



COMMONWEALTH OF AUSTRALIA

Official Committee Hansard

SENATE

ECONOMICS LEGISLATION COMMITTEE

ESTIMATES

(Additional Estimates)

WEDNESDAY, 15 FEBRUARY 2006

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SENATE
ECONOMICS LEGISLATION COMMITTEE
Wednesday, 15 February 2006

Members: Senator Brandis (*Chair*), Senator Stephens (*Deputy Chair*), Senators Chapman, Murray, Watson and Webber

Senators in attendance: Senators Brandis, Conroy, Fielding, Murray, Parry, Sherry, Watson and Wong

Committee met at 9.03 am

TREASURY PORTFOLIO

In Attendance

Senator Minchin, Minister for Finance and Administration

Department of the Treasury

Dr Ken Henry, Secretary

Outcome 1: Sound Macroeconomic Environment

Output Group 1.1: Macroeconomic Group

Dr Martin Parkinson, Executive Director

Mr David Parker, Alternate Executive Director

Dr David Gruen, Chief Adviser (Domestic)

Mr David Pearl, General Manager, International Economy Division

Mr David Turvey, Manager, International Economy Division

Mr Nathan Dal Bon, Manager, International Economy Division

Mr Roger Brake, General Manager, International Finance Division

Dr Steven Kennedy, General Manager, Domestic Economy Division

Mr John Hawkins, Manager, Domestic Economy Division

Mr Graeme Davis, Manager, Macroeconomic Policy Division

Dr Paul O'Mara, General Manager, Macroeconomic Policy Division

Mr Greg Coombs, Acting Manager, Macroeconomic Policy Division

Mr Russell Campbell, Manager, Macroeconomic Policy Division

Outcome 2: Effective Government Spending and Taxation Arrangements

Output Group 2.1: Fiscal Group

Mr David Tune, Executive Director

Mr David Martine, General Manager, Budget Policy Division

Mr Matthew Flavel, Manager, Budget Policy Division

Mr Jason McDonald, Manager, Budget Policy Division

Mr Rob Heferen, General Manager, Social Policy Division

Mr Peter Robinson, Principal Adviser, Social Policy Division

Mr Michael Willcock, General Manager, Commonwealth-State Relations Division

Mr Michael Burton, Chief Financial Officer, Corporate Services Division

Outcome 3: Well Functioning Markets**Output Group 3.1: Markets Group**

Mr Jim Murphy, Executive Director
Mr Chris Legg, General Manager, Financial System Division
Mr Andre Moore, Senior Adviser, Financial System Division
Ms Vicki Wilkinson, Manager, Financial System Division
Mr Trevor King, Manager, Financial System Division
Mr Olaf Schuerman, Senior Adviser, Financial System Division
Ms Lorraine Alan, Senior Adviser, Financial System Division
Mr Geoff Miller, General Manager, Corporations and Financial Services Division
Ms Kerstin Wijeyewardene, Manager, Corporations and Financial Services Division
Mr Matt Brine, Manager, Corporations and Financial Services Division
Mr David Love, Manager, Corporations and Financial Services Division
Mr Jorge del Busto, Secretary, Financial Reporting Council
Mr Steve French, General Manager, Competition and Consumer Policy Division
Ms Sandra Patch, Senior Adviser, Competition and Consumer Policy Division
Ms Louise Seeber, Acting Manager, Competition and Consumer Policy Division
Mr David Hall, Manager, Competition and Consumer Policy Division
Mr Brad Archer, Competition and Consumer Policy Division
Mr Gerry Antioch, General Manager, Foreign Investment and Trade Policy Division
Mr Mike Rosser, Manager, Foreign Investment and Trade Policy Division
Mr Peter Martin, Australian Government Actuary
Mr Michael Burt, Actuary, Australian Government Actuary
Mr Peter McCray, General Manager, Financial Literacy Foundation
Mr Grahame Crough, Manager, Financial Literacy Foundation
Mr John Riley, Financial Literacy Foundation

Outcome 2: Effective Government Spending and Taxation Arrangements**Output Group 2.2: Revenue Group**

Mr Mike Callaghan, Executive Director
Mr Paul McCullough, General Manager, Tax System Review Division
Mr John Lonsdale, General Manager, Superannuation, Retirement and Savings Division
Mr Nigel Ray, General Manager, Tax Analysis Division
Mr Phil Gallagher, Manager, Tax Analysis Division
Mr Colin Brown, Manager, Tax Analysis Division
Mr Peter Greagg, Manager, Tax Analysis Division
Mr Patrick Colmer, General Manager, Indirect Tax Division
Mr Colin Johnson, General Manager, Business Tax Division
Mr Mark O'Connor, General Manager, Individuals and Exempt Tax Division
Mr Alan Mallory, Manager, Superannuation, Retirement and Savings Division
Mr Nigel Murray, Manager, Superannuation, Retirement and Savings Division
Mr Tony Coles, Manager, Superannuation, Retirement and Savings Division
Mr Michael Rawstron, General Manager, International Tax and Treaties Division
Mr Paul McBride, Manager, International Tax and Treaties Division
Ms Jo Ladusko, Manager, International Tax and Treaties Division

Mr Hadyn Daw, Manager, International Tax and Treaties Division

Mr Bruce Paine, General Manager, Board of Taxation

Australian Competition and Consumer Commission

Mr Graeme Samuel, Chairman

Mr Brian Cassidy, Chief Executive Officer

Mr Joe Dimasi, Executive General Manager, Regulatory Affairs Division

Mr Mark Pearson, Executive General Manager, Enforcement and Compliance Branch

Ms Rose Webb, General Manager, Enforcement and Co-ordination Branch

Mr Tim Grimwade, General Manager, Mergers and Asset Sales

Mr Scott Gregson, General Manager, Adjudication Branch

Mr Robert Antich, General Manager, Policy and Liaison Branch

Mr Nigel Ridgway, General Manager, Compliance Strategies Branch

Mr Michael Cosgrave, General Manager, Telecommunications Group

Ms Helen Lu, General Manager, Corporate Management Branch

Mr John Bridge, Chief Finance Officer

Ms Lisa Anne Ayres, Executive Branch

Mr Josh Maldon, Executive Branch

Mr Peter Maybury, Director Finance and Services

Ms Kristy Randall, Executive Branch

Australian Taxation Office

Mr Michael D'Ascenzo, Commissioner

Mr Greg Farr, Second Commissioner

Ms Raelene Vivian, Deputy Commissioner

Ms Donna Moody, Chief Finance Officer

Mr Mark Jackson, Deputy Commissioner

Ms Stephanie Martin, First Assistant Commissioner

Ms Margaret Crawford, Chief Operating Officer

Mr Mark Konza, Deputy Commissioner

Mr Michael Monaghan, Deputy Commissioner

Financial Reporting Council

Mr Jim Murphy, Executive Director, Treasury and FRC Member

Inspector-General of Taxation

Mr David Vos, Inspector-General of Taxation

Mr Rick Matthews, Deputy Inspector-General of Taxation

National Competition Council

Mr John Feil, Executive Director

Productivity Commission

Mr Bernard Wonder, Head of Office

Mr Garth Pitkethly, First Assistant Commissioner

Mr Michael Kirby, First Assistant Commissioner

Mr Ian Gibbs, Assistant Commissioner

Australian Prudential Regulation Authority

Dr John Laker, Chairman

Mr Steve Somogyi, APRA Member

Mr Brandon Khoo, Executive General Manager, Specialised Institutions

Mr Bernie Egan, Program Director, Basel II, Policy Research and Statistics Division

Australian Securities and Investments Commission

Mr Jeffrey Lucy, Chairman

Mr Jeremy Cooper, Deputy Chairman

CHAIR (Senator Brandis)—I call to order this public hearing of the Senate Economics Legislation Committee. On 8 February 2006 the Senate referred to this committee the following documents in relation to the Treasury and Industry, Tourism and Resources portfolios: particulars of proposed additional expenditure in respect of the year ending 30 June 2006, that is, Appropriation Bill (No. 3) 2005-2006; particulars of certain proposed additional expenditure in respect of the year ending 30 June 2006, Appropriation Bill (No. 4) 2005-2006; statement of savings expected in annual appropriations made by act No. 72 of 2005, that is, Appropriation Act No. 1, and No. 73 of 2005, that is, Appropriation Act No. 2; the final budget outcome 2004-05; and the advance to the Minister for Finance and Administration as a final charge for the year ended 30 June 2005.

The committee is required to consider these documents insofar as they relate to the portfolios allocated to the committee by the Senate on 9 February 2006 and to report back to the Senate on or before 28 March 2006. The committee may also examine the annual reports of departments and agencies at this time even if no additional appropriations have been sought. The committee has set Thursday, 30 March 2006 as the date for the submission of written answers to questions that are taken on notice. The committee will consider the proposed expenditure for departments and agencies in the order in which they appear on the circulated agenda. Any changes to the order in the agenda will be notified from time to time.

We begin this morning with the examination of the Treasury portfolio. Before we start there are a few formal matters to mention. I remind officers that the Senate has resolved that there are no areas in connection with the expenditure of public funds where any person has a discretion to withhold details or explanations from the parliament or its committees unless the parliament has expressly provided otherwise. Giving false or misleading evidence to the committee may constitute a contempt of the Senate.

I draw to the attention of senators and witnesses standing order 26, which governs the estimates, and in particular standing order 26(2), which provides that the committees shall hear evidence on the estimates in public session, and the privilege resolutions agreed to by the Senate on 23 February 1988—in particular, clauses 9, 10 and 16 of resolution No. 1. Clause 9 of resolution No. 1, which deals with the question of relevance, provides:

A chairman of a committee shall take care to ensure that all questions put to witnesses are relevant to the committee's inquiry and that the information sought by those questions is necessary for the purpose of that inquiry. Where a member of a committee requests discussion of a ruling of the chairman on this matter, the committee shall deliberate in private session and determine whether any question which is the subject of the ruling is to be permitted.

In 1999 the Senate adopted the following test of relevance:

Any questions going to the operations or financial positions of the departments and agencies which are seeking funds in the estimates are relevant questions for the purpose of estimates hearings.

Ultimately, of course, relevance is a question to be determined by the chair. I ask senators to bear this in mind when framing their answers. Clause 10 of the privilege resolution provides:

Where a witness objects to answering any question put to the witness on any ground, including the ground that the question is not relevant or that the answer may incriminate the witness, the witness shall be invited to state the ground upon which objection to answering the question is taken. Unless the committee determines immediately that the question should not be pressed, the committee shall then consider in private session whether it will insist upon an answer to the question, having regard to the relevance of the question to the committee's inquiry and the importance to the inquiry of the information sought by the question.

Clause 16 provides:

An officer of a department of the Commonwealth or of a state shall not be asked to give opinions on matters of policy, and shall be given reasonable opportunity to refer questions asked of the officer to superior officers or to a minister.

I also remind senators and witnesses that the provisions I have read are not an exhaustive statement. There are certain practices and precedents of the committee in relation to areas of inquiry which are not permitted. Senators will be familiar with what they are. All officers appearing before the committee are protected by parliamentary privilege with respect to their evidence. I now welcome the Minister for Finance and Administration, Senator Minchin, representing the Treasurer, and officers of the Treasury. Minister, do you have an opening statement?

Senator Minchin—Just for the record, I inform the committee of the government decision that I understand most members would be aware of but that I think I should report to this committee as a proper courtesy—that is, the government has directed that officials appearing before Senate legislation committees should not answer questions directed to them on matters before the commission of inquiry being conducted by the Hon. Terence Cole into certain Australian companies in relation to the oil for food program. While examination of officials by the committees might be appropriate in the future, the government considers that Mr Cole should be able to proceed with his inquiry and present his findings without parallel public questioning, which would not assist the consideration of complex issues. I am happy to table that statement.

CHAIR—It might be useful if you do table it, Minister. Thank you. Can I have a resolution to receive that? Thank you.

Senator SHERRY—Can I raise an issue on that matter?

CHAIR—Yes.

Senator SHERRY—I would appreciate your advice on this, Chair. To whom does that not apply?

CHAIR—I am sorry, your question is not clear. Are you talking about witnesses?

Senator SHERRY—Witnesses and/or sections, authorities et cetera—for example, the tax office.

CHAIR—Perhaps that is a question best directed to the minister. It seemed to me clear enough that the statement applies to all witnesses and that what it attaches to is a topic, not an

agency or any particular class of witnesses. Minister, do you want to say anything more about that in response to Senator Sherry?

Senator Minchin—The terms of the decision are that officials are directed accordingly, so that would apply to all officials of government departments and agencies that are federal government agencies.

Senator SHERRY—To what extent can the government direct the Commissioner of Taxation on this matter, for example?

Senator Minchin—I would have thought that he is an official for the purposes of appearing before this committee in relation to this matter.

CHAIR—Can I point out, Senator Sherry, that the standing orders and procedural resolutions that I have read in the opening statement do not distinguish between officers of the Commonwealth, as between officers of departments and officers of independent statutorily defined agencies. The resolutions do treat all officers answerable to this committee as being on the same footing.

Senator SHERRY—On that basis, how was it that questions were allowed to Mr Besley—I think it was last night—with respect to the wheat authority?

CHAIR—If that is a question to me, Senator Sherry, I do not know; I was not there and I have not read the *Hansard*. But, leaving aside considerations of comity between committees, I am not bound by whatever rulings were made by the chair of that committee, and I am not in a position to speak to them because I do not know what they were and I do not know the grounds upon which they were made.

Senator SHERRY—I think the central issue is whether or not the decision, the directive, that Senator Minchin has referred to is in fact binding on a class of public servants in statutory authorities. In this case, I am raising the question of the tax office, whose representatives will be appearing this afternoon. I think it is important to obtain some clarification about whether in fact what Senator Minchin has read out can apply in that particular case, for example.

CHAIR—Well, Senator Sherry, you take whatever advice you choose. But, as I said a moment ago, the Senate standing orders and resolutions governing the conduct of this committee do not distinguish between categories of officers. As you well know, in appearing before these estimates committees, all officers—whether they be departmental officers or officers employed by statutory authorities or agencies—appear through the minister in the sense that, for example, as the resolution I read indicates, they all have an equal right to refer questions of policy to the minister. So, as I understand the procedure and the standing orders and resolutions, the minister in these proceedings stands between, or may stand between, any officer and the committee.

Senator SHERRY—I think we need some consistency. It will become an issue this afternoon when the Tax Office appears, for example, and it may become an issue with respect to ASIC and APRA, who will be appearing tomorrow. I am aware of what occurred in another committee last night and I do not know on what basis the chair permitted questions to the wheat authority but they certainly did occur. Could I request that the committee secretary

obtain some guidance for advice and consideration of this committee about this particular issue.

CHAIR—You can certainly request that, Senator Sherry, and I am sure the secretary will act promptly on your request—the issue being the extent to which the government or the minister can give a direction to an officer of a statutory agency as opposed to a departmental officer in relation to answers to questions.

Senator SHERRY—Correct.

Senator Minchin—I just make the fine point that this is not of itself a question of the permission for questions to be asked. That is a matter for you in terms of your interpretation of standing orders, relevance et cetera. We are not going to the issue of the right to ask questions—questions can be asked. But in asking those questions, given that they fit in with your standing orders, I am informing the committee that, in contemplating an answer, officials have been directed in the fashion that I have described, which may constrain the extent to which answers are able to be given to questions which might otherwise be perfectly within your standing orders. I just clarify that.

CHAIR—I understand that, minister. It is clear enough that we are not talking about questions which are not in order; we are talking about questions which are *prima facie* in order but nevertheless may fall within the scope of the government's decision. I suppose it is then a question for the officer to whom the question is directed to consider their position, having regard to the government's directive, if a proper question is asked of them.

Senator Minchin—I agree with that.

Senator SHERRY—Just on that point, it is clearly a related but separate issue: in my view, they are a different class of persons by virtue of their position. I have raised the tax office and I have raised APRA and ASIC, who may or may not fall into this category, for which I would seek advice through the secretary.

CHAIR—I think you have made that clear, and we know what the issue is.

Senator SHERRY—On a related matter, my office raised with the secretary a request that a Mr Tony McDonald appear before the additional estimates. My understanding is that is impractical because he is based in Papua New Guinea—

CHAIR—This is the man in New Guinea?

Senator SHERRY—Yes, he is based in Papua New Guinea. What I want to suggest to the committee for its consideration for Mr McDonald to appear, or be a witness by phone, is a reference under sessional order 25(2)(b) in order to question that officer when the Senate resumes. I will put that to the committee for its consideration. I am not seeking a decision on that matter now—

CHAIR—We might consider that in a private meeting at the morning tea adjournment.

Senator SHERRY—Whenever it is appropriate. Given the practical issues, timing is not critical. Mr McDonald has some relevant knowledge of wheat trading matters. I assume—I have not had it confirmed—that he is within the international division of Treasury if he is posted in Papua New Guinea. We recognise the practical limits given that he is in Papua New

Guinea. It is certainly our wish to question him about his knowledge of these circumstances surrounding the bribery and the Wheat Board scandal.

CHAIR—Senator Sherry, just so you know and to put it on the record: I first became aware of this request through the secretary about the middle of yesterday afternoon. We had a discussion and it seemed to me, particularly given that the customary advance notice concerning this gentleman had not been given and given his location, not to be practicable. But if you want to agitate that further in a private meeting—

Senator SHERRY—I certainly accept it is not practical for today. We have international economic policy advice and assessment for consideration this morning. But there are alternatives that the committee could consider; hence I make my request.

CHAIR—Anything further of a preliminary character?

Senator SHERRY—One other matter: some issues have been placed on notice about missing laptop computers in Treasury, and I raise this as a preliminary matter as to where I would be best to deal with that matter. I understand there is an allegation that there are laptops missing across Treasury and the tax office. A question was placed on notice about this matter by my colleague Ms Grierson on 7 March 2005, to which no response has yet been received. What would be the most appropriate area? My understanding is there are missing laptops right through the department, so it is a whole of department and tax office issue. I seek your guidance, Chair, as to the best place to raise this issue.

CHAIR—I might handball that question to Dr Parkinson or somebody who has a better view of the morphology of the portfolio than I do.

Dr Parkinson—Senator Sherry, I would suggest that question is best directed to Mr Ian Robinson, who is the general manager of our corporate services division, who I anticipate will attend along with Mr Tune under item 2, fiscal and corporate.

Senator SHERRY—Budget policy advice and coordination?

Dr Parkinson—Yes.

CHAIR—There being no other preliminary matters, I invite Senator Sherry to begin his examination of officers.

Senator SHERRY—I want to go to some issues relating to domestic economic matters and advice forecasting. Firstly, in the national accounts in the September quarter 2005 there was a considerable variation in the growth rates across states: Western Australia recorded a growth in state final demand of 2.1 per cent; New South Wales a decline of 0.8 per cent; South Australia a decline of 0.1 per cent. So there is a reasonable state regional variation reflected in those figures. What are the observations of Treasury about the different figures across the sectors of the Australian economy based on a geographic and regional basis?

Dr Kennedy—It was true in that quarter that overall growth was quite modest, so it was not surprising to see some states falling in terms of their state final demand at least and others rising. There has been some geographic dispersion opening up, particularly between New South Wales—and to a lesser extent Victoria—and other states. The clearest set of statistics we can see this in is in the labour force statistics where we have had extremely strong employment growth until recently in Western Australia and Queensland and weaker growth in

other states, in particular New South Wales, and it is now starting to show up in unemployment rates. For example, the unemployment rate in New South Wales in January, I believe, was 5.7 per cent whereas it was around four per cent in WA. Part of our thinking behind that regional variation would reflect the positive demand shocks, if you like, that are currently running through the economy, and in particular the commodity boom. States like Queensland and WA clearly benefit directly from the very large increase in commodity prices that we have seen and also that flows through into construction and into other parts of the economy.

I would also say that New South Wales has not only been weak just recently but also been weaker than other states for two or three years now in terms of gross state product, which is an annual statistic released late last year. In part that may reflect the fact that the housing cycle in New South Wales turned a little before the other states. So retail trade and consumption and what we anticipate were wealth effects—people spending some of the increase in wealth they got from seeing a large increase in the house prices—started to ease in New South Wales before it did in other states. That is a quick snapshot of some of the regional variation. Were there any other aspects you are interested in?

Senator SHERRY—Thanks for that. You have started to touch on some of the issues I was going to refer to. From what you were saying, firstly, there was a more modest growth level overall in the Australian economy?

Dr Kennedy—In that particular quarter. We never changed our view of the outlook for 2005-06 at MYEFO. When we put MYEFO out we had the benefit of the September quarter national accounts, and the September quarter was a quarter where we only saw about 0.2 per cent quarterly growth but we saw over one per cent growth in the previous quarter. As I said, we have not changed our overall outlook, but consumption has been a little weaker than we anticipated though business investment has been somewhat stronger. So there has been some change in the overall composition of growth. As I said earlier, places in the economy that are strong are being reflected in regional variations.

Senator SHERRY—On that issue of business investment, is the significant impact of the ‘mining boom’ reflected in the business investment area?

Dr Kennedy—Yes. Engineering construction, for example, is at extremely high levels. The ‘work yet to be done’ series, which is a series that measures how much work is in the pipeline to come through, is at record high levels. Often these things are at records because things always rise in terms of dollars, but this is really at extremely high levels. We have seen about \$30 billion in mining related investment in the last three years and investment then around mining. That is a big part of it. Then there is manufacturing investment. The latest Capex survey we saw was very strong as well, relating to people’s expectations of their capital expenditure, and that was quite broad based. Having said that, it may be the case that this strong mining activity is feeding through to other sectors such as manufacturing. There would be parts of manufacturing that support construction mining that would be doing well and other parts that may be struggling if they are in export markets and they are facing a relatively high exchange rate.

Senator SHERRY—Just going to the issue of housing prices, which you mentioned, what has been the trend of housing property prices—when I say ‘housing’ I include units—in New South Wales, particularly Sydney, versus the rest of the country?

Dr Kennedy—I do not have the numbers to hand, but there has been a decline in house prices in New South Wales whereas in other states—in WA, and particularly in Perth—house prices are in fact still rising. The Australia-wide number is dead flat. Basically, house prices have been flat since about the December quarter 2003/March quarter 2004, but house prices in Sydney in particular have fallen by around five or 10 per cent, I think, but I would have to check the details of that.

Senator SHERRY—So within that average national flatness we also have a reasonable level of variation from capital to capital, state to state, and region to region?

Dr Kennedy—Yes, we do. The Reserve Bank statement on monetary policy released very recently showed that house prices in New South Wales had come back to a relativity that they had some years ago. Other states had stayed flat, some are still rising or catching up, but house prices in New South Wales had basically come back to establish a relativity that existed around 10 years ago.

Senator SHERRY—When you use that term ‘catch up’, you mean not catching up effectively to Sydney prices but catching up in terms of relativity?

Dr Kennedy—Yes. The average or median house price is still substantially higher in Sydney than it is in other capital cities.

Senator SHERRY—Just to go back to your opening answer, you made a reference to the ‘wealth effect’, that is, people—or some people at least—spending a part of the increase in house prices. I assume when you make reference to that you are referring to today’s trend—or not trend, it is happening significantly—of equity drawdown against higher price?

Dr Kennedy—Yes, there was for Australia, probably associated with deregulation around financial markets, a substantial increase in mortgage equity withdrawal. Based on our calculations, my understanding is that the trend has unwound itself and we are almost back in a position where there is equity injection now. So that trend has turned around and I think that is reflected in more moderate consumption growth and moderate retail trade, for example.

Dr Parkinson—Could I just add a point there. The wealth effect does not just come through equity withdrawals; it comes through people looking at the total stock of their wealth and perhaps deciding to save less. It is not just an equity withdrawal issue; it is just one mechanism by how they tap into it. The wealth effect is broader.

Senator SHERRY—For example, at the same time, and relatively unusually, we have had very good rates of return from the stock market reflected in both individual purchase and group purchase through super funds. Presumably that must have some overall impact on people feeling wealthier and therefore feeling more confident to, in whatever way they do it, consume more.

Dr Parkinson—That is correct.

Dr Kennedy—That is true. One thing we think about consumption is that we had extremely rapid growth in consumption a year or two ago of rates of five or six per cent. Even

with a positive story around the stock market we would have anticipated consumption easing, which it has done, to more sustainable rates.

Senator SHERRY—It is a bit of a side issue but in terms of domestic economic policy has there been any analysis carried out around issues of mortgage release pension products in retirement, drawing down on equity of home? The reason I raise this is that it seems to me, at least anecdotally, this is a rapid area of growth, certainly in terms of products available. Have you done anything on that?

Dr Kennedy—Not by us. I am not sure if other areas of Treasury might have looked at that issue.

Dr Parkinson—I am unaware of any work being done on the macroeconomic implications of that. Whether people have looked at the financial market aspects would be a question you would need to address to our markets group—

Senator SHERRY—I was going to raise it there as well but I was just thinking of it in the context of equity drawdown prior to retirement, and you have obviously had some analysis of that and made some observations about it. It seems to be growing quite rapidly after retirement, albeit in a different form. There are a range of issues that flow from that that are not so much macro; it is the micro impact.

Dr Parkinson—Absolutely. From a macro perspective, even with very rapid growth, it would be a very small impact. It is not something that we have done any work on.

Senator SHERRY—Just going back to the impact of the mining boom, particularly in WA but to an extent in Queensland too, does Treasury have any observations to make about the medium to longer term outlook in this area?

Senator MURRAY—In your answer to that question I would like you to respond in terms of both volume and price effects. It seems to me the mining industry has taken a view that the long-term volume increase is likely to be sustained because that is why they are investing \$30 billion. But it seems to me the price view is that price will fall as world-wide supply increases. So I would be interested in your comments on price and volume and its effect on the domestic economy.

Dr Kennedy—On the volume side, and also it is relative to the number I gave you on the increase in mining investment, that increase in mining investment came after a fall so that comes off a trough as well. Previously we saw a period where, if you like, there was a little less optimism around these products. Mining investment fell away and then clearly demand came through very strongly from the rest of the world, in particular in China, and we have seen a large increase. Our view on the volume side is that we are yet to see most of the production that will come through from the investment that has been put in place. We expect to see that coming through over the course of the next couple of years and the most obvious place it will show up in is in exports. We have seen some of it come through in iron ore and coal, but offsetting that we have seen declines in oil production. So we have yet to see in there what we think will be reasonably large increases on the volume side.

On the price side, because our forecasting horizon is around 18 months on average, what we have done for forecasting for 2006-07 is basically take what ABARE is suggesting will

happen to the price of our main commodities, iron ore and coal, and that is a minor fall on average. That is what has been coming out so far. The early contracts struck for metallurgical coal have suggested a small fall in the contract prices of those.

Beyond that you may have noticed that MYEFO and previously at budget, we assumed then that the price of commodities falls back in two steps in the projection period—so these are not forecasts, these are assumptions—to around their long-run average. Our existing projection methodology would have built those big increases in the terms of trade into our nominal income projections in perpetuity, whereas we think—perhaps as you were alluding to, Senator Murray—that the volume response that we are likely to see will see some fall in price. We have not got a really fixed view of exactly how big that fall in price will be or exactly when it will occur, but it is very clear that companies in this area are making very large profits. It would be unusual if they did not invest to try and produce more. In fact, this is what has tended to happen in the past: there is typically always a supplier response. People do talk about cobweb cycles. These are cycles that have somewhat of a boom-bust nature to them. The price starts to rise, people tend to invest a lot, a lot of volume comes through, the price falls, and you tend to go around.

There is some argument that the demand for these commodities has ratcheted up and will stay up because of the industrialisation of China essentially. Our view basically is that there will be a supplier response. We think we are seeing just the beginning of it. Those volumes will come through and price will fall. It is just the interaction of supply and demand for those commodities. The timing on this is always the thing that is the trickiest, but generally our view is the volumes will come through and that is when we will see the price start to fall away.

Senator MURRAY—Thank you. It seems to me we must be careful of using the word ‘boom’ then.

Dr Kennedy—Sure.

Senator MURRAY—In my view the word ‘boom’ may be related to price and profits—in other words, they will come back. But in my view the volume is likely to be sustained at the expected levels that are being anticipated by the mining industry. In that sense the need for skills, for people, the continued employment, the continued use of infrastructure and so on, will be sustained—it will not just peak and fall away.

Dr Kennedy—That is a good point. Even in that sort of cobweb cycle that I was talking about those volumes do not go away. If you like, demand catches up with that supply and keeps going. I do not anticipate big rises and falls in volumes; I expect them to step up, as you said, and stay up.

Senator MURRAY—One of the reasons I relate to you in terms of language is that I fear the use of the word ‘boom’ indicates a short termism and might encourage public policy in the states or elsewhere not to accept or recognise that there needs to be a long-term commitment—and at the federal government level, perhaps, in some areas—because they might feel that demand will fall away. My own feeling is that the infrastructure needs and the people needs are going to be sustained at a high level.

Dr Kennedy—I think that is a fair point.

Senator SHERRY—Going back to this description of boom and bust—which is, to some extent, misleading—you may not have a bust in volumes; you might have a bust in profitability of the entities, because the prices drop but the volumes will hold relatively steady.

Dr Kennedy—Again, perhaps I should be careful moving between economic jargon. Their profitability may fall back to more reasonable levels, if you wanted to call that the bust, but what I am talking about I do not think implies an impending bust in terms of mining companies going broke or anything like that. I just mean we anticipate a substantial volume response, and the profitability of these companies will fall back to the profitability of companies that you see more generally rather than the very strong profitability that they are enjoying at the moment. I should be a little bit more careful there. I do not anticipate any—

Senator SHERRY—I was not being critical in any sense. You have raised a terminology that I think is commonly used. Just briefly, Senator Murray and I are exploring the consequences of a downturn—or what would be known as a bust, given the boom. It would be reflected in different ways, presumably.

Dr Kennedy—We drew out some assumptions which we used in putting together our projection methodology. People would look at a chart if they saw prices falling back to average levels and probably call that the downswing of the boom in prices. These are dramatic increases in prices, of the order of 70 per cent and 120 per cent for coal and iron ore. You might want to call that a boom in those prices. I would expect that to come off over time. Potentially, if supply comes on very quickly or more quickly than anticipated, it could come down a little bit more quickly. But I do not think it has terribly negative consequences for the general economy. We are going through this, if you like, rapid increase in the terms of trade and commodity prices. Our economy in overall terms is essentially sailing through the middle of it and growing at around trend or even a little below trend, in part reflecting offsetting factors such as the end of the housing cycle. But we are seeing wages adjust in the areas where there is very strong demand and wage growth in other areas being more moderate. So the flexibility of the economy is working really well in this very strong positive impulse that is running through it. I would expect it to work just as well if things were going in the other direction.

Senator MURRAY—Simplistically, I see volume as delivering employment but price delivering, from a government point of view, revenue. So I do not expect to see employment that is consequential to that sector falling, and I expect profits to be maintained at a respectable level. That leads me to the expectation that we should not expect to see a significant drop in taxation revenue. One of the propositions being put about is that this is a boom, there will be a bust and all sorts of effects will occur: there will be a drop in employment, there will be a drop in profitability and there will be a drop in taxation revenues. I do not see any drop in employment as being likely, because the volume will be sustained, and I do not in fact expect to see a significant revenue drop.

Mr Parker—I would agree with the first part of your conclusion, which is that you would not expect to see employment come off significantly. But I do not necessarily agree with the view that you would not expect to see taxation revenue come off over this period. The reason goes to the nature of the cobweb cycle that Dr Kennedy mentioned. In the very long run, you

would expect commodity prices to be driven basically according to the cost of digging the stuff out of the ground. If prices are higher than that cost then firms will invest more. They will lift capacity, and that lift in capacity will tend to drive the price back down towards that cost. On the other hand, if prices for some reason are below that cost, they will cut back on investment, the growth of supply will come off and eventually prices will come up. We have seen that cycle in the past. Commodity prices go up to a peak and then they come off. Often they come off further than that, in a sense, equilibrium price.

Going forward, we expect prices to come off because investment is now at extraordinarily high levels. There is a question about how far prices will come down and, as Dr Kennedy mentioned, in the budget and in MYEFO we have predicted that prices would come down in two steps to their long-run average. So we have not predicted that they will go through that long-run average into a price bust scenario. They are projections—they are assumptions—but there are two reasons to believe that they are, in a sense, reasonable assumptions. One reason is that demand is going to continue to grow very quickly due to the industrialisation of China. The other is that there has been a very significant degree of ownership consolidation within the global minerals industry, so you have fewer players than you used to have before. They are likely to take account of the potential for overinvestment. Therefore they are less likely to do it than if you have lots of little players who will not take account of their production on world prices.

