Commonwealth guarantees, indemnities and letters of comfort with the aim of ensuring their transparency and appropriate monitoring procedures and examine options for improved accountability practices which embodied comprehensive recording of material instruments.⁵⁸

3.69 There has been significant progress in implementing these recommendations. DoFA's Finance Circular 1997/06 addresses the substance of the recommendations and provides guidance on such things as record keeping, the need to appropriately monitor instruments and the reporting of these instruments in agencies' annual financial statements.

3.70 In addition, revised Financial Statement Guidelines were issued by DoFA in June 1997. The revised guidelines provide improved guidance regarding the contingent liabilities to be included in a "Schedule of Contingencies" and how they are to be presented. Agencies are now required to report all material contingencies in one of two ways in their financial statements. If the potential for loss is not remote, then agencies are to include the contingent liability in the separate schedule of contingencies within their financial statements. If the probability that a loss will eventuate from a material contingent liability is remote, then agencies are to report them in a separate note to their financial statements.

⁵⁸ op. cit., ANAO Audit Report No.6, Recommendation No.3, p. 28 and Recommendation No.13, p. 51.

Public accountability

3.71 The 1998-99 Budget Papers include a Statement of Risks⁵⁹ which provides a consolidated list of the Commonwealth's major⁶⁰ quantifiable and unquantifiable contingent liabilities, and the Government's strategies for managing its guarantees. The instruments listed in this statement of risks that existed as at the 30 June 1997 are included in Appendix 3. The strategies for managing these exposures are aimed at ensuring the underlying strength and viability of the entities with respect to which guarantees have been provided so that the guarantees are not triggered. Similar strategies apply to entities not subject to explicit guarantees. Other arrangements are in place governing the entering into, and monitoring of, contingent liabilities such as indemnities and uncalled capital.⁶¹ In addition, the Treasurer and the Minister for Finance and Administration now jointly issue an annual *Mid-Year Economic and Fiscal Outlook* which provides updated information intended to allow an assessment of the Government's fiscal performance against its fiscal strategy and an updated Statement of Risk.

3.72 In addition, in February 1998 the consolidated financial statements of the Commonwealth Government for 1996-97 were finalised. These are the first accrual based 'whole of government' statements to be audited and tabled in the Parliament. In line with the introduction of a schedule of contingencies for agencies' financial statements, the consolidated financial statements also includes such a schedule.

3.73 Until the 1994-95 financial year, consolidated reporting of the Commonwealth's contingent liabilities was via Table 13 of the Minister for Finance's annual Aggregate Financial Statement. Audit Report No.6, 1996-97 identified serious shortcomings in the accuracy of Table 13 in the Minister for Finance's 1994-95 Aggregate Financial Statement and this method of reporting the Commonwealth's contingent liabilities was discontinued. In this circumstance, the consolidated data on contingent liabilities is no longer presented in tabular form. The Mid-year Fiscal Outlook's Statement of Risks presents information about the Commonwealth's contingent liabilities in descriptive form including quantification of some of the exposures. The information presented in

⁵⁹ Budget Paper No.1 Budget Strategy and Outlook 1998-99, pp. 2-41.

⁶⁰ Major in this case refers to fiscal risks and contingent liabilities with a possible impact greater than \$20 million in any one year, or greater than \$40 million over three years.

⁶¹ Source: *Budget Strategy and Outlook 1998-99, Budget Paper No.1*, pp. 2-43.

agencies' financial statements, the Statement of Risks and the Schedule of Contingencies differ.⁶²

3.74 The information provided in both this audit report and the previous report also differs from that presented in these other sources of information on the Commonwealth's contingent liabilities. The audits sought to collect data on all explicit Commonwealth guarantees, indemnities and letters of comfort on issue as at 30 June 1995, 1996 and 1997 regardless of the likelihood of having to make a payment. Accordingly, while the subset of instruments examined by the audits are included in the subsets of contingencies examined by these reporting mechanisms many of the instruments reported in the audit do not meet the criteria for inclusion in that the risks they represent are too small and/or remote.

3.75 Finding: There has been a marked improvement in the guidance provided to agencies regarding the disclosure and reporting of the Commonwealth's guarantees, indemnities and letters of comfort. The ANAO considers that DoFA has carried out the intent of the 1996 audit report recommendations concerning the need to improve disclosure, reporting and accountability arrangements for Commonwealth guarantees, indemnities and letters of comfort. The improvements to these arrangements made since 1996 have enhanced the transparency of material Commonwealth contingent liabilities.

⁶² The notes to the Schedule of Contingencies advise that:

The information presented in the Schedule of Contingencies differs from that presented in the Statement of Risks published in Budget Paper No. 1 'Budget Strategy and Outlook 1997-98' (May 1997) and the 'Mid-year Economics and Fiscal Outlook 1997-98' (December 1997) due to conceptual differences. These conceptual differences fall into several categories. The first of these is the timing difference associated with the differing publications, with the Schedule of Contingencies reflecting information as at 30 June 1997. Secondly, the Statement of Risks differs in its coverage of items in that it reflects fiscal risks which include events such as court decisions, that may affect revenue collectable, which would not normally meet the Schedule of Contingencies criteria. Thirdly, the Schedule of Contingencies distinguishes between contingent gains and losses and also excludes contingencies whose likelihood is regarded as being remote. Finally, there exists differences in perspective, the Statement of Risks focussing on the Budget Sector, while the Schedule of Contingencies provides a 'whole of government' view with a sector breakdown, including the General Government Sector, which is the nearest in concept to the Budget Sector.

More detail of contingencies of specific Commonwealth entities can be found in audited financial statements, appended to Annual Reports of the entities which are tabled in Parliament.

4. Concluding Remarks

This chapter outlines the Commonwealth's exposure and the overall audit conclusions.

Commonwealth's exposure

4.1 Since the repeal of the *Audit Act 1901* and the introduction of the *Financial Management and Accountability Act 1997* there have been significant changes in the procedures for issuing loan guarantees. Under the *Audit Act* a loan guarantee could only be issued by or on behalf of the Commonwealth if expressly authorised by an act of Parliament. Under the *Financial Management and Accountability Regulations* this may, subject to certain requirements being met, now be authorised by the Finance Minister, or a person authorised by the Finance Minister for the purpose.

4.2 As at 30 June 1997, Australian National Railways Commission (AN) accounted for \$726.4 million of the \$10.1 billion in Commonwealth contingent loan guarantees on issues as at 30 June 1997. The Government announced the sale of AN in August 1997 and that the Commonwealth will assume AN's debt (consisting of borrowings, swap transactions and prepaid interest) with a face value of \$733.6 million. Accordingly, there should be a further reduction in the Commonwealth's aggregate contingent loan liabilities with a corresponding increase in the Commonwealth's liabilities.

4.3 The non-loan guarantees accounted for the largest proportion of the Commonwealth's quantified exposure to contingent liabilities for the three years ending 30 June 1995, 1996 and 1997. The 1995 reported aggregate was \$206.8 billion, compared with \$402.2 billion as at 30 June 1996 and \$201.4 billion as at 30 June 1997. As discussed, in Chapter 2 the large difference in the figures was due overwhelmingly to the changes in the reporting and value of the CBA guarantee and the change in reporting the PSS and CSS funds.

4.4 In the 1995 census, indemnities constituted the largest category of instruments by number but the lowest total reported value. This continued to be the case in the 1997 census. As at 30 June 1995, 1996 and 1997 they amounted to \$1.7 billion, \$2.1 billion and \$3.1 billion respectively. There are two main reasons why the reported total value of indemnities accounts for such a small proportion of the Commonwealth's aggregate exposure from guarantees, indemnities and letters of comfort.

4.5 First, more than half of the indemnities reported were not quantified. Usually where a value is ascribed to an indemnity it relates to the value of the cap on the Commonwealth's liability. In circumstances where such a cap is deemed impractical or inappropriate, there is usually no value specified for the indemnity. Some of these indemnities for which no value is specified can present significant risk to the Commonwealth because of the nature of exposure assumed. For example, the Department of Defence's submarine contract, includes an unlimited indemnity which estimates indicate could be worth up to \$3.0 billion.⁶³ Other liabilities with no dollar limit but with the potential for significant pay-outs include the indemnification of Civil Aviation Safety Authority's air safety functions and the indemnification of the national blood supply.

4.6 Second, the broad range of Commonwealth activities facilitated by indemnities varies in the level of exposure they represent to the Commonwealth. Where an indemnity is used for a purpose such as to secure access for Royal Australian Navy vessels to ports, by assuring the owners that any damage will be paid for, the limit on liability included in each deed is usually around \$10 million. Even when aggregated across the 38 ports involved (\$380 million), this represents a relatively modest sum in comparison to large non-loan guarantees such as those underpinning the operations of AIDC and the Export Finance and Insurance Corporation (as at 30 June 1997, \$1.14 and \$4.09 billion respectively).

4.7 There were a number of significant changes in the agencies' reporting of instruments from the original 1995 census which account in part for the increase in aggregate reported value of indemnities. In the 1996 audit, the Department of Defence reported some \$358 million in exposures overall, whereas in this audit the 30 June 1997 figure was some \$1.04 billion. This was largely due to the inclusion of indemnities relating to the supply of the Anzac ships to the value of some \$500 million.⁶⁴ In addition, the Department considerably improved its reporting regarding a wide range of acquisition, operations and training indemnities. The reported value of these kinds of indemnities increased from \$45 million in the original audit to approximately \$470 million as at 30 June 1997.⁶⁵

⁶³ The Defence Submarine indemnity replaced the Australian Submarine Corporation's (ASC) insurance which covered its marine builders' risk and risks in respect of public liability, property damage and contracts works policy. In 1995, the ASC's insurance brokers provisionally valued the overall liability at \$3.0 billion. Source: ANAO Audit Report No.34, 1997-98 *New Submarine Project*, p. 27.

⁶⁴ The Anzac ship indemnities should have been reported in the original audit.

⁶⁵ Noting that some of these would not have been extant at the time of the last audit.

4.8 A further reason for the increase in the aggregate value of reported indemnities was that the Department of Primary Industries and Energy reported the \$1.8 billion Wheat Board instrument as an indemnity rather than as a loan guarantee as it had in the 1996 audit. In the 1996 audit, the Department of Health and Family Services reported 444 indemnities totalling \$888 million issued to employers taking on Commonwealth Rehabilitation Service clients, these are now reported as having no value.⁶⁶ In addition, instruments issued by the Department of Communications and the Arts to assist arts companies to mount Australian tours which were reported as indemnities in the 1995 census have been reported by the Department as non-loan guarantees as at 30 June 1996 and 1997.⁶⁷

4.9 The Department of Communications and the Arts Commonwealth Indemnity Scheme (CIS) facilitates the presentation of major art and cultural exhibitions in Australia by removing the need for exhibition organisers to pay otherwise unaffordable insurance premiums. Rather than representing a single instrument, the CIS provides a framework under which separate instruments are issued for each exhibition included in the scheme up to a total limit for the CIS approved by the Government. Accordingly, the total value reported for the CIS as at 30 June each year will vary considerably depending on the number of exhibitions indemnified on that date and their value.

4.10 At 30 June 1995, the total limit on the value of exhibitions which could be indemnified under the scheme at any one time was \$500 million. In January 1997, the Government agreed that the indemnity limit under the CIS be increased to \$1 billion due to the increasing difficulty in getting high quality exhibitions to come to Australia without providing higher value indemnities. The Department of Communications and the Arts advised the ANAO that as at 30 June 1996 indemnities current under the CIS totalled some \$787.5 million while, due to the absence of any major exhibition at the time, the indemnities current as at 30 June 1997 under the CIS totalled only \$59.7 million.

4.11 In the 1996 report, the then Department of Transport reported a letter of comfort for ANL's financiers to the value of \$180 million. This was not reported in the recent census and there were no new letters of comfort with a specified value reported in this audit.

⁶⁶ DHFS advise that under the Safety, Rehabilitation and Compensation Act (1988) clients of the Commonwealth Rehabilitation Service (CRS) are declared to be employees of the Commonwealth and as such are covered by Comcare for workers compensation. In light of this advice, the ANAO considers that it is more appropriate not to specify a value for these instruments.