Nevertheless, in the long run you would expect prices to come down quite significantly. While you might not see volumes come off, and we would not expect that—obviously we would expect them to continue to grow with China—prices will come down and so the super profits which are presently being earned in the mining industry will come off. The time frame is uncertain. But, as they come off, the amount of taxation revenue that they are paying out of that super profit will come down.

Senator SHERRY—On this issue of taxation revenue, you used the term ‘super profits’. That would be reflected, say, in corporate tax collections?

Mr Parker—That is correct.

Senator SHERRY—What analysis have you done of this?

Mr Parker—Of profit payments by mining companies in particular?

Senator SHERRY—Yes.

Mr Parker—I might refer part of that question to our revenue group people who have looked at the taxation revenue side of things. We have looked at it from the perspective of its impact on our trade accounts and the current account deficit. The higher commodity prices feed through into an improvement in the terms of trade balance, but that is immediately offset by an increase in the net income deficit—because these companies are earning profits and a substantial part of these companies are foreign owned and so that profit flows immediately out.

Senator SHERRY—On a related issue, I have not looked at the statistics but presumably, given the increased investment, there is a significant lift in imported mining equipment. I do not know how much of it is manufactured in Australia, but there would have to have been a

related lift in the importation of mining equipment, which I think is fairly capital costly. Do you have any observations to make about that?

Mr Parker—Yes, there has been. In fact, the price of these capital items has increased as well. There is a global shortage of large mining equipment at the moment. It is quite difficult to get the really big tyres, for example, to go on these ore trucks—

Senator MURRAY—They are digging up old tyres.

Mr Parker—They are digging them out of the ground to reuse them.

Senator SHERRY—Export earnings is not the only issue; there is an import side to the equation, at least for the foreseeable future, isn't there?

Mr Parker—That is right. You can map that through the savings and investment balance. We are seeing a quite significant lift in investment in this sector, and that maps in through the overall net lending framework into the current account deficit. It is one of the reasons why, notwithstanding the improvement in the terms of trade and the lift in commodity prices, you do not get a one-for-one improvement in the current account deficit.

Senator SHERRY—We have explored mining to a significant degree. I might do a little bit more on that later. I want to come back to the more moderate economy as reflected on a regional basis. Does Treasury have any observations to make about whether the forward projection forecasts for the New South Wales economy, for example—which I referred to earlier with the decline in state final demand—will be ongoing?

Dr Kennedy—In our forecasts we look at the states but we do not forecast state by state; we forecast at the aggregate level. However, it is obviously relevant to go back and think about that regional variation. For New South Wales, as I said, given that they began seeing more moderate growth in housing and less of an increase in house prices earlier than others, I would anticipate that they will tend to come out of that easing before other states. They are obviously not going to benefit as much. Some of their economy is commodity based. They are not going to benefit to the same degree as Western Australia and Queensland. We might expect some of the weakness that we have seen in New South Wales begin to dissipate in aggregate as we go forward, but I would not anticipate New South Wales growing particularly strongly.

Senator SHERRY—But there have been times, if we look back over the last 10 years or so, when New South Wales have had growth above other states and regions of Australia. They are going through a correction for the reasons which have been discussed. That is no indication it will continue on and on.

Dr Kennedy—No, not on and on. The timing of these cycles is always very difficult. But, just like you said, I would expect New South Wales in the future to come back and other states to weaken. An interesting feature of recent economic history is that the effect of the strong growth in housing was across all states. So it was a demand shock that hit the economy not exactly at the same time but Australia wide. So we saw less regional dispersion than we had in the past. Going back to my labour market point, the unemployment rates fell to their smallest differences between states than they had for some time. We had seen states with unemployment rates persistently one or two percentage points above other states. That all fell

back in at around five. While I would expect to see states wax and wane, our current view of the economy is that I would not expect to see that opening up dramatically again. I expect to see some differences, but not to the extent we saw in the past.

Senator SHERRY—You have been using this term ‘commodity’. We have obviously talked in some detail about mining. In terms of commodities we are also dealing with—and I am not going to go to wheat, the topic of the month—broadly agricultural commodities, where the picture is not anywhere near as good in terms of export.

Dr Kennedy—No. I have been talking about non-rural commodities, to be more accurate. Farming has not been as positive. In fact—and I have not got the numbers to hand—I think our rural exports fell through the year to the most recent quarter that we have volume data for, which is September last year. Primarily that reflects seasonal conditions. The prices have been quite good for meat and most of our rural commodities, but there is still herd rebuilding going back, so that affects meat production—that is a sort of echo of dry conditions. Particularly on the export side we often see the production in farm before we see the exports because it is stored here and then it flows through to the exports as it is exported overseas. So there can be a slight disconnect when you can see some of the recovery in farm production in the national accounts, for example, and then when it starts to turn up in the export statistics. We have an improvement in farm production in the forecast for 2005-06, from a fall in 2004-05, from memory. But particularly on the volume, no, things have not been as good. Of course they had a big rebound from the earlier drought and then a slight decline in 2004-05, as I said. In line with ABARE—we tend to follow ABARE’s lead here—we expect it to come back in 2005-06.

Senator SHERRY—Is that rebound on the rural agricultural side a consequence of the lessening of drought conditions—I will not say the end of drought conditions, because there are some areas more hurt than others—or because of world demand? What about the issue of price in terms of world demand?

Dr Kennedy—This is an area that I am not an expert on, but it is a combination of the two. A large part of it reflects improved seasonal conditions. But, in conjunction with that, we have had quite strong demand for a number of our products. I mentioned meat and other products. Dr O’Mara might like to make a comment.

Dr O’Mara—I think the best way to describe the farm sector over the last three or four years is that it has been doing it pretty tough. There was a one-in-100-years drought in 2002-03 which knocked farm production down by 20 or 30 per cent—very severe. We saw something of a recovery, particularly in crop production, in 2003-04. The drought had at least eased, if not broken. But since then seasonal conditions, while not as severe as in 2002-03, have been quite patchy. There have been parts of the country which have remained dry. I think one of the key lingering effects of the drought has been in water storages, which remain well below long-term averages. That has had an impact on the amount of irrigation that can be done. It has had an impact on rice, cotton and other irrigated crops.

On the price front, one of the key commodities, wool, really has not benefited from the very strong growth in the world economy—even in China, which is a key market. Wool has been in the doldrums for quite some time. It has shown some signs of recovery since

Christmas but is still below long-term trends. Wool growers are certainly facing a profit squeeze. Mutton and lamb prices have been quite good but are now easing.

The beef industry has benefited from international trends, not so much in terms of demand coming from strong growth but more through structural factors associated with BSE in other countries. That has allowed us to sell more, particularly into Japan, than we would otherwise have been able at higher prices. We have had something of a reprieve there for another few months as a result of some disease related issues overseas. But at some stage the United States will come back into the Japanese market in a big way, and our beef exports will be affected.

Certainly rural commodities as a whole have not enjoyed anything like the sort of price strength that we have seen in the mining sector. Some of them have done quite well, but they certainly have not seen anything like the price strength. Many of them have struggled on the production side because of adverse seasonal conditions.

Senator SHERRY—Just coming back to New South Wales again, I note the unemployment rate—and you touched on this in your opening answer as well—of 5.7 in January which was up from 5.1 in January last year. What impact do you think this will have on wages in New South Wales—would an increase in the unemployment rate mean less wages pressure?

Dr Kennedy—The wages will reflect the interaction of supply and demand for labour. If we are seeing less demand for labour and that is reflected in the unemployment rate rising, then you would expect to see less wages pressure. You would not expect them to fall, not in the statistics as they present themselves, but you might—

Senator SHERRY—The aggregate statistics, I mean there may be some decline in some sectors.

Dr Kennedy—I would anticipate there would be somewhat less growth perhaps than in wages. That is what we tend to see in wage statistics. The wage price index is the series that we tend to focus on. I do not have that by state, but by industry we see quite marked variation in wages growth. For example, in some industries wages are growing by around 3.1 per cent or 3.2 per cent; in other industries they are growing by about five per cent to 5.7 per cent. So in so much as differences in the industrial structure of states reflects how well they are doing and there are differences in how well industries are doing, we would expect to see more modest wage outcomes for those states where labour demand is weaker.

Senator SHERRY—So what you are saying is there would be a smaller increase—

Dr Kennedy—Sure, yes. The economic circumstances as they stand and our outlook for reasonably moderate growth do not point to wages falling in any sense. The variation you are likely to see is that some wages growing more quickly than others.

Senator SHERRY—You commented earlier about New South Wales and I raised South Australia as well. What about Victoria?

Dr Kennedy—In terms of how well they have been doing?

Senator SHERRY—Yes. I will not go to Tasmania, which is where I come from, which you might assume is the next stop, having traversed all the other states. Victoria is a little larger than Tasmania in its economic size.

Dr Kennedy—I will note that Tasmania had a dramatic improvement in its unemployment rate.

Senator SHERRY—I know. It is a great Labor government, you see. I put my ad in before the election is called. But Victoria—

Dr Kennedy—Conditions have been a little stronger in Victoria compared with New South Wales. Domestic state final demand in Victoria has been stronger and their gross state product over the last couple of years from memory has also been stronger. I guess similarly to New South Wales they do not get the kind of direct stimulus that, as we have mentioned, states like WA and Queensland get.

I will say this: all states do get the benefit of this stimulus. As we were talking about earlier in terms of wealth effects, stock markets increasing, dividend payments and all that type of stuff, we should not fall into the trap of thinking that all of this is just confined to a couple of states. The whole economy benefits and, by its very nature, all states benefit from increased demand for our commodities. I do not want to leave you with the impression that states like Victoria and New South Wales who have some but less of a commodity focus are then destined not to grow well because of the other states doing particularly well. They also benefit; they just do not get the same direct multipliers in terms of the construction that is related to the direct increase in mining employment. Sorry, back to your original point about Victoria, Victoria has been broadly growing around trend or what you consider to be a national trend.

Senator SHERRY—You have made the observation about direct mining impact certainly not being as significant in Victoria and NSW as, say, in Queensland and particularly WA. How do we account for a smaller growth rate in New South Wales than Victoria recently? We have touched on this issue of the wealth effect earlier, is that part of it?

Dr Kennedy—Sure, that may well be part of it. As I pointed out earlier in response to a question, we have not seen house price falls in Victoria to the extent that we have seen them in Sydney or New South Wales in general. If New South Wales benefited from a larger increase in housing related activity and then on the other side of that is having somewhat more of an easing, I think that would be part of the story as to why Victoria would be doing a little better than New South Wales through this period.

Senator SHERRY—Any other issues?

Dr Kennedy—None that immediately come to mind. I am trying to think back to our earlier discussion on the rural side, whether there are any rural factors at play. I am not sure if Dr O'Mara can comment on that aspect of the regional variation.

Dr O'Mara—New South Wales was more severely affected by the drought and the subsequent patchy recovery than Victoria, so that is certainly a factor.

Mr Parker—I will add one other thing: it is really the flip side of the housing story, which is the population flows between the states. If you look at those, you can see there is net interstate migration out of New South Wales at the moment to Victoria, Queensland and other places.

Senator SHERRY—Historically that is unusual, is it not? It has normally been all out of Victoria and Tasmania, but that does not appear to have been the case recently.

Mr Parker—That is right.

Senator MURRAY—When you say ‘New South Wales’, is it just the Sydney region or non-Sydney?

Mr Parker—I do not have the data to track it by region but I could answer it by New South Wales.

Senator MURRAY—I asked the question deliberately because the former Premier Mr Carr some years ago made a very significant statement and criticism about the fact that all migrants were pouring into Sydney and stressing the urban infrastructure beyond its capacity to meet that supply. So if there was a net loss from New South Wales and it was principally from Sydney, I assume that reduces that pressure on Sydney infrastructure and on the state government.

Mr Parker—Other things being equal, it does. There is also international migration, and that is an offset as well. I have not looked at the population figures for New South Wales. Does anyone have those to hand?

Dr Kennedy—No, not to hand. We can take it on notice, if you like, if you would like to see some of the net migration figures.

Senator MURRAY—No, it is really just an observation. The big issues in Sydney are issues of primary infrastructure: energy, water and transport.

Dr Kennedy—One thing you would hope to see when you do have very strong demand in a particular sector of the economy is labour moving to that as well. In my view, it is a good sign that we would see stronger labour flows to states that are growing very strongly in this period. That is a natural part of the adjustment we would hope to see in the labour market, rather than less mobility of labour and people staying where there are not the jobs. Seeing net migration flows increase to Queensland and WA is quite a positive sign in terms of adjustment in the labour market and people improving their economic wellbeing.

Senator MURRAY—I assume that now in this sector of the program is the right occasion to raise the bottleneck or the impediments, if you like, to maximising our growth. I refer particularly to skills and the port and transport infrastructure with respect to the mining industry. Would you like to comment on how you think that area is going and how government policy is acting to meet those difficulties?

Mr Parker—On the policy side in terms of what is being done around port infrastructure and regulatory arrangements that might bear on that, those questions would be best directed to the markets group people. They have responsibility for the relevant regulators and competition policy more broadly. In terms of the labour market issues, the policy side of that would be best directed to the fiscal group people who look after that side. But we can certainly answer questions around the macroeconomic influences of those.

Senator MURRAY—That is what I am interested in, because when we are referring to a very high level of business investment, my understanding is that it is not yet matched by a commensurate public sector investment. There is not the same relativity, if you like, between

investment in ports, road, rail and so on. In some of those respects I have picked up signs of frustration from authorities, councils and so on. For instance, Albany are trying to double its port capacity and is complaining about regulatory impediments to it getting on with the job and being able to meet the flowthrough that they know is going to come from the private sector investment which is occurring in that region. It is those sorts of views as to whether our economy is adjusting quickly enough.

Dr Parkinson—It is useful to draw a distinction between different parts of infrastructure and who owns the infrastructure. For example, in the case of the major iron ore producers where they own everything from the mine through to the port, my understanding is that they have been making investments commensurate with their expectations. In the case of situations where you see different stages of the production process being owned by different groups—the example that caught people’s attention last year was Dalrymple Bay—the point that there may have been a slower than optimal response in terms of expanding capacity may be a legitimate conclusion to reach. That goes to the competition arrangements and the like which, as Mr Parker said, are best addressed to our colleagues from the markets group. But if you are asking about specific types of impediments in the case of Albany, I think we would need to know what those impediments were: whether they were things that were amenable to federal government policy or whether they were issues for the state government. I am afraid I do not actually know anything about the port of Albany expansion.

Senator MURRAY—Well invariably it is a mix of the two, but I am looking for a kind of general sense as to whether the in tandem development of road, rail and port infrastructure and skills provision in your view is running parallel with the high level investment in the minerals industry in particular. In my state of WA, Albany is a bone of contention; they are talking about the difficulties with Geraldton and Oakagee because of the mid-west developments that are coming up there; and there is constant agitation for improvements along the North West Shelf infrastructural belt. I was just interested whether you have a general perception from your broad macroeconomic perspective as to whether these are just normal course of business events or whether there is a particular problem out there.

Dr Parkinson—My sense is that what we are seeing is the sorts of lags and adjustments that occur in a complex economy when a particular sector receives a boost that was not anticipated. Let me go back to the point Dr Kennedy made earlier, if you go back and look immediately after the Asian financial crisis in 1997, global commodity prices fell dramatically and investment in the Australian mining industry fell dramatically. It is really only from around 2001 that you see both commodity prices begin to take off and investment begin to occur. Investment always occurs with a lag because these are very large projects, as you know, and it means you do not get the volume responses very quickly because you have to put a lot of investment in to expand capacity.

It is probably true that the overall investment response, whether you are talking about expanding productive capacity in terms of the mines or the capacity to ship the stuff, occurred a little later than would have been ideal. But I do not think it is particularly unusual. We do not have any sense that this is an economy that is grinding to a halt because of labour shortages. We do not have a sense that this is an economy that is grinding to a halt because of the inability to expand our exports. As Dr Kennedy said earlier, the export response will come

through; we expect it to be bigger than what we have seen to date; and that is just a function of the normal sorts of lags.

Senator SHERRY—We have touched on it earlier, and I think it was Mr Parker who made some observations. The flowthrough of greater profitability for mining companies into the hands of consumers effectively presumably comes about because of greater employment, particularly direct employment, with those employees presumably earning higher wages and salaries. I think it is factual that they are. There is a tax revenue issue there. The issue of the dividend flow was also touched on—and this issue of the growth of conglomeration and a much higher proportion of overseas ownership of our mining sector in Australia over the last 20 years, and presumably a significant proportion of those profits flow out as distinct from remaining in the Australian economy and more broadly distributed as dividends.

Mr Parker—Yes, that is right. As we have crunched the numbers, the offset is about 50 per cent—that is, the improvement in the terms of trade lifts export earnings which flows into profits, and about 50 per cent of that then flows back out again through the net income deficit. So the improvement in the current account is roughly 50 per cent of the improvement that you would get if you just looked at the commodity export side of things.

Senator SHERRY—And where it flows through to Australian consumers I would think largely through dividends in a more dispersed way, and that is obviously right across the national economy—Dr Kennedy touched on that earlier in terms of the other level effect of the ‘mining boom’, if we use that expression. Have you done any analysis of the distribution of that to particular types of consumers?

Mr Parker—I am not aware that we have.

Dr Gruen—I just want to make a point on the previous interchange: part of the increase in the net income deficit in some sense is accounting rather than what is actually happening in the economy. If a foreign-owned mining company makes profits which it reinvests in Australia, so the money never leaves Australia, it is treated in accounting terms as those profits having been repatriated and then reinvested. So the current account goes up and the capital inflow goes up, but, in fact, no money has ever gone anywhere. There is no actual flow, so some of that is simply the way that the Australian Bureau of Statistics treats the data.

I also make the point that there is another very substantial way in which, in some sense, the effects of the mining boom get spread through the economy—that is, via the exchange rate. When we have a big lift in mineral export prices, as we have had, the exchange rate tends to appreciate very substantially with that, because we have a floating exchange rate. Several things flow from that. First of all, it tends to keep the economy on an even keel, and that is an extremely important way in which we now deal with terms of trade increases. It imposes restraint on other parts of the export sector and import-competing sector to buffer the overall aggregate impact on the economy of the very substantial increase in incomes that is being earned in this sector.

Senator SHERRY—How do you mean ‘buffer’?

Dr Gruen—If the exchange rate had not gone up, no restraint would have been imposed on other manufacturers and industries that are exporting things other than these things for which the price has gone up a lot.

Senator SHERRY—Effectively, you are saying that they are more constrained as a consequence of the increase in the dollar?

Dr Gruen—They are more constrained as a consequence of the exchange rate going up than they would otherwise be, and that helps very substantially. Dr Kennedy spoke before about the fact that we have had this truly extraordinary lift in the terms of trade. We have only had one other lift of this order of magnitude in the last half decade.

Dr Parkinson—The last half century.

Dr Gruen—Yes, good point; thank you, Dr Parkinson. I was out by a factor of 10—the last half century. Although we have had this discussion about the fact that there are differential impacts through the economy, depending on which state you are looking at; if you look at it in aggregate, the economy has dealt with this very substantial positive shock in a remarkably restrained way. I guess I am anthropomorphising the economy, which perhaps I should not do.

Senator MURRAY—It humanises your profession.

Dr Gruen—That is right! Now I have lost my train of thought.

Senator MURRAY—That is what emotion does to you!

Dr Parkinson—That is a very unusual experience for us, Senator!

Dr Gruen—The point I wanted to go back to was that it provides a restraint on other parts of the export sector and the import-competing sector, but the other side of the coin is that it also improves the purchasing power of consumers. So not only is there the direct effect via dividends and higher share prices but there is also the effect of higher purchasing power by consumers from the fact that the exchange rate has gone up and made imports cheaper, so that improves the purchasing power of consumers.

Senator SHERRY—When you say ‘restraint’ on some sections of the economy, in fact it makes it tougher for them, doesn’t it?

Dr Gruen—Yes, indeed.

Senator SHERRY—Because they are subject to much greater import competition because of the better terms of trade.

Dr Gruen—Indeed.

Senator SHERRY—At some point the terms of trade will be returning to the long-run average. We have touched on how significantly it has increased. What would be the impact of that on domestic consumption and the domestic economy?

Dr Gruen—One angle on commodity prices returning to their long-run average is to make the point that that whole mechanism—the buffering mechanisms that I talked about earlier, particularly the exchange rate, and I guess you should add to that the whole framework of macroeconomic policy, with an independent central bank keeping its eye on medium-run inflation outcomes—has responded extremely well in the aggregate to this very large increase in the terms of trade. So I think that that should give one considerable confidence that, were the terms of trade to come back down again, the system would continue to be able to respond to that in a way that, in aggregate, did not generate large swings in economic activity.

Dr Kennedy—I might add to that. It is perhaps fortunate that we got this big positive from mining just at the time when we saw the effects of the increase in housing activity begin to wane. One might also expect that, as that stimulus runs its course, we will see the domestic adjustment that we hope to see. We would probably see house prices not doing very much for a considerable amount of time. Households currently would have consolidated their balance sheets to the extent they felt comfortable. We may see stronger domestic demand too. So—at least just in this near-term outlook—there is a quite likely scenario that you would get that kind of shifting. Basically, we are seeing shifting engines of growth at the moment from internal to external sectors. Through the equilibrating mechanisms that Dr Gruen was talking about, we would expect that potentially then to shift back the other way.

Senator SHERRY—The shift will occur at some point in time—there is a degree and there is a timing issue. What would underpin consumption when that shift occurs?

Dr Parkinson—It is very difficult to have this discussion in a comprehensive way unless we are going to start making assumptions about what else is happening in the economy. For example, if the terms of trade were to fall at the time when there was a new housing boom, you would get quite different impacts in aggregate. If you just isolate the individual components and look at those, you are not going to get the picture of what will be happening in the economy. But, if you accept that partial approach and the caveat to that, obviously to the extent that everything else was unchanged and the terms of trade fell, you would have the dividend effects, the tax revenue effects and the like from the reduction in profitability. Would you have direct employment effects? It would depend very much on what was happening to global demand for commodities, but probably you would not have an impact there. In terms of what supported consumption, it would depend on what else was happening in the economy. It could be that the terms of trade effect was matched with a commensurate fall in the exchange rate, so what you saw was a shifting of the engine of growth away from mining and towards, for example, manufacturing and service exports or manufacturers competing with imports. All I am trying to say is that it is hard to get a sense of what will drive any particular component of the economy by simply asking that one question.

Dr Kennedy—The underlying growth—or, in a sense, the supply of the economy—is going to be driven by population growth and the productivity that we see. A lot of what we talk about here are various shocks to demand—some to supply, but increases or declines in demand for certain things which see a cycle around that. Ultimately prosperity or how quickly the economy grows in aggregate will depend, at least for the aggregate level, on our population growth but also on the underlying productivity of the economy and how rapidly that grows.

Senator SHERRY—On the issue of the ‘commodity minerals boom’, where does Australia sit by comparison with other advanced economies in the OECD? Is Australia the most significant commodity exporter in the OECD by, say, value or proportion of market share? There would be a number of different ways to measure. It is hard to think of another country.

Dr Parkinson—Canada.

Dr Gruen—I think commodities are a larger share of our exports than Canada’s.

Senator SHERRY—What about by volume and earnings?

Dr Gruen—Do you mean as a proportion of the economy?

Senator SHERRY—Yes.

Dr Gruen—Yes, I think so. Something like 80 per cent of Canada's exports go to the United States, and a very substantial proportion of those are manufacturers with cross-border arrangements, sometimes within the same firm. There is an awful lot of trade like that.

Senator SHERRY—I know Canada is a significant oil producer. Are they a significant oil exporter?

Dr Parkinson—No, I do not think they are. They export a lot of energy in the form of electricity. The Canadian and US systems are interlinked. They export a lot of commodities, both rural and non-rural.

Senator SHERRY—When the Americans let them. I notice in respect of timber and a few others there are a few disputes raging.

Dr Parkinson—There always seem to be disputes about lumber exports from the Pacific Northwest.

Senator SHERRY—Come to Tasmania, the deep south.

Dr Parkinson—I think Dr Gruen's forgetfulness is contagious. I have now lost my train of thought as well.

Senator SHERRY—I will put it down, to some extent, to the banter.

Dr Gruen—You will be pleased to know that we know a lot more about the Australian economy than the Canadian.

Senator SHERRY—In terms of where we sit, Australia would be the most significant nation in the OECD in terms of commodity exports.

Mr Parker—For completeness, Norway is another OECD country which is—

Senator SHERRY—Maybe I should have added 'non-oil'.

Mr Parker—Norway is predominantly an oil state.

Senator SHERRY—Overwhelmingly oil. I turn to the balance of trade and the balance of payments position of key commodity exporters in the OECD. Wouldn't it be fair to say that many are running trade and current account surpluses?

Dr Gruen—I am not sure about the payments of Norway.

Senator SHERRY—Australia is not?

Dr Gruen—No, certainly not. Australia is not.

Senator SHERRY—Let us take Canada. Norway is overwhelmingly oil based, as I understand. If you took oil out of the equation in terms of commodity exports, it would be a very different picture. But, as to the balance of trade and the balance of payments, we are running a trade and current account deficit, whereas a country like Canada is running a surplus.

Dr Parkinson—You would recall that the current account is a function of the saving and investment gap in the economy. So the balance of trade I do not think is necessarily the right way to think of it. It is a very common way to think about the issues, but I think it is more valuable to think in terms of saving investment gaps. Put aside the OECD for a moment. If you look at what has happened to the key oil-exporting countries of the world, they have seen a very significant current account surplus emerge in the last year or so as global oil prices have gone up. Why? Basically because that money flows directly into government revenues, and their aggregate expenditures have not increased anywhere near commensurately with that. In other words, there has been a massive increase in national saving without an equal offset in investment, and so they run surpluses. In our case, we are running a current account deficit. That is a function of the fact that our investment exceeds our saving.

Senator SHERRY—I understand that, but I want to come back to the issue. Put aside the oil-exporting countries. I am not sure whether countries of the Middle East are in the OECD.

Dr Parkinson—No, they are not.

Senator SHERRY—I did not think so. Norway is an exception in its oil exports. Aren't most of the other countries of the OECD running current account surpluses?

Dr Gruen—The current account surplus of the OECD taken as a whole is pretty close to zero.

Senator SHERRY—But what about the countries within that?

Dr Gruen—Some are running surpluses and some are running deficits. The net is roughly zero because they make up such a large proportion of the world economy.

Senator SHERRY—Yes, but in the case of Australia with its 'mining boom', we are not running a current account surplus. I accept the other factors of Dr Parkinson as a matter of fact. It seems to me that it would be at a highly favourable time. It best describes the current account as poor.

Dr Gruen—I do have some data on Canada. Canada at the moment, as you say, are running a current account surplus. That is primarily because they invest significantly less of their national economy than we do. The figures I have suggest that Canadian national investment is currently about five percentage points of GDP below Australia's. In principle you can run a current account surplus either by investing less or by saving more. Their national saving is a little above ours. On the figures I have got it is something in the order of two per cent of GDP, but their investment is five per cent less. As Dr Parkinson was saying, that is a more fruitful way to look at the current account. Certainly one of the implications of the mining boom, as we have been talking about this morning, is that it has led to a very significant rise in investment. That will tend to make the current account larger unless it is also matched by a big rise in saving.

Senator SHERRY—Yes. We are importing a significant proportion of the capital. It is not domestically based saving that is funding it. There are some, but we have to import capital, significantly, to fund that difference.

Dr Kennedy—And we always have, because we are a small population with a very large set of investment opportunities.

Senator SHERRY—I accept that. I think in all but one year in our 200-odd year history we have been a capital importer. I was told that once.

Dr Parkinson—That seems plausible.

Senator SHERRY—Overwhelmingly, in our national history. But is it a consequence that we are currently negative in our saving, as a country?

Dr Parkinson—No, our national saving—

Senator SHERRY—Where is the figure at the moment?

Dr Parkinson—I think you might be confusing the household saving ratio from the national accounts with national saving. National saving comprises public sector and private sector saving, and private sector is both business and households. Our gross national saving rate is about 21 per cent of GDP.

Senator SHERRY—Has that declined in recent times?

Dr Parkinson—No. One thing that really is quite interesting is that over the last decade or so it has bounced around. It has dropped from the average it had in the eighties, but over the last period since the early nineties it has just cycled around at a bit over 20 per cent of GDP.

Senator SHERRY—And household saving?

Dr Parkinson—Household savings declined. For the five years I have been coming to this committee we have talked about this issue on a regular basis.

Senator SHERRY—I am not going to explore it in any great detail today, but I understood it was still declining.

Dr Parkinson—Yes.

Dr Kennedy—One thing we should distinguish between is gross household savings and, if you like, net savings—which these guys are talking about—which is that savings minus investment. That tends in part to be reflected in what you see in the national accounts. Gross savings for households have also declined somewhat. In part, the reason households are net borrowers now, or net desavers, is also because their investment increased—particularly in housing, as a sector—reasonably substantially. Housing investment as a proportion of GDP remains relatively high.

Senator SHERRY—Nevertheless, household savings continue to decline. I am not sure whether it has levelled off, but I am not sure whether it could actually go down much more.

Dr Kennedy—They cannot decline forever—that is true.

Senator SHERRY—You would hope not.

Dr Gruen—The other point is that one of the strong contributing factors in the decline in household savings was the housing boom—which we have talked about earlier—and this wealth effect, the idea that as people's houses became more valuable they could spend some of that wealth consuming. With the waning of the housing boom you would expect what I think is a very strong influence on household savings to lead to some rebound.

Senator SHERRY—Yes, perhaps. As much as we are debating these issues in question-answer, I tend to agree with you. However, it has been in long-term decline for a long period of time, even before the housing boom.

Dr Parkinson—Absolutely, and the reason for that is partly technological. It is partly the fact that people are able to more easily access their capital because we deregulated the financial markets. But, also, technological changes have occurred that allow them to run their lives holding far smaller balances in order to undertake day-to-day business.

One thing that is interesting is that the current account deficit has not changed very much over the last few years, but at its peak housing investment was about 1½ to two percentage points of GDP above its long-run average. It is interesting that, as the housing boom has come off, business investment has picked up, and business investment is now running at about one-and-a-bit percentage points above its long-run average.

Senator SHERRY—Is there a direct relationship impact between the two, or is it coincidental?

Dr Parkinson—It is coincidental, but it is one of the reasons why, everything else being equal, the current account deficit has not closed up as housing investment has eased.

Senator SHERRY—Going back to this issue—and it relates to a comment Mr Parker made earlier—of importing capital to assist to pay for investment, what has been the trend of our level of overseas ownership in the last 10 or 15 years? Has it been down as a consequence?

Dr Kennedy—Of the mining sector in particular?

Senator SHERRY—Mining, I think it is pretty obvious, has been down. Yes, and also across the economy.

Dr Parkinson—If you look at it as external liabilities as a share of GDP, they have been reasonably stable over the last decade or so, having picked up quite significantly in the eighties and the first half of the nineties. There are swings between equity and debt. It is misleading to just look at our foreign debt, because sometimes debt spikes because we borrow rather than take equity investment. At other times it goes in the other direction. But the aggregate level of external liabilities has been reasonably stable. It picked up a little bit in the last couple of years.

Senator SHERRY—What has accounted for the increase in—I am not sure how you would express it in economic terms—dividend flow overseas? Is increased profitability the reason for the increase in dividend flows overseas, or is there another explanation?

Dr Parkinson—Increase in foreign ownership of Australian firms or increase in profitability of those firms that foreigners already owned?

Senator SHERRY—Yes.

Dr Parkinson—Both of those things are probably in play.

Senator SHERRY—I have a few questions on Australian and US trade. The trade deficit with the United States, I notice, increased in 2005. I saw a recent reference to this in an article. What is the magnitude of increase in our trade deficit with the US?

Dr Kennedy—I do not have that number to hand. Mr Pearl, do you?

Mr Pearl—No, I do not.

Dr Kennedy—I would be happy to take that on notice for you.

Senator SHERRY—Do you have any observations to make about why this is occurring?

Dr Kennedy—No. You can back out where the components of the deficit have increased—export and import—but it always strikes me to not be particularly fruitful to focus on bilateral trading arrangements in that sense.

Senator SHERRY—Yes, but I think it is valid to focus on it because we have had a big debate about US-Australia free trade recently. I am interested in these very early signs.

Dr Parkinson—It would be a very brave call to attribute what is happening in the bilateral balance at the moment to the FTA.

Senator SHERRY—Do you have any observations to make about Australia's exports to the US?

Dr Parkinson—You are asking for a level of detail that we do not have in front of us.

Senator Minchin—Can I proffer the observation that perhaps the exchange rate had something to do with it.

Senator SHERRY—You just got to my next question, Senator Minchin. I note that the exchange rate probably is not a factor, because it has been around US74c or US75c for most of 2005; it has not tended to shift much during that period.

Senator Minchin—It was in the sixties, not that long ago.

Dr Gruen—And in the forties.

Senator SHERRY—No, in 2005.

Dr Gruen—That is true.

Dr Kennedy—It is true that the exchange rate has been flat for some time, but the appreciation we saw mostly through 2003 will have lagging effects. It will flow through; it will tend to come through in the following years.

Senator SHERRY—Do you have any modelling on the impact of the US free trade agreement on the Australian economy?

Dr Parkinson—We have been asked that question before. We do not have anything to add to the information we provided.

Senator SHERRY—I know, but it is another round of estimates and I will give it another go. You may, in fact, have done something since I last asked about it.

Dr Parkinson—We have done many things but not on this issue.

Senator SHERRY—I accept that on this issue you have not. There are some other issues I ask about in other areas of estimates where I know things are being done but I do not get the answer. That is for another area of estimates. I do not have any more questions on domestic or international.

CHAIR—Thank you very much, Dr Parkinson and officers.

Proceedings suspended from 10.48 am to 11.10 am

CHAIR—I welcome to the table Mr Tune and other officers concerned with outcome 2.

Senator SHERRY—Before we begin, could I clarify the issue of advice lists of government appointees. Who is dealing with that?

Mr Tune—To boards?

Senator SHERRY—Yes.

Mr Tune—It would depend on which board we were talking about or which entity we were talking about.

Senator SHERRY—Let us take the Reserve Bank and the Future Fund board.

Mr Tune—It was Dr Parkinson, who has just left us.

Senator SHERRY—I thought it was your area. Could I put in a request for Dr Parkinson to come back, please, at a time convenient.

Mr Tune—Before we start, could I clarify this issue about laptops that you raised earlier?

Senator SHERRY—Yes, thank you.

Mr Tune—Our understanding is that the question on notice was in the House of Representatives and related to the Australian tax office only. Certainly our records do not indicate the question going to the Treasury, so the ATO is the appropriate place to raise that.

Senator SHERRY—On the issue of missing laptops, what is the position in Treasury?

Mr Tune—The situation appears to be that one has been lost in the last year. The way those laptops are set up is that they have encrypted data in them, so no-one could access any Treasury documents already contained on them.

Senator SHERRY—It was not so much the information that may or may not be contained but particularly the issue of how many were missing.

Mr Tune—One.

Senator SHERRY—That is right across Treasury—excluding, obviously, the tax office?

Mr Tune—And it would exclude places like ACCC, ASC and APRA.

Senator SHERRY—I will pursue that with the tax office when they are present. Who would deal with the issue of examining outcomes of various policies, firstly in industrial relations matters?

Mr Tune—We do.

Senator SHERRY—I thought so. Also related to industrial relations, workforce participation and child-care expenditure?

Mr Tune—Yes.

Senator SHERRY—Are you aware of the information released to the *Australian* newspaper under FOI on 5 November 2005?

Mr Tune—I am.

Senator SHERRY—Before I get into specific questions on that, are you aware of a government advertisement for Work Choices that is headed ‘If you are serious about an even stronger economy, more jobs and higher wages, we need a new workplace relations system’. Are you generally aware of that? I will pass up the document.

Mr Tune—I am aware of the information campaign that the government undertook around that, yes.

Senator SHERRY—Are you aware of that slogan?

Mr Tune—Could you read it out to me again?

Senator SHERRY—I will pass it up. Just have a quick look at it. Dr Parkinson released a press release on 15 November which states:

Treasury was not commissioned to provide specific advice on the economic justification for proceeding with workplace relations reforms.

Can I confirm or otherwise that Treasury was not asked for advice as to whether the workplace relations changes would deliver more jobs and higher wages, as claimed in the advertisements?

Mr Tune—That is correct. I think I have said this before—in the last hearing in fact—that Treasury was not commissioned. We provided advice to the Treasurer in the context of the government’s consideration of the workplace relations changes that were considered by cabinet shortly after the budget last year, and that was the context in which we provided that advice.

Senator SHERRY—I am going to get to that in a little more detail but I just wanted to confirm that Treasury was not asked for advice as to whether the workplace relations reforms would deliver more jobs and higher wages. I just want to clear that issue off first. The press release on 19 December 2005 entitled ‘Treasury minute of 6 October 2005’ says:

Treasury has never undertaken any modelling of the effects of the government’s workplace relations reforms—

Mr Tune—No, it says, if I may quote it, ‘nor did it undertake modelling on the effect of these changes’. These changes are the changes that the government announced. The modelling that was done was not about the government’s changes; it was about a series of options or scenarios that may have been under consideration leading up to a government decision about the particular change. It is quite distinct.

Senator SHERRY—I just want to make sure that people are aware of this distinction. So what you are saying is that there was no modelling on the specific contents of an issue surrounding the bill.

Mr Tune—That is correct.

Senator SHERRY—However, there was modelling in respect of general options on workplace relations reforms?

Mr Tune—Yes, that were being considered by the government in forming its views about the IR changes.

Senator SHERRY—Sorry?

Mr Tune—They were done in the context of the government considering where it wanted to take the IR changes. So there are two distinct phases here.

Mr Heferen—If I can just turn you back to the press release of Dr Parkinson as acting secretary on 5 November. The fourth paragraph makes it clear:

As noted in evidence to the Senate Economics Committee—

Mr Tune provided that evidence—

... Treasury prepared indicative estimates of employment effects under various scenarios. This was done before any change to workplace relations policy was adopted.

Mr Tune's evidence before was about a range of indicative estimates of employment effects under various scenarios. The references in Dr Henry's press releases of 19 December and 2 February draw this distinction between the material that was done then, not related to anything the government had released, and the advice that we released on 19 December about the government's announced package.

Senator SHERRY—I am going to get to this in a bit more detail. I think it was me who asked this question to you, Mr Tune, back in June 2005:

Has the department recently carried out any modelling on various scenarios that eventuate from industrial relations changes?

And you said:

Yes, there was some modelling done.

They were the words you used on that occasion.

Mr Tune—That is correct.

Senator SHERRY—How does that accord with the press release that we have touched on already that says:

The Treasury has never undertaken any modelling.

Mr Tune—No, it says:

Nor did the modelling—

Senator SHERRY—This is the press release of 19 December issued by Dr Henry. It says:

The Treasury has never undertaken any modelling of the effects of the government's workplace relations reform.

Mr Tune—The distinction is the one I was referring to earlier that we did not do any modelling on the actual reforms that the government announced, and that is what Dr Henry is saying in that press release of 19 December. What we did do modelling on were some scenarios prior to the government making a decision. That modelling was done in the context of providing advice to the Treasurer.

Senator SHERRY—And the modelling that was done and the scenarios that were modelled, did any of these scenarios that were modelled approximate closely—I doubt they would have been identical to—the subsequent announcement of the government in relation to specific industrial relations reforms?

Mr Heferen—If I could be of assistance: not closely enough to warrant being able to release that information. I might note that was the subject of an FOI from the *Australian* newspaper, and that is how these things came to be released. In my response—because I was the initial decision maker—back to the *Australian*, I made clear there were these two separate things. With regard to the second lot on the government's actual package, because it was in the public domain—I think our advice of 6 October is pretty standard analysis of the package—there was no problem with that being released. But, with respect to the other material, because it was not on something that eventually was adopted by the government, it really serves no purpose in being put in the public domain.

Senator SHERRY—You are pre-empting a few of my questions. Just on the modelling that was not released as part of the freedom of information request, why was that not released?

Mr Heferen—Sorry, there was no modelling released.

Senator SHERRY—None?

Mr Heferen—No modelling has been released.

Senator SHERRY—None at all; that is right.

Mr Heferen—And when we say 'modelling', it is the indicative estimates of the employment effects under the various scenarios. The package the government ended up agreeing on—

Senator SHERRY—No, I accept that. The modelling that was done was not released under FOI. That is my understanding.

Mr Heferen—That is correct.

Senator SHERRY—Okay. Why was that not released?

Mr Heferen—The FOI Act provides a range of exemptions for material not to be released, and of course we apply our minds rigorously to the material that needs to be released and whether or not the exemptions apply. There is a range of exemptions, as I am sure you are aware. Two of the common exemptions are the section 34 exemptions—where material has been put to cabinet, and that is ordinarily exempt—and the section 36 exemptions, where the material is of a deliberative nature, a matter of opinion, and in the consideration of the decision maker it is not in the public interest to release it.

Senator SHERRY—Presumably, on refusing the release of that modelling, there was consultation with the Treasurer's office. It was not you who made the decision without reference to the Treasurer's office, was it?

Mr Heferen—It was my decision; I made it. As you would expect, people were informed that I was going to make this decision, because, in a matter such as this, I think you would be a bit naive to think it would not get into the public domain. In fact it did—

Senator SHERRY—That an *Australian* journalist is requesting it is a fair show that it would.

Mr Heferen—Yes, I followed that logic through and came to that conclusion—

Senator SHERRY—‘In the public domain’: should that be a criteria in the consideration for not allowing the release of information under FOI?

Mr Heferen—No. The point I was making was to ensure that people were informed of the decision I was going to make and have that material released.

Senator SHERRY—That is necessary under FOI, is it not? One of the criteria for refusing is to inform—

Mr Heferen—Sorry, we are talking at cross-purposes. You asked me originally about whether I informed the Treasurer’s office of the fact I was going to release certain material, and the answer to that is yes; I did inform them that I was going to release certain material. The issue of what material was released and what material was not is a decision for me as the decision maker, not a decision for anyone else.

Senator SHERRY—For you alone? What if the Treasurer’s office says, ‘No, don’t release it’?

Mr Heferen—In this case they recognised that the decision maker is the decision maker. They obviously want to be informed about what is going to go out in the public domain, because it is inevitable that it will be the Treasurer who will get questioned, not the decision maker sitting back in the department.

Senator SHERRY—I want to explore this a little bit: are you saying that, at the end of the day, if you believe something should be released and the Treasurer’s office say, ‘No, do not release it,’ that you make the call?

Mr Tune—Yes, that is correct under the law.

Senator SHERRY—Under the law that is the situation.

Mr Heferen—But I do not think that second part of the argument arises—

Senator SHERRY—Well, not in this case.

Mr Heferen—It is clear who the decision maker is. With regard to the idea that a minister’s office would say, ‘Well, you cannot go around releasing that,’ or, ‘Here is a material order release,’ I do not think that sort of thing enters into it.

Senator SHERRY—You do not? I am surprised. Anyway, the issue of release, in your view and in terms of the FOI law, is your decision and your decision only.

Mr Heferen—The FOI Act sets it up that it could be the minister or the agency head. In the Treasury, that power or the authority to make that decision has been delegated. It is delegated to division heads, of which I am one. So it is pretty clear that it is my decision.

Senator SHERRY—But there are certain circumstances where the Treasurer—in this case—can prevent information under FOI, are there not?

Mr Heferen—You are referring to the conclusive certificate?

Senator SHERRY—Yes.

Mr Tune—That is correct; yes, he can.

Senator SHERRY—In fact, he has exercised that.

Mr Heferen—Not in relation to this, of course.

Senator SHERRY—No, in another matter which I understand is going to the High Court. So, at the end of the day, it is not your decision. There are ‘checks’—whether they are applied correctly or not is another issue—whereby the Treasurer can prevent anything being released, within the confines of whatever is seen as a conclusive certificate, for example.

Mr Tune—That is right; those are the circumstances.

Senator SHERRY—Can I confirm that the minute of 6 October 2005 which was released in respect of the FOI was prepared after the policy changes had already been agreed but before they were announced? That seems to be the time.

Mr Tune—Yes, that is correct.

Senator SHERRY—Attachment B to the minute that was released says ‘The economic case for reform’—this is industrial relations reform. It is on page 3 and runs to three-quarters of a page. Is that it?

Mr Heferen—In the minute, yes, that was it.

Mr Tune—Yes.

Senator SHERRY—So the best Treasury can do in terms of industrial relations reform is to come up with three-quarters of a page on the economic case for reform. Is that the best that can be done?

Mr Tune—This was a brief to the Treasurer to inform him ahead of the announcement of the changes, to put it in a form that was easy for him to use. Therefore, it is an abbreviated version of a whole lot of work that has been done in the Treasury and indeed by the government and other agencies over a long period of time. It is not meant to be the bible on industrial relations changes; it is a brief to the Treasurer.

Senator SHERRY—No, I am not suggesting that it is supposed to be the bible on IR changes. You are not suggesting, surely—it seems to be implied—that the Treasurer cannot read a brief more than three-quarters of a page long on economic reform as a consequence of industrial relations. You are not suggesting that, surely?

Mr Tune—No, this is a 16-page brief covering a wide range of issues on a fairly complex set of changes.

Senator SHERRY—Yes, a very wide range of issues, but we are dealing here with the economic case for reforms. We have a three-quarter page outline of the economic case for reform.

Mr Tune—If it takes three-quarters of a page to put that down, it seems fine to me.

Senator SHERRY—Is that all it took?

Mr Tune—That is all it took, yes.

Mr Heferen—The issues here, from an economic point of view, are so standard and commonly agreed. They are really just stating things for people who look at these issues and think about these issues. They are propositions which are pretty straightforward.

Senator SHERRY—You say they are pretty straightforward. The issue is one of very significant contention. I referred to this ad earlier. The government is even advertising the economic case for reform. I actually do not see the claims made in the ad appearing in the economic case for reform brief to the Treasurer.

Mr Tune—Did they have to? I was not aware that they would need to be in there.

Senator SHERRY—They are not there. Did you analyse—

Mr Tune—They are covered off in—

Mr Heferen—Excuse me, Senator. It does say ‘more jobs’ and makes it clear that a higher employment growth is expected. It talks about higher wages. The government’s information piece talks about more jobs and higher wages. In this, in a world where you have greater levels of both individual and collective bargaining, as opposed to award systems, you would expect, over time, the wages to be a reasonable proxy for the productivity of the employees. So by saying you will go down the route of having higher productivity, it almost follows that you are looking at greater growth and higher wages.

Senator SHERRY—That is your assertion; that is your claim. Where is the modelling to back it up?

Mr Heferen—As I said, over on the next page we talk about the third-party endorsements, particularly from the IMF and the OECD.

Senator SHERRY—Hang on. I could ask where their economic modelling and research is in the Australian context. That is not here. I do not even know whether they have done it, and if they have done it I suspect that the source of it would come from Treasury anyway. Where is the economic modelling conducted within Australia to back up the assertion and claim?

Mr Heferen—When you say assertion and claim, there are certainly assertions which people who look at these things—of course, the Treasurer is one who is right across this information—say are straightforward propositions. Essentially, we are talking—

Senator SHERRY—Hang on. They are not straightforward, to the extent that they are disputed. They are a part of a public debate.

Mr Heferen—I am not aware—

Senator SHERRY—Where is—

CHAIR—Hang on. Mr Heferen, finish what you were going to say.

Mr Heferen—With regard to our propositions about the higher employment growth and our comments about a longer term increase in labour productivity due to greater flexibility in the labour market, I am not aware of any disputation about that issue.

Senator SHERRY—Where is the economic modelling that would, in part at least—economic modelling is fallible, but it is a higher level of research and evidence than an assertion—back this up?

Mr Tune—Economic modelling may give you, and there are lots of assumptions involved in economic modelling, as you would know—

Senator SHERRY—I understand that.

Mr Tune—We readily acknowledge that you cannot get an absolute answer. But all of that is going to be based on a set of assumptions and understandings about how the economy works, and they would be fitted into a model and some numbers put against them. But the fundamentals—the economic theory, if you like—underlying that is what is in here, and I think that is supported by various studies over a long period of time.

Senator SHERRY—Economic theory. You refer to studies. Where is the specific study or modelling, if you like, of the specific industrial relations changes? The answer is that you did not do any, did you?

Mr Tune—No, that is correct. I have said that.

Senator SHERRY—We know that. But we do know that modelling was done of a range of scenarios—okay?

Mr Tune—Yes.

Senator SHERRY—We know that is fact. Why was that not attached to this particular minute and, secondly, why was it not publicly released as part of the debate?

Mr Tune—There are two reasons. One—I think I have explained this a number of times in the past—is that the modelling that was done was done in the context of providing advice to the Treasurer to assist him in cabinet deliberations, and on that basis we do not release it.

Senator MURRAY—Could you clarify for me: did you do modelling to support the information you provided for the OECD reports on Australia?

Mr Tune—In general?

Senator MURRAY—On the specific issue.

Mr Tune—No, we would not have. The OECD would form their own views about these issues.

Senator MURRAY—Treasury give a brief to the OECD.

Mr Tune—They discuss these things with us.

Senator MURRAY—Did modelling on this issue accompany that brief?

Mr Tune—I do not think so, no.

Senator MURRAY—You do not think so?

Mr Tune—No. I would need to check. I am pretty positive, but I will check for you.

Senator SHERRY—Taking up Senator Murray's point: you obviously consult with the OECD and they consult with you on these issues.

Mr Tune—The OECD come out and do their economic survey every year in Australia. They talk to us and to a range of other people—other government agencies, academics and other groups.

Senator SHERRY—So there is a dialogue—information exchange or observation exchange?

Mr Tune—Just discussion is probably more to the point.

Senator SHERRY—Similar to with the IMF?

Mr Tune—Yes, the same sort of procedure.

Senator SHERRY—Is ‘third-party endorsements’ an appropriate heading?

Mr Tune—They are independent bodies; they are not associated with the government.

Senator SHERRY—Yes, but where do they draw at least part of their information and views from?

Mr Tune—I think they would guard their independence very jealously, in fact.

Senator SHERRY—It is not headed ‘independent third-party endorsements’. There is no reference to their independence.

Mr Heferen—Third-party itself—

Mr Tune—I think it is implicit.

Mr Heferen—Certainly, if you were to speak to the fund or the OECD I suspect that they would say they are certainly independent.

Senator SHERRY—The second paragraph refers to a relationship between wages and employment.

Mr Tune—I am sorry, are we on attachment B?

Senator SHERRY—Yes, this pretty pathetic economic case for reform—three-quarters of a page.

Mr Heferen—I think that is a little harsh.

Senator SHERRY—I do not think it is harsh. Three-quarters of a page on an issue of this magnitude! But, anyway, let us go to the first dot point. Frankly, it is not a personal criticism of you as public servants. If you had been allowed to, I think you could have done a much better job—at least given us the modelling. That dot point: ‘a 1 per cent increase in wages is correlated with a 0.4 per cent fall in employment.’ That is a statement. What is the source of this?

Mr Heferen—We took some questions on notice from you—I think at the last hearing—on studies about productivity and the impact of wages on employment. In that, I draw your attention to the little box on page 3—

Senator SHERRY—I would need a copy.

Mr Heferen—I only have got one.

Senator SHERRY—If it was an answer to a question on notice it should be available.

Mr Tune—It was, yes. It was from the last estimates hearings.

Senator SHERRY—What is the number?

Mr Heferen—Number 32.

Mr Tune—I have one here that we could get photocopied, though it has some marks on it.

Senator SHERRY—The secretariat may be able to get their hands on it pretty quickly. I just want it in front of me when we are discussing it. I have it now.

Mr Heferen—On the third page is a box with six referenced studies all in relation to the Australian economy. Those elasticities are in that third column. The first thing to note is that there is a very broad range, and also note Andrew Leigh's paper, which says 'minus 0.15'. Dr Leigh's paper is one of the few that have actually gone off a natural experiment—sorry, 'experiment' is probably used in the technical jargon. What has happened is that WA did increase their statutory minimum wage over a period of time and you could actually measure and look at what has happened. Dr Leigh did that. Whilst the minus 0.15 is the overall elasticity, he interestingly found for the lower age group—those people below 24 getting into the labour market—that it was minus 0.4. By using those there is a broad range, and the minus 0.4 used in the Dungey and Pitchford paper is one that I gather is reasonably commonly used amongst Australian academics.

Senator SHERRY—That is where the 1.4 per cent is derived from?

Mr Heferen—Yes, and that is where we say 'conservatively.'

Senator SHERRY—I must say I was a little intrigued that I actually got a better set of advice in answer to a question on notice than you gave to the Treasurer in his brief.

Senator MURRAY—You asked the right questions!

Senator SHERRY—It is the one occasion when I actually got more by asking for it than you gave to the Treasurer!

Mr Tune—We distil our advice to the Treasurer to make sure the essential points are covered. It is highly appropriate, in my view.

Senator SHERRY—I just find it quite amazing that I ended up getting more in specific terms than the Treasurer got.

CHAIR—Perhaps you need more, Senator Sherry. The Treasurer is very quick.

Senator SHERRY—He would have to be quick to read a three-quarter of a page minute on the economic case for industrial relations reform, given the nature of the issue.

Mr Heferen—Attachment B was originally much longer and was scaled down for the Treasurer's briefing.

Senator SHERRY—It was scaled down?

Mr Heferen—Of course. We do want to distil the key issues.

Senator SHERRY—Can I have a copy of the original on notice?

Mr Heferen—I think what we will do is attach this material.

Senator SHERRY—Was that the original to the Treasurer?

Mr Heferen—No, I am not saying that, but that is the kind of thing that you would normally put in there. Some of these studies, not so much those ones but through the rest of the document, are based on material that is around. You asked two things, firstly about the impact of productivity on wage-setting arrangements and flexible workplace productivity and also on wages. Some of the material done on productivity is material that is around—different people were aware of it—but this is the first time that has been put together.

Senator SHERRY—I have just found a copy of that answer to the question on notice; I have some further questions about it. I will pass this back to you. The table that you referred to is on page 5 of the copy I have here. On the table where you have listed the impact of the six, they all show a negative between employment and wages. That is what it does show, although a range?

Mr Heferen—Yes, always negative.

Senator SHERRY—If there is a negative relationship between wages and employment in this context, isn't that inconsistent with the advertisement that I referred to earlier 'more jobs and higher wages'?

Mr Heferen—This is all done in the context of a statutory minimum wage when looking at the time periods or through increases in wages through the awards system. That is making the point that when wages are moved up there is a negative impact—

Senator SHERRY—On jobs.

Mr Heferen—on employment, which is to contrast it with the situation where you have a more flexible labour market and where wages are determined through bargaining between the employer and the employee or the employer and a group of employees—so either individual or collective, but the idea is that they can tailor the requirements for the purpose of that particular firm. That sort of thing is not really dealt with here. This refers to statutory increases and not just movements in wages.

Senator SHERRY—The claim in the ad is 'more jobs and higher wages', but that is not borne out by the research that you have referred to.

Mr Heferen—That is because implicit in the ad is that you get more jobs and higher wages out of the new industrial relations system. The new industrial relations system is no longer underpinned by the award system; in all these, the underpinning is the award system. These studies and these numbers are based on either statutory minimum wages or the award levels which apply to everyone. You cannot make the adjustment depending on an individual or small group's particular capabilities that you would like to pay more for as an employer. I think it would be a mistake to look at a one-to-one correspondence between what is in this material and what is likely to be seen under the new system.

Senator SHERRY—Is that what you think will be seen? You say 'likely'.

Mr Heferen—That is our view.

Senator SHERRY—But your research does not bear this out. Wouldn't the research indicate that the slogan 'lower wages and more jobs' is consistent with the research that you have highlighted rather than higher wages?

Mr Heferen—I keep going back to the issue that what this is done on, when you look at those time periods, is a time when the award system was predominantly used to set wages across the board. So, irrespective of different levels of productivity per worker, the wage rate was pretty well constant, and that is different to what the package is about.

Senator SHERRY—For some employees. Some employees are covered by award wages.

Mr Heferen—That is right, some employees. It is not across the board. On that, I refer you to attachment D in the minute, which looks at the contrasting returns for awards, collective agreements and individual agreements, whether they are registered or unregistered. Obviously, there are other relevant factors there, but it does note that the more flexible arrangements are consistent with outcomes of higher wages.

Senator MURRAY—Were you referring to just federal awards or to both federal and state awards?

Senator SHERRY—The minute refers to both.

Mr Heferen—Yes.

Senator MURRAY—So, regardless of the fact that the two award systems are very different, you still came to the same conclusions?

Mr Heferen—The award systems across the board are extremely different. My understanding is—and I do not have a good understanding of the entirety of the award system—you broadly have the federal and state award systems but within those there are thousands of different awards.

Senator MURRAY—Yes, but the actual systems are remarkably different. As a result of the 1996 reforms, the number of federal awards was reduced by two-thirds and the size of those awards was reduced by a third. Federal awards have a limited number of allowable award matters—at least, they used to. Of course, we changed the system, but there were 20 allowable award matters. State systems were open-ended and, what is more, state systems applied mostly to a completely different sector to that which federal awards applied to. Federal tended to cover all large businesses, most medium sized businesses and about a third of small businesses. It is the reverse with state systems. I find it difficult to accept you can come to the same conclusions about the economic effects of reform in those two separate systems. That is my question to you, which I think goes back to Senator Sherry's fundamental proposition that, to assess this adequately in an academically relevant and expert way, you would need to disaggregate the systems and examine them on a much more detailed and informed modelling basis than you seem to imply.

Mr Heferen—Whilst the state awards and the federal awards are different in content and involve different conditions and possibly different ways to arrive at the content of the award, nonetheless the underlying issue is that, for those on the award, the wage rate and the conditions will be set uniformly for a person at that particular classification. So the scope for individual bargaining or collective bargaining in a smaller group, to ensure that what they do fits the requirements of the particular business in that particular area, is not available.

Senator MURRAY—The economic effects directly on the award apply to about 20 per cent of all employees.

Senator SHERRY—Are you saying that the outcome for all of those people—award-only is 20 per cent in your own table—will be higher employment and higher wages. Is that what you are claiming?

Mr Heferen—We are saying that in aggregate.

Senator SHERRY—In aggregate. So, in an aggregate, some may in fact have lower wages than would otherwise have been the case. In an aggregate, they must.

Mr Tune—It also depends on whether you are looking at short term or long term. I think the basis of the changes is that, because the system is more flexible, you will be relating wage changes to productivity to a greater extent. To the extent that that leads to an increase in productivity in the economy and hence to economic growth, you will see wages increase. So you cannot just think about it at one point in time; you need to think about it as a dynamic economy.

Senator SHERRY—Well I might pose questions about both points of time, at some point. I come back to you, Mr Heferen. Is it your claim that no-one would be worse off in terms of wages and employment in that category that I am referring to: the 20 per cent on award only?

Senator Minchin—I think that is an unreasonable question to put.

Senator SHERRY—Why?

Senator Minchin—I do not think it is reasonable for the officer to be expected to answer that. That is part of the political debate. I think it is appropriate for officers to comment on macroeconomic effects, community-wide considerations, but to seek to have an official respond to a question of that kind—‘Can you guarantee,’ or ‘Can you say that not one’—I just think is quite unreasonable, and I do not think the officer should be expected to answer that question. They can restrict their answers to their analysis of broader effects. It is for to the political debate to counter that.

Senator SHERRY—Chair, I would claim it is a reasonable question, given the conversation we have been having.

CHAIR—Can you just repeat the question, Senator Sherry, and I will listen to it more carefully?

Senator SHERRY—Consistent with your earlier comments, Mr Heferen—for the award only group, the 20 per cent group that we are talking about here, you referred to their aggregate outcome as being higher wages and higher employment—is it your contention that that is the case for all employees in that category, within the aggregate?

Mr Heferen—It is my understanding that the act itself makes it clear that, for people who have particular conditions—pay, and other conditions of work—they will remain.

Senator SHERRY—But we are not talking about the act here. We are talking about the document and the conversation we are having on that.

Mr Heferen—This is about the government’s package, and a key element of the government’s package, as I understand it—and I must confess that I do not know the particular provision in the now act, but certainly officers from DEWR will be able to locate it, and I could take it on notice—is the provision of ensuring that people’s current entitlements do not fall.

Mr Tune—This is only aggregate analysis, Senator. It is not trying to get at the individual level. As the minister said, we are looking at the macro impacts.

Senator SHERRY—We can make claims about aggregate overall and averages. It is what is contained within that for some people that I think is important as well. That is the issue.

Mr Tune—That may be so, but we have not done any work on that. That is not what this analysis was doing. It was not trying to do that.

Senator SHERRY—You have not done any work on that in the context of the modelling of the specific bill? Did you do any work on that in the context of the modelling you have done?

Mr Tune—No.

Senator SHERRY—None at all?

Mr Tune—No, not the distributional consequences.

Senator SHERRY—I understand that Dr Parkinson has returned.

CHAIR—Yes, Dr Parkinson has returned. Does it suit you, Senator Sherry, to ask those questions of him?

Senator SHERRY—Yes.

CHAIR—I ask Dr Parkinson, who has very kindly, and no doubt at great inconvenience, come back, to return to the table.

Senator SHERRY—Thanks, Dr Parkinson, for coming back. There are two areas of Treasury involvement in terms of government appointments. Firstly, there is the Future Fund. We have heard some evidence in respect of Finance yesterday. Do Treasury provide a list to the Treasurer of possible appointees?

Dr Parkinson—The Future Fund falls under the responsibility of Mr Tune.

Mr Tune—The Future Fund. I thought you said the Reserve Bank.

Senator SHERRY—I am going to go to another question in a moment. We will do the one that I think you do have some knowledge of.

Dr Parkinson—I am happy to talk about the Reserve Bank.

Senator SHERRY—Good. If the Reserve Bank is yours, we will get to Mr Tune with the Future Fund shortly. Why is there a separation, by the way? One is the Reserve Bank. Is the separation because it is the Reserve Bank?

Mr Tune—No. It is just the way the responsibilities in the department are allocated. Appointments follow function, in a sense, so Dr Parkinson has macro-economics, which is the Reserve Bank; I have budget and hence the Future Fund appointments.

Senator SHERRY—In terms of other appointments, what falls in your bailiwick, Dr Parkinson, besides the Reserve Bank?

Dr Parkinson—We might occasionally be consulted about or discuss with the Bureau of Statistics possible appointments to the Australian Statistics Advisory Council, but that is the ABS's responsibility. There are no other appointments akin to the Reserve Bank. We are, however, responsible for advising on appointments to the international financial institutions: IMF, World Bank, Asian Development Bank, and so on.

Senator SHERRY—Is the European Bank for Reconstruction and Development another one?

Dr Parkinson—Yes.

Senator SHERRY—I remember we canvassed that.

Dr Parkinson—We have canvassed that.

Senator SHERRY—Perhaps this is a question on notice: could you give us a list of the responsibilities of each respective section of the department in terms of recommended appointments—for future reference, that is all.

Dr Parkinson—Yes.

Senator SHERRY—Thanks. I just want to be clear—this is with respect to Mr Gerard and his appointment to the Reserve Bank board. On 19 August 2002, Treasury wrote to the Treasurer proposing candidates to replace Mr Warburton if he was not reappointed to the RBA board when his term expired in December of that year. Is that correct?

Dr Parkinson—You, I assume, are reporting from the chronology that was listed in the *AFR*?

Senator SHERRY—Yes. But that is factually correct?

Dr Parkinson—That is based on the documents that were registered.

Senator SHERRY—And on that document the Treasurer wrote, ‘Some other names, please.’

Dr Parkinson—I do not have the document in front of me at the moment, but that is the extent of my recollection. In other words, I will not commit to those being the exact words, but that was the sentiment.

Senator SHERRY—Does the other officer who has come to the table have the document? Can he confirm that that is what the Treasurer wrote?

Dr O’Mara—I would need to go back and look at the original document, but certainly that was the sense of it.

Senator SHERRY—What was the date of the Treasurer’s response? Was it dated?

Dr Parkinson—I do not have the document in front of me.

Senator SHERRY—I might come back to that later. On 9 September, Treasury wrote back with some additional candidates. Is that correct?

Dr Parkinson—Yes.

Senator SHERRY—The Treasurer responded: ‘Any more? Give me a list of BCA members, ACCI directors.’ Do you recall that?

Dr Parkinson—As a general sentiment, yes—again, not having that original document in front of me.

Senator SHERRY—So presumably, given your previous answer, you do not have the date of the Treasurer’s response?

Dr Parkinson—No.

Senator SHERRY—Then, on 27 October, Treasury responded. Do you recall the Treasury's response on 27 October?