⁶⁷ The total values of instruments on issue under this scheme as at 30 June 1996 and 1997 were \$419 327 and \$189 000 respectively.

4.12 Finding: The broad proportions of guarantees, indemnities and letters of comfort have remained essentially the same between the 1995 and 1997 surveys, with non-loan guarantees accounting for the overwhelming proportion of quantified exposure, and indemnities accounting for the largest number of instruments.

Conclusions

4.13 The ANAO considers that changes in the Commonwealth's financial management arrangements have created a framework which now places greater emphasis on the visibility and effective management of the Commonwealth's guarantees, indemnities and letters of comfort.

Potential size of the Commonwealth's exposure

4.14 The ANAO found that the overall value of the Commonwealth's exposure to guarantees, indemnities and letters of comfort increased significantly in the first year after the original audit reaching an aggregate of some \$415 billion as at 30 June 1996. This figure reduced to some \$214.6 billion as at 30 June 1997. Both variations were largely due to the changes in the value and reporting of the Commonwealth Bank Australia guarantee and the reporting of the Commonwealth Superannuation Scheme and Public Sector Superannuation guarantees. As the CBA guarantee continues to diminish in size in the next few years, there should be a corresponding material reduction in the size of the Commonwealth's overall financial exposure.

4.15 Total exposures reported in the census amounted to at least \$214.6 billion as at 30 June 1997. The breakdown by category of instruments with dollar value was loan guarantees of \$10.1 billion; non-loan guarantees of \$201.4 billion; and indemnities of \$3.1 billion.

Management and monitoring

4.16 There has been an overall improvement in the number of agencies implementing registers for their guarantees, indemnities and letters of comfort. The ANAO found that relatively few agencies have adopted contract registers as an adjunct to a main or central document registry system for the management of guarantees, indemnities and letters of comfort. It is not clear whether those agencies, which do not have such registers, have actively considered and rejected the possibility of introducing them. The ANAO considers that transparency of agencies' contractual indemnities and guarantees would be enhanced by the use of contract registers.

4.17 There continues to be a need for agencies to improve their security arrangements to ensure that they have effective administrative control of their guarantees, indemnities and letters of comfort. The ANAO considers that sound management practice require that agencies should ensure that all staff are aware of the need to provide appropriate safe custody arrangements for these instruments.

Risk management

4.18 Commonwealth asset sales over the past decade have generated proceeds of some \$31 billion and the opportunity to effectively transfer significant risks formerly borne by the Commonwealth to the private sector. Notwithstanding some examples of increased exposures, over time, a by-product of Commonwealth asset sales will be a reduction in the Commonwealth's overall exposure as a result of guarantees, indemnities and letters of comfort provided.

4.19 The ANAO considers that despite the wide coverage devoted to the importance of risk management in current financial instructions and guidelines, agencies have not generally placed sufficient emphasis on establishing comprehensive risk management strategies with direct links to the management of their guarantees, indemnities and letters of comfort. Although agencies report a high degree of awareness of the existence of the DoFA Finance Circular 1997/06 that was circulated to all agencies in May 1997, there has not been high levels of compliance with these guidelines. The ANAO considers that this situation has the potential to expose the Commonwealth to unnecessary risk and warrants further action to raise awareness of the importance of sound procedures in the preparation of these instruments. Such action might include explicit reference to the preparation and management of guarantees, indemnities and letters of comfort in agencies' CEIs.

4.20 The Non-Insurance Review instigated by DoFA in 1997 considered not only the risk management issues relating to Commonwealth guarantees, indemnities and letters of comfort but also addressed the wider risks faced by the Commonwealth including assessing options for appropriately managing those risks. The implementation of the managed fund (*Comcover*) policy from 1 July 1998 should provide an effective means of managing of all of the Commonwealth's normal insurable risks.

Accountability

4.21 There has been a marked improvement in the guidance provided to agencies regarding the disclosure and reporting of the Commonwealth's guarantees, indemnities and letters of comfort. The ANAO considers that DoFA has carried out the intent of the 1996 audit report recommendations

concerning the need to improve disclosure, reporting and accountability arrangements for Commonwealth guarantees, indemnities and letters of comfort. The improvements to these arrangements made since 1996 have continued to enhance the transparency of material Commonwealth contingent liabilities.



Canberra ACT
23 June 1998

P.J. Barrett
Auditor-General

Part Three

Appendices

Appendix 1

Parliamentary Committees' Recommendations

Recommendations of JCPAA Inquiry: Report 350.⁶⁸

Recommendation No.1: In preparing the Finance Minute to this report, the Department of Finance should seek up-to-date statements from all agencies with guarantees, indemnities and letters of comfort within their portfolios, on the steps they have taken to address each relevant recommendation in Audit Report No.6, 1996-97.

Recommendation No.2: Full statements of off-balance sheet contingent liabilities associated with guarantees, indemnities and letters of comfort should be a mandatory inclusion in annual financial statements of departments except where disclosure may adversely affect the Commonwealth's interests.

Recommendations of HORSCFIPA Report of the Inquiry into ANAO Audit Report No.6, 1996-97 on Commonwealth Guarantees, Indemnities and Letters of Comfort, (September 1997).⁶⁹

Recommendation No.1: That the power of Commonwealth statutory authorities to accept liabilities, including contingent liabilities, be regularly reviewed by portfolio departments, in consultation with the ANAO and Finance, to ensure that the Commonwealth's interests are protected.

Recommendation No.2: That agencies be required to follow the recommendations of the ANAO and Finance concerning the formal authorisation of officers to issue indemnities on behalf of a Minister. Each agency should also be required to provide a copy of its register of authorised officers to Finance on a regular basis.

Recommendation No.3: That agency heads be required to take account of their responsibility with regard to management of the Commonwealth's contingent liabilities. Subject to ultimate Ministerial responsibility and accountability to the Parliament, it is the responsibility of agency heads to ensure the agency complies with guidelines and other instructions concerning contingent liabilities.

Recommendation No.4: That agencies take account of the direction to include a limit where possible. Agencies should always attempt to measure the potential financial cost as part of risk assessment either internally or

⁶⁸ The Government responded to these recommendations on 17 September 1997.

⁶⁹ The Government responded to these recommendations on 7 May 1998.

with external assistance, and should keep a record of that assessment. Where a limit is not included, agencies should record the reason for that arrangement as part of the risk assessment.

Recommendation No.5: That the Department of Finance in consultation with the ANAO issue a 'better administrative practice' document to provide agencies with more direct assistance on how to introduce and maintain a central register of contingent liabilities.

Recommendation No.6: That agencies consider introducing contract registers, in particular with a view to addressing concerns about the increased emphasis on outsourcing Commonwealth functions. In the absence of a register, agencies should ensure that contingent liabilities in contracts, if any, are recorded separately on a Register of Guarantee, Indemnities and Letters of Comfort.

Recommendation No.7: That Defence review its existing contracts and its contract management practices to ensure that its central record keeping and finance areas are fully informed of all contingent liabilities contained in contracts.

Recommendation No.8: That agencies which report contingent liabilities to the public or to Ministers, review those values, in consultation with the ANAO where relevant, to ensure that they calculate the values accurately.

Recommendation No.9: That the Department of Finance, in consultation with the ANAO, takes all steps necessary to ensure that whole of government risk reporting in the Statement of Risks provides an accurate description of the Commonwealth's exposure.

Recommendation No.10: That Finance, in its review of the Commonwealth policy of self insurance, take account of the need for expertise in managing risk and the cost to departments of providing such expertise in-house or externally.

Recommendation No.11: That the review of the governing legislation for Export Finance and Insurance Corporation under the Commonwealth's Legislation Review Schedule include consideration of the appropriate prudential regulation arrangements for Export Finance and Insurance Corporation where commercial risks are covered.

Recommendation No.12: That the ANAO review the management of the Commonwealth's contingent liabilities, and agency compliance with the guidelines on issuing indemnities, guarantees and letters of comfort, in two year's time.

Appendix 2

Recommendations and comments from ANAO Audit Report No.6, 1996-97, *Commonwealth Guarantees, Indemnities and Letters of Comfort*.

Recommendation No.1: The ANAO *recommends* that all relevant agencies conduct a review of their records to ensure that they have a complete register of all Commonwealth guarantees, indemnities and letters of comfort within their portfolio.

- *Agree:* DoCA, Tsy, PM&C, DIST, DVA, DoF, DHFS, DAS DoTRD, DPIE and AG's.
- *Agree in principle:* DEETYA and DoD.
- *No comment:* DEST and DFAT.

Recommendation No.2: The ANAO *recommends* that the Department of Finance, initiate, in consultation with agencies, an awareness program concerning risk management of off-balance sheet exposures, notably those relating to indemnities and letters of comfort.

- *Agree:* DAS, DoCA, Tsy, PM&C, DIST, DEETYA, DoTRD and AG's.
- *Agree in principle:* DoF.
- *No comment:* DoD, DHFS, DEST, DPIE, DFAT and DVA.

Recommendation No.3: The ANAO *recommends* that the Department of Finance, in consultation with agencies, and cognizant of commercial sensitivities, reviews the disclosure and reporting arrangements of Commonwealth guarantees, indemnities and letters of comfort with the aim of ensuring their transparency and appropriate monitoring procedures.

- *Agree:* DAS, Tsy, PM&C, DIST, DoTRD, AG's and DEETYA.
- *Agree in principle:* DoF and DoCA.
- *No comment:* DoD, DHFS, DEST, DVA, DPIE and DFAT.

Recommendation No.4: The ANAO *recommends* that, where applicable:

- agencies develop a risk management plan for the management of off-balance sheet liabilities; and
- there be an explicit link between the risk management plan for off-balance sheet liabilities and their corporate risk management plan to ensure effective and consistent management of Commonwealth guarantees, indemnities and letters of comfort.

- *Agree*: DoCA, PM&C, DIST, DVA, AG's, DAS, Tsy, DoTRD, and DPIE.
- *Agree in principle*: DoF, DoD, DHFS and DEETYA.
- *No comment*: DEST and DFAT.

Recommendation No.5: The ANAO *recommends* that the Department of Finance Circular on Indemnities be revised to incorporate the concept of subrogation in regard to indemnities and that agencies should include such clauses in indemnities where applicable.

- *Agree*: DAS, Tsy, PM&C, DIST, DEETYA, AG's, DoTRD, DoF and DoCA.
- *No comment*: DoD, DHFS, DEST, DVA, DPIE and DFAT.

Recommendation No.6: The ANAO *recommends* that, where appropriate and commercially practical, time limits, termination clauses and financial limits should be stipulated by agencies when issuing Commonwealth guarantees, indemnities and letters of comfort.

- *Agree*: DAS, Tsy, PM&C, DIST, DEETYA, AG's, DoF, DoTRD, and DoCA.
- *Agree in principle*: DPIE.
- *No comment*: DHFS, DEST, DVA, DoD and DFAT.

Recommendation No.7: The ANAO *recommends* that agencies review their authorisation arrangements, particularly those relating to officers' authorisation to bind the Commonwealth to contractual arrangements pertaining to the issue of Commonwealth indemnities.

- *Agree*: DoF, DOCA, DPIE, DoD, DHFS, DAS, Tsy, PM&C, DIST, DVA, DoTRD and AG's.
- *Agree in principle*: DEETYA.
- *No comment*: DEST and DFAT.

Recommendations No.8: The ANAO *recommends* that agencies consider introducing contract registers which are regularly monitored to facilitate and enhance the records management of their contingent liabilities.

- *Agree*: DHFS, DAS, DoCA, Tsy, PM&C, DIST, DVA, DoF, AG's, DPIE and DoTRD.
- *Agree in principle*: DEETYA and DoD.
- *No comment*: DEST and DFAT.

Recommendation No.9: The ANAO *recommends* that agencies review their physical security measures with a view to establishing appropriate safe custody arrangements for the documents associated with Commonwealth guarantees, indemnities and letters of comfort.

- *Agree*: DoD, DHFS, DAS, Tsy, PM&C, DIST, DVA, AG's, DoF, DoCA, DPIE and DoTRD.

- *Agree in principle:* DEETYA.
- *No comment:* DEST and DFAT.

Recommendation No.10: The ANAO *recommends* that agencies regularly review the effectiveness of their reporting and monitoring arrangements for guarantees, indemnities and letters of comfort to ensure that the Commonwealth's interests are protected for the legal duration of the instruments.