Dr O'Mara—Yes.

Dr Parkinson—Yes.

Senator SHERRY—And Mr Gerard's name was on that response for the first time?

Dr Parkinson—Mr Gerard was an active board member, and his name would have been on that.

Senator SHERRY—As an active part of that?

Dr Parkinson—Yes.

Senator SHERRY—In including Mr Gerard's name for the first time, on that date, was that a recommendation from Treasury to the Treasurer?

Dr Parkinson—No, it was not. At that time Mr Gerard's name was listed, along with those of a range of other people, and we were responding to the Treasurer's request.

Senator SHERRY—So it was the provision of factual information, no recommendation?

Dr Parkinson—Yes.

Senator SHERRY—Okay, thanks. According to the documents, the Treasurer considered another unknown candidate.

Dr Parkinson—Yes.

Senator SHERRY—I do not want to go to who that was; it is not relevant. On 15 November, a Mr Gaetjens—I think he is—

Dr Parkinson—He is the Treasurer's Chief of Staff.

Senator SHERRY—the Treasurer's Chief of Staff, yes—asked Treasury for directors of the top 15 manufacturers, for a recommended short list and for the RBA governor to be consulted. Is that correct?

Dr Parkinson—That is correct.

Senator SHERRY—Was Mr Gerard's name on the recommended short list?

Dr Parkinson—I am sorry; I missed that.

Senator SHERRY—Was Mr Gerard's name on the recommended short list that Mr Gaetjens asked for?

Dr Parkinson—I do not recall, off the top of my head. I would need to see the original document. On that, I also wonder whether it is appropriate for me to actually answer.

Senator WATSON—Chair, is it an appropriate question to canvass individual people who might or might not be on a short list?

CHAIR—I was listening carefully to the questions, and I was wondering that myself. It does seem to me, Senator Sherry, that we are getting very close to, if not over the borderline of, advice to ministers, which is not, as you well know, a proper question in this instance.

Senator SHERRY—Chair, I would argue that I do not think we are at that point yet.

Senator WATSON—But leading to it.

CHAIR—I think a question as to whether a recommendation was made is necessarily a question as to whether certain advice was given—namely, that it would be a good idea to do something.

Senator SHERRY—I do not think we are at that point yet, Chair. But could I draw your attention—you were not in the Senate on this occasion—to when we were discussing the appointment to the European Bank for Reconstruction and Development. I am sure Dr Parkinson remembers it. In fact, I think I asked someone—I am not sure whether it was you individually—an almost identical question about the list provided: was the name of the former Assistant Treasurer, Mr Short, on that list? I was told, ‘No.’ So I have asked and received a response, and it was permitted for me to ask that question on that occasion.

CHAIR—I do not doubt what you say, Senator Sherry, but I am going to have to interpret the rules for myself, of course.

Senator SHERRY—Of course you do, but precedence is interesting.

Dr Parkinson—I leave it to the committee to determine whether this is precedent. But that was a process whereby people nominated themselves for consideration. This is not a process whereby people nominate themselves.

Senator SHERRY—Well, in that case, I asked—

Dr Parkinson—I recall you asking questions. I am a simple economist. I would feel very uncomfortable answering a question about who was recommended.

Senator SHERRY—Yes, but lots of public servants come here feeling uncomfortable about questions that are put to them and the answers they may or may not give. That is certainly not a criterion.

CHAIR—I agree. Dr Parkinson, I am sorry but your level of comfort will be a matter of utter irrelevance to me, just as Senator Sherry’s vexation will be if I rule it out of order.

Senator Minchin—On that point, Mr Chairman: I think questions about process are reasonable, but questions that go to the issue of individual names and whether or not they were on lists that went between the Treasury and the Treasurer I would not have thought were appropriate at all.

CHAIR—No. I agree, Senator Minchin. Any question which tends to open the topic of whether certain advice—including a recommendation—was given and what that recommendation or advice was is out of bounds.

Senator SHERRY—I notice the prompt from the minister there.

CHAIR—There was no prompt from the minister there.

Senator SHERRY—There was. It was obvious. You have changed your position.

CHAIR—No, I have not changed my position.

Senator SHERRY—You have made a ruling now.

Senator Minchin—Senator Watson raised a fair point, and I am commenting on the point that he raised.

CHAIR—Senator Watson raised a point of order concerning which I have been—

Senator SHERRY—The chair gives a consideration. Chair, with due respect to you, the minister comes in and just tries to do this. It is the usual style. We know you want to cover up your embarrassment about this Gerard appointment.

CHAIR—Senator Sherry, you are out of order. I think most of the deadlines for the radio current affairs programs have passed, so you need not worry about that.

Senator SHERRY—Well, they have not.

CHAIR—Most of them have.

Senator SHERRY—There are a lot of hours to go under the bridge yet. I reject the implication.

CHAIR—Senator Sherry, you know the rules. I have given you so far perhaps more latitude than I should have but the rule is that advice to ministers is not to be canvassed.

Senator SHERRY—Chair, you should reflect on the implication you made, too, in terms of me posing these questions. I do not think it is reasonable for you to make that sort of comment from the chair.

Senator Minchin—You reflected on the chair, Senator Sherry. You get it back in spades.

Senator SHERRY—No, you do not get it—

CHAIR—Order! Senator Minchin and Senator Sherry, I am going to stop this. Go on to your next question, Senator Sherry.

Senator SHERRY—I will do. I will go back to what I was saying before I was so rudely interrupted by a minister covering up this matter. On 15 November I referred to Mr Gaetjens asking Treasury for directors of the top 15 manufacturers, for a recommended shortlist, and for the RBA governor to be consulted. Was the RBA governor consulted?

Dr Parkinson—Usual practice would be that the Treasury and the Reserve Bank governor would consult on names that might be put forward to the Treasurer. If you are asking whether he was consulted in this particular instance, I would have to go back and check the records but my recollection is that he was.

Senator SHERRY—What was the form of the response?

CHAIR—That is a question that goes to the recommendation.

Senator SHERRY—No, I am not asking about individual names and recommendations at the moment.

CHAIR—I let the last question in because I think it was a process question or a question about the sequence of time in which events occurred, both of which I think are fair enough. But anything disclosing the substance of what may or may not have been recommended I think, as I indicated before, is beyond the rules.

Senator SHERRY—On 19 November Treasury provided a list of the directors of the top 15 manufacturers. Is that correct?

Dr O'Mara—I believe so.

Senator SHERRY—What was the basis for measuring the top 15? Was it revenue or employment?

Dr O'Mara—I would have thought we would have used market capitalisation as a measure of the size.

Senator SHERRY—Was there a response from the Treasurer's office to Treasury as to the suitability or otherwise of the 15 largest manufacturers' directors that were identified?

CHAIR—I think that is—

Senator SHERRY—I am not asking for an individual.

CHAIR—I know you are not, but I think that that goes beyond process.

Senator SHERRY—I do not think it does.

CHAIR—You are entitled to your opinion, but that is my view.

Senator SHERRY—I am not asking for the commentary from the Treasurer's office on individuals. I am asking whether the Treasurer's office made a comment as to the suitability or otherwise of the names submitted regarding the 15 largest manufacturers.

CHAIR—I understand the question, but I think the question goes beyond process.

Senator SHERRY—I disagree. I think, again, that is unreasonable. Your ruling is unreasonable. On 2 December there was a cabinet meeting which did not consider the RBA appointment, as I understand it. Can you confirm that the RBA board appointment was not dealt with at that cabinet meeting?

CHAIR—That is not a proper question. You cannot ask what goes on at cabinet.

Senator SHERRY—Mr Warburton's term on the RBA board expired on 31 December.

Dr Parkinson—Again I do not have the exact date, but that would be around the time. Chair, I will take your guidance, but would it be of assistance if I explained the general process by which appointments are made?

CHAIR—It is probably best if we let Senator Sherry ask his questions. If they are in order, I will remain silent and if they are not I will not. We will do it that way.

Senator SHERRY—When a vacancy is to occur—when a board position is expiring—what is the normal process? Is an appointment made before the expiration of that individual's term?

Dr Parkinson—It is not required to. It will be a function of who we find is willing and able to take on the position. Normally, prior to the expiry of the term of a sitting board member we would consult with the Treasurer as to whether or not the person was to be reappointed or, if they were retiring, we would start a process by which we would pull together a list of candidates and start that process some time in advance of the expiration of the person's term.

Senator SHERRY—But is it the norm—whether an existing person is being reappointed or a new appointment is being made to what will become a vacancy if the existing person is not to be reappointed or not seeking reappointment—for the announcement of that vacancy to be made prior to the expiration of the individual's term on the RBA?

Dr Parkinson—I would need to go back and check the facts. I can recall that there have been times when there have been vacancies on the board. There is one at the moment. It is not the case that in every instance the appointment is announced. Reappointments would be announced, but an appointment would not necessarily be announced prior to the expiry of the previous incumbent's term.

Senator SHERRY—On 30 January there was an internal Treasury memo by the secretary that refers to consideration of Mr Gerard. Again, that is in the public domain.

Dr Parkinson—That is right.

Senator SHERRY—A reference is made to initiating checking. Did the reference to Mr Gerard come from the Treasurer's office?

CHAIR—I do not think that is a proper question either.

Senator SHERRY—Where did it come from?

CHAIR—You are going about that from a different angle. I do not think it is proper. Anything that trespasses upon what may have passed between officers and the Treasurer's office or the Treasurer is in my view not a proper question.

Senator SHERRY—But many of these documents—

CHAIR—Some of the documents are in the public domain—

Senator SHERRY—Yes, they are in the public domain.

CHAIR—and I have allowed you to ask questions in relation to documents in the public domain, which might, strictly speaking, be beyond the rules themselves, but there seems little point in ruling out questions about things that are in the public domain. But what passes between officers and the Treasurer's office or the Treasurer and vice versa is beyond the bounds of the procedure.

Senator SHERRY—On 31 January the internal response to the Secretary noted that 'Gerard Industries is a regular donor to the South Australian Liberal Party.' That is correct, isn't it?

Dr O'Mara—Yes, that is correct.

Senator SHERRY—And it is a reference to Gerard Industries as distinct from Mr Gerard the individual?

Dr O'Mara—According to the records I have it was a reference to Gerard Industries.

Mr Coombs—This material is drawn from newspaper articles and other public sources. To the extent that those public sources are accurate, we understand it was from Gerard Industries. It does not rule out—

Senator MURRAY—So you are saying that you do not as a matter of course in considering appointments examine the donations returns lodged with the AEC?

Mr Coombs—That is correct.

Dr Parkinson—No, we do not.

Senator SHERRY—At any time did the Treasurer or his office indicate to Treasury why people were unsuitable for appointment?

CHAIR—That question is not in order.

Senator SHERRY—Have there been other instances where the current Treasurer has rejected Treasury's candidates for appointment?

CHAIR—That question is not in order.

Senator SHERRY—This question was posed I think in a very similar context in respect to the appointment of Mr Short to the European Bank for Reconstruction and Development, where the Treasury officers on that occasion made it clear that the Treasurer—indeed the Treasurer boasted about it in question time—had rejected the list put forward. That was allowed and answered on that occasion.

CHAIR—That may be the case, Senator Sherry, but the arbiter of what is allowable or not allowable in the proceedings today is me, and I have ruled the question out of order.

Senator MURRAY—Chair, on a point of order, I wonder if we are not getting oversensitive. It would seem to me obvious that, if the Treasury put up six names and the Treasurer selected one, five were rejected. I see it as unexceptional.

CHAIR—You may, Senator Murray. I have stated the principle that advice to and from the Treasurer's office or the Treasurer is not a proper subject of inquiry. I have also said that questions of process and questions of sequence are permissible and I have also allowed questions which would not ordinarily be permissible in relation to matters that are part of the public record. I am going to adhere to that set of guidelines.

Senator SHERRY—What is the process for checking a person's suitability for appointment to the Reserve Bank board?

Dr Parkinson—It is a set of informal guidelines which we think about when we are thinking about what names might be put forward to the Treasurer for his consideration. We basically think about the roles and responsibilities that board members have to play. That leads us to consider what expertise they might bring to the board. Would it be of a technical nature—that is, would it be knowledge of economic or financial systems or markets—or is it corporate governance, broader corporate management skills and the like?

We also use that to think about whether or not individuals might have potential conflicts of interest. As you know, there are prohibitions on people who are associated with deposit-taking institutions from being members of the board. Using those as a metric, we then begin to think about what sort of a list we might be able to compile. That would include, but is clearly not limited to, past candidates, directors of large companies, prominent businesspeople with extensive expertise, academic experts, and other people who might have appropriate skills.

Senator SHERRY—Can I give you a couple of issues and ask you whether you consider them. If, for example, a regulatory authority had disciplined or removed a person, prohibited them from practising in a particular area—the precise example I am thinking of is APRA

removing someone as a licensed financial planner—do you check whether they are a fit and proper person with APRA or ASIC at all?

Dr Parkinson—No, we do not. We basically undertake a media search. I suppose it might be put like that. Basically we are looking for material that is on the public record that is about the individual. We do not have access to confidential information about those individuals.

Senator SHERRY—But in the case I have referred to, it would be publicly available.

Dr Parkinson—If it was thrown up through our search, we would obviously take note of it. But we do not, as a matter of course, consult with regulatory authorities, with the tax office, with anyone else.

Senator MURRAY—Or the police.

Dr Parkinson—Or the police.

Senator SHERRY—Federal and state?

Dr Parkinson—No, we do not consult. Basically this is a pre-screening stage. Then it is incumbent upon the person who is approached to fill out a declaration of interest form, which is quite explicit about their having no conflicts of interest and having nothing that would cause embarrassment.

Senator SHERRY—Do you check whether they are an Australian citizen? I am not sure whether a non-Australian can be an appointee to the RBA. Is that checked?

Dr Parkinson—I am afraid I do not know—that is, I do not actually know whether a noncitizen can be a member of the board.

Senator SHERRY—It just came to mind. I certainly know that some governments require only citizen appointments across a whole range of areas.

Mr Coombs—If that material came to our attention through the public record then we would note that in the information that we would put forward on that candidate. From time to time we do have people who make the first list who turn out to be non-Australian citizens.

Senator MURRAY—But it is not part of your conflict of interest declaration that you are a dual citizen or not a citizen.

Mr Coombs—No.

Senator SHERRY—There is that issue and the direct legal issue of whether a noncitizen can be appointed to the RBA or, for that matter, other boards, but it is not an issue here.

Dr Parkinson—I am racking my brains on this, but I do not recall the act saying anything about citizenship, but we can check that if you wish.

Senator SHERRY—I do not know, but there may be a constitutional issue as well. However, you are not asking about it. What is the length of time for this process?

Dr Parkinson—It can vary dramatically. If it is a simple reappointment, it can be dealt with very quickly. If it is a new appointment, it will depend on how long it takes us to find the relevant information about the people that we might be putting forward for the Treasurer's consideration and then for iterations with the Treasurer as to whether any of those individuals are the ones that he wishes to appoint or whether he wishes us to undertake more checking.

Senator SHERRY—I note in the memo dated 31 January that there was a checking of the ASIC database.

Dr Parkinson—That was just a checking of directorships. As I said earlier, people who are associated with deposit-taking institutions are not eligible. So one of the first things to do is to check the ASIC database and find out whether the person is associated with an ADF.

Senator SHERRY—If, in the course of checking the ASIC database, it threw up an adverse finding against an individual, that would not automatically exclude them but it would be an issue that would be reported?

Dr Parkinson—It would be reported, but I am not sure that such information would be recorded in the database itself.

Mr Coombs—The ASIC database contains quite a simple list of people and directorships. Very little additional information is supplied in that database. If something did come up in that database, we certainly would have drawn it to the attention of the Treasurer.

Senator SHERRY—I regularly look at the ASIC releases, for example, and streams of them refer to bannings, prohibitions and findings against a whole range of individuals. As a matter of course you do not check it?

Mr Coombs—No.

Senator SHERRY—Was the ASIC database researched with respect to Gerard Industries Pty Ltd or Mr Gerard the individual?

Dr Parkinson—I will stand corrected if I am wrong, but it would have been about Mr Gerard and finding out which companies he was a director of.

Senator MURRAY—And companies that he had been a director of or just those currently?

Dr Parkinson—I think it is only a current listing, but I could be wrong.

Senator SHERRY—I understand from the publicly available information that Treasury performed a company search on a company by the name of Aranj Pty Ltd ACN 075289824. Why did Treasury perform a company search on that company as distinct from the other companies?

CHAIR—Before you can ask that, you had better ask him whether that is the case.

Dr Parkinson—I cannot answer whether that is the case. I do not have that information in front of me.

Senator SHERRY—Under the material provided under FOI, that is the case. It is in the FOI material.

Dr Parkinson—I would have to check why that company in particular was focused on.

Dr O'Mara—I think we need to remember that the material on the public record was released by the Treasurer's office. It is not actually FOI material provided by Treasury as such. So we are not privy to the detail of what was or was not provided.

Senator SHERRY—It indicates that Treasury performed a company search on that company. No-one can recollect why this particular company?

Dr Parkinson—Can I take that on notice?

Senator SHERRY—Yes. As distinct from—

Dr Parkinson—As distinct from any of the other 78 companies—I have no idea.

Senator SHERRY—Why was this one focused on?

CHAIR—Senator Sherry, it is half past 12. I am happy to sit on for a little while if you are reaching the end of this topic; otherwise we will adjourn.

Senator MURRAY—Chair, if I could just add something for your consideration. I have one short question that I want to put on the matter.

CHAIR—On this topic?

Senator MURRAY—Yes. So if we were to conclude the topic before we adjourn, that is all I have.

Senator SHERRY—I am not intending to conclude, Chair. I have got a few more questions; it would take more than five minutes.

CHAIR—Would they take beyond a quarter to one?

Senator SHERRY—They could do.

CHAIR—All right, we will suspend. Do you want to ask your question now, Senator Murray?

Senator MURRAY—Yes, thank you. It is a short one. I think I know the answer, but I just want it on the record. Once an appointment has been made to the Reserve Bank board, and thereafter in the years of service that follow, it is true that any management of or reaction to or declaration about a board member's personal or business or tax affairs is a matter for the board, isn't it—its processes and its systems and governance mechanisms and so on?

Dr Parkinson—Yes, and the board has a code of conduct.

Senator MURRAY—So you would not ever interfere with or get involved in that as an agency? It is then entirely a matter for the board?

Dr Parkinson—No, unless the individual had done something under the act which would allow for the consideration of their removal.

Senator MURRAY—For instance, if a board member became a manager or a director of a deposit-taking institution, you would react to that?

Dr Parkinson—We, and the Governor, would react that.

Proceedings suspended from 12.32 pm to 1.38 pm

Senator SHERRY—Can I just clarify one issue before I continue the questioning? I was of the view that the documents from which I am quoting were released by Treasury under FOI, but there seemed to be a view, I think from you, Mr Coombs, that they were released by the Treasurer.

Mr Coombs—Dr O'Mara actually answered that question, but it is the case that the documents were released from the Treasurer's office to the *Financial Review*, and that was done by arrangement.

Senator SHERRY—By arrangement? Not under FOI?

Mr Coombs—That is correct.

Senator SHERRY—We were dealing with the company extracts that ASIC provided. I referred earlier to the fact, based on the documents provided, that a search was done of Aranj—I am not sure how it is pronounced—and, according to the information provided, that was the only specific search done, beyond the name, into the 79 on the list.

Dr Parkinson—There were 79 directorships listed. I will give you additional information if it turns out that we have any back in the department, but my understanding is that the search on that company came about because some information was needed for filling out forms.

Senator SHERRY—That is why the search was done on that particular company?

Dr Parkinson—I think so, because I think it is alphabetically the first company on the list.

Senator SHERRY—Yes, I was going to raise that point. It appeared to me that the only logic for selection was that it began with A.

Dr Parkinson—It was first, yes. But we will double-check that, and if it turns out that there is additional information we will provide that to you.

Senator SHERRY—The only other logical explanation that I could think of was that it was a superannuation fund, and in the context of the deposit-taking institution—but then that raised the question with me: how would you know it was a superannuation fund? It does not say ‘superannuation fund’ in the title; it is just a company name. So I came back to the logic that it was first on the list.

Dr Parkinson—I think that is right. But, as I said, if it turns out that there is another reason, we will let you know.

Senator SHERRY—Okay. I understand from the documents provided that the search of the ASIC registry provided Treasury with a complete list of documents received by ASIC.

Dr Parkinson—You have access to documents that we do not have in front of us.

Senator SHERRY—In terms of access to documents that you do not have in front of you: I can understand why you did not have them before lunch, but surely when these were released by the Treasurer’s office you were made aware that these documents were to be released?

Dr Parkinson—We were not provided with a copy, and there is no reason why we should be.

Senator SHERRY—Were you made aware of their release?

Dr Parkinson—We were made aware that documents had been released.

Senator SHERRY—And the Treasurer did not provide you with a copy of the documents released?

Dr Parkinson—The Treasurer’s office did not provide us with a copy of the documents that were released. We provided documents to the Treasurer’s office; they chose which ones to release. Remember, this was not an FOI request that was directed to us; it was directed to the Treasurer.

CHAIR—I thought your colleague said it was not an FOI request.

Dr Parkinson—It was an FOI request. The FOI request was, as I understand it, subsequently withdrawn, and documents were provided.

Senator SHERRY—I find it a little surprising—it is no criticism of you—that, given that there would have been an expectation that questions would be put about this issue, the Treasurer’s office did not provide you with that information. There was a reasonable expectation that you would be asked questions about it.

CHAIR—Those are your comments, Senator Sherry; you are entitled to that view. Dr Parkinson, you have no obligation to respond. In fact, you were not being asked to respond.

Senator SHERRY—Let us go back to the list of 79 companies that were identified—the directorships. The first one on the list was checked for further information—in other words, there was a further exploration beyond the name. We know that, if he had in fact been a director of a deposit-taking institution—which apparently he is not, but you certainly did not know that at the time—that is an automatic exclusion from RBA consideration. So why didn’t Treasury check behind each of the company names to see if any of them were in fact deposit-holding institutions?

CHAIR—Deposit-holding or deposit-taking?

Senator SHERRY—Deposit-taking institutions; sorry.

Dr Parkinson—I would have to check what exactly was done.

Senator SHERRY—Wouldn’t it be reasonable, given that that is an automatic exclusion from consideration? You have 79 companies of which he is a director. One or more of those might in fact have been a deposit-taking institution behind the company name. Wouldn’t that seem reasonable?

Dr Parkinson—That is possible; it could have been the case. But we would have to go back and revisit the records to see whether people had looked at the list of deposit-taking institutions first or just exactly how it was done.

Senator SHERRY—Are there many deposit-taking institutions?

Dr O’Mara—A very considerable number, yes. If you think about the banks, the building societies, the credit unions—they would all come under that category. So there are certainly dozens in the Australian market.

Senator SHERRY—Yes, that is what I thought. I take it that a deposit-taking institution is not defined as a superannuation fund in this case.

Dr O’Mara—That is something that we would need to confirm.

Senator SHERRY—Presumably, you would have checked this at the time, because your first company brings up a super fund.

Dr Parkinson—If you set up your own super fund—so it is a self-managed fund—I cannot see that that would exclude you from the board.

Senator SHERRY—It may still be a deposit-taking institution.

Dr Parkinson—Is it a deposit-taking institution? It is not taking deposits—

Senator SHERRY—It may or may not be.

Dr Parkinson—Yes, it may or may not be.

Senator SHERRY—I think it is coincidence that the first one you checked was in fact his superannuation fund. Was a company search performed on Gerard Industries, the company, on the ASIC database?

Dr Parkinson—In the sense of: did we feed Gerard Industries into the ASIC database?

Senator SHERRY—Yes.

Dr Parkinson—No, I think we just fed in Mr Gerard's name. That produced a set of directorships. That is how we got the list of 79.

Senator SHERRY—I understand that. What I am asking is whether you went a step further in respect of Gerard Industries, the company.

Dr Parkinson—No, there is no reason why we would. Gerard Industries is a publicly listed company. If we were considering someone else who was associated with a publicly listed company, we would not search the company as such; we are searching for the individual.

Senator SHERRY—I referred earlier to a reference in the material released to Gerard Industries—I underline the words 'Gerard Industries' as distinct from the individual—as a regular donor to the South Australian Liberal Party. In that context, why didn't Treasury do a check on the ASIC database of Gerard Industries?

Dr Parkinson—Gerard Industries was not up for appointment to the Reserve Bank board; Mr Gerard was. There is no reason why an individual's political donations or political affiliations should impact on their appointment to the Reserve Bank board.

Senator SHERRY—Given that, what about other circumstances of checking Gerard Industries?

Dr Parkinson—We did not check Gerard Industries.

Senator SHERRY—I am trying to find out why you didn't.

Dr Parkinson—We followed exactly the same practice here that we have followed for at least a decade. The reason I say 'at least' is that we actually went back and checked to see whether there were any differences in our approach. We were able to access our files back to the end of 1994. So we went back 11 years. There has been no change of practice. We have at no stage gone and searched companies associated with past Reserve Bank board appointees or people under consideration for nomination to the board.

CHAIR—So you are telling us, Dr Parkinson, that your conduct in this instance was entirely uniform and consistent with your conduct in every other instance.

Dr Parkinson—That is right, which was why I offered earlier this morning to explain the general process—the point being that there was no deviation from the general process.

Senator SHERRY—In terms of deposit-taking institutions, wouldn't it have been appropriate to check—Gerard Industries could in fact have been an owner of a deposit-taking institution?

Dr Parkinson—Yes.

CHAIR—Are you putting a proposition, Senator Sherry, or are you putting a hypothetical?

Senator SHERRY—I am putting both.

CHAIR—But you are not asserting that that was the case, are you?

Senator SHERRY—No, I am not. We in fact know that Gerard Industries is not an owner or even a substantial shareholder of a deposit-taking institution. The point I am making is that if you are a deposit-taking institution you are automatically precluded from the Reserve Bank. It seems to me reasonable that to go behind the name Gerard Industries to identify whether or not it in fact did own a deposit-taking institution would have been necessary. But that did not happen?

Dr Parkinson—We are talking about the pre-screening. This is before nomination. There is no reason why somebody who is currently associated with a deposit-taking institution could not become a member of the Reserve Bank board if they were to break their relationship with that institution.

Senator SHERRY—Yes.

Dr Parkinson—In the process of inquiring with someone as to whether they would be interested in nomination to the board, that point would be made to them quite clearly—that they would not be able to maintain that affiliation. But that does not preclude them from being considered.

Senator SHERRY—Correct. But the point I am making is that it did not happen in this case with Gerard Industries.

Dr Parkinson—It did not happen in any case or in any instance.

Senator SHERRY—If Gerard Industries had been an owner of a deposit-taking institution, you would not have known, unless he self-declared later on?

Dr Parkinson—That is right, and recall here that the whole process is actually a self-declaration process. The nominees are required to sign a declaration that says that there is nothing in their affairs that would conflict with their role on the board or that would cause embarrassment.

Senator SHERRY—Wouldn't looking into Gerard Industries on the ASIC website have revealed the tax dispute with the ATO, if that had occurred as a matter of course?

Dr Parkinson—I have absolutely no idea whether the tax dispute would have been listed on an ASIC database.

Senator SHERRY—According to my information it is.

Dr Parkinson—The point is that Gerard Industries was not up for nomination. Mr Gerard was up for nomination and Mr Gerard's personal tax affairs were what were of interest, as are the personal tax affairs of any person considered for nomination or appointment to the board.

Senator SHERRY—So you draw a distinction between the personal tax affairs of a person and the activities of a company of which that person is a substantial if not a majority shareholder—the chief executive?

Dr Parkinson—It is a public company. If we were to preclude every person who has an affiliation with a public company where that public company has a dispute with a regulator of some type or the tax office I think you would find that we would have a very small pool.

Senator SHERRY—No, I am not suggesting that. You know I am not suggesting that. In the 31 January email from Mr Gaetjens to Dr Henry he was wanting to know if there was any news on Mr Rob Gerard. On 5 February Dr Henry advised a colleague that Mr Gaetjens had said to start the process that led to Mr Gerard's appointment. Is that a reference to the process that you were already undertaking, or is it some other process that you were expected to carry out in checking?

Dr Parkinson—No, that would be the process of starting to pull together the paperwork—fill out the papers.

Senator SHERRY—As distinct from the actual checking that was already under way?

Dr Parkinson—Yes.

Mr Coombs—That is correct, yes. It is the preparation of declarations and other correspondence for appointment.

Senator SHERRY—Two separate minutes were released: the minute of 5 February that I have mentioned, but also the minute of 6 February. In one of those two minutes, it says 'your office suggested'. This is to the Treasurer. It specifically says 'your office suggested Gerard'. Are you aware of that minute?

Dr Parkinson—Yes, I am.

Senator SHERRY—And there is a separate minute—

CHAIR—You are dealing now, aren't you, Senator Sherry, with documents that are on the public record?

Senator SHERRY—Yes. There is a separate minute from Treasury to the Treasurer's office, where the terminology—

Dr Parkinson—That is to the Treasurer.

Senator SHERRY—Okay, to the Treasurer—where the terminology 'your office suggested' had been removed. Is there any explanation for that?

Dr Parkinson—Not that I am aware of. I do not know why there was a difference between the two when we found those on the file.

Senator SHERRY—Is it usual for Treasury, or an officer, to contact a possible candidate for appointment by the Treasurer directly at any time, or is that left to the Treasurer's office or the Treasurer himself?

Dr Parkinson—There is no hard and fast rule. It will depend on the circumstances. It may be that it is easier for the department to contact someone—for instance, the department may have a past relationship with them—or it may be easier for the Treasurer's office. There is no process guideline in that sense.

Senator SHERRY—In this case, was it someone from Treasury who contacted Mr Gerard, or the Treasurer, or someone from his office?

CHAIR—I think the first part of that question is all right; you can ask, I think, whether an officer of Treasury contacted Mr Gerard. I do not think you can ask the second part of that question.

Senator SHERRY—Well, let us see how we went with Treasury.

Dr Parkinson—I am unaware that a Treasury official contacted Mr Gerard.

Senator SHERRY—Have you checked that? Or do you mean that you personally are unaware?

Dr Parkinson—I personally am unaware; my colleagues are unaware—

Senator SHERRY—And did you have any liaison with the tax office at all during this process?

Dr Parkinson—No, and we would not. As I said earlier, we deal only with publicly available information.

Senator SHERRY—I will return now to an earlier point. I think it was Mr Coombs who referred to a public search of the media?

Mr Coombs—Yes.

Senator SHERRY—There was a reference to that earlier: you had done a check. That did not throw up any media coverage of issues relating to Gerard Industries and a tax dispute?

Mr Coombs—The media covered issues of a general nature in terms of Gerard Industries and Mr Gerard. But there was no information regarding outstanding tax disputes. There was quite a lot of personal information about Mr Gerard, in his undertakings in Adelaide particularly and in terms of his export orientation with Gerard Industries.

Senator SHERRY—And presumably a significant amount of that material would have come from a South Australian newspaper?

Mr Coombs—That is correct. That is right.

Senator SHERRY—Mr Gerard was appointed. Once the appointment is made, is any further checking carried out? The circumstances of any individual who is appointed to the Reserve Bank may change—for example, they may become involved in or part of a deposit-taking institution. So is any further check carried out? It is unlikely, but—

Dr Parkinson—No.

Senator SHERRY—So once the appointment is made, that is it?

Dr Parkinson—Once the appointment is made, it is incumbent upon them to advise the governor of changes in their circumstances. I think that is covered in the board's code of conduct: they advise the governor if there are changes. And only if there were changes that were material and that were passed to us would we actually do anything about it, in the sense of investigating it.

Mr Coombs—The Reserve Bank board members are subject to the Commonwealth Authorities and Companies Act. Under that basis, they are required to annually disclose financial interests to the bank board, but not that we in Treasury would see that type of documentation.

Senator SHERRY—So the process ends with appointment. Nothing about Mr Gerard came to light subsequently, in the normal course of work, that was referred to the Treasurer?

Mr Coombs—That is correct.

Senator SHERRY—You all read clipping services?

Mr Coombs—That is correct.

Senator SHERRY—But nothing came to light. I understand the current Governor of the Reserve Bank is up for reappointment. I am not sure whether he has expressed an interest in being reappointed.

Dr Parkinson—His term ends on I think 17 September this year. The appointment is for seven years, but when he was reappointed he sought reappointment for three. It is his intention to retire.

Senator SHERRY—So would the process that we have been through in terms of Mr Gerard's appointment be the same or a similar process?

Dr Parkinson—No. It will be a matter for the Treasurer how he wishes to conduct that. Different approaches have been taken in the past. I cannot recall exactly what the process was for the appointment of the governor, but the appointment of I think the previous deputy governor involved a search company. This was in the early 1990s. But prior to that I am not aware.

Senator SHERRY—You say a search company in respect of the deputy governor?

Dr Parkinson—What I am saying is there is no pattern. So the Treasurer could choose how he wishes to do it. He may decide he knows whom the appropriate candidates are, he may decide to ask us to assist him or he may decide to appoint someone outside to help compile a list of candidates.

Senator SHERRY—That is it.

CHAIR—Thank you very much indeed, Dr Parkinson. You are excused.

Dr Parkinson—Thank you.

[2.03 p.m.]

CHAIR—We continue with output group 2.1.

Senator SHERRY—I want to stay on the same theme of appointments. I know from the Finance estimates, because the Future Fund board is a joint Minister for Finance and Administration-Treasurer, a list of possible appointees is provided to the Treasurer.

Mr Tune—Yes. In late August last year a list was provided to the Treasurer, or to the Treasurer's office at least.

Senator SHERRY—Any further additions to that?

Mr Tune—No. I do not know whether there is anything to add. Mr Flavel might be able to add something; I am not sure.

Mr Flavel—No, there has not been anything further. I think we covered this in a previous hearing, but some people have written in to the ministers, putting their names forward. Those

names would have been added to the list, but that was just simply adding names to the bottom of the list, if you like, for completeness.

Senator SHERRY—Has there been a request, Mr Tune, for your area to be involved in any background checking-verification of any description of any names?

Mr Tune—No.

Senator SHERRY—None at all?

Mr Tune—No. I can confirm that.

Senator SHERRY—That makes it short and sharp, in this area anyway, and I suspect there will be a sigh of relief. This morning there was some discussion about domestic economic policy advice on the ‘minerals boom’. The issue of impact or issues relating to revenue are not your—

Mr Tune—No, that would be Revenue Group output 3.

Senator SHERRY—Okay; we will get to them. In relation to the examination of child-care expenditure, is Treasury doing or has it done any analysis of work force participation implications with respect to child care?

Mr Tune—Of the impact of child care on participation, no, we have not done anything—certainly nothing in any detail. We are constantly doing work or monitoring analyses of issues around work force participation. It is sort of a major theme of our work. But there has been no detailed analysis of the relationship between child care and work force participation.

Senator SHERRY—So work force participation, yes, but the issue of child care specifically—

Mr Tune—There is the issue of child care being important in the context of work force participation for certain groups, but it does not go much beyond that at this stage.

Senator SHERRY—So work will be done; is that what you are indicating?

Mr Tune—Not necessarily, no. If we were asked to do some work, we would. Going back a couple of years, we did do a lot of work on the changing demography, the ageing of the population, and we put out a publication called *Australia's demographic challenges*. That included some discussion, I suppose, of the relationship between child care and labour force participation and noted that it is an issue of substance.

Senator SHERRY—Has there been any examination with respect to labour force implications of other issues, for example child-care expenses being tax deductible?

Mr Tune—Not by Fiscal Group. Any analysis of tax deductibility of child care or anything else would be undertaken by Revenue Group.

CHAIR—Thank you, gentlemen, you are excused. Minister, is it proposed that we take the Revenue Group of Treasury and the ATO together? That has been the custom in the past.

Senator Minchin—Sure. Senator Coonan was going to replace me when we got to the Taxation Office.

CHAIR—We shall suspend proceedings for five or 10 minutes while those arrangements can be made.

Proceedings suspended from 2.12 pm to 2.25 pm**Australian Taxation Office**

CHAIR—I welcome to the table the Minister for Communications, Information Technology and the Arts and newly appointed Deputy Leader of the Government in the Senate, Senator Coonan, and the officers concerned in Revenue Group of Treasury and the Australian Taxation Office. In particular I welcome Mr D'Ascenzo, the Commissioner of Taxation, who is making not his first appearance before this committee but his first appearance in this capacity. Welcome, sir, and congratulations on your appointment.

Mr D'Ascenzo—Thank you.

CHAIR—I think we will proceed directly to questions, unless you want to say anything, Minister?

Senator Coonan—No, I have no opening statement.

Senator SHERRY—Congratulations on your appointment, Mr D'Ascenzo. You are not new to estimates but are new to the position; so congratulations. Perhaps we could clear up a matter I referred to earlier. I referred this morning to an unanswered question by my colleague Sharon Grierson with respect to missing laptop computers. This question was put on notice in the House on 7 March 2005, some 10 or 11 months ago, and there has been no response. Can I have an explanation as to why there has been no response to a question on notice?

Mr Farr—That particular question on notice is still with the minister's office. Although I do not have the information specifically regarding the breakdown by offices that was asked for in that question, as I understand it, I can certainly give the committee information around the number of lost-stolen laptops in total et cetera, if that would be of any assistance to you.

Senator SHERRY—Just before we get to that, when approximately was an answer sent—was it to the Assistant Treasurer's office or the Treasurer's office?

Mr Farr—My understanding is the Assistant Treasurer's office. I think it actually got misplaced between changes of ministers and things like that.

Senator SHERRY—Even if that were the case, the change in Assistant Treasurer occurred four or five weeks ago approximately, did it not?

Mr Farr—Yes.

Senator SHERRY—That takes us back to January. That is not an explanation, given the question was put on notice in March last year.

Mr Farr—As I said, my information is that it is with the Assistant Treasurer's office and that somewhere along the line it actually had fallen through the cracks. But I am able to give some information, if that is of assistance to you.

Senator SHERRY—Okay, but I still have unanswered: do you know on approximately what date the answer that you provided to the Assistant Treasurer's office was actually sent to the Assistant Treasurer's office?

Mr Farr—I may have. No, I am sorry, I do not.

Senator SHERRY—Can you take that on notice?

Mr Farr—Sure.

Senator SHERRY—At the end of the day, I am not going to be critical of the Taxation Office if it turns out that it was sent in a reasonable amount of time to the Assistant Treasurer's office and it got stuck there.

Mr Farr—Yes. I will take that on notice.

Senator SHERRY—And the information that you have for us?

Mr Farr—I am not sure how much detail you want me to go into, but I can tell you, for example, for the last completed year, which is 2004-05, the total number of laptops that the tax office actually had issued was 5,221. Of those, we had actually lost 19, which is 0.36 per cent of the laptops that we had issued. We had had a further 21 stolen, which was about 0.4 per cent of the total number that we had issued. So in total 40 laptops were either lost or stolen during 2004-05, which is about 0.77 per cent of the number that we had issued.

Senator SHERRY—It is not just the number that is the issue, although I contrast that with the earlier evidence from Treasury. I think they reported one.

Mr Farr—Yes, but we have a significantly higher number, I would think, plus we have a mobile work force that is out of the office quite a lot.

Senator SHERRY—I think equally as important, if not more important, in relation to stolen or missing laptops is the issue of security and the information contained therein.

Mr Farr—Sure. All our laptops are fully encrypted to DSD certification. So there is no way that anyone who picked up a laptop would actually access any data that is on it. The ones that are used by our field staff by and large are also protected by a smartcard as well as a password. But, as I said, we have DSD standard encryption. So there is no way that a person would be able to get hold of any data that was actually on them.

Senator SHERRY—You can guarantee that—absolutely no way? I am told in the world of computer technology nothing is foolproof.

Mr Farr—Nothing that a normal person or a normal hacker or a normal thief would be able to decrypt. I am not sure about intelligence agencies and things like that. But, leaving them aside, no, they would not be able to get into them.

Senator SHERRY—And approximate value?

Mr Farr—It is hard to put a value on them because we lease that equipment from EDS. If we have lost them or had them stolen, we agree on a book value, which is a depreciated value. A significant number of the ones that we had were quite old. Our mobile computing platform is quite old. They have no book value at all. So they were in essence valueless. We are not paying for them anymore. If I had to give an average on the others, they were probably a few hundred dollars, and that is the written-down value.

Senator SHERRY—When a laptop is stolen, presumably the officer concerned reports it?

Mr Farr—Yes.

Senator SHERRY—Is there any follow-through? Regardless of whether we believe these systems are safe, secure and impenetrable by anyone except perhaps intelligence services, there is the potential that a stolen computer may have been stolen for the purposes of access.

Mr Farr—As soon as one is either lost or stolen, the incident is raised and reported. Those out in the field are most commonly the ones that are lost or stolen. If they have smartcard protection, we immediately cancel the smartcard so that, even if someone did get hold of a smartcard of some description or other and tried to get in, that would be locked down. They are all reported through to our security area, and the security people go through the circumstances of it and do any follow-up that is necessary.

Senator SHERRY—Thanks for that information. I want to turn to another issue. Commissioner, you or maybe other officers may wish to respond in detail. I want to go to the interpretation of section 26-52 of the Income Tax Assessment Act. That covers bribes and facilitation payments. Section 26-52(1) says:

You cannot deduct under this Act a loss or outgoing you incur that is a bribe to a foreign public official.

There is a similar section in the Criminal Code Act 1995. Are you aware of that particular provision?

Mr D'Ascenzo—Yes, I am. My officers are as well.

Senator SHERRY—Just as a facilitation payment is not a bribe under the Crimes Act, similarly a facilitation payment is tax deductible as distinct from a bribe. Would you agree that the definitions of a facilitation payment in both the Crimes Act and the Income Tax Assessment Act are very similar?

Mr D'Ascenzo—I am not sure about the Crimes Act.

Mr Monaghan—Yes, they are largely similar.

Senator MURRAY—Do you have copies?

Senator SHERRY—I do have copies here, I think.

Senator MURRAY—Of the definitions?

Senator SHERRY—Of the definitions, yes. It is not critical in the sense of the Crimes Act.

Mr Monaghan—They are very long definitions.

Senator SHERRY—Yes. In the event of an individual or a company making a false expense claim deduction and it is brought to the attention of the tax office, what action would the tax office take with respect to that taxpayer?

Mr Monaghan—We take account of information from a broad range of sources. If there were information that suggested a significant risk, that would be part of a risk grading within the organisation as to whether audit action might be undertaken in relation to that information.

Senator SHERRY—So you have the ability to go back and audit to check whether that occurs?

Mr Monaghan—Yes.

Senator SHERRY—If it were found not to be an allowable deduction, reassessment?

Mr Monaghan—Yes. That would be normal, yes.

Senator SHERRY—Is there any statute of limitations, a limited period in which you can go back in these circumstances?

Mr Monaghan—I think it does vary depending on the nature of the amendment. I think it is now two years for most taxpayers. If there is fraud or evasion, it is forever.

Senator SHERRY—Forever?

Mr Monaghan—No, just under the amendment provisions of the act. If it were a deduction issue there are time limits of between two and four years, depending on the legislation.

Senator SHERRY—So in the case of fraud or evasion, though, forever?

Mr D'Ascenzo—That is right.

Senator SHERRY—What is the range of penalties that would be applied in addition to obviously the direct tax assessment that would apply in circumstances?

Mr D'Ascenzo—Again, it would depend on whether or not there is fraud or evasion. If there is fraud or evasion, the penalty regime gets to 60 per cent of the tax shortfall.

Senator SHERRY—Do you have a discretion in the application?

Mr D'Ascenzo—The law imposes a position, an amount, and the commissioner does have a discretion to remit based on circumstances such as cooperation, whether a matter is reasonably arguable—those sorts of issues.

Senator SHERRY—The Income Tax Assessment Act describes facilitation as:

An amount is not a bribe to a foreign public official if it is incurred for the sole or dominant purpose of expediting or securing the performance of a routine government action ...

Mr Monaghan—Yes.

Mr D'Ascenzo—‘Of a minor nature’.

Senator SHERRY—Yes, ‘of a minor nature’.

Senator Coonan—It is specified in the act.

Senator SHERRY—‘Minor nature’, yes. We will get to the minor nature some time soon. In contrast, the Criminal Code requires not only the same criteria, through part (b), as in the ITAA but also two further conditions. To make out a defence against bribery it is necessary to show that, as soon as practicable after the conduct occurred, the person made a record of the conduct and also that the value of the benefit was of a minor nature. Referring to my earlier question about assessment problems, from the ATO’s perspective do the slightly different definitions contained in the Criminal Code and the Income Tax Assessment Act present any practical problems?

Mr Monaghan—We do not believe so. Our view is that the policy intent is reflected in the wording. In terms of our legislation, it is about a tax deduction and whether or not that is allowable. The Crimes Act is about a criminal matter. You might expect there to be more precision in that wording. So we do not believe there is any particular issue in that.

Senator SHERRY—Just to go back to the penalty provision, does the 60 per cent that you referred to include interest penalty, that is, the specific penalty on top of the amounts?

Mr D'Ascenzo—When I was referring to 'penalty', I was referring to what we call culpability penalty. Interest is a different element that is designed to capture time value of money concepts. You have a debt, then you late-pay the debt and then interest applies or there is an adjustment to a previous year which gives rise to a debt, which gives rise to a liability and, therefore, the interest then applies from that previous date.

Senator MURRAY—If the amount is \$100 million and you applied 60 per cent and it was \$160 million, the interest is on \$160 million, is it not?

Mr D'Ascenzo—Not necessarily. It is on \$100 million in relation to that period prior to the date of payment, and then it is on what remains outstanding, which is the \$160 million if there is not payment of the amount once that is recorded.

Senator SHERRY—What is the current interest charged?

Mr D'Ascenzo—With the changes under the review of self-assessment, I am not quite sure what the interest rate charged is for the pre-assessment period, that earlier part that I referred to as being reduced. Let us say it is in the order of eight per cent. Once the debt becomes due and payable and there is a late payment component, there is an addition to make it, let us say, 12 per cent or thereabouts. Those figures are not accurate, but it is in that order.

Senator SHERRY—So if there is an assessment carried out and an amount is payable going back, say, five years—I just want to be clear about how it would apply—it would be X amount the base figure plus eight per cent each year cumulative?

Mr D'Ascenzo—I am not sure whether it is cumulative or simple. I think it is cumulative from the year 2000.

Senator SHERRY—Let us take 2000. The base figure plus eight per cent cumulative, five years—it will be more than eight by five.

Mr D'Ascenzo—That is right.

Senator SHERRY—So it would be higher than 40 per cent.

Mr D'Ascenzo—That is right.

Senator SHERRY—So 40 per cent, if it were on five years, plus a culpability penalty, as you mentioned. I just want to be clear on this. That 60 per cent would be applied on top of the total, including the eight per cent we have been discussing?

Mr D'Ascenzo—No, it is on the—

Senator SHERRY—On the base figure. If it is five years, it will be around 100 per cent.

Mr D'Ascenzo—That is right.

Senator SHERRY—Approximately.

Mr D'Ascenzo—I am not sure whether it is 50 per cent or it is 60 per cent, but the same outcome arises in both. For the purposes of discussion, it is the same conclusion.

Senator SHERRY—The range appears to be in the area of 90 per cent to 100 per cent.

Mr D'Ascenzo—Yes.

Senator SHERRY—For a base figure going back five years.

Mr D'Ascenzo—That is right.

Senator SHERRY—As far as 1990.

Mr D'Ascenzo—In relation to fraud and evasion.

Senator SHERRY—I am sure you have made decisions about what constitutes a major facilitation payment as distinct from a minor facilitation payment.

Mr D'Ascenzo—I think they depend on the facts and circumstances. I am not sure we have categorised every situation, but we are reviewing our guidelines and trying to provide more guidance to our people in that regard.

Senator SHERRY—Obviously I accept it depends on the circumstances, but what sorts of circumstances in respect of a major facilitation payment?

Mr Monaghan—I am not aware of any case. No case on this has been brought to my attention.

Senator SHERRY—You have not had a case of this before, or it has just not been brought to your attention?

Mr Monaghan—I have been looking at the provisions, including for working with the OECD last year, and no cases on these terms and definitions have been brought to my attention.

Senator SHERRY—So you have been looking at the provisions. No case has been brought to your attention?

Mr Monaghan—No. I am assuming you are asking about decided cases. You asked me whether there had been an interpretation, so I meant a decided case.

Senator SHERRY—Are any companies currently being investigated in this area?

Mr Monaghan—Not by my area.

Senator SHERRY—You are looking for some help, I notice, Mr Monaghan. Is there someone who can help us?

Mr Monaghan—I am more across the broader issues. My colleague is more across audit issues.

Mr D'Ascenzo—The explanatory memorandum which accompanied the changes stated that an example of a payment made to secure a routine government action of a minor nature is where, upon arriving in a foreign country, a businessperson is informed that his or her visa is invalid and that a fee must be paid to a foreign public official for the sole purpose of expediting the issue of a new visa. So the matters that I think are intended to be there are of that type, of a minor nature.

Senator SHERRY—I am glad you have given us that example because that is not really an example I have in mind. It is a useful yardstick.

Mr Monaghan—I was going to mention some of those provisions. As I said earlier, the definition is quite lengthy and does spell out a range of the sorts of payments which would be considered facilitation payments. As the commissioner indicated, that is a good example. Another good example would be ensuring that your refrigerated container was plugged in and turned on at the port whilst it was waiting transit. So it is generally in the nature of services to which you are entitled. I look at it as almost like a tip paid in advance.

Senator SHERRY—Ms Martin, are you able to help me with respect to my earlier question? Are there any companies being examined at the present time?

Ms Martin—There would be a range of companies. We look at a range of issues with a number of companies. I am not in a position to say specifically. We do follow up information from a range of sources, such as media articles, for any deduction that may not be allowable. When people let us know what is happening, we also use our own mechanisms to detect deductions that may not be allowable. When we see those issues, we do follow up.

Senator SHERRY—If something comes to your attention through the media, you would carry out a preliminary check to try to ascertain some details?

Ms Martin—That is our normal course of action. Often things are reported in the media, as you know, that we may already be aware of and we may have already undertaken our own risk assessment and our own actions. So we generally monitor the media and follow up information in there to make sense of it of a compliance nature, and then we follow up from that point for appropriate tax adjustments if necessary.

Senator SHERRY—In the case of a \$300 million facilitation payment—let us use that as an example—that came to your attention and was called by local authorities as a facilitation payment, given the size of such a payment, given the earlier example we have had, would that be an issue of interest in respect of the Income Tax Assessment Act?

Senator Coonan—Mr Chairman, I think it is appropriate at this point—I wanted to let Senator Sherry proceed with his questions—for me to say something to the committee about what appeared to be an issue that had been unresolved this morning. Earlier today, as I understand it, Senator Sherry made a statement to the effect that the Wheat Export Authority had responded to questions in relation to matters before the Cole inquiry, and this of course refers to the government's direction to officials concerning matters that are currently the subject of the Cole inquiry. I am in a position to provide some clarification of the position that the government takes in this matter.

My understanding is—and this issue will come up obviously with later agencies—that Senator Sherry asked whether the ATO, ASIC and APRA would be in a similar position by virtue of being statutory authorities. The position, at least in respect of the Commissioner for Taxation of course, is that the commissioner and the second commissioners are agency heads under the Public Service Act—despite, of course, being statutory appointments, which they clearly are—and all other officials, at least in the ATO, are subject to the Public Service Act and certainly on the government's interpretation would be subject to the direction.

I am trying here not to be excessively legalistic. I understand that, with the flow of questions, certain questions—as I think the chair pointed out this morning—may be entirely proper questions, but the direction would mean that officials who are subject to the direction

would not respond. I did think it was an appropriate time, given the way in which your questions were going, Senator Sherry, to make that statement.

Senator SHERRY—I had not mentioned the AWB.

Senator Coonan—You had not, but it is appropriate that I clarify that for you, for the committee and indeed for the officials.

Senator SHERRY—Thank you. I will proceed with my questions. Can I have an answer to that question?

Ms Martin—My answer is about generally any transaction of that size.

Senator SHERRY—Yes. I have used by example the purely hypothetical figure of \$300 million.

Ms Martin—Anything of that size, even in a large market client, would warrant a review if, when we looked at it, it looked as if there were a real question about deductibility or otherwise. The question of deductibility or otherwise turns on the interpretation of the tax law deductibility. So, whether it is this issue or any other issue, as I said, we would look at it.

Senator Coonan—And of course it is hypothetical.

Senator SHERRY—So far. A 90 per cent to 100 per cent penalty would be a probability if that \$300 million were found to effectively be a bribe?

Mr D'Ascenzo—That is what the law provides.

Senator SHERRY—Yes. That is what we have been through, taking the figure close to \$600 million.

Mr D'Ascenzo—It is of the tax avoided. So it depends on how much tax it is.

Senator SHERRY—There is currently a commission of inquiry taking place. Does the Taxation Office have any officers either at the commission or examining material presented to the commission?

Mr Monaghan—We do not have any officers physically at the commission. But, as we have indicated, we would typically monitor any activity along those lines, be it in the form of a commission or media or information from the community. So we are keeping an eye on the information emanating.

Senator SHERRY—When the inquiry concludes its deliberations and makes its findings, will the Taxation Office seek that documentation and the evidence and material presented therein?

Mr Monaghan—I cannot answer that at the moment. I guess that would depend on the circumstances.

Senator SHERRY—You have not made a decision yet? There has been media coverage. You have not made a decision yet to explore further beyond that media coverage?

Mr Farr—I think that would be getting into the affairs of an individual taxpayer, which it would not be appropriate for us to go into here. As Mr Monaghan said, we monitor all of those things and, as Ms Martin said, it forms part of our risk assessment process. So it depends on the outcome of that risk assessment process from all sorts of information. But I do

not think it is appropriate to go into something that may be able to be tied back to an individual taxpayer.

Mr D'Ascenzo—Generally speaking, in relation to all sorts of inquiries, often we wait until the outcome of those inquiries to make our judgments on the basis of the findings of those processes.

Senator SHERRY—Findings, but also the material presented, I would have thought, because the findings of a commission of inquiry, whatever they may be, may or may not be directly relevant to any potential tax owed.

Mr D'Ascenzo—That is right.

Senator MURRAY—Hypothetically, if someone were in a court case or an inquiry and were accused of bribery and said, 'It cannot be bribery because the Taxation Office has already accepted it as a facilitation payment; it was an allowable facilitation payment,' would you ever query or revisit such a claim? I presume it is claimed on a basis of self-assessment. You might not have checked or validated such a claim.

Mr D'Ascenzo—I do not know what the outcome might be in that hypothetical. If that were not a correct statement, then that person would be subject to perjury before those committees.

Senator MURRAY—But it would be correct on the face of it if it has already been accepted in the tax office returns, unless you had revisited those returns and made a new ruling. On the self-assessment system it is accepted. So a person would be justified in saying to a court or a royal commission or any other inquiry, 'You may be accusing me of bribery, but the tax office has accepted it as an allowable payment.'

Mr D'Ascenzo—It is possible, but even in that case the tax office's acceptance of it would not preclude the application of the criminal law or other laws for that matter.

Senator SHERRY—Has the Cole royal commission made any contact with the tax office?

Mr D'Ascenzo—Not that I know of.

Senator SHERRY—And vice versa to this point in time?

Mr D'Ascenzo—That is right.

Senator SHERRY—You are personally not aware of any, or you are not aware of any on behalf of the other officers?

Mr D'Ascenzo—I think my awareness is correct.

Senator SHERRY—In circumstances where prima facie a bribe may have occurred, do you examine the auditor or the auditing of the accounts?

Mr D'Ascenzo—Our processes really depend on the circumstances of the particular case. To the extent that there is fraud or evasion, there may be consideration of the role played by the adviser in those cases and whether that adviser is complicit in those arrangements.

Senator SHERRY—An OECD report was released on 4 January 2006: *Australia—phase 2: report on implementation of the OECD anti-bribery convention*. Is anyone familiar with that?

Mr Monaghan—Yes, I am.

Senator SHERRY—On page 4 of the report it says:

The defence of facilitation payments was also identified for further monitoring because of concerns such as the practical effectiveness of the record-keeping requirement and the prohibition against facilitation payments under some State criminal codes.

Are you aware of any measures being taken in relation to that recommendation?

Mr Monaghan—In relation to that recommendation, my understanding is that the committee that prepared this report accepted the approach that was in the Australian tax law and is proposing to come back in about a year's time to look at the practical application of that particular provision. As we indicated in our response to the report, we are already preparing, following our initial discussions some time ago with the OECD, a better manual for our officers on these provisions, and the OECD when they return will get our cooperation in looking at the application of those provisions.

Senator SHERRY—It could be called a criticism in this report that current Australian laws do not impose a positive duty on auditors or public officials to look for evidence of bribery of foreign government officials?

Mr Monaghan—I am in a difficult position, because the policy framework is set by the parliament, and what the OECD was commenting on was the way the law works. The laws, as I understand it, are the Attorney-General's responsibility, and the Treasury for the tax law. I believe the OECD gave Australia a reasonably positive report and flagged a number of provisions in relation to tax that we are currently working on.

Senator Coonan—Senator Sherry, my recollection is that when the parliament enacted the legislation pursuant to the convention it was really meant to be on all fours; there was not much interpretation between what we enacted and what the convention originally set out. This may be some other development. I can remember conducting a joint treaty inquiry into this and at the same time looking at the legislation that we proposed to implement, and I do not recall that having been a criticism at the time.

Senator SHERRY—This was 4 January this year.

Senator Coonan—I understand it is more recent.

Senator SHERRY—It is very recent. Are you aware why the OECD working group in its report expressed concern about the abuse of facilitation payments?

Mr Monaghan—In relation to the tax aspects of facilitation payments, my understanding of what the committee found was that they wanted to come back and look at whether our procedures adequately implemented the law as passed. I am not in a position to comment, nor would the tax office be I suspect, on the broader policy questions covering the bribery provisions.

Senator SHERRY—Obviously you have to enforce the current law, the statute?

Mr Monaghan—Yes. We only enforce the tax law obviously, not the crimes law.

Senator SHERRY—Going back to an earlier comment, obviously you are looking at your manuals, but they are practical implementation of existing law issues?

Mr Monaghan—Yes.

Senator SHERRY—I cannot recall, when I was briefed on this, that the tax office was specifically criticised for its manual?

Mr Monaghan—The working group did make a recommendation that we give additional guidance.

Senator SHERRY—Going back to your response of a couple of questions ago, I took it to mean that you are having a look at examining the law in this area?

Mr Monaghan—What I am looking at is whether we provide adequate guidance to our officers to ensure that the law is effectively applied as it stands.

Senator SHERRY—That is current law as it applies?

Mr Monaghan—Yes.

Senator SHERRY—But is there any examination of existing law and possible changes being undertaken at the present time to refer on to government for possible enacting?

Mr Monaghan—I am not aware of that, but that would be a matter for Treasury, not for us.

Senator MURRAY—Just on that same line of questioning, if I may, one thing that might trigger the need for a re-examination by Treasury is if the existing provision was ineffective, namely, that you were not discovering and acting on instances of bribery in our community, because it is impossible to envisage a country where no bribery ever occurs. The question is—and you might want to take it on notice, because I am not sure you would have it readily to hand—in a general sweep of tax returns to you have you had cause to exercise and use that bribery provision so that you overturn a previous self-assessment and impose a penalty because what somebody has claimed was a fee was in fact a bribe?

Ms Martin—I can talk in general terms about how we would approach an issue like this. The legislation is relatively recent.

Senator MURRAY—My question is quite specific. I want to know if the provision in the law has been used and, if it has been used, how often, if it is possible to tell me. It might not be possible to tell me that.

Mr D'Ascenzo—I do not know if it is possible. We will certainly take that on board and see whether or not we can work out whether adjustments have been made under that provision, but I am probably forewarning the committee that I do not think our systems are sufficiently flexible to do that. Talking about the wide sweep of things, just from my own knowledge of our operations I cannot recall that provision being used over the last few years. What happens is that you do not often see in the return a facilitation payment, and it is often done through a range of more complex offshore arrangements and hidden under more difficult processes. When we look at these activities, it is a question of what we see on the face of the information that is available to us and whatever intelligence we have from other sources and other activities as to what seems to be amiss or worth inquiry in relation to particular matters, and we do what follow-up we can in those cases.

Senator MURRAY—That adds weight—and it is why I have pursued Senator Sherry's quoting on the positive onus on auditors—to the view that the people most likely to know that

that has happened and to have the integrity to report it would be auditors, but they need perhaps the encouragement of law to do so, namely, a positive obligation to do so. If it is not being thrown up naturally by the system, they would be the only people probably likely to throw it up otherwise, I would have thought.

Senator SHERRY—I take your point that it would be I think very unusual to see the description ‘facilitation payment’ in the accounts. One of the responsibilities, it seems to me, of an auditor would be to verify in the accounts in more detail the expenditures. That would be the normal job of an auditor when looking at accounts, would it not?

Mr D’Ascenzo—Various other areas look at audit responsibilities and work. I am not sure just how far behind the provisions they need to go to satisfy their statutory responsibilities. It is really outside my field of expertise.

Senator SHERRY—I take your point. Given circumstances where there is a deliberate decision made, it would be more likely to be described as something quite different, would it not? ‘Trucking payment’, for example, would be a convenient head to put this under?

Mr D’Ascenzo—It could be a range of things. As I said, if there were some intentional activity to get into fraudulent or evasive activity, I do not think they would put it under the heading of ‘facilitation payment’. As you pointed out previously, if that facilitation payment is large, we would under our processes see if there is a risk.

Senator SHERRY—Is the manual a publicly available document?

Mr Monaghan—It is not at the moment.

Mr D’Ascenzo—Typically, we would put those sorts of documents on our website.

Senator SHERRY—Can the existing manual be made available? You have indicated it is not available.

Mr Monaghan—No, I think this is the first internal manual. We would have been working off the explanatory memo and that sort of material otherwise.

Senator SHERRY—When could we expect this revamped manual to appear?

Mr Monaghan—I expect that that will be available in a very short time. It is just awaiting some technical clearance at the moment. It is close to being ready.

Senator SHERRY—A couple of weeks, a month?

Mr Monaghan—A few weeks, I would say.

Senator SHERRY—Going back to the relatively minor differences between the Income Tax Assessment Act and the Criminal Code sections that we had a brief discussion about, I think you indicated that you did not see any particular issue or problem emerging from that difference?

Mr Monaghan—No, I do not.

Senator SHERRY—Have the Taxation Office to this point ever reassessed and imposed penalties with respect to facilitation payments where they have discovered them? Has there ever been a case in recent times?

Mr D'Ascenzo—The provision came in in the year 2000, effective from about that period. It is only the last five years that that could have occurred. As far as I know, it has not occurred. I do not know if anybody knows—

Mr Farr—I think that is Senator Murray's question that we have taken on notice.

Senator SHERRY—I do not have any further questions on that issue.

CHAIR—Would you like a break?

Senator SHERRY—Yes, I am happy to.

CHAIR—We will pass the call to other senators. Senator Parry had something; he was first in the queue. Then we will go to you, Senator Fielding. Senator Murray, do you have anything? Is it all right if we take it in that order, Senator Parry, Senator Fielding, Senator Murray?

Senator PARRY—My questions relate to the interest benchmark rates used for sections 109M and E for the Income Tax Assessment Act. Who is the best person to answer that question?

Mr Farr—Is that the general interest charge provisions?

Senator PARRY—It is the interest benchmark rate that is utilised. I have some questions about how the rate is determined and when the rate is determined. It is for company loans to shareholders.

Mr Farr—Mark Konza is in charge of our small business area.

Senator PARRY—The rate is published on the website on an annual basis. This basically stems from constituent inquiries. How is the rate determined?

Mr Konza—I think I am going to have to take that question on notice, because it is a specific question and I think I would be speculating if I answered it today.

Senator PARRY—That is fine. The rate is published on the internet a year in advance, and I notice for the year 2004-05 the interest rate, which was 7.05 per cent, was published on 7 July 2004, and there is nothing on the website to indicate the rate for 2005-06. You might need to take that on notice as well.

Mr Konza—Yes, we will.

Senator PARRY—I must commend the Taxation Office on the website. It is a great website and is very useful for constituents and taxpayers alike. Finally, once you have established how the rate is determined, is that rate used in any other application apart from sections 109E and 109M of the Income Tax Assessment Act?

Mr Konza—Not to my knowledge. To my knowledge, that rate is set as a result of a survey of commercial interest rate terms and it is only used in that context, setting that benchmark rate.

Senator PARRY—There has not been one over the past few years, but if there was a huge interest rate differential on the commercial market for that year would that benchmark rate be altered at all or is there a provision for that to be altered by the commissioner?

Mr Konza—You are asking whether there is a discretion to manually change it?