- *Agree:* DoD, DHFS, DAS, Tsy, PM&C, DIST, DVA, AG's, DoF, DoCA, DPIE and DoTRD.
- *Agree in principle:* DEETYA.
- *No comment:* DEST and DFAT.

Recommendation No.11: The ANAO *recommends* that agencies establish well documented procedures to ensure the effective review and evaluation of their financial exposures as a result of Commonwealth guarantees, indemnities and letters of comfort.

- *Agree:* DoD, DHFS, DAS, DoTRD, Tsy, PM&C, DIST, DVA, AG's, DoF, DoCA and DPIE.
- *Agree in principle:* DEETYA.
- *No comment:* DEST and DFAT.

Recommendation No.12: The ANAO *recommends* that the Department of Finance prepare an explicit strategy to manage the Commonwealth's overall risk associated with guarantees, indemnities and letters of comfort.

- *Agree:* Tsy, PM&C, DIST, AG's, DoTRD, DAS and DEETYA.
- *Agree in principle:* DoF and DoCA.
- *No comment:* DoD, DHFS, DEST, DVA, DPIE and DFAT.

Recommendation No.13: The ANAO *recommends* that the Department of Finance, in consultation with agencies, examine options for improved accountability practices which embody comprehensive recording of material Commonwealth guarantees, indemnities and letters of comfort.

- *Agree:* Tsy, DoTRD, PM&C, DIST, DEETYA, AG's, DoD, DAS and DoCA.
- *Agree in principle:* DoF.
- *No comment:* DHFS, DEST, DVA, DPIE and DFAT.

Recommendation No.14: The ANAO *recommends* that agencies entering into any form of written commercial arrangement should undertake a formal process of contract vetting to ensure that the Commonwealth exposure to risk is minimised.

- *Agree:* DHFS, Tsy, PM&C, DIST, DEETYA, DVA, DoF, DPIE, DoTRD, AG's and DAS.
- *Agree in principle:* DoD and DoCA.
- *No comment:* DEST and DFAT.

Recommendation No.15: The ANAO *recommends* that the Department of Finance, in consultation with relevant agencies, examine the application of appropriate risk based systems to the management and pricing of risk pertaining to Commonwealth guarantees, indemnities and letters of comfort.

- *Agree:* PM&C, DIST, DoTRD, AG's and Tsy.
- *Agree in principle:* DEETYA, DoF, DAS and DoCA.
- *No comment:* DoD, DHFS, DEST, DVA, DPIE and DFAT.

Recommendation No.16: The ANAO *recommends* that the Department of Finance, in consultation with the Attorney-General's Department and other relevant agencies, review the merits of the Commonwealth carrying all the risk associated with guarantees, indemnities and letters of comfort, given that there may be commercial options for the cost effective transfer of risk to other parties.

- *Agree:* Tsy, PM&C, DIST, AG's, DoF, DoTRD and DAS.
- *Agree in principle:* DEETYA and DoCA.
- *No comment:* DoD, DHFS, DEST, DVA, DPIE and DFAT.

Appendix 3

Guarantees, Indemnities and Letters of Comfort as at 30 June 1996 and 1997

LOAN GUARANTEES	1996 value (\$m)	1997 value (\$m)
DEPARTMENT OF COMMUNICATIONS AND THE ARTS		
ABC Yen 3 billion term loan	35.30	35.90
ABC \$53 million domestic bond	53.00	53.00
ABC eurobond issue	100.00	100.00
SBS building loan	39.00	39.00
Telstra loan ^a	455.80	396.29
Total	683.10	624.19
DEPARTMENT OF DEFENCE		
Bank Guarantee - Malaysia (Health Care)	0.00*	
Defence Housing Authority	343.50	246.00
Total	343.50	246.00
DEPARTMENT OF THE ENVIRONMENT		
Northern Territory Guarantees ^b	237.13	197.83
Total	237.13	197.83
DEPARTMENT OF EMPLOYMENT, EDUCATION, TRAINING AND YOUTH AFFAIRS		
Schools		
- Canterbury Christian School (LG-22)	0.07	0.05
- Glenaeon School (LG-4)	0.04	0.01
- International Grammar School (LG-21)	0.50	0.50
- Macarthur Region Anglican School (LG-14)	0.01	-
- Radford College (LG-10)	0.46	0.31
- Radford College (LG-20)	1.25	1.02
- Redlands College (LG-23)	0.50	0.47
- St Paul's Grammar School (LG-19)	0.43	0.38
- Southside Montessori School (LG-18)	0.04	0.03
Austudy/Abstudy Supplement	826.30	994.10
Total	829.59	996.86

LOAN GUARANTEES	1996 value (\$m)	1997 value (\$m)
DEPARTMENT OF INDUSTRY, SCIENCE AND TOURISM		
AIDC ^c	3 234.34	3 115.53
EFIC	2 973.00	3 038.00
Total	6 207.34	6 153.53
DEPARTMENT OF PRIMARY INDUSTRIES AND ENERGY		
Australian Wheat Board	5.00	5.00
Queensland Fish Management Authority	11.61	9.00
Snowy Mountain Hydro-Electric Authority	139.14	108.39
Wool International	1 083.43	691.00
Total	1 239.18	813.39
DEPARTMENT OF THE PRIME MINISTER AND CABINET		
ATSIC guarantees provided under Sec.19(1) of the <i>ATSIC Act 1989</i> :		
Cummeraragunga Pty Ltd	0.00*	0.00*
AD & YD Lester	0.01	0.01
M Campbell TA AB-OZ PTY LTD		0.01
Balranald Aboriginal Corporation	0.04	0.04
Nyampa Aboriginal Housing Company	0.03	0.02
Jumbun Pty Ltd	0.02	0.02
Morr Morr Pastoral Company	0.10	0.14
H & E Rix	0.02	0.02
A & M Bon	0.24	0.22
Woorabinda Pastoral Company	0.07	0.12
Yanangu Stores	0.02	0.08
CAAMA		0.00*
Total	0.55	0.68
DEPARTMENT OF TRANSPORT AND REGIONAL DEVELOPMENT		
ANL Ltd promissory note ^d	45.00	45.00
ANL Ltd (finance and lease facilities)	192.16	
Air Services Australia medium term Bank Loan (<i>Civil Aviation Act 1988</i>)	5.63	1.88
Sub total	242.79	46.88

LOAN GUARANTEES	1996 value (\$m)	1997 value (\$m)
<i>Air Services Australia Act 1995 Promissory Notes as at 30/6/96</i> (date of maturity)		
- Promissory Note (15/7/96)	4.94	
- Promissory Note (15/7/96)	4.94	
- Promissory Note (4/7/96)	10.90	
- Promissory Note (12/8/96)	8.39	
- Promissory Note (13/9/96)	14.72	
- Promissory Note (12/8/96)	9.88	
- Promissory Note (16/8/96)	9.87	
- Promissory Note (16/8/96)	10.87	
- Promissory Note (20/8/96)	19.75	
- Promissory Note (18/9/96)	19.63	
- Promissory Note (6/8/96)	14.88	
- Promissory Note (31/7/96)	24.83	
Sub total	153.59	
<i>Australian National Railways Commission Act 1983</i> P-Notes (date of maturity)		
Promissory Notes on issue as at 30/6/96		
- Promissory Note (4/7/96)	19.88	
- Promissory Note (8/7/96)	9.66	
- Promissory Note (15/7/96)	4.82	
- Promissory Note (22/7/96)	9.80	
- Promissory Note (29/7/96)	19.28	
- Promissory Note ((30/7/96)	9.88	
- Promissory Note (13/8/96)	10.80	
- Promissory Note (19/8/96)	14.73	
- Promissory Note (19/8/96)	14.73	
- Promissory Note (12/9/96)	14.72	
- Promissory Note (25/9/96)	25.52	
Sub total	153.82	
Promissory Notes on issue as at 30/6/97		
- Promissory Note (1/7/97)		24.64
- Promissory Note (10/7/97)		29.58
- Promissory Note (21/7/97)		6.90
- Promissory Note (1/8/97)		6.90
- Promissory Note (8/8/97)		11.82
- Promissory Note (14/8/97)		3.94
- Promissory Note (18/8/97)		11.83

LOAN GUARANTEES	1996 value (\$m)	1997 value (\$m)
- Promissory Note (15/9/97)		8.88
- Promissory Note (19/9/97)		19.73
- Promissory Note (22/9/97)		4.93
- Promissory Note (25/9/97)		10.85
- Promissory Note (1/12/97)		22.37
- Promissory Note (5/12/97)		9.73
Sub total		172.09
Australian National Line		
- Containers 1 (Operating Lease)		11.71
- Containers 2 (Operating Lease)		10.02
- Containers 3 (Operating Lease)		8.22
- MV River Yarra (Operating Lease)		37.10
- Australian Endeavour (Financial Lease)		62.25
- Searoad Mersey (Operating Lease)		27.95
- Searoad Tamar (Financial Lease)		40.38
- River Boyne (Operating Lease)		28.79
- River Embley (Operating Lease)		37.19
- Tranztas Trader (Financial Lease)		15.97
Sub total		279.57
Australian National Railways Commission Inscribed Stock	2.37	
Australian National Railways Commission Inscribed Stock	77.30	77.30
Australian National Railways Commission Yen Zero Coupon	90.64	93.49
Australian National Railways Commission Yen Zero Coupon	91.94	98.48
Australian National Railways Commission Zero Coupon Bond	57.08	64.64
Australian National Railways Commission Eurobond	100.00	100.00
Australian National Railways Commission Eurobond 3	50.00	50.00
Australian National Railways Commission Reverse Dual Samurai	69.00	70.41
Sub total	538.33	554.32
Total	1 088.52	1 052.86
Grand Total	10 628.92	10 085.34

Notes:

- (a) Reported as four separate instruments in the original audit.
- (b) Northern Territory Loan Guarantees from the then DEST (as from October 1997 with DoTRD).
- (c) Source: AIDC 1997 Annual Report.
- (d) Includes instruments relating to maritime function from DoTRD (as from October 1997 with DWR&SB).
- * Values less than \$5000 have been rounded down to zero.

NON-LOAN GUARANTEES	1996 value (\$m)	1997 value (\$m)
DEPARTMENT OF COMMUNICATIONS AND THE ARTS		
Deed of Guarantee between the Commonwealth and Telecom Superannuation Pty Ltd	1 036.00	1 060.00
Outback Arts	0.00*	0.00*
State Lyric Opera		0.01
Dance North	0.01	
State Opera of South Australia	0.22	
Theatre Royal Management Board	0.04	
Country Arts Western Australia	0.10	
State of South Australia Adelaide Festival	0.04	
Jazz Co-ordination Association	0.00*	
Australian Capital Territory Government Canberra Theatre	0.01	
South Australian Country Arts Trust		0.02
Arts on Tour - Bell Shakespeare		0.03
Theatre North		0.02
Canberra Youth Theatre		0.02
Australian Chamber Orchestra		0.07
Made to Move		0.03
CAST		0.03
Total	1 036.42	1 060.22
DEPARTMENT OF FINANCE and ADMINISTRATION		
Department of Defence	0.11	0.11
Department of Defence - Removals Australia		0.02
Business Services Trust Account for Asset Services	0.94	0.73
Department of Primary Industries & Energy (Australian Construction Services)	3.00	3.00
Total	4.05	3.87
DEPARTMENT OF FOREIGN AFFAIRS AND TRADE		
Austrade	208.96	145.36
Total	208.96	145.36
DEPARTMENT OF HEALTH AND FAMILY SERVICES		
Supplementation of UK resident's nursing home services ^a		unspecified
DEPARTMENT OF INDUSTRY SCIENCE AND TOURISM		
AIDC (for guarantees and credit risk facilities) ^b	805.49	1 140.13
EFIC	3 929.00	4 093.00
Total	4 734.49	5 233.13

NON-LOAN GUARANTEES	1996 value (\$m)	1997 value (\$m)
DEPARTMENT OF THE TREASURY		
Commonwealth Bank of Australia (<i>CBA Act 1959</i>)	324 221.55	104 174.00
Commonwealth Bank Officers Superannuation Corporation (<i>CBA Act 1959</i>)	3 695.57	4 017.00
Commonwealth Development Bank	1 793.20	1 102.00
<i>Reserve Bank of Australia Act</i>	26 615.34	41 190.05
<i>Housing Loans Insurance Corporation Act 1965^a</i>	39 892.00	44 505.00
<i>Papua New Guinea Loans Guarantee Act 1975</i>	9.83	6.13
Total	396 227.49	194 994.18
Grand Total	402 211.41	201 436.76

Notes:

- (a) \$20.10 per day subject to 1997-98 currency fluctuations.
- (b) Source: AIDC 1997 Annual report.
- (c) The Department of the Treasury's 1996-97 Annual Report states that the principal amount covered by the guarantee and the balances outstanding are unable to be reliably measured. The guarantee relates essentially to the Housing Loans Insurance Corporation's (HLIC) contracts of mortgage and any borrowings approved by the Treasurer. As at 30 June 1997 the HLIC had no borrowings.
- * Values less than \$5000 have been rounded down to zero

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
ATTORNEY-GENERAL'S DEPARTMENT		
Westpac Compass Pilot Contract (AUSTRAC)	unspecified	unspecified
Australian Federal Police - Lease of base sites for communications (13)	unspecified	unspecified
Australian Federal Police - Lease of premises (32 for 1996 and 29 for 1997)	unspecified	unspecified
Australian Federal Police - Vehicle Fleet (DASFLEET)	unspecified	unspecified
DEPARTMENT OF COMMUNICATIONS AND THE ARTS		
Commonwealth Indemnity Scheme (CIS)	787.47	59.71
OPTUS Promissory Note	75.00	-
Total	862.47	59.71
DEPARTMENT OF DEFENCE		
Defence Housing Authority	5.00	
Submarine Escape and Rescue	20.00	
Elms Control Systems	0.00*	
O'Donnell Griffin	0.00*	
Direct Engineering Services	0.01	
Callan Constructions	0.01	
Mid City Resources P/L	0.01	
Loan of paintings	0.04	
OA Link Computers	0.07	
Wagga Hospital	5.00	
Department of Primary Industries	5.00	
QLD Ambulance Service	5.00	
QLD Ambulance Service	5.00	
NT Department of Health	5.00	
Darwin Private Hospital	5.00	
St. John Ambulance	5.00	
Concord Hospital	5.00	
NSW Fire Brigades	5.00	
Sydney Water	5.00	
NSW Ambulance	5.00	
Liverpool Hospital	5.00	
NSW Ambulance	5.00	
NRMA Careflight	5.00	
Townsville Water Supply Board	5.00	
Townsville General Hospital	5.00	
Townsville General Hospital	5.00	

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
Telecasters NQ	5.00	
QLD Ambulance Service	5.00	
Townsville General Hospital	5.00	
Townsville General Hospital	5.00	
Pacific Bay Ltd	5.00	
Townsville General Hospital	5.00	
Indonesian Air Show	5.00	
Ambulance Service training	5.00	
Ambulance Service training	5.00	
Street Signage	5.00	
ESSO Australia - Sea Survival	5.00	
ADI Land	20.00	
Submarine Prime Contract	unlimited	
Thistle Island Management Inc	unlimited	
Peter Morgan - Training	unlimited	
Queensland Air Museum	unlimited	
Various Training activities (56 Separate Indemnities)	unlimited	
Northern Territory Corporation (3 Separate Indemnities)	unlimited	
Housing Land Department (3 Separate Indemnities)	unlimited	
Katherine Local Housing Dept (2 Separate Indemnities)	unlimited	
Department of Lands	unlimited	
Mornington Shire Council	unlimited	
M. Maher - Drainage Easement	unlimited	
Department of Lands	unlimited	
Port of Brisbane Authority	unlimited	
Department of Primary Industries	unlimited	
Department of Interior	unlimited	
Pine Rivers RSL	unlimited	
QLD Government	unlimited	
Department of Primary Industries	unlimited	
Department of Primary Industries	unlimited	
WA Police	unlimited	
Supply of ANZAC Ships and related supplies (C218318) - shored Based Builder Risk		400.00
Supply of ANZAC Ships and related supplies (C218318) - Wrap Up Comprehensive General Liability		100.00
Sea King LOTE - Limitations of Commonwealth total cumulative liability		56.00
Electro Optical Systems for HMA Ships - Termination for convenience		13.08
Ordnance Support and Training Centre Contract (C218434)		5.00

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
Supply of CWI transmitters (ANZACSPD) (C218443) - Termination for convenience		5.00
Supply of CWI transmitters (ANZACSPD) (C218443) - Damage to supplies prior to delivery		5.00
Individual Training - Work Experience (Wagga Wagga Day Surgery Pty Ltd)		5.00
Individual Training - Work Experience (Townsville General Hospital)		5.00
Individual Training - Work Experience (Townsville District Health Service)		5.00
Work Experience (Greater Murray Health Service)		5.00
Individual Training - Work Experience (Townsville District Health Service)		5.00
Individual Training - Work Experience (Queensland Ambulance Service)		5.00
Individual Training - Work Experience (Townsville District Health Service)		5.00
Individual Training - Work Experience (Queensland Ambulance Service)		5.00
Individual Training - Work Experience (Careflight Ltd)		5.00
Individual Training - Work Experience (Ambulance Service NSW)		5.00
Individual Training - Work Experience (Liverpool Health Service)		5.00
Work Experience (Ambulance Service of NSW)		5.00
SASR Activity (Beverly Shire)		5.00
Training - CEO		1.00
Training - L.E. Hedges		1.00
Training - Whian Whian Forest		1.00
Training - Whian Whian Forest		1.00
Lost Cheque		1.80
Recruiting Display at Townsville Showgrounds		5.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port Kembla Port Corporation)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Newcastle Port Corporation)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (for Ports of Eden and Yamba)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Marine Board of Hobart)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Marine Board of King Island)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Launceston Authority)		10.00

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Bernie Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Devonport)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Bunbury Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Dampier Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Albany Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Esperance Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Geraldton Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Darwin Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Marine Board Flinders)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Townsville Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Rockhampton Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Freemantle Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (South Australian Ports Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Cairns Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port Hedland Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Mackay Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Victoria Channels Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Sydney Ports Corporation)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (GEELONG PORT Pty Ltd)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Brisbane Corporation)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Onslow)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Walcott)		10.00

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Wyndham)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Broome)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Derby)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Carnarvon)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Barrow Island)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Varanus Island)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Gladstone Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Port of Perth)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Bundaberg Port Authority)		10.00
Liability for loss or damage caused by RAN vessels whilst in or entering Port (Melbourne Port Corporation)		10.00
Personal injury or damage to property caused by (1) any defect or fault in any product manufactured or produced by ADI and its predecessors and (2) loss or damage to any Australian defence vessel berthed or under repair/refit at an ADI facility	unlimited above \$1m	
The Commonwealth was responsible for and has accepted responsibility for contamination of land upon which it conducted defence manufacturing activities until 3 May 1989		unlimited
Supply of a Submarine Escape and Rescue Service (SERS) Contract (C225049, Clause 16A.1)		unlimited
Lease of Avalon Airport		unlimited
Agreement for the Sale and Purchase of Shares in Avalon Airport Geelong Pty Ltd		unlimited
JP7 (Kalkara) Acquisition - Termination for convenience		unlimited
JP7 (Kalkara) Operations - Termination for convenience		unlimited
Sea King LOTE - Reciprocal indemnity against infringement of IP rights		unlimited
Supply of ANZAC Ships and related supplies (C218318) - Infringement of IP rights		unlimited
Supply of ANZAC Ships and related supplies (C218318) - Damage by Commonwealth following contract termination due to default		unlimited
Supply of ANZAC Ships and related supplies (C218318) - Infringement of IP rights by third party which cannot be recovered by third party		unlimited

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
Indemnities associated with sale of shares in ASTA:		
Clause 7.1 containing 6 aspects		unlimited
Claims against ASTA in respect of Nomad Aircraft		unlimited
Maintenance of the Australian Underwater Ranges Activity (AURA) Contract (C225031, Clause 21.1)		unlimited
Design, Develop, Test and Install Shallow Acoustic Underwater Range (SAUR) Contract C225075, Clause 19.6		unlimited
ANZAC Ship Maintenance Planning System Lead Contract (C218427)		unlimited
JP7 (Kalkara) Acquisition - Exceptions to contractors responsibility to indemnify the Commonwealth		unlimited
Sea King LOTE - Exceptions to contractors responsibilities to indemnify the Commonwealth		unlimited
Sea King LOTE - Termination for convenience		unlimited
Supply of 10 5in MK45 Mod 2 Gun Mounts and associated goods and services (C218360)		unlimited
Supply of 10 5in MK45 Mod 2 Gun Mounts and associated goods and services (C218360)		unlimited
Agreement between Thistle Island Management Association Incorporated and Commonwealth of Australia		unlimited
New Submarine Project Prime Contract (C218269, Clause 6A.5)		unlimited
New Submarine Project Prime Contract (C218269, Clause 37.2)		unlimited
New Submarine Project Prime Contract (C218269, Clause 40.3.1, Annex MM, Annex SS)		unlimited
New Submarine Project Prime Contract (C218269, Clause 40.3.3)		unlimited
New Submarine Project Prime Contract (C218269, Clause 64.6)		unlimited
New Submarine Project Prime Contract (C218269, Clause 64.8(g))		unlimited
New Submarine Project Prime Contract (C218269, Clause 67A.3)		unlimited
Maintenance of the Australian Underwater Ranges Activity (AURA) Contract (C225031, Clause 20.4)		unlimited
Supply of support vessel for Collins sea trials in WA Contract C225081, Clause 14.2.5		unlimited
NSP Contract C225031 - Termination for Convenience clause		unlimited
NSP Contract C225049 - Termination for Convenience clause		unlimited
NSP Contract C225075 - Termination for Convenience clause		unlimited
NSP Contract C225081 - Termination for Convenience clause		unlimited
NSP Contract C225087 - Termination for Convenience clause		unlimited
NSP Contract C225046 - Termination for Convenience clause		unlimited
NSP Contract C225060 - Termination for Convenience clause		unlimited
NSP Contract C225078 - Termination for Convenience clause		unlimited
NSP Contract C225086 - Termination for Convenience clause		unlimited
Supply of ANZAC Ships and related supplies (C218318) - Commonwealth lease for Premises		unlimited

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
Supply of ANZAC Ships and related supplies (C218318) - Commonwealth lease for Premises		unlimited
Memorandum of Agreement between AA and Commonwealth on responsibility for the exchange of surveillance radar data (under contract No C96/76)		unlimited
Deed of Indemnity cited by Commonwealth between AA and another party		unlimited
13 BDE Admin Support Battalion		unlimited
Helicopter Safety Training		unlimited
Area Support - Fire Services in Townsville		unlimited
Provision of Drinking water to Army base at Oakey		unlimited
Defence use in support of contingencies and civil airline assets		unlimited
Defence use in support of contingencies and civil airline assets		unlimited
Exercise Dundee		unlimited
Total	185.14	1 039.88
DEPARTMENT OF ENVIRONMENT		
Service contract indemnities (Bureau of Meterology)	1.5	1.5
Total	1.5	1.5
DEPARTMENT OF EMPLOYMENT, EDUCATION, TRAINING AND YOUTH AFFAIRS		
Deed of Indemnity - International College of English	unspecified	unspecified
Air Services Australia - Chaton Ridge	unspecified	unspecified
Air Services Australia - Mt Majura	unspecified	unspecified
Air Services Australia - Mt Edith	unspecified	unspecified
Air Services Australia - Mt McAlister	unspecified	unspecified
University of Technology - Sydney	unspecified	unspecified
State Forests - Shooters Hill	unspecified	unspecified
DEPARTMENT OF FINANCE AND ADMINISTRATION AND OFFICE OF ASSET SALES & IT OUTSOURCING		
Transigo ^a		unspecified
Tuggeranong Office Park ("TOP") Deed of Indemnity - Australian Estate Management ^a	unspecified	54.78
AIDC Ltd- AIDC directors and nominated officers (OASITO)	unspecified	unspecified
Avalon Airport Sale - Foxerco tax liability (OASITO)	unspecified	unspecified
Avalon Airport Sale - Foxerco contamination issues (OASITO)	unspecified	unspecified
Avalon Airport Sale - various issues covered (OASITO)	unspecified	unspecified
British Airways PLC - share values (OASITO)	unspecified	unspecified
HLIC Sale-Sir Laurence Street, losses and liability sustained (OASITO)	unspecified	unspecified