Senator PARRY—To reflect it, yes.

Mr Konza—I would need to take that on notice.

CHAIR—I do not think there is, Mr Konza. Look at section 8AAD of the Taxation Administration Act.

Senator FIELDING—My questions focus around a program that is described as being easier, cheaper and a more personalised program or the Change Program. What is the Change Program designed to achieve?

Mr D'Ascenzo—It has a number of objectives. It arose a few years back out of a program which we call Listening to the Community. We went to various community groups, focus groups, we engaged some external facilitators for that process and we asked people what were the problems and what issues and irritants did they have that perhaps we could do something about to improve. We found that a lot of the irritants related to the way our systems had been developed over 20 to 30 years, having been pioneers in systems development in terms of tax administrations around the world. Those systems were becoming older, they were not integrated, they had high maintenance costs and, therefore, some of the things that people needed to do to transact were not as easy as we thought to provide to them or not as easy as our taxpayers thought they could be, particularly tax agents. A lot of those focus groups were with tax agents.

Basically, we have a proposition of saying, 'How could we provide you with a better service to meet the sorts of expectations you have?' Some of the services were about how we could provide better phone contacts. After the new tax system, we had very high levels of phone inquiries, people asking about issues such as how much tax they owed and how much their total bill was. We had agents trying to get that information as well. Because the systems were modular in the sense that they did not integrate with a running balance, so to speak, we had to pull down nine different systems to try to provide that sort of service. Basically, we were not able to provide that service to taxpayers without some improvement in our basic infrastructure.

Another area of telephony was in relation to people who ring up. They go to one operator and then, after a period, either that call is proceeded with or they then remember something else and come back and nobody knows the history. Or even when you are dealing with the same operator our own staff person does not know your own compliance history. We thought something that could provide us with some ability to understand the history of the taxpayer would help us provide them with better answers.

Then we found out that how we managed our case management system was also very expensive for us, in the sense that we had many case management systems that were directed to particular areas but they were not integrated. Once a taxpayer's matter went out of this area and went into another area, as an organisation it was difficult for us to track. When people came to us and said, 'How is my matter going?' it was a fairly difficult task to answer that—in fact, an impossible task—without a number of interventions. That is why we call the program the easier, cheaper, more personalised program. Ultimately, it also had to do with a robust infrastructure for the tax office. We had to have an infrastructure that provided flexible systems because, as laws might change, the effective delivery of those laws would require a

system that was able to be built on rather than the legacy systems that are very difficult to adapt.

Point 2: the integration itself I think allows us to provide an extra level of service and really an extra level of differentiation. We can take people's circumstances better into account in trying to tailor both our help and active compliance strategies to that market. I see that investment in the Change Program as an investment in lifting tax office performance an extra notch. If you look at the contract we have with our integration partner, you will see that the contract is all about trying to produce outcomes for the community rather than delivery of particular widgets or boxes and dices. It is really about trying to provide that bit of service to provide a more integrated and flexible system. It is a challenging investment which I see as a launch pad to improve our administration. Greg is formally in charge of that area.

Mr Farr—I think that is a good general summary. I am happy to go to any specifics.

Senator FIELDING—Last year's expenditure is over \$100 million on it?

Mr Farr—Off the top of my head, yes, it is \$150 million or something like that.

Senator FIELDING—What is the overall budget for that program?

Mr Farr—It is a four-year program. The total cost over that four years is around \$453 million, so that is not just money that is paid out to partners and others, but it is our own internal costs. It includes depreciation, so it is a full absorption costing.

Senator FIELDING—When did that start?

Mr Farr—The contract was signed and we officially got under way in December last year. We had done some much earlier work to provide some of the facilities that the commissioner has mentioned, particularly for tax agents that were suffering with not being able to access the sort of information they needed to complete their clients' affairs.

Senator FIELDING—How is it being funded? Is it allocated budget, is it out of savings, is it straight cost or are there savings involved as well?

Mr Farr—Over time it is to be self-funding. Our business case is self-funding over the course of the program and beyond. It is within our own funding base. We have not sought additional funding from government to do that. Largely we are funding that from the depreciation of our existing systems. We have actually built up some cash reserves through depreciation, which is normal under a pure system, which we are now using to reinvest into our systems.

Senator FIELDING—Over what period do you see it self-funding? You said it is a four-year program.

Mr Farr—The payback period, or the return on investment, is 6.1 years, from memory, which if you were looking at it from a purely commercial perspective is not an attractive payback; but, as the commissioner said, our primary objective was actually to provide better levels of service and to make the experience of dealing with the taxation system better for the community. That is our primary concern, and to do that we are looking at the way to actually fund that internally rather than go back and seek additional funding for it.

Senator FIELDING—What was the payback period again?

Mr Farr—It is 6.1 years.

Senator FIELDING—The sources of funds are allocated from savings or is it a separate business case? What was the break-up again?

Mr Farr—It is all covered by a very detailed business case, but the sources of funds are internally funded, so each year the Taxation Office has a level of capital and operational expenditure available to it. Traditionally we have not always spent all our capital, so that is a very significant part of reinvesting that capital expenditure.

Senator FIELDING—So the figure of \$453 million includes all sources of funds.

Mr Farr—Yes, it does. That is total costs.

Senator FIELDING—How much of the overall budget still remains to be spent on the Change Program?

Mr Farr—I would have to take that on notice. I could give you an approximate answer.

Senator FIELDING—Approximately?

Mr Farr—In round terms \$300 million of the \$453 million, perhaps a little bit less—somewhere between \$250 million and \$300 million.

Senator FIELDING—It is, say, 40 or 50 per cent complete as far as the money side of things?

Mr Farr—We have broken up the program essentially into three very major releases. The first release, as the commissioner mentioned, was to provide our telephony staff with a view of the client, to actually allow them to provide a better service in telephony. That roll-out was completed in December last year. In May through to December this year we will have our second major release, which will be a further roll-out to people in telephony that have escalated calls as well as replacing our existing case management systems with a single case management system to once again provide a single view of the client. At the same time we will be starting to image all letters that come into the Taxation Office; so, instead of letters coming in and being passed around for some period of time, they will actually be imaged when they come in and they will be work flowed through to people. We are just about to go through to deployment of that. The third major release, which is in December 2007, will be basically replacing all our mainframe computers with a new processing system—an accounting, registration system. That is the point we are at at the moment: we are just about to implement. We have finished virtually building and are now ready to deploy the second of the three major releases.

Senator FIELDING—So what has been spent so far is about 30 or 40 per cent? I will not hold you to it. I am just trying to get a rough feel. It is obviously not 80 per cent.

Mr Farr—It would be around that number. It is somewhere between 30 and 40 per cent. We have a program of work obviously, and we are currently within about one per cent of our budgeted expenditure. So we are virtually right on budget at the moment.

Senator FIELDING—How much has been spent on the first phase so far of that?

Mr Farr—Once again, I would take that on notice. In the last year I think it is around \$150 million to \$170 million.

Senator FIELDING—You said there was a contract signed in December last year. Was that to do with other work, not this work? Obviously it was signed in December and something was delivered in December.

Mr Farr—No, sorry, I have got my years mixed up. It was actually December the previous year.

Senator FIELDING—Thank you. It did not seem to make sense to me. So December 2004 the contract was signed.

Mr Farr—That is right.

Senator FIELDING—What has been delivered is obviously the telephony part of it. Have you measured what has been achieved through that? Obviously you have had some time now to look at that.

Mr Farr—It is difficult at this early stage, and we completed that roll-out in December last. We are tracking that and our business case very clearly sets out what needs to be tracked and what outcomes we would expect to see. As with any of the major programs of this nature, what you actually expect initially is a productivity dip as we bed in our new systems but also as staff come to terms with the whole new tool set that we are actually handing them. We actually budgeted for some productivity dip, and that was less than we anticipated, so the staff have adopted and are using the new tool set much more quickly than we thought. We are probably back to being at about the same level of efficiency, if I could call it that, as we were prior to deploying the tools, which is earlier than we expected, and we are already seeing reductions in call-handling times, better ability to handle a range of print calls, less pass-offs from person to person because they have got it entirely. We would expect to more than meet our efficiency savings on that.

Senator FIELDING—Has there been any independent assessment of the achievements so far, and then any independent assessments of the whole program? There are two questions there.

Mr Farr—We have a relatively unusual arrangement. We have signed a contract, as the commissioner mentioned, with Accenture which is based on outcomes as opposed to very detailed requirements, and it is a fixed price contract for outcomes.

Senator FIELDING—That was the December 2004 contract?

Mr Farr—That is correct. We have also signed up another company, Capgemini, as essentially independent assurers. Capgemini are also a large international consulting firm, similar to Accenture. They actually look over our shoulder and over Accenture's shoulder and report monthly to us on whether the outcomes have been achieved and what the quality of work is. We have what we call a series of stage gates, which are very major points where we sit back into a full review, including independent reviews by Capgemini and others, to say, 'Yes, you have achieved what you set out to achieve.' It is not until that stage gate is passed that we actually make the payments. It is a continual series of assessment against the outcomes and when they should be achieved.

Mr D'Ascenzo—Mr Farr said that this was quite a new approach to have both an integration partner plus an assurer for the program. I understand actually in business a lot of

major projects are being developed with that sort of model, and it is a good model, because you have an independent party that can assure both the proprietary nature of the program and also whether or not it is achieving its objectives. The interesting part about it is that we actually got advice from Capgemini to say that our original plan was too challenging and too difficult to achieve within the time frame. One of the particular concerns was whether we could get the right level of expertise. So what we ended up doing was to extend the program from a three-year program to a four-year program, and we also evened out the likely requirements for expertise in the IT area to meet that expectation. So not only did we have it there but also it has actually proven to be very valuable because we have been able to adjust our program to take on board the advice of a third party rather than the perhaps more challenging tasks that we might have taken on ourselves.

Senator FIELDING—The contract that was signed in December 2004 was for three years or four years?

Mr D’Ascenzo—The December one was a four-year program, so we got this advice as we were developing the processes.

Mr Farr—The final deliverable, if you like, of the program is in June 2008. We are in the process of wondering whether we can actually bring that back and bring that forward a little bit, and we think we will probably attempt to do that, but under the contract the deliverable is June 2008.

Senator FIELDING—So can you provide the committee with a report of the independent assessment of what has been achieved so far?

Mr Farr—We can, yes.

Senator FIELDING—Is the ATO expected to reduce staff levels as one of the outcomes of the Change Program?

Mr Farr—I would not expect significant reductions in staffing as a result of the Change Program. The ATO staffing level generally is decreasing in the out year projections. Purely from the potential of the Change Program I do not see that as a major impact on the number of staff. Certainly the types of jobs that people would be undertaking I would expect to change fairly significantly. The actual deployment of what we are doing is very focused not just on the IT—the IT is part of it—but on the training, the cultural change and the people side of it, that we actually move people from the old ways of doing work to the new ways of doing work. That is a big component of our effort.

Mr D’Ascenzo—But, having said that, that is subject to the luxury that we may have in terms of the bucket of funding that we have under our budget processes. Undoubtedly the Change Program will allow some efficiencies in our operations. If we were to have the luxury of using those efficiencies to better achieve other aspects of our operations, then that is what we would do. The reality may well be that ultimately, as a consequence of efficiency gained in this area, the full range of on-costs in terms of pay and pay increases that might occur, the situation of the 1.25 efficiency dividend—some of these efficiencies—will need to be used to balance the budget. While Mr Farr is quite correct that we could restaff people, we could use retrained people for the activities, there will be certain tasks that we do now that will not

necessarily be appropriate for a new environment. There will also be difficulties in retraining some staff and there will be the budget realities of trying to balance the budget.

Senator FIELDING—So the issue there is that there has been some ongoing efficiency savings anyway and the Change Program is part of that.

Mr D'Ascenzo—That is right, part of that.

Senator FIELDING—You reckon there could be some types of jobs changed.

Mr D'Ascenzo—That is right.

Senator FIELDING—I think you referred before to the national taxpayer system. Is it part of the—

Mr Farr—The national taxpayer system is our main income tax processing system, yes.

Senator FIELDING—What percentage of the budget is allocated to that replacement?

Mr Farr—One of the problems that we have, without getting too technical, is that we have any number of different processing systems. So we have the national taxpayer system processing our income tax. We have another system doing our GST and our BAS payments. We have another one doing our FBT payments. We have different accounting systems, different processing systems, different registration systems. That makes it very difficult to get a complete picture of a taxpayer—their history, their accounts and things. So all of those systems essentially will be replaced and we will have one processing system, one registration system and one accounting system, irrespective of what sort of tax it is. So it is not really possible to put a figure on replacing that system, but certainly when we do that that will be a pretty big chunk of our funds, probably at least a third of the funds, and I can take it on notice to give you a more accurate figure.

Senator FIELDING—That is fine.

Mr Farr—A third of the funds would be around replacing our core processing capability.

Senator FIELDING—I am just trying to get a bit of a feel for the numbers. I do not need them to be accurate, but it is not 10 per cent; it is not 90 per cent.

Mr D'Ascenzo—A lot of the \$453 million costing that Mr Farr mentioned is not direct cost on the IT equipment or software development. A lot of that is in relation to re-engineering, training, skilling our people to work under a new platform, a new environment.

Senator FIELDING—The new system that is being purchased through I assume the contract with Accenture was originally brought from Washington State, USA?

Mr Farr—Washington DC.

Senator FIELDING—Correct?

Mr Farr—It is part of a worldwide suite of products that Accenture have. They call it their tax administration system, or TAS. In our version we are calling it the integrated call processing system, but it is based on a transfer of the solution. When we looked across the world at the various products that were available for us to use, and we used independent evaluations by Gartner and others on what was available to us, we came back that this was the

most suited to our needs and the one that was most suited to the Australian circumstance was Washington DC, so that is the one that we have actually adopted.

Mr D'Ascenzo—Just in relation to the choices that were available in that suite of products, there was a much more modern version which the Singapore government has invested in, but we thought that, in relation to scale issues and risks of a new DSE environment, that was going to be too risky for us to undertake.

Senator FIELDING—The core of the system, though, is based on obviously the Washington tax system.

Mr Farr—That is right. It is about a 70 per cent fit with what was being done in Washington DC .

Senator FIELDING—And that system was first implemented in 1980? I think that system was based on 1980s technology. Would that be right?

Mr Farr—I am not sure about that but, yes, it has been around for quite a while. Having said that, it has also been modernised progressively as we go. The part that the staff actually use—the staff user interface, if you like—we are completely rebuilding and modernising. So that bit of it which needs to be actually modernised is exactly what we are doing and that is the bit that is not the fit for us. We have done a full evaluation of it.

Senator FIELDING—Knowing you are down the track a bit from there, is the percentage fit still about 70 per cent, do you think?

Mr Farr—There have not been any material changes to the sort of percentage fit that we are looking at at the moment.

Senator FIELDING—Is there any of the Change Program being done overseas at all? Is any of the work being done not in Australia but overseas?

Mr Farr—No. The way that the program has been set up we are actually doing a lot of the detailed technical design for the systems at the same time. So the design and the build are running in parallel. That does not lend itself to any overseas work, which is not to say that if we need capacity we might not use that temporarily some time in the future, but it is not something we are using now. We have got between 20 and 25 people in Australia who have worked particularly in the Washington environment and also in Singapore and in Arizona. They are used to this system and we are actually bringing that expertise into Australia temporarily to assist us.

Senator FIELDING—What area are they working on exactly? Are they working on technical skills they cannot get in Australia?

Mr Farr—It is not so much the technical skills that we cannot get in Australia; it is actually that they have experience using the system that we are basing our platform on. So they have actually done it before. The commissioner mentioned that one of the things we did not want to do was to get into any sort of leading-edge technology. It is not somewhere a tax administration traditionally feels comfortable being. So what we actually wanted to do was to take something that someone had done before and put that to work. To do that, to rely on that as much as we could, we needed some people who did the work previously to come in there and help the people currently in Australia doing that, and that is what we are doing.

Senator FIELDING—So is it programming skills or—

Mr Farr—Not so much programming skills as design skills, how things worked previously. If something had been thought through previously in, say, Washington DC or one of the other areas—the Accenture TAS system is used in a number of US states and in New Zealand, Singapore, France and Ireland; it is right across the world—and if there were people who had actually solved problems before, we did not want to actually start with a clean sheet of paper. We wanted to bring them in and help us to solve those problems.

Senator FIELDING—So the system is designed in COBOL, is it? That is an old language.

Mr Farr—Yes, it is. Part of it is. The part we are rebuilding is in .NET.

Senator FIELDING—So you are of the view that the system is obviously to make it easier, and you know that there will be changes to our tax system along the way?

Mr Farr—Yes.

Senator FIELDING—Those changes will require future changes to the system. I am just interested to know your views. If the system is based on a 1980s design and on a language like COBOL, which is not current programming—it is quite old—I am just trying to work out how we are going to work forward with this if a contract was signed in December 2004 for a system that seems to me already outdated.

Mr Farr—There are a couple of answers to that question—there is one answer, with a couple of parts to it. COBOL has been around for a long while, but it is also very widely used, and when we actually looked at the system, or the whole solution, that we were buying, one of the things that we have actually set out in the contract and one of the things that is being delivered is that most of the changes are not actually done through programming but actually configuration changes. So, instead of doing a lot of coding and people writing millions and millions of lines of code, it is actually being done much more readily and much more easily through configuration changes. Our ability to do that and to make the savings that are required as well as the responsiveness to government and other initiatives that are required are written in as terms of the contract.

Having said that, are we going to stick with COBOL forever? No, probably not. But to go from a system which said we have seven major accounting systems, multiple registration systems and multiple processing systems and make a big leap into the most modern technology that you can find was probably something that was just putting us into a risk profile that we did not want to be in. It may be that we will take over time a couple of steps to get to the end point, but this was actually bringing together the integration that we needed before we could actually go anywhere else. We did not want to start with a clean sheet of paper. We have seen too many of these programs of much lesser size and complexity than we are undertaking fail around the world, and we did not want to be in that position.

Mr D'Ascenzo—Our current legacy systems have actually served us very well over a 40-year period and you cannot run a tax administration unless you have robust accounting and registration systems. We consciously made the choice that we would not go to what the technology experts would say is the most modern and most sexy part of the IT world and that we would take something that is tried and true. Our experience from countries that have taken

the more modern technology is that they have found difficulties because they are pathfinders in what is still untried technology.

Senator WATSON—Surely there is an intermediate step, rather than adopting the latest whiz-bang technology, compared with using a 1970s or 1980s COBOL type language approach?

Mr D'Ascenzo—I think our review found that this was the one that was going to be best suited to our needs.

Senator WATSON—Even though it was very old technology?

Mr Farr—Yes. It is very old technology, that is true, but it is still very widely used for large mainframe applications. But a significant part—I mentioned this to Senator Fielding—is that it is about a 70 per cent fit. The other 30 per cent is done in the most modern technology. So it is not either/or. Where we are going to rebuild, we are doing that in the most suitable technology. If we can actually bring something over and get it working for the benefit of the community, let us do that, and then we will look at another technological platform somewhere down the track.

Senator FIELDING—I am certainly no expert. I obviously come from a technology and finance background, but it just seemed to me that it is based on some fairly old technology and the language seems to be a bit of a concern, especially since going forward we are going to want a flexible taxation system, especially with a lot of talk at the moment about tax and some major, significant changes. I am just concerned about signing a contract in December 2004 based on technology that could mean that the next thing we will hear is that we cannot implement a tax system because the system is not flexible enough. So I suppose I am just letting you know that I am looking at it and I am a little concerned. I appreciate the answers today. If you are saying that the fit was about 70 per cent when you started and your view of the fit today is still 70 per cent, I hear what you are saying.

Mr Farr—I do not want to take any more time up, but there is a publication we put out very early on that actually has the outcomes that we put into the contract, one of which is addressing very much what you said about our ability to respond quickly, that being an outcome we need to make. Those outcomes are actually spelt out in that publication. They are a direct lift out of the contract.

Senator FIELDING—Which publication was it?

Mr Farr—It is on our website and I think it is actually a speech by former Commissioner Carmody to the OECD. I think it is called *Revitalising tax administration: The Australian experience*. If it is not that, it is something similar to that. At the back of that publication there are the outcomes that we are actually required. I think they address a number of those concerns.

Senator FIELDING—I appreciate the responses.

Senator WATSON—Does this technology also allow the direct reading of direct entry, because that is the way it is going, is it not?

Mr Farr—Yes, it does.

Senator WATSON—Direct entry rather than having to take that and re-enter?

Mr Farr—Yes, it does. Without getting too technical, the services that are being produced will be available as web services for people to pick up as well, so that part of it will be redeveloped in a much more modern way.

Mr D'Ascenzo—Just on that side of it, basically you have the web services that allow you to have that direct entry process. These were the back-end systems. So currently we have seven accounting systems and registration systems and none of them talk to each other. This current system will allow them to talk to each other so that, when you enter through the web services, you are going to get the one running account that can be used for that purpose.

Senator WATSON—When I say 'direct entry', this means that you can get a bank statement and feed it through and the system will read that information without further transcribing. That is what I meant by direct entry.

Mr Farr—Yes, that is possible. A lot of people still lodge by paper and that will be imaged; but, yes, they will be able to enter stuff directly into the computer.

CHAIR—We will take the afternoon break now and we will resume at about five past four.

Proceedings suspended from 3.52 pm to 4.10 pm

Senator MURRAY—You might recall an interchange I have had with Treasury and the Taxation Office since, I think my records show, November 2003 on the issue of off-market share buybacks. I quarrelled with both for a while about the tax impact. Eventually, on 17 February 2005, a question of mine to Mr Carmody was taken on notice, and the third paragraph of the answer—E8283 is the reference—stated:

Treasury regularly reviews the benchmarks for measuring tax expenditures as part of the process for preparing its annual tax expenditure statement. Treasury advise that the treatment of off-market share buybacks will be examined in this context.

I wanted to compliment you, because I noticed in the tax expenditure statement for 2005 that off-market share buybacks may result in a tax expenditure for some participating shareholders. For the year 2004-05, it was listed as being costed at \$530 million, which I still think is modest, but I am delighted you accepted the argument and put it in. My compliments to you for doing that. The question arising out of that I think for you and for me is that there are asterisks shown for the forward years and I assume that is because, with respect to this particular item, it is dependent on market activity and therefore each year the analysis would have to be done separately. That is correct, is it not?

Mr Callaghan—I will turn to Mr Brown. He is our expert on the tax expenditure statements.

Mr Brown—That is correct. The level of the tax expenditure would be dependent on the level of market activity each year.

Senator MURRAY—For instance, I see that Rio Tinto is in for a very big one. I suspect that would change the figures.

Mr Brown—Yes, the transactions involved can be fairly lumpy from year to year and the activity varies a lot, so it is not quantifiable.

Senator MURRAY—Thank you for taking note of that. I wish now to move to you, Mr D'Ascenzo. I want to refer you to an article of Tuesday, 15 February 2005 in the *Financial Review* by Allesandra Fabro. I do not need to give you a copy, because you would be alert to the issue. It says 'ATO targets \$3 billion company tax haul' and the first paragraph states:

The Australian Taxation Office expects to raise \$3 billion from audits of big companies this year and is investigating a number of new tax structures that could amount to an abuse of group consolidation and transfer pricing rules.

Mr D'Ascenzo, I have assumed that your 2004-05 annual report would only run into the end of June. Companies report after that date, so your annual report would not have covered this prospective area completely. What I am looking for is an update with respect to that program of audit.

Mr D'Ascenzo—Is that in relation to our large case audit program?

Senator MURRAY—This simply reads 'audits of big companies this year' and 'investigating a number of new tax structures that could amount to an abuse of group consolidation and transfer pricing rules'. I would assume that those new structures would have resulted from opportunities taken as a result of the tax consolidation tranche of legislation that is upon us. What are we up to—four or five sets?

Mr D'Ascenzo—I actually do not recall that newspaper article. I am wondering whether the statement as to new structures was ours or whether it was—

Senator MURRAY—You have a look at that. I will tell you where I want to go with this, apart from a general update, and you can pick it up in your answer. My assumption was—and I continually said so when I had a look at the tax consolidation legislation, which those who are close to it will remember I on behalf of my party supported very strongly—that the revenue cost would be greater than that envisaged by Treasury. Of course, that would be exhibited to the Taxation Office in terms of shifts in revenue in companies that had taken advantage of the new tax consolidation rules. That article seems to me to touch on that topic, and that is why I wanted to know what your views were.

Mr D'Ascenzo—The reason I ask that is that it looks like the former commissioner was talking more of our general approach to large business in talking about the \$3 billion, and I think the journalist would have picked up comments in our compliance program that this was associated with that which said we were looking at various potential risks to the revenue, including new structures, transfer price and a range of activities. I do not think that \$3 billion necessarily related to the consolidation regime per se.

Senator MURRAY—No, I understand.

Mr D'Ascenzo—Having put that in context, again my close dealings with that regime over the last few years have suggested that there have been tax advantages that were budgeted for, and they have been pretty close to estimates as far as we are concerned. We still have a high level of scrutiny of these in relation to consolidations. While there are situations where we are questioning the amount of uplift or the valuation provided to goodwill, and a range of specific areas are still under scrutiny in relation to particular taxpayers, we have not really seen any significant abuse that would require us to provide that advice back through Treasury to

government. Basically, in relation to that regime, while we are vigilant on how that is being implemented, we have not seen the abuse that may have been a concern to you and to us.

Senator MURRAY—I am concerned with abuse, but I expected perfectly legitimate revenue loss to occur. The reason I supported the consolidated measure is that I regard it as essential for freeing up the market so the market could operate more effectively. I think it is no accident that last year was the strongest mergers and acquisition year in the history of corporate activity in this country. If you couple the Corporations Law changes with the takeover panel initiative and the tax consolidation rules, you are bound to get a much more flexible and dynamic market. My concern was not that there would be revenue losses as a result of that, because I thought the benefits to the market justified the cost. My concern was that I thought Treasury had underestimated the legitimate revenue loss. My question to you is whether you have now identified greater legitimate revenue losses occurring because of the restructuring in the market that is under way.

Mr D'Ascenzo—To the best of my knowledge, we have not identified legitimate revenue losses that are materially greater than the estimates. We still are very vigilant in that area. Our inquiries into how these have been implemented are going to occur over some time, because it will take some time for these to be implemented at the company level, for the outcomes to be reflected in their accounts and then for us to follow through those accounts to see whether or not everything is done in accordance with the provisions. While there are matters that we want to continue to inquire into in terms of how particular companies may have groups that may have implemented the regime, we are not seeing any blow-out in the Treasury estimates.

Senator MURRAY—The consolidation loss regime is one of the most significant tax changes we have seen for some time. Will you be reporting on that to some extent or in some depth in your next annual report, because it is the next annual report when the flow-through effects will be seen, I would have thought?

Mr D'Ascenzo—It may still be early for the flow-through effects, to be fair. I have not considered that, but I will take that on board when I sit down to present a report to parliament.

Senator MURRAY—I would appreciate it if you would consider some commentary on that. There is a small but what I thought was a significant and symbolic matter I wanted to ask you about. I thought in recent days the lack of concern over bribery and corruption in some quarters is reflected sometimes in how people regard compliance with tax law. I recall the very poor record of those who are supposed to uphold the law in that respect, namely, vast numbers of solicitors, barristers and some judges, who are really bad in getting their tax returns in and in acting with integrity in that area. I know the Taxation Office targeted this area very closely, as did the law societies, to their credit. Is that now a problem that is over? Is that profession up to the mark in keeping their tax returns in and their tax affairs up to date?

Mr D'Ascenzo—I could not give a guarantee in relation to any particular person in the profession, and we are still working with that profession and also taking similar action in relation to others in matching lodgment profiles with activities. I would have thought that the profession itself has taken action to clean up its act in that regard and that they are now exhibiting better behaviour in compliance with basic lodgment and payment of tax obligations.

Senator MURRAY—My impression is that it is a vastly improved situation to what it was. Are you saying with respect to other professions you have targeted—I think you have targeted accountants, for instance, and I seem to recall another profession—that you are seeing similar problems in other professions but to a lesser extent?

Mr D’Ascenzo—The lesson to us was a fair one when these matters arose, and the question was: how can a person in a high-profile profession not lodge returns for a lot of years? The question asked of the tax office was what are we doing in the way of fairly obvious checks in the process? We had a project of looking at other professions where there was a licensing regime, for instance, so that you could match our lodgment details with the licensing details to see whether there was some cross-matching of that—basic good compliance work. We did architects, engineers and a range of others. By and large, the outcome, while not squeaky clean, was quite positive. That is just going to be part of our normal processes, matching information against other publicly available information, to see whether or not people are complying with basic obligations such as lodgment and payment of debt.

Senator MURRAY—I had the impression that the other professions examined by you did not have as bad a starting point, if I can put it that way, as had the lawyers and barristers, who seem to be particularly bad. Is that impression accurate?

Mr D’Ascenzo—It may be. Part of the rationale for any compliance work is not necessarily to impact directly on the party concerned; it is also to send some clear messages to the rest of the community that this is not the right sort of behaviour. It is supposed to be a deterrent for others and it is supposed to support people who want to do the right thing to make sure that they are not disadvantaged. It may be that the media and the publicity that arose out of that project has salutary effects on others. In terms of the outcome, as I said, we found it a worthwhile compliance task. We have seen reasonable levels of compliance.

Mr Konza—The big difference between the professions was that with the barristers we found a high rate of people who were essentially dropping out of the system. Some did not have TFNs and some had not lodged for many years. With other professions we have found very few people who have not been in the system. In other professions we have found, for example, one or two individuals. That is the qualitative difference between the professions.

Senator MURRAY—Do you know why that is so? It seems odd to me that the morality of judges, solicitors and barristers should be different in tax terms from the morality of other professions.

Mr Konza—I would not want to speculate on that. I would only get myself into trouble, I think.

Senator SHERRY—With the lawyers? Give it a go.

Mr Konza—What was similar about the professions was, though, that we did find that there were still quite a number of people who were behind in their lodgments, maybe by two or three years returns. As Mr D’Ascenzo said, we now have to incorporate in our systems things like professional membership to keep those people up to date.

Senator MURRAY—The Taxation Office, as a result of parliamentary interest and the interest of the Auditor General and your own interest, has been trying to improve the integrity of the TFN and to bring those dilatory or delinquent on tax terms into the fold and to make them more reliant. Against that there is a lot of criticism about *TaxPack* and the complexity of doing tax returns if you do them on your own. However, that assumes tax agents do not struggle. Do you have figures to show that there is an improved compliance percentage—in other words, that for every hundred Australians ninety-something are putting in their tax returns within the year that they should?

Mr Konza—The short answer I think is no. That is a very complex calculation, because people come in and out of the tax system. There are many people who hold TFNs legitimately but are not required to lodge a return. We were sufficiently concerned about the lodgment compliance that we established a part of the office under a Deputy Commissioner for Lodgment Compliance, Mr Reardon, and they have—

Senator MURRAY—That is the man who was heavily involved in the GST, was it not?

Mr Konza—Yes. They have been really pushing some of the innovative methods that the commissioner referred to, which is attempting to essentially lock our business systems into the natural systems in the environment—areas where people have to be registered or have licences—just so that our system stays in sync with the real economy.

Senator MURRAY—Are you telling me that there are no ready measures such as benchmarks or targets for tax return lodgment that you are able to monitor and see if you are improving?

Mr Konza—We do monitor on-time lodgments and we do monitor absolute growth in tax returns. We do try and see whether or not the number of returns lodged is keeping pace with the economy, so to speak. But I would be unable to give you any details of those, because we would need to take them on notice, and Mr Reardon perhaps might be able to answer that.

Senator MURRAY—I am not seeking to give you lots of unnecessary work, because I do know that the tax office has been making a genuine effort to lift its game in this area. But it would seem to me that, unless you have some mechanism for monitoring your progress and for ensuring compliance, it is difficult for public policy people such as parliamentarians to properly assess to what extent the tax act—its complexities with tax returns and so on—acts as a genuine impediment to people fulfilling a duty they might otherwise fulfil. I am interested in your answer to me as to what efforts you are going to be making for better reporting to both the executive and to parliament in this area.

Mr Konza—We could take that on notice and we could see what we can do there. The real lesson, I think, to which the commissioner referred a moment ago, is that in the past our lodgment strategy was to take those who were lodging tax returns and make sure they keep lodging tax returns. What we learnt was that people slipped out of the system or disappeared and then, once they were out of our system, they were out of our monitoring system. We have essentially turned our monitoring system inside out, if you like, to monitor the outside world and to try to keep our systems relevant to what is really going on. That is the type of innovation that Mr Reardon is leading.