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
Telstra Sale - directors and officers (OASITO)	unspecified	unspecified
Qantas Trade Sale - Tax Liability (OASITO)	unspecified	unspecified
Catering Service - Settlement Balance Sheet (OASITO)	unspecified	unspecified
Catering Service - Taxation Liability (OASITO)	unspecified	unspecified
Catering Service - Directors Loss of Office (OASITO)	unspecified	unspecified
Catering Service - Superannuation Entitlements (OASITO)	unspecified	unspecified
Catering Service - Conduct before sale (OASITO)	unspecified	unspecified
ACT Residential Mortgages - Excess Credits (OASITO)	unspecified	unspecified
ACT Residential Mortgages - Variable Rates (OASITO)	unspecified	unspecified
Separate Airlines Sales - Financial Adviser (OASITO)	unspecified	unspecified
Qantas PSO - Mk1 Joint Lead Managers Indemnities (OASITO)	unspecified	unspecified
Combank II - Directors of Hogan Marketing Service and Directors of Achcove Pty Ltd (OASITO)	unspecified	unspecified
Qantas PSO Mk1 Financial Adviser (OASITO)	unspecified	unspecified
Commonwealth Bank- stamp duty payments (OASITO)	unspecified	unspecified
Commonwealth Bank -losses and liabilities suffered from future exercise of powers the CFM Act (OASITO)	unspecified	unspecified
Commonwealth Bank directors and certain officers - civil liability (OASITO)	unspecified	unspecified
Qantas Trade Sale - C of A Performance (OASITO)	unspecified	unspecified
Qantas PSO - Debt Assumption Agreement (OASITO)	unspecified	unspecified
Qantas PSO - Mk2 Hogan Marketing Services (OASITO)	unspecified	unspecified
Qantas PSO - Withholding Tax Indemnity (OASITO)	unspecified	unspecified
Toronto Dominion Bank of Canada	unspecified	
CSL Float - protection for litigation costs Potter Warburg/ Price Waterhouse (OASITO)	unspecified	unspecified
CSL Float-protection for litigation costs Arthur Andersen (OASITO)	unspecified	unspecified
CSL Sale - Breach of confidentiality (OASITO)	unspecified	unspecified
CSL Limited - claims by persons contracting specified infections and employees contracting asbestos related injuries (OASITO)	unspecified	unspecified
Reserve Bank of Australia, Drawing Account	unspecified	unspecified
Australian Airlines litigation costs (OASITO)	unspecified	unspecified
Australian Airlines Ltd -due diligence (OASITO)	unspecified	unspecified
Australian National and National Rail Commissioners - provision of information (OASITO)	unspecified	unspecified
Mallesons Stephen Jaques-confidentiality agreement (OASITO)	unspecified	unspecified
Citibank - London	unspecified	
Nations Bank of USA	unspecified	

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
ASTA Sale - Protection for the costs of asbestos, pollutants or other contaminants (OASITO)	unspecified	unspecified
ASTA Sale - Prior to closing date warranties (OASITO)	unspecified	unspecified
ASTA Sale - Protection from liability under <i>Income Tax Assessment Act 1936</i> (OASITO)	unspecified	unspecified
ASTA Sale - Protection from liability arising from R and D Claims (OASITO)	unspecified	unspecified
Software Licence and Production of Commonwealth Managers Toolbox	unspecified	unspecified
FAC Board Indemnity (OASITO)	unspecified	unspecified
BZW Indemnity on Legal Costs (OASITO)	unspecified	unspecified
CFM and TRM directors and certain officers - against all actions (OASITO)	unspecified	unspecified
Asset Purchase - Australian Pipeline Ltd (OASITO)	unspecified	unspecified
Uranium Stockpile sale - clean-up costs (OASITO)	unspecified	unspecified
Ernst & Young legal costs (OASITO)	unspecified	unspecified
49% Trade Sale Purchase Agreement -GasInvest	unspecified	unspecified
Tinbury Ltd deed - SMEC (OASITO)	unspecified	unspecified
Compensation Deed -The Pipeline Authority, Paceno Pty Ltd and the Australian Gas Light Company (OASITO)	unspecified	unspecified
Agreement for the Sale of shares in SMEC (OASITO)	unspecified	unspecified
Commonwealth Banking Services Agreement	unspecified	unspecified
CSS Contributions plus interest - issued 1/7/76	unspecified	unspecified
PSS Contributions plus interest - issued 1/7/90	unspecified	unspecified
Total		54.78
DEPARTMENT OF HEALTH AND FAMILY SERVICES		
CSL Ltd - against claims from specified CSL products	unspecified	unspecified
CSL Ltd - diagnostic products agreement	unspecified	unspecified
CSL Ltd - exchange of Letters	unspecified	unspecified
CSL Ltd - therapeutic plasma product product production	unspecified	unspecified
Commonwealth Rehabilitation Service- work training ^b	unspecified	unspecified
DEPARTMENT OF IMMIGRATION AND MULTICULTURAL AFFAIRS		
CPS System Pty Ltd		4.33
Total		4.33
DEPARTMENT OF INDUSTRY, SCIENCE AND TOURISM		
Bloomberg Contract	unspecified	unspecified
Australian Technology Group	unspecified	unspecified

INDEMNITIES	1996 value (\$m)	1997 value (\$m)
DEPARTMENT OF PRIMARY INDUSTRIES AND ENERGY		
Australian Wheat Board	1 063.50	1 857.50
Geosafe Australia	13.94	13.94
Australian Wheat Board Indemnity under <i>Wheat marketing Act 1989</i>	unspecified	unspecified
Total	1 077.44	1 871.44
DEPARTMENT OF TRANSPORT AND REGIONAL DEVELOPMENT		
ANL Ltd Board protection against civil claims	unspecified	unspecified
Civil Aviation Safety Authority - Air Safety Functions	unspecified	unspecified
Civil Aviation Safety Authority - Insurance (under <i>Civil Aviation Act 1959</i>)		unspecified
WA Service Delivery Agreements	unspecified	unspecified
DEPARTMENT OF VETERANS' AFFAIRS		
Defence Service Homes Insurance Scheme	14.88	21.64
Total	14.88	21.64
Grand Total	2 141.42	3 053.28

Notes:

- (a) Indemnities from the then Department of Administrative Services.
- (b) A total of 444 of these instruments were reported in the original audit valued at \$2m each for a total value of \$888m. DHFS advise that under the Safety, Rehabilitation and compensation Act (1998) clients of the Commonwealth Rehabilitation Service (CRS) are declared to be employees of the Commonwealth and as such are covered by Comcare for workers compensation. In light of this advice, the ANAO considers that it is more appropriate not to specify a value for these instruments.
- * Values less than \$5000 have been rounded down to zero.

LETTERS OF COMFORT	1996 value (\$m)	1997 value (\$m)
DEPARTMENT OF FINANCE		
Australian National Line Credit Rating (OASITO)	unspecified	unspecified
Federal Airports Corporation - Standard and Poor's (OASITO)	unspecified	unspecified
Qantas Trade Sale - Loan Facility (OASITO)	unspecified	unspecified
DEPARTMENT OF TRANSPORT AND REGIONAL DEVELOPMENT		
Federal Airports Corporation	unspecified	

Appendix 4

FINANCE CIRCULAR

No: 1997/06

Ref: 95/1360

DEPARTMENT OF
FINANCE
CANBERRA ACT 2600

CIRCULAR MEMORANDUM TO DEPARTMENTS

POTENTIAL LIABILITIES AND LOSSES

This circular provides guidance on the issuing of **indemnities, guarantees and letters of comfort**. Essentially, it updates our *Guidelines for the Issuing of Commonwealth Indemnities* - issued as Finance Circular 1989/11 in June 1989 - and provides additional advice on guarantees and letters of comfort which, like indemnities, expose the Commonwealth to potential liabilities or losses at some future date.

2. Agencies would be aware that the Australian National Audit Office (ANAO) conducted a performance audit of these instruments last year; the results were published in Audit Report No. 6, 1996-97 entitled: *Commonwealth Guarantees, Indemnities and Letters of Comfort*. **The audit found that, overall, most agencies needed to strengthen their administrative and management practices in relation to risks associated with such contingent liabilities.**

3. The Guidelines aim to answer questions commonly addressed to this Department and include:

definitions of indemnities, guarantees and letters of comfort and their use;

the **types of risks covered** by indemnities and guarantees;

the importance of these instruments in the context of **risk management**;

the **basis of authority** for issuing guarantees and indemnities;

the difference between issuing these instruments and **spending** public moneys;

the importance of seeking appropriate authority for **contracts which contain indemnities as well as spending proposals**;

the means of **protecting the Commonwealth's interests**; the need to seek **legal advice** on relevant instruments; the need to **record all**

contingent liabilities in agency registers; and the need to **monitor, report and review** all contingent liabilities.

4. The ANAO's "Better Administrative Principles", Appendix A to Report No. 6, is attached to the Guidelines for easy reference.
5. A separate Finance Circular on the protection (indemnification) of persons acting in an official capacity on behalf of the Commonwealth will be issued shortly.

M. J. Kennedy
Assistant Secretary
Financial Management Advisory Branch
April 1997

Guidelines for Issuing Indemnities, Guarantees and Letters of Comfort

Introduction	1
What are indemnities, guarantees and letters of comfort?	1
When does the Commonwealth issue indemnities and guarantees?	1
Should letters of comfort ever be issued?	2
What types of risks do indemnities and guarantees cover?	3
Risk assessment and management	4
Whom may the Commonwealth indemnify?	5
Who has the authority to issue an indemnity?	5
Who has the authority to issue a guarantee?	6
Is the authority to issue an indemnity or performance guarantee any different from the authority to spend public money?	7
Indemnities in contracts	7
What authorisation is necessary to enter into contracts comprising both spending proposals and indemnification clauses?	8
Once a decision to issue an indemnity or guarantee has been taken, what should it contain to protect the Commonwealth's interests?	8
Should legal advice be sought on the terms and conditions of each instrument?	9
How should these contingent liabilities be recorded, monitored and reported?	10
Do indemnities and guarantees need to be reviewed?	10
Do agencies need contract registers?	11
Further guidelines	11
Contents	

Introduction

Ministers, in administering their portfolios, have certain inherent (but not unlimited) powers under the Constitution to commit the Commonwealth. The power to approve the Commonwealth's indemnifying another party against loss or damage from some departmental activity is an example of these powers. In contrast, Ministers may not ordinarily commit the Commonwealth to stand as a guarantor of someone's loan: that power has been curtailed by statute (section 70B of the *Audit Act 1901* which requires loan guarantees to be supported by legislation).

The Commonwealth's policies and practices underpinning its involvement in these matters are often complex and require careful judgement on the part of officials. Therefore, these guidelines have been developed as a help to officers who may need to advise on or issue indemnities, guarantees and letters of comfort on behalf of the Commonwealth.

The guidelines focus on the management and review of the Commonwealth's contingent liabilities which result from such instruments. Unlike other liabilities which comprise likely future payments or losses (arising out of identified past events) which a body is presently **obliged** to meet, contingent liabilities entail future payments or losses **only if** the particular circumstances upon which they are contingent or conditional, actually eventuate.¹

What are indemnities, guarantees and letters of comfort?

An **indemnity** is a legally binding promise whereby one party undertakes to accept the risk of loss or damage another may suffer.

A **guarantee** is a legally binding promise whereby one party undertakes to another party to be responsible for the debt or obligations of a third party, should that third party default in some way.

A **letter of comfort** is a form of reassurance that may be used to facilitate an action or transaction that might not otherwise occur. Unlike indemnities or guarantees, letters of comfort are not intended to give rise to legal obligations. The reason for drawing attention to them in these Guidelines is to warn agencies that there are some circumstances in which such 'letters' could be considered to be tantamount to indemnities or guarantees, and therefore legally or morally binding on the Commonwealth.

¹ Statement of Accounting Concepts (SAC) 4 provides that whether a liability qualifies for recognition depends on the probability of the sacrifice of economic benefits being required in the future (paragraph 66). Due to guarantees' and indemnities' generally low probability of being called, they may not need to be recognised in agencies' financial statements.

When does the Commonwealth issue indemnities and guarantees?

Indemnities

Each indemnity issued by the Commonwealth obligates it to protect another party against the consequences of the risks specified in the indemnity. In effect, the recipient of the indemnity is exempted from the possibility of incurring particular losses or liabilities which, if they ever arise, are assumed by the Commonwealth.

The Commonwealth's policy on issuing indemnities is to accept such risks only when the expected benefits (financial or otherwise) outweigh the potential losses. Before issuing an indemnity, potential losses should be rigorously investigated and identified (see separate section below - Risk assessment and management - at paragraphs 24-30).

Indemnities can form separate contracts (whether or not in the form of a separate deed) or they can be contained in another contract as a clause(s).

Guarantees

Guarantees are provided by the Commonwealth when it is considered in its interests to accept the risk of assuming responsibility for performance, debts or liabilities of another party, if that party fails to fulfil its obligations. With very few exceptions, such guarantees are limited to Commonwealth owned entities for such purposes.

Under section 70B of the *Audit Act 1901*, a Commonwealth guarantee of the loans of another entity (usually a Commonwealth statutory authority) must be expressly authorised by an Act of Parliament. The enabling legislation of these entities provides either for the discretionary issue of loan guarantees by the Treasurer on a case by case basis, or the entity's borrowings are guaranteed automatically under the terms of its legislation, as part of a broader guarantee of its liabilities. The requirement that guarantees of loan borrowings must have a statutory basis is not replicated in the proposed *Financial Management and Accountability (FMA) Act* - expected to operate from 1 July 1997. Central executive authority over the issue of loan guarantees will, however, be preserved under the subordinate legislation, namely the FMA Regulations (see separate section - Who has the authority to issue a guarantee? - at paragraphs 40-42).

Guarantees by the Commonwealth of the liabilities of entities are typically provided, under legislation, to public financial enterprises. These statutory guarantees automatically provide for the due payment of monies payable by the entity to any person other than the Commonwealth.

Guarantees of performance are less common and may be issued using the executive power of the Commonwealth, eg the guarantee by the Commonwealth of Telstra's performance in making payments to the Telecom Superannuation Fund.

Like indemnities, guarantees can form separate contracts (whether or not in the form of a separate deed) or they can be contained in another contract as a clause(s).

Should letters of comfort ever be issued?

Letters of comfort should generally be avoided, but may sometimes be appropriate to give a party an indication of a general government position on a matter. However, great care should always be exercised in how they are drafted to avoid giving rise to any liability.

In this regard, agencies need to be aware that a letter of comfort may lead to an actual liability - either through a court finding that the party receiving the letter was entitled to rely upon its contents, or through a moral obligation for the Commonwealth to make good on its assurances.

It is therefore important to carefully consider who may sign letters of comfort. In a worst case scenario, a letter of comfort that was held to indicate probable Commonwealth financial support for an activity may cause the Commonwealth significant expenditure. Letters of comfort need to be appropriately authorised; they need to be offset by adequate benefits; and they should be limited in some way to minimise the Commonwealth's exposure.

It is prudent to seek legal advice on the form of words to be used to ensure that the Commonwealth's risk exposure is minimised.

What types of risks do indemnities and guarantees cover?

Indemnities

Indemnities issued by the Commonwealth cover:

A: potential losses or damages for which the Commonwealth may otherwise be liable (at law) although the initial loss would accrue to the other party.

For example:

- the Commonwealth, in purchasing a good or service from a contractor, may indemnify the contractor against some loss suffered as a result of the Commonwealth's negligence, or breach of the contract (such as neglecting workplace safety standards); or

- the Commonwealth, in providing its goods or services to a client, may indemnify that client against possible losses arising from legal action by a third party, injured or otherwise disaffected as a result of the Commonwealth's actions (such as negligently providing defective equipment to the client).

B: potential losses or damages for which the Commonwealth, without having issued an indemnity, would not otherwise be liable.

For example:

- the Commonwealth, in selling shares in one of its companies, may decide to indemnify a director for potential losses associated with providing information to facilitate the sale (such as losses that may result from a claim against the director for providing misleading information in a prospectus); or
- the Commonwealth, in using goods or property owned by another party, may indemnify the owner against losses that may be suffered if a third party damages those goods (such as losses that may result from destruction of an exhibit by a member of the public).

Indemnities in Group B are issued to cover potential losses for which the Commonwealth would otherwise be blameless.

Guarantees

Guarantees issued by the Commonwealth cover the same type of risks as those relating to Group B indemnities, namely potential losses that would not otherwise be met by the Commonwealth, eg for the borrowings, performance or liabilities of other entities, although guaranteed borrowings are generally restricted to statutory authorities (for reasons of competitive neutrality new borrowings by GBEs are not usually guaranteed by the Commonwealth). Nearly all guarantees are currently provided under legislation.

Risk assessment and management

For indemnities relating to activities for which the Commonwealth would otherwise be blameless (Group B above), the benefits of granting these indemnities are offset to varying degrees by the potential losses that may result from honouring the indemnities.

Because indemnities within this group increase the size of the Commonwealth's potential liabilities, a comprehensive risk/benefit analysis should be undertaken to ascertain whether the value of the perceived benefits outweighs the value of any potential losses. Proposals for non-statutory guarantees should be analysed in the same way.

It is important that each proposal for an indemnity or guarantee of this type be scrutinised in the following ways:

- test if there is an alternative means of achieving the expected benefits. This may require negotiation to determine whether the other party is prepared to accept and transfer all or some risks to a commercial insurer; and
- if no other means are considered viable and the risks are assessed such that the benefits are reasonably expected to outweigh any losses or damage, assess the likely impact of potential liabilities which may arise from issuing the indemnity or guarantee.²

Risk assessments of proposals to issue indemnities and non-statutory guarantees should be analysed and well explained and documented by managers before authorisation is sought to issue the particular instruments.

Relationship between contingent liabilities and other program risks

It is essential that risks associated with contingent liabilities be examined together with other risks faced by an agency. In terms of their impact on program outcomes, risks which involve contingent liabilities cannot be assessed in isolation from strategies to manage other risks (such as the risk of non-compliance with required product/service standards) which, depending on their success, may reduce or exacerbate potential losses related to indemnities or guarantees.

In view of the ultimate impact on program outcomes and the fact that claims resulting from the indemnities or guarantees would be expected to be met to the maximum extent possible by existing portfolio appropriations, proposals to issue indemnities and guarantees should be considered in the context of each agency's overall risk management plan.

In October 1996, the Management Advisory Board/Management Improvement Advisory Committee published: *Guidelines for Managing Risk in the Australian Public Service*. Agencies are advised to refer to this publication.

Whom may the Commonwealth indemnify?

The Commonwealth can indemnify any party other than itself. The Commonwealth "itself" means the Executive Government of the Commonwealth, as the composite legal entity which can sue and be sued.

² Agencies should be aware that the importance of quantifying future liabilities was raised in ANAO Report No. 14 of 1995-96, *Sale of CSL, Commonwealth Blood Product Funding and Regulation*. The Joint Committee of Public Accounts (JCPA) has endorsed the ANAO's recommendations in this regard in its recent Report 349, *Review of Auditor-General's Reports 1995-96*.

Indemnities cannot be issued by one “agency” within the Executive Government of the Commonwealth to another such “agency”, as these agencies are part of the same entity (“the Commonwealth”) for the purposes of the law; the entity cannot contract with itself. This one (legal) entity comprises: all Departments and such Commonwealth agencies whose enabling legislation does not confer a power to contract in their own names. The components of this entity are bodies which will be subject to the proposed FMA Act.

Commonwealth companies and authorities which have been established by legislation as separate legal entities, capable of contracting in their own names, are legally (and financially) separate from the Executive Government of the Commonwealth (even if they are Budget funded). Therefore, the Commonwealth is capable of indemnifying those entities which will be subject to the proposed *Commonwealth Authorities and Companies (CAC) Act* (expected, like the proposed *FMA Act*, to operate from 1 July 1997) - as well as other Governments and persons/bodies within the private sector.

Who has the authority to issue an indemnity?

Each Minister has the inherent power to commit the Commonwealth to indemnities which relate to his or her area of portfolio responsibilities. This power is derived from sections 61 and 64 of the Constitution.

If a Minister is duly authorised to act for or on behalf of another Minister, the acting Minister also has the authority to issue indemnities with respect to the authorising Minister’s portfolio. (This is provided for in section 19 of the *Acts Interpretation Act*.) In circumstances where an indemnity encompasses the responsibilities of more than one portfolio, the Minister of the portfolio with the main carriage of negotiating the indemnity generally issues the instrument on behalf of the Commonwealth as a whole.

Ministers may authorise others to issue indemnities

Although indemnities may be issued by Ministers themselves, there are circumstances where, for administrative ease, Ministers may decide to authorise particular officers, or holders of particular positions, to exercise this power for and on their behalf. Ministers may authorise any official within their departments or portfolio agencies to use this power for them. When an authorised officer binds the Commonwealth in this way, the officer does so on behalf of the Minister, as if the Minister were making the decision personally. (This contrasts with the power of delegation found in some legislation, where a delegate exercises power in his or her own right.)

Carltona

Even in the absence of an explicit authorisation from a Minister, the law, via a common law principle known as the Carltona Principle (named for the case in which the principle was first expounded) recognises that Ministers can be presumed, in practice, to act through responsible officers in their departments and agencies if functions are to be performed in a timely and effective manner. In this respect, an officer of an agency may be held to be acting under the implicit authorisation of a Minister, ie, the officer acts as he/she considers the Minister would act, (ie, for and on behalf of that Minister) in the context of the current obligations and priorities of the Government of the day.

Explicit authorisation is best practice

Although it is not a strict legal requirement that Ministers issue formal instruments explicitly authorising officers to issue indemnities on their behalf, prudence, accountability and good practice demand it. Indeed, it is recommended that agencies regularly (eg at least yearly) seek formal instruments of authorisation from their Ministers for specific categories of indemnities and with specific financial limits. Sound accountability practice suggests that it is also appropriate for agencies to report back to their Minister at the end of each year on the exercise of those authorisations.³

It is also recommended that agencies maintain up-to-date central registers of officers authorised to issue indemnities, and the financial limits involved.

The authorisations (to act for and behalf of the relevant Minister) remain valid only for the period in which the Minister holds the particular office, ie if a particular portfolio Minister changes, authorisations need to be re-issued by the incoming Minister. Where administrative arrangements under which an agency operates change, authorisations remain valid unless the portfolio Minister also changes as a result of those arrangements.

Who has the authority to issue a guarantee?

At present, discretionary loan guarantees may only be issued by the person in whom authority is conferred by legislation, usually the Treasurer or, where provided for in the legislation, his delegate. Following the repeal of the *Audit Act 1901*, the regulations under the proposed *FMA Act* will provide

³ Agencies should be aware that the importance of briefing Ministers was raised in ANAO Report No. 14 of 1995-96, *Sale of CSL, Commonwealth Blood Product Funding and Regulation*. As with the issue of quantifying potential liabilities, the JCPA has endorsed the ANAO's recommendations in regard to briefing of Ministers in its recent Report 349, *Review of Auditor-General's Reports 1995-96*.

for the preservation of central executive authority over the issue of loan guarantees (see separate section - When does the Commonwealth issue indemnities and guarantees? - at paragraphs 10 -14).

Where the liabilities of an entity, including its borrowings, are automatically guaranteed under its enabling legislation, that legislation removes any discretion that Ministers or officials have over the provision of guarantees for those particular liabilities.

Non-statutory guarantees, which are usually provided for risks associated with a body's performance, should be authorised in the same way as indemnities (simply because considerable financial losses can eventuate if the Commonwealth is required to honour another party's performance obligations or to discharge its liabilities).

Is the authority to issue an indemnity or performance guarantee any different from the authority to spend public money?

Yes. The authority to issue an indemnity or performance guarantee needs to be clearly distinguished from the authority to approve spending proposals and to enter into commitments. Agencies should emphasise this fact in their internal guidance on the exercise of authorisations.