Senator MURRAY—That sounds encouraging, but I am not sure I understand it. Give me an example of how you would do that. Do you read death notices?

Mr D'Ascenzo—It was basically what I mentioned. There are licensing provisions for various professions with a name and address, and we can match those names and addresses against those who have lodged tax returns.

Senator MURRAY—Are you doing cross-agency database checks?

Mr D'Ascenzo—That is right. That is one example, but there could be others. We could go through state approaches of using real estate lists and name and address checks. Basically, it is just matching identities with our registration provisions.

Senator MURRAY—But if you are telling me you are doing that then you must have a sense of what the consequence of that is and what the response was?

Mr D'Ascenzo—We certainly have figures of what our lodgment is, what we expect the lodgment to be and what it eventually happens to be. As Mark said, sometimes the reasons for variances do not necessarily disclose any more than the churn that exists in terms of people coming into the system and people going out of the system. I think the difficulty that Mr Konza and I were having is how do we then work out qualitatively what the underlying reason is why people did not do that. Our compliance policy does say that that is the sort of thing that we want to do. I am not sure where the extent of that sort of qualitative study is in terms of lodgments. We do have surveys—you mentioned in a similar vein—of why taxpayers might go to tax agents. Often the answer there is, 'I don't want to give up my weekend for the one day a year that I have to do my tax return.'

Senator MURRAY—You will take on notice, not in the sense of responding, the general need from our side of things for more concise reporting as to what progress you are making. As you know, I have been watching tax affairs for a long time and I read your reports and so on. I do not have a good sense of things, and that is probably a sign that there is a problem.

My last set of questions relates to crime. Like many Australians, I take an unhealthy interest in all the murders in Melbourne, and I have noticed in the reporting of these crimes that the reporters mention how criminals and alleged criminals seem to live astonishingly good lives in amazing locations and expensive houses with assets all over the world and apparently put in tax returns as being unemployed, getting very low incomes and so on. It seems odd to me that the tax office would not take an interest in the affairs of people who seem to have unaccounted income. But perhaps you do. I would like to be assured that the tax office watches the very public doings of a very large class of people with very high assets with the same interest and intensity as you do other high-wealth individuals and that you are not frightened off or in any way dilatory in that area.

Mr Monaghan—The short answer is, yes, we do involve ourselves in that sort of area. The Serious Non-Compliance Business area that I head was put in place to increase our capability to deal with people who are very persistent about not complying with their tax obligations. We have very close relationships with law enforcement authorities to enable us to do what you are talking about.

Mr D'Ascenzo—I was going to preface Mr Monaghan's comments by saying that I anticipate that the answer will be, 'Yes, we do that.' But I wanted to qualify that by the fact that you have to do that in the context of risk management choices. It depends on how much the level of tax mischief associated with this criminal activities is in terms of our allocation of resources to that task. Another thing that I would like to add is that, where it becomes much more organised crime and where the amount of mischief, particularly from a tax perspective, is large, we have increasingly been working with other law enforcement agencies in more whole-of-government approaches, including work with state police officers; that is, to do it on a task force basis rather than on a tax office basis. In tackling organised crime the best approach is for us to make our contribution to task forces led by other agencies that can attack those sorts of issues across a range of different ways. Often the outcome of that for us is not necessarily an increase in tax revenue, because if there are criminal prosecutions we do not apply penalties. You cannot have double jeopardy in the context of these matters. Usually the proceeds of crime legislation takes the ill-gotten revenue gain into a different environment.

For the tax office it is important to be involved with, actively participate in and totally support those whole-of-government efforts, because it sends a clear message to the community that for people who are not complying with their tax obligations, whether it be because of criminal intentions or otherwise, there are consequences. In the criminal area, the Commonwealth and states are prepared to work together to do something about it.

Senator MURRAY—Can I suggest—and I think you have recognised this in your answer—that this has a high symbolic value in terms of the community's perception of the Taxation Office. The actions of the tax office with respect to notorious high-wealth individuals a decade ago strongly publicised your effectiveness in this area, showed how much money you were getting back and who you were targeting and reassured the community that you were on the case. Whilst you might be seeing yourselves as working effectively, I do not think your message is as clear in terms of how much you are achieving now, as it was in the analogy that I have just given of high-wealth individuals. I just leave that impression with you.

Mr D'Ascenzo—Again, I did not want to understate our involvement there. People often ask what is the area where, if you put more resources in, you might get more direct revenue. That is a very short-term and narrow answer, because the responsibility for the tax office is to have a coverage that ultimately maintains that community confidence. I am agreeing very much with your concept that community confidence is very important in the way we allocate our resources. I was not saying that we were not doing work in that area in our own right. As Mr Monaghan answered to you, we are. I was just bringing forward the reality that ultimately there are some choices and you cannot go down to the last dollar in every transaction. I also was trying to promote the idea that, in relation to organised crime, the joint task force approach to me seems to be a very effective way of operating.

Senator MURRAY—I would suggest you publicise your successes a little more than you have.

Senator SHERRY—On this issue specifically, I think Senator Murray was referring to drug barons in Victoria. Can you tell the committee how many drug barons have been convicted in the past couple of years as a consequence of any activity by the tax office?

Mr D'Ascenzo—If you are getting to the broad proposition of organised crime, we will be working with other agencies, and usually under the leadership of the Australian Crime Commission and the Director of Public Prosecutions. Offhand, I do not know that answer. That is the context of it. Mike, if you can add any more?

Mr Monaghan—I would not have a figure that precise.

Senator SHERRY—Have you got any figure? Has there been one, two, three?

Mr Monaghan—I will take it on notice to provide some detail, but the nature of the work in this area takes various forms, and the proceeds of crime path is one of those, and there are both federal and state proceeds of crime regimes. There is also supporting the law enforcement agencies in financial analysis to assist them in identifying the full scale of the crime that has occurred, which may or may not lead to a tax assessment.

Senator SHERRY—I understand that, and I understand the issue of the proceeds of crime; you might not collect any tax. What I am asking about is in how many cases has the tax office played a role—and it may not lead to tax collection—in the successful conviction of a drug baron?

Mr D'Ascenzo—Again, I am not sure what that heading refers to. I use the more generic term of organised crime, so without knowing who those are—

Senator SHERRY—Senator Murray commenced the questioning, but the reason I am raising it so explicitly is that I have a quote from a speech given by the Treasurer himself about the work you should be doing in this area. Back in May 2004, he said:

A few weeks ago, I called for a sense of outrage about what is happening in our midst and I pledge that if federal tax authorities can assist in tracking and taxing the flow of money that sustains the lifestyle of these drug barons, then everything that can be done will be done. We stand ready, anxious to assist.

That is the federal Treasurer, a reference to the federal tax authorities and drug barons, getting the money out of them and sending them to jail. That was back in May 2004. It is a fair time ago; that is why I am asking the question quite bluntly. What has been success rate following the Treasurer's call for the tax office to deal with drug barons?

Mr D'Ascenzo—We have—then and before—been ready and assisting other government enforcement agencies in trying to apply the full force of the law to people involved in organised crime. As for the statistics, perhaps we need to ask the ACC and the DPP about their prosecution activities.

Senator SHERRY—Were there any specific programs implemented by the tax office as a result of this call by the Treasurer back in May 2004? He is specifically referring to the tax authorities. Was anything put in place following this speech?

Mr Monaghan—I am reluctant to be specific, because it might draw attention to particular work we are doing, but we do work very closely with federal and state law enforcement agencies where we can provide assistance. That covers a wide range of criminal activities.

Senator MURRAY—Which is why I focused on outcomes. I am not as interested in the methods, I am interested in knowing you have done the job, and I do not think you have been publicising it, if you have been doing the job.

Senator SHERRY—Yes, I agree with Senator Murray. What you are doing in the minutia is interesting, but here we are in February 2006 and the Treasurer made a very strong statement in May 2004. We would like to know what the outcomes have been. That would be useful.

Mr D'Ascenzo—We can consult with the other government agencies that are usually the leaders of our joint task forces and see what they feel is appropriate or what they are able to provide.

Mr Monaghan—I might just refer the committee to pages 89 and 90 of the 2004-05 annual report, where there is some information about the occasions on which we provided information to law enforcement agencies to assist them.

Senator SHERRY—The Treasurer talked about 'tracking and taxing'. How has the ATO sought to track the money flows of drug barons?

Mr Monaghan—We have various ways of tracking income flows, from AUSTRAC information to our intelligence capability. Where it is a joint operation, we would work jointly with law enforcement agencies. Within the law there are ways in which they can disseminate information back to us that would enable us to raise assessments on the basis of information that they have obtained in the course of their investigations. Over time there is a wide range of ways that we could obtain intelligence to enable us, if it was appropriate, to raise assessments.

Senator SHERRY—You are tracking money flows of suspect individuals. With respect to the intelligence, are you informed that X or Y is involved in drug trafficking? Do you have access to that information?

Mr Monaghan—We might come across their particular activity, if they were limited in their activities to one particular product. We will get intelligence from a wide range of areas and we put it together to ascertain whether that would support an assessment, or we might judge that we have evidence that is relevant to establishing a serious offence, and the law allows us to provide that to a law enforcement agency. It would be a case of what is the appropriate conduct in the circumstances of the matter. As Mr D'Ascenzo said, in relation to serious criminal activity, the law enforcement agency would normally be the lead agency and we would provide, within the law, such information as we can to support its work.

Senator SHERRY—I understand that, but the Treasurer wants you to 'track and tax'. That is in his announcement. How many tax dollars have been collected from the tracking of drug barons in the past two years? Are we dealing with a few thousand dollars, hundreds of thousands, millions of dollars? Do you have any idea?

Mr Monaghan—I do not have any idea. In a definitional sense, I am not sure whether we would have anything that would say someone is a drug baron or not.

Senator MURRAY—To assist you, I remember reading in the mid-nineties that the drug trade in Australia was then estimated at over \$2 billion. I suggest it is more than that now. I would assume drug barons have a fair amount of money.

Senator SHERRY—Can you not point us to any dollar collection from drug barons?

Mr Monaghan—I cannot. I am happy to inquire, but I suspect that people do not fill in their occupation on a tax return as 'drug baron'.

Senator SHERRY—No, of course not.

Mr Monaghan—I am not being silly.

Senator SHERRY—That is why I asked you whether any of the intelligence had identified drug barons.

Mr Farr—I am not sure whether this is of any assistance to you or not, but Mr Monaghan referred you to the commissioner's annual report at page 89, where it provides some details of information provided to other agencies. On that page it says, for example, that during the year we processed 237 requests for information to law enforcement agencies in respect of offences under the Drugs Misuse and Trafficking Act. It does actually spell out in those tables the types of offences, and it also spells out the law enforcement agencies that the information is being disclosed to.

Senator SHERRY—That is good, but you cannot point me to a tax figure that has flowed from the information you have shared. I do not blame you particularly for this. I am not criticising you. It is just that my attention has been drawn to this announcement by the Treasurer back in May 2004. There was a big announcement that he was going to track down and tax drug barons. Eighteen months on, I am wanting to know what the result of this announcement has been. It does not seem that you can give us a great deal of specific detail about convictions, tracking or taxing.

Mr Monaghan—As I said, we do have figures for assessments we have raised and tax collected from our work around crime. I doubt whether I could identify what particular activity people were in. As I said, I will have a look, but I doubt that we would have that detailed information. People in this area of activity are typically involved in a wide range of criminal enterprises and are very flexible and fluid and move from one thing to another; it is just a business. To define someone in that way would be extremely difficult.

Senator SHERRY—I understand all that. I take it, given what you have said, there has been no specific report to the Treasurer outlining success or otherwise in tracking and taxing drug barons?

Mr Monaghan—I am not aware of any specific report. I believe that the law enforcement agencies are satisfied with the degree of assistance they get from us.

Senator SHERRY—It is just that the Treasurer made the announcement in May 2004, and it obviously refers to tax authorities and tracking and taxing. It is just interesting to follow through on these issues some time later to see what your success or otherwise has been in, I think, a reasonable level of detail requested.

Mr Farr—I seek to clarify some comments prior to the previous break. Senator Sherry, you asked whether we had any people present at the Cole royal commission at any time, to which we answered no. In the break, it was pointed out that we did have one officer there for two or three days just observing proceedings. We did not stay there the whole period of time, but just in case that gave you a misleading answer earlier.

Senator SHERRY—What were they doing there?

Mr Farr—Just observing proceedings.

Senator WATSON—What is the ATO doing, from an administrative perspective, to simplify the tax system for ordinary Australians?

Mr D'Ascenzo—Again, the shape and content of the law is primarily a matter for government. What we try to do is make it as easy as possible for people to comply with those laws. I suppose the classic example is our e-tax product. The e-tax product says: 'Put the facts and figures that you know of,' because they are yours, 'in boxes that are prompted to you and, if you want further information, you can go behind the e-tax product to a level of detail,' if you want to get into the detail. But ultimately all you have to do is do basically what you used to do in a full assessment system, which is provide full and true disclosure of your facts. You put your facts into the box and then the system works out and calculates your liability or your refund in accordance with how we think the law operates.

Senator WATSON—How many taxpayers have taken advantage of the e-tax system?

Mr D'Ascenzo—Some 1.3 million currently use e-tax. A large number of other taxpayers, for a whole range of reasons, use specialists such as tax agents. That is one area. I talked beforehand about the opportunity of our Change Program—our easier, cheaper and more personalised program. Again, as you rightly point out, one of the long-term objectives of that program is to try to reduce compliance costs and red tape by allowing direct input or through specially adapted software products to enable taxpayers to use their information. It is the same principle. You use your own accounts, your facts and figures that you use in business, and then the system dices them in a way that produces the requirements for the tax office. In the long term, one could see the same approach applying on a whole-of-government perspective.

Another way that we are doing this, in a more measured and perhaps one-step-at-a-time approach, is in terms of changes of addresses and the use of our Australian Business Register for that purpose. *TaxPack*, in another way, was an attempt to try to make the filling out of your tax return as simple as possible for people. It was a guide. If you follow the guide, that should provide you with a reasonable amount of certainty in terms of your affairs. It is true, though, as the nature of the Australian community changes and we have fewer people on the old system, the pay-as-you-earn environment, where you have different ways of operating, where there are more Australians owning shares, more Australians owning property and other investments, those sorts of affairs have their own tax implications and people then say, 'Well, maybe I will go for an expert to allow me to carry out those obligations.' So there is a range of issues.

Ultimately, I do see it as the responsibility of the tax office to try to make the administration such that it is directed at helping people to comply with their obligations in a way that is simple, easy and personalised for them. That is why we called our Change Program the easier, cheaper and more personalised program. But that has to be in accordance with the law and the shape and content of those requirements.

Senator WATSON—Are there any aspects of the law that you believe should be changed to facilitate that program?

Mr D'Ascenzo—Again, when we get to policy, one of the areas on which we provide advice is, as we interact with the community, where we see perhaps the outcome that is desired is inconsistent with the policy intent or we see that there are significant compliance

costs that perhaps seem to outweigh the policy intent. In those cases we would work with Treasury in providing that advice to government. It is part of our role, but it is a minor role in the scheme of things, and ultimately the shape of the system is a matter for others.

Senator WATSON—Following the call from CPA director Gary Addison, does the tax office intend to employ tax experts to staff the hotline, rather than relatively untrained call centre operators? The CPA national director, Gary Addison, said:

Generally agents avoid the phone because the service is so poor.

That is a quote from the *Financial Review* of 7 February 2006.

Mr D'Ascenzo—I had some people from my office, from the area looking after phones, ringing me up very affronted with that comment, saying, 'No, our statistics show that not to be the case.' Indeed our surveys in terms of the tax agents' satisfaction with our call arrangements has actually been improving quite significantly. What has occurred is that, rather than using the phone for these sorts of inquiries, people are using the tax agent portal, so there is a reduction in our phone calls but an increase in the use of the portal for agents to satisfy most of their requests.

I suppose when you get into more complex technical issues you have got to ask whether the phone is for tax professionals the right channel to be enacting those inquiries. I think there is a limit or a bar to what you can expect from a phone service where you want to get into more complicated arrangements. We do have other processes, like the private ruling system. We had trialled approaches that provided tax agents and professional bodies with quick responses to common answers. I am looking forward to working with the professional bodies to see if we can do more in trying to help them at that level. I think we have actually tidied up a lot of the irritants in relation to our operational systems, subject to the qualification that until I have an integrated processing system I cannot overcome all the irritants that they have currently. I cannot give them a fully integrated view of their affairs.

So we have got the operational side tidied up and now the next phase is to see what we can do in helping them understand how the law might operate in relation to their clients' perspectives. The reason I say that is that, if I can help, say, one tax agent who then can deal with many clients, it is quite an efficient and effective way for me to try to provide through the tax agent as much help as I can for people who want to understand and comply with their rights and obligations. I see the tax agents as a very important leverage point in the community, and the first thing for me to do is to sit around a table with them and see whether or not there is something more we can do to make their jobs easier, because if they can ultimately work with us to explain areas of the law that might otherwise seem complex to others, then in a sense we are providing that simplification role in a practical sense by ensuring that the agents of taxpayers are able to do that without having to start from taws in understanding the issues themselves. So I do see it as a very important leverage point. I am not sure whether Mr Addison's point was totally on point, but if it is a situation that tax agents are looking for more discussion at a more complex technical level, then we will see what sort of processes we can put in place to facilitate that. I do not think a call centre is the right answer.

Senator WATSON—So when do you intend to have these meetings with the professional bodies to try and facilitate a good mechanism to resolve issues? Having to get tax rulings is a very slow method for something that should be fairly straightforward.

Mr D'Ascenzo—I have a heads of professional body meeting next month. We have an ATPF meeting coming up on Friday, the 24th. I cannot make that one, but I have asked some senior people to go there on my behalf. I have got the NTLG meeting and the next round of processes in the next couple of months as well, so there are some scheduled meetings that are in place, and, hopefully, we can get to the bottom of what might be required.

Senator WATSON—A case in point that I was involved with related to classes of income for Veterans' Affairs pensions, how some are assessable and others are not. It took going to the Department of Veterans' Affairs to get a schedule, because the call line just could not provide those sorts of answers and the detail that was required. A taxation claim, if you rang the tax office and got an answer, subsequently proved to be wrong.

Mr D'Ascenzo—That is surprising because, again, the criticism in Mr Addison's little excerpt in the newspaper was that tax office staff are directed by their own scripting to provide answers to what are the common questions. They are actually not authorised to go beyond that scripting to provide answers that they do not necessarily have the wherewithal to provide. So either our script was wrong, which—

Senator WATSON—That might be the problem.

Mr D'Ascenzo—In that case we would like the feedback and then we will try to fix it up. Or maybe that was not the case.

Senator WATSON—Where is the mischief that denies a life tenant an imputation credit? I refer you to an invalid person who has subsequently committed suicide, who was in receipt of moneys from a trust which was set up by his late mother, where the total income of that trust was less than \$25,000 and just provided ongoing support. There was nothing complicated in it. We have the problem of ATO interpretation decision 2002/122, which indicates that 'life tenants are not entitled to imputation credits from shares or units acquired by the estate after 31 December 1997 if their imputation credit from all sources exceeds \$5,000'. I ask where is the justice in that interpretation for that particular person?

Mr D'Ascenzo—I might have to take that on notice in the sense of what the background to the ATO ID 2002/122 is all about. My proposition is ultimately, without pre-empting what the answer might be—

Senator WATSON—That was interpretive decision 2002.

Mr D'Ascenzo—I understood that. The answer might be that that might well be the effect of the law, I do not know. I just do not know that interpretive decision.

Senator WATSON—The *Age* newspaper of 1 February referred to the ATO as being the worst offender of government agencies in spending public moneys without legal authority—that is, not in accordance with section 83 of the Constitution, which says,

No money shall be drawn from the Treasury of the Commonwealth except under appropriation made by law.

What was the nature of those withdrawals that were the subject of criticism?

Mr D'Ascenzo—I know the background, having been on the ATO audit committee and chairing that committee for some time, but I think Ms Moody is just dying to answer that question.

Ms Moody—That newspaper article referred to an ATO cross-portfolio performance audit referred to as the net appropriations agreement, also sometimes colloquially called the section 31 agreements. Section 31 of the Financial Management and Accountability Act allows agencies to in effect keep some revenue that they might raise. For instance, if they were to sublet a building that they were a tenant in, rather than that money immediately going back to consolidated revenue, despite the fact that the agency had to pay the rent, it allows the agency with the section 31 agreement, which is in effect an agreement between the Minister for Finance and the portfolio minister, to in effect appropriate that money to the agency for its use. The Audit Office looked at a range of agencies and, in fact, at the risk of not wanting to sound defensive, certainly we had some issues about being able to locate records. However, I would dispute the fact that we were the worst-performing agency in the Commonwealth. The Audit Office found in the audit that there were issues in their view with 52 agencies. Of those agencies, 16 had in effect no agreements in place, despite having kept some of the money; 23 had ineffective agreements and 18 had in-doubt agreements. We were one of the 18 agencies that had in-doubt agreements.

In effect our advice from the Australian Government Solicitor was that that did not constitute a breach of the Constitution, specifically section 83; however, it certainly meant that for a range of agencies, including the tax office, we needed to get—the technical nature of the agreement was we could not prove whether there was an appropriate delegation to the person who had signed that agreement. This is going back a fair number of years, to immediately after the introduction of the Financial Management Administration and Accountability Act.

As a result a number of agencies, including the tax office, entered a new net appropriation agreement in which there is no doubt. At the same time, to remove any doubt about whether any money collected under the prior section 31 agreements was valid or not, the secretary of Finance issued an instrument that in fact validated all money that had been collected, whether in doubt or not, so that there was no doubt that agencies could continue to use that money. So certainly we need to get better at our technical interpretation of how the financial management framework applies. I am very conscious of that and we are working through that issue. Certainly now we have an agreement which, by everybody's standards, is in accordance with the law in place, and the proceeds of any in-doubt agreements have been ratified by the secretary of Finance, as was his power to do so.

Senator WATSON—So the past arrangements would have been ratified on the basis of some sort of documentary evidence that you produced to show your bona fides, or was it across-the-board ratification because of a technical problem in the interpretation of section 31?

Ms Moody—It was the second. It was an across-the-board ratification in light of technical issues raised in the course of the audit that had a range of legal interpretations applied to them as well. As one of the agencies in it I have to say it was probably one of the most

controversial audits, and there was a great deal of discussion about the interpretation of both the FMA Act and indeed to some extent the Constitution around that audit.

Mr D'Ascenzo—The outcome basically is, while we might argue that on the basis of advice that we have got there was no breach on the part of the tax office, we did not see the point in being defensive. There was a suggestion that this could be cleaned up by a new process, so we tried to ensure that all our future agreements satisfied the views of the Australian National Audit Office. We are now in the position, as Ms Moody has mentioned, where we are fully compliant with the ANAO recommendation as far as we know, and we plan to stay that way.

Senator WATSON—When the new change came into effect, the section 31 arrangements, did you seek advice as to the protocol to be followed before proceeding with the application of the benefits of section 31?

Ms Moody—That is part of the issue that we can neither prove nor disprove. We had a section 31 agreement signed by the then chief finance officer on behalf of the Treasurer. That agreement was also signed within the department of finance by a delegate within the department of finance. The issue about our in-doubt agreement was that we could not prove in definitive form that there was a delegation or an authority from the Treasurer to the chief finance officer at that time, and that is why the issue was in doubt. There are various legal interpretations about what may have been required or what could have been required, but that comes down to the essence of: we cannot find a piece of paper that says, in effect, 'The Treasurer says you can do this.' However, the legal advice provided to us from the Australian Government Solicitor says that, certainly since that time, we are entitled to rely on the fact that senior officers in the tax office and the department of finance at that time believed such authority existed, in effect because we have documentation that they signed in a way that suggested that they did.

Mr D'Ascenzo—Ultimately, whatever the situation, we did not rest on that. We have changed our processes and we have gone forward. Really, the time it came to our attention was past the time when that authority was being used.

Ms Moody—Yes.

Senator WATSON—In terms of section 31, since the protocol has been changed, what parliamentary evidence is there of the tax office's use of section 31? Are you required to list in the parliament, in your annual report, transactions that do not go through the normal course of section 83 of the Constitution? Is there a requirement that, for example, these must be reported in your annual report? How does the parliament know what moneys you have kept under these arrangements?

Ms Moody—There are certainly included in our financial statements the receipts and the related expenditures. In terms of how they are separately identified, generally on the face of our departmental income statement they will be identified as 'other revenue'. I would have to have a quick look at the financial statements. I do not believe it actually says section 31.

Senator WATSON—So they are not identified as section 31. Do you not think it would be a desirable feature for good transparency that section 31 be there? It is a significant change

from the fundamental requirement that all appropriations have got to go through a process under section 81 of the act, which is approved by parliament.

Ms Moody—Certainly we could include disclosure of that in the financial statements. I will come back to you on notice about whether there already is some disclosure in there, because certainly in terms of expenditure appropriations there is a series of different notes within the financial statements but I cannot, off the top of my head, tell you whether section 31 is one of them. The other thing is that we have done a series of disclosure notes ourselves around issues raised with us by the Audit Office, which I think also cover this issue.

Senator WATSON—I am not querying that you are not returning it in some form, but rather that you are returning it in the form of other income. I would have thought that a special arrangement to get around the requirements of section 83, namely a section 31 approach, really should be a separate disclosure, and that is what worries me.

Mr D'Ascenzo—Ms Moody is going to check whether or not that is the case, and it may well be disclosed; if it is not, we will in our next financial statement make that disclosure in that way.

Senator WATSON—Ms Moody said that it is disclosed but under 'other revenue'. My concern is that if it is getting lost in 'other revenue', parliament loses sight of the fact that it is a special section 31 arrangement.

Mr D'Ascenzo—We would have no problems in trying to make that clearer statement.

Senator WATSON—Could you air this with the Audit Office to see whether a special disclosure is required and let the parliament know?

Ms Moody—I will talk to the department of finance about that if you would like, because they are certainly responsible for the content of the notes. The Audit Office looks at it and says, 'Have you done all you should?' but the department of finance controls the actual content. I will say in relation to the net appropriation audit on page 353 of our annual report that we do provide in a note disclosure about the effect of this audit on the 2004-05 financial statements, but when I look at it note 3(b), which is revenue from services, and also note 3(d), other revenue, it does not specifically refer to section 31.

Senator WATSON—It does not.

Ms Moody—Yes. That is the problem. We will look that up.

Mr D'Ascenzo—We will take up your suggestion.

Senator WATSON—I refer to division 7A of the Income Tax Assessment Act.

Mr D'Ascenzo—In fact, Mr Konza has some answers to Senator Parry's questions on division 7A. Would this be a good time to answer that before we start into your approach?

Senator WATSON—That is no problem.

Mr Konza—The way that benchmark interest rate is set is in accordance with subsection 109N(2), which says:

The benchmark interest rate for an income year is the Indicator Lending Rates—Bank variable housing loans interest rate last published by the Reserve Bank of Australia before the start of the income year.

However, the benchmark interest rate is the rate worked out under the regulations if they provide for it being worked out. I am advised that the regulations have never yet provided for a rate; we have always used the indicator lending rate, which is a standard published rate. It is not prepared for us. It is a standard rate. It is only set either by the Reserve Bank or by regulation .

Mr D'Ascenzo—So we do not have a discretion.

Senator PARRY—Part of your answer there included 'before the start of the financial year'. Is that correct ?

Mr D'Ascenzo—Yes.

Senator PARRY—So it is set in advance for the ensuing financial year?

Mr D'Ascenzo—The indicator lending rates are published regularly by the Reserve Bank and we take the last one before the beginning of the year to which they are to be applied.

Senator PARRY—So that would be the final June released or published rate?

Mr Konza—Yes. We publish a tax determination at the end of the year. Our last one, which set the 7.3 per cent rate, was tax determination 2005/31. So at the end of this year we will publish a 2006 tax determination simply informing everyone that this is the last published rate that we are using under subsection 109N(2).

Senator PARRY—Thank you, and the other matters are still on notice as in the aspect of variation, if there was a huge fluctuation, or it is locked into legislation.

Mr Konza—We do not have a discretion in that. I think the choice of the housing loan interest rate is a guard against fluctuations that might occur in commercial interest rates, seeing the housing loan rate is locked against real estate. But we do not have a discretion. However, the pressure valve, if you like, is that it can be set by regulation.

Senator PARRY—Thank you. And could I suggest that your website just needs updating with the current rate. Thank you .

Senator WATSON—Division 7A does not address the mischief in the transaction. It effectively brings all transactions within its scope, apart from two exceptions—that is, the franked dividend and the prior signing of a loan agreement. But the problem appears to be that the inadvertent breaches cannot be rectified. For example, you have an operation, say, in the bush with some bush accountants and they treat a transaction in those journals in a chronological sense without knowing tax law. Quite an inadvertent, unintended breach cannot subsequently be rectified, say, at the end of the year when the tax accountants look at it because it is what has been referred to in the profession as a 'drop dead' provision. There is no discretion from the tax office which can catch quite innocent, unintended consequences, quite often as a result of unintended staff off-site, where an operation might be conducted, whereas ultimately tax affairs are done in a capital city when the tax accountants go through it. I understand that the tax office people are having some grief in raising these sorts of assessments because of the penalties and the consequences that give rise to these so-called unintended breaches. Would you like to comment?

Mr Konza—I have two comments. Firstly, when our officers come across instances in which there are unintended consequences they generally try to work with the taxpayer to minimise the tax impact of that and to recognise the lack of culpability in any penalties or anything of that nature. So I would hope that that is not really a significant problem. The primary tax they might have a problem with, because they cannot simply ignore the law. But my understanding of where this issue mainly arose was in the requirement where loans were created, that the loan agreement be created at the same time as the loan was made. That is being remedied by legislation which now allows the creation of a loan agreement at any time up to the lodgment of a tax return so that, if people are inadvertently running up a loan account through the year, when it goes to the accountant for the preparation of the tax returns they are able to enter a loan agreement with the corporation and get themselves onto a footing that avoids 7A.

Senator WATSON—That is prospective, isn't it?

Mr Konza—No, in respect of that year. In respect of the year, yes.

Senator WATSON—But, in terms of tax audits in relation to these sorts of things, that does not help a lot of taxpayers.

Mr Konza—It is prospective in effect. But our auditors try to recognise people's inadvertence when they come across these issues.

Mr D'Ascenzo—Again, the shape of the legislation is a matter for Treasury. If that is the consequence of the legislation, as Mr Konza said, we try to do what we can in trying to take the taxpayer's situation into account, at least from a penalty and interest perspective, but ultimately our role is to apply the law.

Senator WATSON—But, as I say, I am referring to these transactions which are without mischief because of the nature and location of the particular entities involved.

Mr D'Ascenzo—That gets us to the question of how much discretion you want to put into a tax act or not.

Senator WATSON—There is no discretion here.

Mr D'Ascenzo—Exactly.

Senator WATSON—That is the problem. There is absolutely none. What are the strategies for collecting the so-called \$9.6 billion in tax debts, and what percentage approximately of that debt relates to the GST debt?

Mr D'Ascenzo—I will ask Ms Crawford to answer that, but to preface her remarks she will probably say to you that our systems do not actually allow us to work out how much of our debt is GST or otherwise. We work with our revenue analysis branch to make an informed estimate about how much of that goes to GST or otherwise. I just put that proviso to this sort of figure.

Senator WATSON—Could we have an informed estimate from Ms Crawford?

Ms Crawford—The figures that I have in front of me say that of—

Senator WATSON—As a percentage of the total.

Ms Crawford—Yes. They do not give me a percentage, they give me a total, which is, of the \$9.6 billion that you mentioned in collectable debt, \$5.4 billion.

Senator WATSON—Sorry?

Ms Crawford—Of the \$9.6 billion of collectable debt, the activity statement debt is \$5.4 billion.

Senator WATSON—GST is \$5.4 billion?

Mr Farr—That is not necessarily all GST. You will be aware that we have a running balance account, so all the different taxes on the activity statement are actually all collated. What Ms Crawford has referred to is activity statement debt. It is a consolidated figure which would include GST.

Senator WATSON—So GST debt is quite high. Are those strategies, as reported in the press, about using outside debt collectors correct?