Exercising the authority to enter into actual liabilities is controlled by rules which do not apply to exercising the authority to issue indemnities or performance guarantees. The authority to enter actual liabilities must be exercised in accordance with the relevant financial legislation. In contrast, the authority to give an indemnity or provide a performance guarantee is not constrained by anything other than Ministers' Constitutional responsibilities for the operations of their respective portfolios.

Indemnities in contracts

Where the Commonwealth is involved in a contract where a party is engaged to provide a good or service to the Commonwealth, the other party may attempt to seek an indemnity from the Commonwealth for the actions of that party, its employees, or agents.

However, usually the contrary is more appropriate - that is, for the Commonwealth itself to obtain an indemnity from the contracting party against loss or damage to the Commonwealth from non-performance on the part of the contractor. In this context, agencies often insist on the contractor taking out insurance to back up the indemnity (eg, covering product liability and other default or negligence). While this is prudent where the supplier may not otherwise have the financial resources to meet

a damages claim by the Commonwealth, agencies need to be careful to treat each case on its merits so as not to insist on the contractor purchasing insurance products (the cost of which will be passed on to the Commonwealth in the price of the contract) without first assessing which risks (or level of those risks) need to be covered by insurance. However, regardless of whether a contractor self insures or purchases commercial insurance, the Commonwealth, unless indemnified by the contractor, remains exposed to potential liabilities which rightly are the responsibility of the contractor.

It is important to recognise that risks that the Commonwealth would normally bear through its involvement in a particular activity may sometimes appear to have been accepted by the other party, whilst they actually remain with the Commonwealth. This sort of situation may arise, hypothetically, where:

- the other party to a contract agrees to insure all the risks involved in an activity in its name (for example, risks associated with potential public liability claims), but does not provide the Commonwealth with an indemnity in the event of a third party suing both the contractor and the Commonwealth; or
- the Commonwealth decides to outsource a public sector program activity to a private sector contractor who, in turn, is negligent in delivering a service to which a member of the public has an entitlement.

In both circumstances, the Commonwealth may unintentionally be exposed to liability for losses suffered by third parties resulting from the work performed by the contractor. In both circumstances the Commonwealth should seek an indemnity from the contractor concerned (and ensure that the terms of the contract provide the Commonwealth with adequate remedies to deal with default by the contractor) so that the liability is retained by the party best able to minimise the potential losses. Agencies need to be very careful in this regard given the increasing emphasis on outsourcing Commonwealth functions to the private sector.

What authorisation is necessary to enter into contracts comprising both spending proposals and indemnification clauses?

Persons with the authority to enter into contracts involving definite financial commitments to commit public monies may not have the authority to issue the indemnities which are frequently contained in such contracts.

Although indemnities in standard contracts (which often limit the Commonwealth's risks to those for which it would normally be responsible

at common law) may not have the distinguishing features of indemnities which expose the Commonwealth to risks which would normally be borne by other parties, it is recommended that Ministerial authorisation be obtained for both types of indemnities so that the Commonwealth is aware of the nature of all potential liabilities which have been accepted on its behalf.

This need not be an onerous imposition on agencies. For standard contract indemnities, a generic authorisation to issue indemnities for a particular activity may be sought from the Minister, obviating the need to obtain a separate authorisation for each contract, with the same, or different suppliers.

Once a decision to issue an indemnity or guarantee has been taken, what should it contain to protect the Commonwealth's interests?

With any contract of indemnity or Commonwealth guarantee, it is imperative to limit the Commonwealth's exposure by ensuring that the instrument does not protect other parties against their own shortcomings, eg fraud, bad faith or other culpable behaviour. Agencies should also ensure that these instruments:

- contain a **financial limit**, where possible;⁴
- specify events or periods covered by the indemnity, and/or include termination clauses; alternatively an indemnity should be reviewed periodically (see separate section - Do indemnities and guarantees need to be reviewed? - at paragraph 60);
- specify conditions regarding the requirement to notify the Commonwealth of any impending disputes or claims (including those from third parties);
- in the case of indemnities, contain subrogation clauses to protect the Commonwealth's interests (ie the right to exercise the option of conducting, or participating in, the defence of any claims against the indemnified party, and to require full assistance from that party); and
- in the case of discretionary loan guarantees, specify and limit the scope of the particular instruments, ie usually including only basic principal and interest obligations (with the latter capped at 30 days from the time

⁴ Agencies should always attempt to measure the potential financial implications of an instrument as a part of the risk assessment process. An agency may need to import help in this task where expertise is not available in-house (see also separate section - Risk assessment and management - particularly paragraph 25-26).

of any default by the borrower) and excluding taxes, fees, expenses, charges and other costs consequential to, or associated with, the borrowings.

Should legal advice be sought on the terms and conditions of each instrument (apart from guarantees already established by legislation)?

Yes, unless an essentially identical instrument has been issued recently covering the same activity or responsibilities. Because the terms and conditions of the instrument itself may inevitably affect the extent of the Commonwealth's liabilities, legal advice should be sought regarding instruments (including standard contracts) covering an activity for which other parties have not previously been indemnified or their performance or liabilities guaranteed. (With respect to guarantees to be authorised by the Treasurer or his delegate, legal advice on the form of particular instruments is sought by Treasury and the costs of the advice borne by the body concerned.)

As the terms and conditions (by inclusion or omission of particular clauses) may impose unintended risks, the need to seek legal advice applies equally to indemnities intended to involve potential liabilities for which the Commonwealth would be likely to become liable at law, as well as other instruments intended to involve potential liabilities which would otherwise remain the responsibility of the indemnified party, or party to which a guarantee is provided, ie both Groups A and B above (see separate section - What type of risks do indemnities and guarantees cover? - at paragraphs 19-23).

Difficulties with clarifying and crystallising the terms and conditions of an indemnity may be experienced if the other party has transferred a degree of risk to a commercial insurer and wants the Commonwealth to provide an indemnity to cover any losses (associated with that same risk) over and above those covered by insurance. In these circumstances, the Commonwealth's subrogation rights, to assume the rights of the indemnified party and conduct the defence or settlement of any claim relating to the indemnity it has provided, may conflict with those of the insurer, who would normally have the same rights relating to the insured party with respect to the cover it has provided. To obviate the chances of such a scenario arising, the terms of such indemnities need to be carefully negotiated (with the involvement of the insurer where possible) to provide the fullest practicable control/involvement/protection for the Commonwealth in such a conflict.

How should such potential liabilities be recorded, monitored and reported?

Once an indemnity or guarantee has been issued, the agency concerned should record the details on a central register that will enable all of the Executive Government's contingent liabilities relating to the agency to be monitored and audited (see paragraph 57 below). (Such registers are mandatory under the subordinate legislation (Finance Direction 23) pertaining to the *Audit Act 1901*; however, whilst this requirement is not replicated in the subordinate legislation pertaining to the proposed *FMA Act*, prudence and efficient management practice clearly dictate the need to maintain such registers in order to supply information for the purposes of audit and financial reporting.) The register should provide complete and accurate records of current indemnities, guarantees, and any letters of comfort that are considered to be binding.

Departmental registers do not need to include instruments issued by other agencies or by separate legal and financial entities within their Minister's portfolios. Departments should, however, record indemnities and guarantees issued by the portfolio Minister to those separate legal and financial entities on behalf of the Commonwealth (eg indemnities to GBEs relating to Commonwealth asset sales), or in the case of loan guarantees, by the Treasurer or his or her delegate.

For indemnities issued via numerous standard contracts each year, it is sufficient to record the name of the activity, the name(s) of indemnified parties, the (cumulative) number of indemnities issued for this activity each year and, if possible, the (cumulative) known or estimated financial limit to which the Commonwealth has a potential commitment.

Information about such potential liabilities should be reported in agencies' annual financial statements as required in accordance with Financial Statements Guidelines, issued from time to time;⁵ these statements are, of course, subject to routine audit. In addition, audited information will be requested periodically by the Department of Finance for inclusion in Whole of Government financial statements and Economic and Fiscal Outlook reports. The proposed *Charter of Budget Honesty Act* requires the Government to prepare a regular Statement of Risks which is likely to include, amongst other things, details of such potential liabilities.

⁵ A revised set of Financial Statement Guidelines will be issued by the Minister for Finance soon. The guidelines will require compliance with Australian Accounting Standards which will include AAS 33, 'Presentation and Disclosure of Financial Instruments'. The standard, which is to apply to financial years ending on or after 31 December 1997, includes disclosure of financial derivatives.

Do indemnities and guarantees need to be reviewed?

Yes. All indemnities and guarantees should be periodically reviewed to ensure that they are still the most appropriate means of achieving the particular benefits they were intended to deliver. For example, a risk for which a consultant was once indemnified because insurance was unavailable, may later be insurable.

Do agencies need contract registers (as well as registers of contingent liabilities)?

The maintenance of such registers has the potential to assist agencies in their overall management of contracts. Agencies may decide to introduce comprehensive contract registers which record all contracts. Given, however, the number of contracts that some Commonwealth agencies enter into, it may be neither practical nor cost-effective to maintain a central record of the details of each and every contract (given that all indemnities contained in those contracts need to be recorded on agencies' registers including such potential liabilities).

An alternative would be for agencies to introduce a threshold level above which the pertinent details of all contracts would be recorded. Registers of such details have the capacity, amongst other things, to reflect all significant risks accepted by other parties for the benefit of the Commonwealth and provide summary information on contracts which require close monitoring to:

- ensure that ongoing contracts where the other party has purchased insurance to cover joint Commonwealth/contractor risks, continue to protect the Commonwealth; and
- ascertain that ongoing contracts for the outsourcing of Commonwealth activities have been fulfilled to agreed standards (and are thus unlikely to result in any additional liabilities).

Ultimately, it is for the managers of agencies, in meeting their responsibilities to ensure the effective, efficient and ethical use of public money, to judge the scope and form of contract registers best suited to their respective agencies' circumstances.

Further guidelines

Agencies should be aware that both the Joint Committee of Public Accounts (JCPA) and the House of Representatives Standing Committee on Financial Institutions and Public Administration have examined ANAO Report No 6, 1996-97, *Commonwealth Guarantees, Indemnities and Letters of Comfort*.

Indeed, JCPA Report 350, *Review of Auditor-General's Reports 1996-97 First Quarter*, recommends that the Department of Finance "should seek up-to-date statements from all agencies with guarantees, indemnities and letters of comfort within their portfolios, on the steps they have taken to address each relevant recommendation in Audit Report No. 6, 1996-97". This information will be sought through the Auditor-General's follow-up arrangements administered by this Department.

Further consideration of the issues by both Committees may result in additional guidance being provided to agencies on this subject.

Financial Management Advisory Branch
April 1997

Attachment¹

Better Administrative Practice Principles for the management of Commonwealth Guarantees, Indemnities and Letters of Comfort

Risk Management Plan

A comprehensive risk management plan which links to the management of agencies' contingent liabilities. Managing these risks involves:

- establishing an awareness of the agency environment;
- identifying the risks;
- analysing the risks;
- assessing the risks;
- treating the risks (such as they are retained, reduced, eliminated, controlled or transferred); and
- monitoring and reviewing the risks.²

Preparation

When preparing a guarantee, indemnity or letter of comfort, the rationale for issuing the instrument must be that the Commonwealth's interests are advanced sufficiently to outweigh the level and cost of the risk which the Commonwealth would be assuming. The specific rationale behind issuing particular instruments should be adequately documented to ensure:

- transparency in the decision-making process;
- the instruments are issued for sound reasons; and
- original justification for the issue of the instrument will be available for review and evaluation.

Legal advice and contract vetting is needed when agencies enter into any form of written commercial arrangement, to ensure that the Commonwealth is exposed to the minimum risk necessary to achieve the particular objective. As a general rule:

- routine instruments can be issued on the basis of generic advice provided that additional advice is sought where circumstances change or the

¹ This is Appendix A to ANAO Report No 6, 1996-97, *Commonwealth Guarantees, Indemnities and Letters of Comfort*, p. 64.

² Alexander & Alexander brochure, *Public Liability Insurance, Issues and Benefits for Government*, p. 8.

specifications for the instrument fall outside the parameters of the generic advice;

- individual advice should be sought for all other instruments; and
- documents intended as letters of comfort need to be subject to specific legal advice to avoid inadvertently exposing the Commonwealth to a contingent liability.

Terms and conditions need to be considered and should canvass the following:

- setting a time limit on the operation of the instrument when this is practicable to minimise the Commonwealth's exposure to risk;
- inclusion of a termination clause, where appropriate, so that when the need for the instrument has ceased to exist the Commonwealth has the option to terminate the arrangement;
- setting, where possible, minimum and maximum financial limits on claims which can be made under the instrument;
- the inclusion of subrogation-like clauses and clauses giving the Commonwealth the right to take over any litigation related to the indemnity; and
- ensuring that the instrument (notably indemnities) does not cover damage resulting from malicious or reckless acts by the indemnified party.

Authorisation

The person issuing an instrument on the Commonwealth's behalf needs to be properly authorised to do so. Considerations should include:

- Section 70B of the *Audit Act 1901* requires that specific authority exist under legislation for the issuing of loan guarantees. The person issuing a loan guarantee must be a person authorised by legislation to do so or have had such authorisation properly delegated by such a person;
- indemnities may be issued by Ministers who may not delegate this power but they may authorise officers to issue indemnities;
- specific instruments of authorisation should identify the officers who may issue indemnities on behalf of the Commonwealth and set financial limits on their authority;
- a register should be kept of all persons authorised by the Minister to issue indemnities;
- departmental guidelines on financial management should make clear those officers within the department who are authorised to bind the Commonwealth; and

- departments should ensure that their staff are made aware of the ramifications of their actions.

Records Management

Sound management of guarantees, indemnities and letters of comfort requires effective records management. Key characteristics of records management are:

- the effective capture of information;
- compliance with legislative and policy requirements;
- appropriate security classification of documents;
- systematic registration of documents within the agency;
- accessibility; and
- secure storage.

Agencies should maintain:

- a register which is accessible to the staff who require the information; and
- a contract register for tracing contractual obligations for Commonwealth guarantees, indemnities and letters of comfort.

Document Security

Effective procedures should be in place to ensure that records, both electronic and paper are protected. Measures need to include:

- considering the agencies' overall records management strategy for the storage and retrieval of the instruments and associated documentation, taking into account the long term and/or indefinite nature of some of the obligations; and
- the appropriate indexation and storage of the instruments themselves and associated documentation including consideration of secure storage such as the Commonwealth Security System provided by the Attorney-General's Department for valuable, long term or otherwise significant instruments.

Reporting

To ensure sound measures of public accountability are in place agencies should (subject to possible confidentiality and security implications):

- accurately and comprehensively report in their annual financial statements those instruments which meet the criteria for inclusion;
- in accordance with the disclosure requirements; accurately and comprehensively report, on an annual basis, to the Department of

Finance a listing of instruments current as at the end of the financial year; and

- compile a comprehensive list of contingent liabilities (summarised where appropriate) which can be produced for public scrutiny, except where excluded under public interest considerations.

Review and Evaluation

The instruments should be reviewed to monitor risks over the life of the instruments and evaluated to determine the efficacy of the instrument in advancing the Commonwealth's interests.

Australian National Audit Office

11 September 1996

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Index

A

- accountability iv, viii, xi, xiii, xv,
3-5, 7, 20, 33, 40-43, 47-48, 51, 55,
83, 93
- Agency risk controls 34
- Agency risk management planning 30
- ANAO Audit Report No.6, 1996-97,
*Commonwealth Guarantees,
Indemnities and Letters of Comfort*
3, 53
- Asset Sales viii, xii, xiv, 7-8, 16-19, 69,
47, 88
- Audit approach xii, 7
- Audit Conclusions xiii, 43
- audit criteria xiii
- Auditor-General Act 1997 iii-iv, xi, 4
- Australian Taxation Office 39, 44
- authorisation arrangements 35, 54
- awareness xiv, 6, 9, 13, 16, 37, 47, 53, 91

B

- Background xi, 3, 9, 20
- Better Practice Principles 15
- Budget Strategy and Outlook 1998-99,
Budget Paper No. 1 41

C

- CAC Act vii, 4-5, 15
- CBA guarantee 12-13, 43, 46
- CEIs vii, 4, 9, 15-16, 21, 30-31, 35-37, 47
- census xii, 7, 9-11, 19-21, 23, 30-31, 43-46
- Centrelink 39, 51
- Chief Executive Instructions vii, xiv,
4, 30-31
- Chief Executive Instructions - CEIs 4
- Comcover* xiv, 39, 47
- Commonwealth Authorities and
Companies Act 1997 (CAC Act)* 4
- Commonwealth Bank of Australia vii,
xiii, 12, 62, 96
- Commonwealth Bank of Australia
guarantee xiii

- Commonwealth Indemnity Scheme
(CIS) 45, 63
- Commonwealth Superannuation
Scheme vii, xiii, 10, 46
- Commonwealth Superannuation
Scheme (CSS) 10
- Comparison of portfolio departments'
guarantees, indemnities and
letters of comfort 14
- Conclusions xiii, 1, 8, 43, 46
- Contract registers xiii, 21, 24-26, 46,
52, 54, 76, 89
- contract vetting 35-38, 55, 91
- cost of the audit 8

D

- DAS vii, 29, 53-56
- DEETYA vii, xvi, xvii, 23, 25, 28, 32,
34, 37, 53-56, 97
- Department of Administrative
Services vii, 17, 72
- Department of Communications and
the Arts vii, 28, 45, 57, 61, 63
- Department of Defence vii, 10, 20, 23-
24, 26, 35, 44, 57, 61, 63, 97
- Department of Employment,
Education, Training and Youth
Affairs vii, 96-97
- Department of Finance vii, 51-56, 73,
88, 90, 93
- Department of Finance and
Administration vii, xi, xiv-xv, 4,
13, 16, 22, 37, 47, 61, 69
- Department of Finance and
Administration Finance Circular
1997/06 xi
- Department of Foreign Affairs and
Trade vii, 61, 97
- Department of Health and Family
Services vii, 19, 45, 61, 71, 96, 97
- Department of Immigration and
Multicultural Affairs vii, 71, 96, 97
- Department of Industry, Science and
Tourism vii, 36, 71

- Department of Primary Industries and Energy vii, 31, 45, 58, 72
- Department of Social Security vii, 44, 97
- Department of the Environment vii, 57
- Department of the Environment, Sport and Territories vii
- Department of the House of Representatives vii
- Department of the Parliamentary Library vii
- Department of the Parliamentary Reporting Staff vii
- Department of the Prime Minister and Cabinet vii, 58
- Department of the Senate vii
- Department of Transport and Regional Development vii, 24, 96
- Department of Veterans' Affairs vii, 72, 97
- Department of Work Relations and Small Business vii
- DEST vii, 14, 53-56, 60
- DFAT vii, xvi-xvii, 23, 25, 28, 32, 34, 37, 53-56
- DHFS vii, xvi-xvii, 23, 25, 28, 32, 34, 37, 45, 53-56, 72
- DHoR vii, xvi, 25, 32
- DIMA vii, xvi-xvii, 23-26, 28, 32, 34, 37
- DIST vii, xvi-xvii, 23, 25, 28, 32, 34, 37, 53-56
- DoCA vii, xvi-xvii, 23, 25, 28, 32, 34, 37, 53-56
- Document Register 21, 23, 28
- Document Security 26-28, 93
- DoD vii, xvi-xvii, 23, 25, 28, 32, 34, 37, 53-56
- DoE vii
- DoF vii, 53-56
- DoFA vii, xvi-xvii, 4, 11-13, 15-16, 20-21, 23, 25-32, 34-35, 37-39, 40, 42, 47
- DoS vii
- DoTRD vii, xvi-xvii, 14, 23, 25, 28, 32, 34, 37, 53-56, 60
- DPIE vii, xvi-xvii, 23-26, 28-29, 32, 34, 37, 53-56
- DPL vii, xvi-xvii, 23, 25-26, 28, 32, 34, 37
- DPM&C vii, xvi-xvii, 23, 25, 28, 32, 34
- DPRS vii, xvi-xvii, 23, 25, 28, 32, 34, 37
- DSS vii, xvi-xvii, 23, 25, 26, 28, 32, 34, 37
- DVA vii, xvi-xvii, 23, 25, 28, 32, 34, 37, 53-56
- DWR&SB vii, xvi-xvii, 14, 23, 25, 28, 32, 34, 37, 60
- ## F
- Finance Circular 1997/06 xi, xiv, 4, 15-16, 21, 25, 30-31, 33, 35, 37, 40, 47
- Financial Management and Accountability Act 1997 (FMA Act)* 4
- Finding 11, 13, 16, 19, 23, 25, 28, 31, 33, 37, 39, 42, 46
- ## G
- Government Business Enterprises viii, xii, 4-5
- Guarantees, Indemnities and Letters of Comfort as at 30 June 1996 and 1997 57
- ## H
- HORSCFIPA viii, xi-xii, 6, 15, 51
- House of Representatives Standing Committee on Financial Institutions and Public Administration (HORSCFIPA) xi, 6
- ## I
- Indemnities 14
- ## J
- JCPA Report 350, Review of Auditor-General's Reports 1996-97 6, 90
- Joint Committee of Public Accounts (JCPA) xi, 6, 81, 89
- Joint Committee of Public Accounts and Audit viii, xi
- ## L
- Letters of Comfort 14
- loan guarantees xi, xii, 4, 9-11, 14, 16, 19, 43-46, 57-62, 77-78, 83-84, 86, 88, 92
- ## M
- MAB/MIAC 29
- MAB/MIAC Guidelines 29, 31

managed funds 39
 management and monitoring xii-xiii,
 7, 20, 46
 management and monitoring
 performance 20
 Mid-Year Economic and Fiscal
 Outlook 41

N

Non-Insurance Review xiv, 16, 38-39, 47
 Non-Loan Guarantees xi, 9, 11, 14, 19,
 43-46, 61-62

O

OASITO viii, xvi-xvii, 8, 23, 25, 28, 32,
 34, 37, 69-71, 73
 Office of Asset Sales and IT
 Outsourcing viii, 7-8, 16-18

P

Parliamentary Committees xi, xiii, 6-7,
 51
 pay-outs 20, 44
 Potential size of the Commonwealth's
 exposure xiii, 46
 privatisation xii, 8-9, 16, 19, 38
 public accountability xi, xiii, 3, 7, 41, 93
 Public Sector Superannuation Scheme
 viii, xiii, 10

R

Recommendation No.1 21, 23, 51, 53
 Recommendation No.2 13, 25, 51, 53
 Recommendation No.3 28, 40, 51, 53
 Recommendation No.4 30, 32, 51, 53
 Recommendation No.5 33, 35, 52, 54
 Recommendation No.6 34, 37, 52, 54
 register of contingent liabilities 22, 52
 registers xiii, 15, 21, 23-26, 46, 52, 54,
 75-76, 83, 88-89
 Report 350, *Review of Auditor-General's
 Reports 1996-97* 90
 Report of the Inquiry into ANAO
 Audit Report No.6 xii, 6, 51
 reported value 11, 43-44
 review and evaluation xvii, 32-33, 34,
 55, 91, 94
 Review of GBE Governance

Arrangements 5

risk management xii-xiii, xiv, xvi, 6-7,
 13, 15, 26, 29-33, 37-39, 47, 53, 74,
 81, 91, 96

Risk management and control
 measures 29

Risk pricing and risk transfer 37

S

Schedule of Contingencies 40, 41-42
 security arrangements xiv, 27-28, 47
 self insurance 38, 52
 Statutory Marketing Authorities xii,
 4-5
 subrogation xvii, 13, 22, 35, 37, 54, 86,
 87, 92

T

The Non-Insurance Review xiv, 38-39,
 47

Time limits, financial limits and
 termination clauses 35, 37

Total exposures xi, 46

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Titles published in the financial year 1997-98

Audit Report No.1 <i>Audit Activity Report: Jan-Jun 1997</i> Summary of Audit Outcomes	Audit Report No.12 Performance Audit <i>The Pharmaceutical Benefits Scheme</i> Department of Health and Family Services
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Department of Employment, Education, Training and Youth Affairs

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July to December 1997
Summary of Outcomes

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Department of Social Security
Centrelink

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