Mr D'Ascenzo—We are looking to trial an approach to use not so much outside debt collectors but a debt collection agency of the type that was being used in the Commonwealth beforehand that has a basic understanding of Commonwealth requirements in terms of privacy, security and professionalism. I understand that Centrelink have used this debt collection process in the past and we want to trial it with small debts where we have basically tried to contact the taxpayer, originally by letter and then by telephone call, and the next port of call for us being to take some very firm action. We want to allow our debt collection agency to make that contact and just see whether or not they have any better outcome than we have had so far. It is a trial; we will evaluate how it operates. In a sense, rather than it being a pressuring exercise, it is really trying to help give taxpayers one last help before ultimately the option for us is to take firm action.

Senator WATSON—Will the Taxation Office be implementing greater security on its online services, such as requiring taxpayers to use digital certificates as well as passwords?

Mr D'Ascenzo—That sort of level of security has been operating in our business area and we have been having public key infrastructure to provide that security in our portal between business and ourselves, and we also have a range of security requirements for tax agents. I am not sure about individuals, though.

Senator WATSON—Do you use digital certificates?

Mr D'Ascenzo—Yes, we do. I think we are by far the largest Commonwealth agency using those certificates.

Mr Farr—I missed the first bit of your question. Was that digital certificates for individuals?

Senator WATSON—Yes.

Mr Farr—No. We do not use digital certificate technology for individuals at all.

Mr D'Ascenzo—But we do use it for business.

Mr Farr—We use it for business and we are moving progressively for taxation—

Senator WATSON—So it is used for business but not for individuals?

Mr Farr—Not for individuals, yes.

Senator WATSON—When do you intend to use it for individuals to provide a greater level of security?

Mr Farr—It is difficult to see a move to digital certificates for individuals, because most of the transactions that individuals have with the tax office is once a year and it is really not necessarily worth their while to go to the trouble of getting a digital certificate. What we are doing is working with other APS agencies and following the lead of Attorney-General's and others to actually look at the way that we could authenticate individuals more securely. We are looking at that, but I doubt that the answer, quite frankly, will be digital certificates because the interaction between ourselves and individuals is simply not frequent enough.

Mr D'Ascenzo—But, for businesses, we have in the order of 200,000 such certificates.

Senator WATSON—I have read in the press of some criticism of the STS, with fewer than anticipated taxpayers electing to enter the system. Can you assure us that there is no intention to abolish STS?

Mr D'Ascenzo—That would be a matter for government. I understand that the Board of Taxation has a wider brief in terms of compliance costs for small business and it may be looking at STS as part of that wider review.

Senator WATSON—What are the concerns with the STS? What concerns do taxpayers have of the STS in that they are not entering into the system as strongly as you and government had anticipated?

Mr Konza—About 27 per cent of businesses have entered the STS. There are about 600,000 people who have elected to enter the STS. So it would be no small matter to abolish it all, to walk away from it. Part of the issue with the STS from our feedback is that some of the advantages are offset by requirements by banks and lenders and other people which have meant that, for example, in the early days of STS you could use cash accounting and you had to use cash accounting. We saw that as being a big advantage, but the feedback that we got over time was that many people were required by their lenders to use accrual accounting for quite prudent reasons and therefore felt they were not able to use it. The rules were changed recently to allow accrual accounting. I think there was some reticence amongst agents to move their clients, some into STS and some not into STS, because they would have to use two different approaches. It is a pretty strongly supported system. We have no cause to believe that it is not viable in the long term.

Senator WATSON—I think it is a good system. The criticism I have heard is that some of the benefits of the pooling arrangements are offset by the fact that, when you sell it, you effectively have to trace back the depreciation written off.

Mr Konza—I have heard that criticism as well, yes.

Senator WATSON—It requires a lot of recalculation, the effective maintenance of individual calculations, rather than having the benefits of the pooling which STS was intended to provide. It is not a problem where assets are disposed of in the long-term. If you held them for, say, 10 years and you have written them off, that is easy, but where, for example, you

have held them for, say, four, five or six years and the depreciation rate may not be all that high then I think it is a recalculation problem.

Mr Konza—I have heard that criticism. The STS provides a range of advantages which people have to balance, I think, with how they see their business operating. So some will choose to go in and some will not.

CHAIR—Thank you, Senator Watson. Senator Sherry, the Inspector-General of Taxation?

Senator SHERRY—Given the time and the priority, I will not have any questions for the Inspector-General of Taxation. I have questions, but they will have to go on notice.

CHAIR—We will put them on notice. Senator Watson, do you have any questions for the Inspector-General of Taxation?

Senator WATSON—I have and I will put them on notice.

CHAIR—So I will excuse officers from the Office of the Inspector-General of Taxation but indicate that you can anticipate questions on notice from Senator Watson and Senator Sherry. What about the markets group?

Senator SHERRY—I will have to take some advice on that. I understand Senator Wong did have some questions she wanted to ask.

CHAIR—We have to start with the ACCC at eight. Can I send the markets group away?

Senator SHERRY—To come back after the ACCC?

CHAIR—Yes.

Senator SHERRY—I do not see an alternative, frankly.

CHAIR—Do you know how long Senator Conroy is likely to be with the ACCC?

Senator SHERRY—A couple of hours, I understand.

CHAIR—That is probably right. What about the Productivity Commission?

Senator SHERRY—I have some questions, but I can put them on notice. I do not know about other senators from other parties.

CHAIR—The options are to ask the markets group to come back at 9.30 pm this evening or to ask them to come at 9 am tomorrow.

CHAIR—I think 9.30 this evening, because we then may run into a problem with ASIC and APRA, of which I know there are some substantial questions to be asked.

CHAIR—No other senators have questions for the Productivity Commission?

Senator WATSON—I have a problem with tomorrow morning at 9 o'clock.

CHAIR—The Productivity Commission was listed for this evening. Do you have any questions for them or can I send them away? The Productivity Commission then are also excused. Any senators who may have wished to ask questions of them will have to put their questions on notice. The markets group of Treasury will not be required before 9.30 pm this evening. We will proceed with these officers until 6.30 pm, and then we will resume at 8 pm with the Australian Competition and Consumer Commission.

Senator SHERRY—I have a couple of quick issues in respect to the regulation of small SMSFs, self-managed superannuation funds.

Mr D'Ascenzo—Before we do that, I want to clarify: we were asked about the GST debt outstanding and the answer we gave was in relation to the BAS, the activity statement, which includes pay as you go, withholding, and a range of other things. My information is the estimated total GST debt outstanding is \$2.994 billion to the end of November 2005. So that would make the ratio slightly less than Senator Parry made. I wanted to correct that because it left a different impression. It is still a high amount.

Senator WATSON—So 50 per cent of that is PAYE?

Mr D'Ascenzo—That is four out of 9.6, so it is 40 per cent.

Senator WATSON—That is a bit of a worry, is it not, because that means other people's money has not been returned. In other words, employers have not been remitting their tax obligations in respect of their employees?

Mr D'Ascenzo—No, this is the GST. \$2.994 billion was the GST component for the BAS.

Senator WATSON—Yes, but if the 5.4 is the total off the BAS, the only other element on the BAS is the PAYE withholding tax?

Mr Farr—There are a number of other things on there.

Senator WATSON—But that is the big one?

Mr Farr—It is the big one, yes.

Senator WATSON—So there are a huge number of employers in default of their withholding deductions for PAYE?

Mr Farr—There are some other big ones. It is probably the biggest. We would need to check that, but there are things like—

Senator WATSON—How many taxpayers are in breach of not regularly remitting PAYE withholding deductions?

Mr D'Ascenzo—I do not have that figure offhand. I will take that on notice.

Senator SHERRY—A couple of issues I wanted to raise in respect to the regulation of small self-managed super funds. Has ASIC been in contact with the tax office about any aspects of these funds, particularly in respect to Westpoint?

Ms Vivian—We have a number of joint meetings with ASIC. We have a memorandum of understanding where we work regularly with them. In terms of a specific taxpayer, I am not in a position to comment on that.

Senator SHERRY—I am not asking about a specific taxpayer. Have you heard of Westpoint?

Ms Vivian—Yes.

Senator SHERRY—I am not asking about an individual taxpayer, I am asking about the number of likely small superannuation funds through which Westpoint has been identified as an investment?

Ms Vivian—Are we aware of those, is that the question?

Senator SHERRY—Yes?

Ms Vivian—No, I am not aware of how many self-managed super funds have been affected by Westpoint.

Senator SHERRY—Has ASIC raised this issue in any context with the tax office, specifically relating to Westpoint and the impact?

Ms Vivian—We have a memorandum of understanding; we meet regularly with ASIC. We monitor any press releases they put out. Probably in those terms, that is where we would be aware of any issues.

Senator SHERRY—So nothing specific, that is what you are saying?

Ms Vivian—Not to my knowledge.

Senator SHERRY—My understanding is that a substantial proportion of the taxpayers affected by Westpoint, and this will be explored with ASIC, the moneys were invested through an SMSF, but you have done no specific work as a consequence of ASIC identifying Westpoint and its particular problems?

Ms Vivian—Certainly we look at self-managed super funds. We are aware and monitoring, looking at where the risks in terms of how they are being regulated or meeting their SIS requirements. That is probably the work that we have been looking at.

Senator SHERRY—How many of these have been monitored and checked, say, in the last calendar year or financial year?

Ms Vivian—Of self-managed super funds?

Senator SHERRY—Yes?

Ms Vivian—We have a range of the ways we deal with self-managed super funds. It is certainly put on notice that we are concerned about some of the areas of compliance with the SIS regulations, particularly over the last year. What we do is that we range from both education activities to strong compliance activities. In terms of the actual numbers of what we have been doing, any new self-managed super funds that come into us, we focus very much in trying to get them on the right track at the start. So we look to send out booklets to them. We have also been trialling, or piloting, a phone-type approach where we are ringing up some of the trustees of new self-managed super funds to make sure they are aware of their obligations and are meeting them. In addition to that, we are working with professional bodies to look at how we can assist and improve auditors. In terms of hard compliance action, what I call where we are taking the more formal audits, our aim or program this year was approximately 3,600. Probably about the end of December, we had actually undertaken 1,540 of those audits.

Senator SHERRY—That 3,600 is for this financial year?

Ms Vivian—Yes, that is for this financial year.

Senator SHERRY—That is a small proportion of the number of these, isn't it?

Ms Vivian—It certainly is a small proportion. Where we look is certainly to leverage into the self-managed super funds. There are three key stakeholders for self-managed super funds;

there are the trustees, the auditors and then there are the tax agents that are assisting with the preparation of their income tax. So what we look is for a range of activities that help us get out into that market. We also work very closely with the professional bodies in this area as well.

Senator SHERRY—One of the difficulties in this area that I have encountered is actually getting some statistical data, in the same way that APRA presents data about a cross-section or, in its case, the entire other categories of superannuation-type funds, such as range of investments, level of holdings, fees and those sorts of things. That is just not available. Would you agree with that?

Ms Vivian—We actually have also had that feedback from industry about that and they see the tax office as one of the key people that hold that data. We do run a super consultative committee and one of the areas that we have discussed with them, and are about to start some work, is to work with them about what might be some of the data that might be useful in understanding this industry and see if we can look at what we might then put in our taxation statistics booklet to assist with this area.

Senator SHERRY—ASIC have indicated that an amount less than \$200,000—and I think they were right but brave in nominating a figure—as an amount below which should not be in an SMSF. Do we have any data on that? How many contain an amount less than that figure of \$200,000?

Ms Vivian—I can certainly take that on notice to have a look. I do not have that with me here.

Senator SHERRY—Have you seen the questions I put on notice about this issue of data, the specific questions? I put them on notice last November.

Ms Vivian—Yes, I have seen them.

Senator SHERRY—Is there any indication of when that data would be supplied?

Ms Vivian—They are currently with the minister's office.

Senator SHERRY—Do you know when they were passed to the minister's office?

Ms Vivian—I am not aware. I think possibly around December or January, but I am not quite sure.

Senator SHERRY—That is the assistant treasurer?

Ms Vivian—Yes.

Senator SHERRY—What is your budget for the regulation of this particular area?

Ms Vivian—For the regulation of self-managed super funds, I would have to take that on notice because the way that I look at my budget is probably how we spend money across our education and cost compliance, and it is not structured as such. In fact, I think it would be difficult to get to the actual budget we spend on self-managed super funds.

Senator SHERRY—But a levy is paid?

Ms Vivian—There is certainly a \$45 levy paid by self-managed super funds.

Senator SHERRY—Yes, which is hypothecated, is it not, to the regulation of this area?

Ms Vivian—I think that levy was established some years ago.

Senator SHERRY—But you are suggesting it is not enough?

Ms Vivian—It is not for me to suggest that.

Senator SHERRY—But it is collected supposedly on the basis of the cost of regulation. It is a contentious issue, the level of levy applying across categories.

Ms Vivian—My understanding is that the levy was set particularly low for the self-managed super funds. We have been regulating them since October 1999. That was when the levy was set. I should imagine that no doubt with inflation there probably have been some shifts as well.

Senator SHERRY—I am conscious, though, that it is well over 200,000 now—the number.

Ms Vivian—In terms of self-managed super funds?

Senator SHERRY—Yes.

Ms Vivian—It is about 308,000.

Senator SHERRY—It is even higher. In terms of the asset holding, it is a very substantial and rapidly growing proportion of our total superannuation savings pool. You have given a figure of 3,600. I accept others would have been subject to education, advice and all the rest of it, but it is a very low proportion. If you compare this with the activity that APRA is carrying out, for example, in its current licensing—very vigorous—you see there is not the same approach in respect of an SMSF.

Ms Vivian—There are roughly 311,000 self-managed super funds at the moment. They are growing by about 2,000 a month. What we are always looking for are what are our really key leverage points, such that we can make a difference in that market. When they are setting up, we find that it is worth while investing some time to make sure that they are on the right track and are meeting their right obligations. Whilst I talk about the hard audits, as I said, there is a number of other areas in terms of both education and some of the phone calls that we are starting to make just to talk to some of the trustees and auditors. We also action auditor contravention reports as part of that as well. There is a range of activities.

Senator SHERRY—I understand that, but APRA is going through, I am sure you are aware, the current licensing process, which is very rigorous, and applying that to trustees. But there is not the same approach in respect of this class of fund, is there?

Ms Vivian—I think it is different. The numbers that APRA is dealing with is substantially less than ours.

Senator SHERRY—Yes, but that is my point. That is one of the points that I am making. You have an area that is growing rapidly and a substantial part of our superannuation pool that is not having the same level of rigour. This is not a personal criticism of you or the tax office for that matter. It is not being subject to the same level of rigour and it is growing dramatically/significantly. Other areas of the superannuation system are being subject to very rigorous requirements on relicensing—the whole lot of them, all of them.

Ms Vivian—That is true. The distinction I would make there, though, is that we have a regulatory responsibility in terms of making sure that the self-managed super funds meet the requirements of the SI(S) Act, whereas APRA, and certainly the self-managed super funds, were set up with some less onerous prudential requirements. Again, I emphasise that we do see some non-compliance in this market, and we look for what we can do in terms of risks to make sure that these self-managed super funds are meeting the requirements.

Senator SHERRY—Going back very briefly, you indicated discussions with various groups about production of data. Is there any timeline on when we are likely to see any production of a set of data?

Ms Vivian—The timeline in terms of that would be about enhancing our taxation statistics booklet. That would not be this financial year but it would be the following year.

Senator SHERRY—Presumably at the end of the following financial year?

Ms Vivian—Yes, the end of the following year.

Senator SHERRY—It is still a long way away. Just one other brief point on this area: is it permissible, allowable, for an individual who is a trustee of their own fund to effectively pay themselves from the investment savings proceeds of the fund as the administrator and investment manager if they do that themselves?

Ms Vivian—I will check that out, but my understanding is that, as the trustee or administrator of self-managed super funds, a part of being a self-managed super fund is that you cannot pay.

Senator SHERRY—What if the individual who is the trustee owns and operates their own administration and investment company/structure/entity? So it is legally a separate entity. It just seems to me difficult, but I have heard of this practice going on. It seems to me it would be difficult under the current SI(S) Act to argue, provided the fees were not consuming a significant proportion of the moneys under investment—I will give you an example, the admin fee and the management fee were \$20,000 or \$30,000 a year and the investment totalled half a million dollars in the fund—why that would not be permissible. I am not suggesting it should happen, but this issue has been brought to my attention and it does seem to me, if you use that hypothetical example in your examination in this area, that that would not be in breach of the sole purpose test and could happen.

Ms Vivian—I think that is where we would have to look at the facts of the case, and obviously you would be looking at whether the sole purpose test was in breach.

Senator SHERRY—If you could take that on notice, anyway. It has been suggested to me that, depending on the facts of the matter, the case would not contravene the sole purpose test. Effectively, the individual, by being an administrator/manager, et cetera, of their moneys, it is de facto early access, if you like.

Ms Vivian—That is right, and I think that is one of the things we would be looking at.

Senator SHERRY—I do not have any further questions in that area. Could I just confirm that in your previous role you were the Second Commissioner (Law) and reported directly to the tax commissioner?

Mr D'Ascenzo—That is right.

Senator SHERRY—Is it fair to assume that the tax commissioner would be aware of major tax litigation involving the ATO?

Mr D'Ascenzo—I would have thought—no, I do know—basically we had a litigation report that was provided to me and also the commissioner.

Senator SHERRY—Is there anything to prevent, of which you are aware, a commissioner acknowledging or saying that legal proceedings are afoot once they have commenced, and legal proceedings for which the papers and documents have been lodged in a court? Is there anything to prevent the tax commissioner disclosing that that process has occurred?

Mr D'Ascenzo—I am not sure about the answer to that. The area of what is in the public domain, what can be used and what has been acquired by an officer in the ordinary course of their duties is actually quite complex. I continually go to the Crown Solicitor to get advice on some of these matters to ensure that there is no breach of our secrecy provisions. I am not quite sure about that answer.

My own view had been that, once information had become public and was on the public register, it would be no longer necessarily advice acquired in the course of our duties, even if we had acquired it that way; being public, the secrecy provisions would not apply. I have recently received advice from the Crown Solicitor that takes a different view.

Senator SHERRY—In what context has that advice been provided to you?

Mr D'Ascenzo—The context was the extent to which we could use prosecution action in relation to our ATO officers.

Mr Farr—Yes, it was both, I think, for ATO internal officers, how much we could use that; the second one was for areas like barristers and things like that, where the matter had actually been brought to court. Was it then on the public record and could we actually provide that to the relevant professional associations? In that case the Crown Solicitor's advice was, no, we could not; it was still covered by the relevant secrecy provisions.

Senator SHERRY—Given that opinion you have recently received, how will this matter be clarified?

Mr D'Ascenzo—We have informed Treasury of the issue and Treasury is in the process of raising the matter with government.

Senator SHERRY—So there may be a possible legislative change?

Mr D'Ascenzo—That is a matter for government.

Senator SHERRY—Can you recall approximately when this legal view was presented to you, or the tax office?

Mr Farr—Not exactly, but well and truly over 12 months ago—18 months or more.

Senator SHERRY—Over 12 months ago?

Mr Farr—Yes.

Senator SHERRY—You would be aware that the Treasurer's office made a request of the tax commissioner in early 2003 in regard to the tax affairs of Mr Gerard; are you aware of that?

Mr Farr—Yes.

Senator SHERRY—That was in early 2003. Was that before this opinion was received?

Mr Farr—No, that would have been well after it.

Senator SHERRY—After?

Mr Farr—We would have had the opinion well before that.

Mr D'Ascenzo—Sorry, is that right, in the sequence sense?

Mr Farr—I am sorry.

Senator SHERRY—The opinion was received—

Mr Farr—I would have to take that on notice. It might be around the same time.

Senator SHERRY—We are looking at early 2003?

Mr Farr—That is right, 2003.

Senator SHERRY—You will check to see when that opinion was provided to the tax commissioner. Let us assume the tax commissioner had not received that advice in early 2003 when the Treasurer's office contacted the tax commissioner. If he had not had that advice, would it not have been reasonable for the tax commissioner to refer to the legal proceedings already under way in respect to Gerard Industries?

CHAIR—Senator Sherry, I wonder if that is not a bit of a stretch too far. It is sort of a double hypothesis that, if something which has not been conceded had happened, then would it not have been reasonable for something else to have been done that may or may not have been done.

Senator SHERRY—But I can pose the question.

CHAIR—I think you can ask a hypothetical question, but there seem to be so many hypotheses and non-conceded assumptions wrapped up/rolled up in your question.

Senator SHERRY—I will pose it another way.

CHAIR—I doubt whether it is a fair one.

Senator SHERRY—It is not for you to determine, frankly.

CHAIR—It is for me to determine the fairness of a question. It is for me to determine whether a question is fair to a witness. That is part of the chairman's obligation to keep order.

Senator SHERRY—Are you aware as to why the then tax commissioner, Mr Carmody, did not inform the Treasurer's office about the then public availability of a tax dispute between the tax office and Gerard Industries?

Mr Farr—My understanding is that his view was that the secrecy provisions would not allow him to.

Senator SHERRY—Do you have any basis on which you have reached that conclusion?

Mr Farr—That is my understanding from simply being in the office around that time, yes.

Senator SHERRY—Had this view been formed on the basis of the legal advice that you referred to earlier?

Mr Farr—The legal advice that we referred to earlier was perhaps a further strict interpretation of what was already a very strict area of the law. It is very generally the case, and always has been, that we do not speak publicly to other than the taxpayer about the affairs of an individual taxpayer.

Senator SHERRY—Yes, I understand that and I understand the secrecy provision. We discussed it before. This was a publicly available document registered in the court that any member of the public could access if they so wished.

Mr Farr—Yes, and whatever doubt there would have been I think the Crown Solicitor has made it clear in his view that that is not a publicly available document simply because it is available in the court.

Mr D'Ascenzo—But that advice was in relation to a different matter that had to do with providing information about whether or not we could give the law societies information about barristers that had been prosecuted under our processes.

Senator SHERRY—It is a different matter. Are you aware that the tax commissioner wrote to Mr Gerard on 3 March 2003, amongst other things, saying:

As requested, there are no current disputes in relation to your personal tax affairs.

The letter addressed to Mr Gerard said, 'As requested', rather than 'As you requested'. Was that a request from Mr Gerard or someone else?

Mr Farr—From Mr Gerard, is my understanding.

Senator SHERRY—Was the request from Mr Gerard by phone or written?

Mr Farr—Phone request is my understanding, once again.

Mr D'Ascenzo—I can add that I have seen a note on file made contemporaneously by the former commissioner to that effect.

Senator SHERRY—On the phone request, is that an acceptable level of proof that you are actually speaking to the right person? Otherwise, anyone could phone up the tax commissioner and say, 'Look, I need a letter from you' and it may not be the person as claimed.

Mr Farr—I do not know the particular circumstances of that phone call, but I assume that Mr Carmody has satisfied himself that it was Mr Gerard that we was speaking to.

Senator SHERRY—But how would he do that?

Mr Farr—I really do not know. He was obviously satisfied that it was the case.

Mr D'Ascenzo—But ultimately the information was provided to Mr Gerard.

Senator SHERRY—Yes, I understand it was, but I am just interested in how you could verify on a telephone conversation that that is the person you are in fact speaking to without any sort of written authorisation. This has implications for other people who phone the tax

office or, in this case, the tax commissioner and seek information. He has a direct line, does he, Senator Watson?

CHAIR—Maybe he felt satisfied that whoever made this call would have taken whatever reasonable and necessary measures to satisfy themselves they were talking to the right person.

Mr Farr—Yes, that is my assumption.

Senator SHERRY—Sure, but I am just exploring the difficulty I can see in actually doing it over a phone when there was no written authorisation.

Senator Coonan—Senator Sherry, who else other than Mr Gerard would have an interest in receiving that letter?

Senator SHERRY—No, I am talking about general taxpayers. I am sure that it was Mr Gerard, but if someone else rings up and says that he or she is a taxpayer, whether it is to the tax commissioner or the tax office, ‘I want you to send a letter out’, that there is no dispute, how would identification be carried out in that course of events?

Mr Farr—I am not sure whether you want me to get into a call centre environment where people are calling. It is a completely different circumstance and we actually have very strict proof of identity proceedings where, in essence, it is shared secrets. We actually ask them things that only they would know. That is in a bulk environment, if you like.

Senator SHERRY—Gerard Industries was certainly in the bulk environment.

Mr Farr—Handling calls in large numbers.

Senator SHERRY—Yes, but whether it is handling calls in large numbers, there are still specific taxpayers involved here.

Mr Farr—Indeed. As I said, I assume Mr Carmody satisfied himself that it was Mr Gerard calling.

Senator SHERRY—The ATO’s prosecution policy, obviously with the DPP, states:

Offences involving taxation matters should be prosecuted by the DPP under the Crimes Act or the Crimes (Taxation Offences) Act where serious fraud on the revenue was involved.

To some extent we discussed this a little earlier. What is meant by ‘serious fraud on the revenue’?

Mr D’Ascenzo—The practice statement does go into detail there. One example is very much the drug barons you mentioned earlier.

Senator SHERRY—Is ‘serious fraud’, though, constituted by the size of the money?

Mr D’Ascenzo—I think the definition under the law relates to the level of sanction that the law itself imposes. Off the top of my head, I think if it is an indictable offence with more than two years maximum penalty then it becomes a serious offence, but I might be wrong. Mr Monaghan is nodding in agreement, so I must be right.

Senator SHERRY—Mr Monaghan, you should be at the table to affirm agreement verbally. The nod is not recorded.

Mr Monaghan—Mr D’Ascenzo was doing fine, so I did not think there was any need to come.

Senator SHERRY—I think he felt the need. He is learning fast. Let me put it to you: does not an issue around \$250 million constitute serious prima facie fraud on the revenue?

Mr Monaghan—I am not going to speculate on individual cases. The prosecution guidelines are an application internally under the Commonwealth prosecution guidelines, which contain a wide range of factors and considerations that are taken into account.

Senator SHERRY—Let us use a ball park figure of \$100 million. Does that prima facie constitute a serious fraud on the revenue?

Mr Monaghan—There are a lot of assumptions in there. Fraud is obtaining a benefit dishonestly and there are different ways of dealing with tax issues such as that. Criminal prosecution is one remedy that requires the approval of the Commonwealth Director of Public Prosecutions. Decisions are made on all those factors at various times in the process.

Senator SHERRY—In respect of the settlement on Gerard Industries, was the DPP consulted on this issue?

Mr Farr—It would be inappropriate to discuss the individual affairs of a taxpayer before this committee.

Senator SHERRY—I understand that in a speech in January, Mr D'Ascenzo, you said:

We are working closely with law enforcement agencies on the abuses of the tax system that appear to be blatant, artificial and contrived. The effective resolution of that work through the courts will send a message to the tax system that the community does not tolerate egregious tax behaviour.

Do you recall that?

Mr D'Ascenzo—I do.

Senator SHERRY—Yet we have here a case in respect of Gerard Industries that appears to be a very good example of this.

Mr D'Ascenzo—As Mr Farr said, we are trying very hard not to narrow this discussion to the particular facts and circumstances of the case.

Senator SHERRY—The particular case, yes.

Mr D'Ascenzo—Perhaps I can approach this in an elliptical way. My approach might be this. I actually drafted the first set of guidelines and memorandum of understanding with the DPP many years ago. They have been refined, but basically the propositions remain the same. Where there are questions of serious fraud, our approach is to refer those cases to the DPP. While I have not checked every single case in our total portfolio, my working assumption is that, if there is serious fraud and it comes within those guidelines, we will refer it to DPP. If it is not within the guidelines, we handle it on our own.

Senator SHERRY—Do you have statistics on an annual basis of the number of cases that you have referred to the DPP, let us say, for an amount over \$1 million, a significant amount?

Mr D'Ascenzo—I am sure we would have that information.

Senator SHERRY—Then of that referral, how many the DPP chose to prosecute and how many were prosecuted successfully?

Mr D'Ascenzo—The first part is certainly within my bailiwick. I am just wondering perhaps whether the second part might be more in the public prosecutor's bailiwick.

Senator SHERRY—We will deal with the DPP. If you could give us the data on that number, say over the last five years, a quantum more than \$1 million.

Mr D'Ascenzo—I know we have that information. It is quite appropriate to provide that to you.

Senator SHERRY—You went on in that speech to say:

You will sometimes get situations where the state of the evidence or the timeframe of the prosecution or the prospects of success, all documented with the benefit of external advice, it is better for the Commonwealth to take a certain amount rather than pursue something that might not be able to be garnered.

Is that a call that is taken after advice from the DPP?

Mr D'Ascenzo—The proposition is that, if it falls within the guidelines, we have to refer such matters to the DPP. We cannot settle matters by providing any agreement to not provide information to the DPP that falls within our guidelines or to pre-empt what the DPP might do with the matter. My comments there were more general in terms of the proposition of how does the community have some confidence that settlements are done in a proper and professional way and that there are inbuilt checks and balances. There inevitably is a number of players that all have to be involved in countersigning the decision, including advice from external counsel, and there might be situations where the DPP might also be involved, although that is not normally the case.

Senator SHERRY—Are these guidelines that you are referring to publicly available or are they an internal document?

Mr D'Ascenzo—I am not sure about those. They are. They were not until recently.

Mr Monaghan—The DPP site has got the Commonwealth prosecution policy and the ATO—

Senator SHERRY—I am referring here to the internal—

Mr Monaghan—The ATO prosecution policy is on the web site.

Mr D'Ascenzo—Our MOU with the DPP.

Mr Monaghan—The MOU itself.

Mr D'Ascenzo—I think that is what you are asking for.

Senator SHERRY—Yes. I am sorry.

Mr D'Ascenzo—You might want to ask the DPP about that. I do not think it is on the website.

Senator SHERRY—I understand the publicly available documents in respect of Gerard Industries concluded there was a deliberate and knowing intention on the part of Gerard Industries, acting through its directors, RG Gerard and others, to avoid the payment of tax; it was a flagrant disregard of the operation of the taxation law.

Mr D'Ascenzo—Again, we are going right into the details of a particular case.

Senator SHERRY—This was on the public record.

CHAIR—What was the question, Senator Sherry?

Senator SHERRY—In view of that conclusion, why did prosecution not take place?

CHAIR—I do not think he can say that.

Mr Farr—We are going to the individual taxpayer case.

CHAIR—Not only that, you were also asking a question that is perhaps more a matter for the DPP than the commissioner.

Mr D'Ascenzo—I was going to go on in terms of the checks and balances and return to our settlement processes more generally. As well as situations that there is no unilateral agreement to settle, in other words, it is inbuilt that other people need to be involved in the settlement arrangement, including invariably external counsel. In addition, we then have it put on a register within the organization, and then that is subject to our quality assurance. Our quality assurance panel includes an external expert, and that expert is there to make sure that the process has been due and proper according to our guidelines. It is also there for the Australian National Audit Office if they, again, also want to see whether we have exercised due process. The point I want to make is that these processes have rigorous checks and balances. As far as we can be within the confines of our secrecy provision, we are very much accountable and transparent in terms of the ANAO, the external person on our register and the external advice that we usually get in reaching these conclusions. Ultimately, the point I was making is that there is a responsibility for all government departments to determine whether the expenditure of more funds on a certain matter is likely to provide a commensurate benefit to the Commonwealth.

CHAIR—If there is a case in which there is a sufficient concern that a crime has been committed for you to refer the file to the DPP, presumably you do that in the first instance to seek the DPP's advice as to that matter. In the event that a prosecution is commenced, that is ultimately the DPP's decision, is it not, not yours?

Mr D'Ascenzo—Ultimately, whether to prosecute or not is the DPP's decision.

CHAIR—Is that a decision taken collaboratively with you or ultimately is it the DPP's own decision?

Mr D'Ascenzo—Ultimately it is the DPP's decision. That is not to say that the DPP does not have collaborative arrangements with us. It works as a partner in the process.

CHAIR—That is what I thought. Thank you.

Senator SHERRY—You have to provide the evidence or a large part of it, presumably.

Mr D'Ascenzo—That is true. Often in relation to such matters we engage the services of the Australian Federal Police.

Senator SHERRY—I notice in today's media there was some coverage about the telemarketing contact being made of small business. I can recall Mr Carmody announcing this program at the last estimates. I think that was the first time it became publicly known.

CHAIR—He was very proud of it.

Senator SHERRY—He was very proud of it. I am not sure whether he was considering moving on at that stage. It was announced, as I recall, publicly at the last estimates, and there has been some media coverage of this issue again, I notice, today in some sections of the media. In respect of this phoning to the homes of taxpayers who owe debts, what are the criteria for the calls, which I assume have commenced?

Mr D'Ascenzo—I have the criteria, but I think Ms Crawford might be able to provide more detail.

Senator SHERRY—When I say 'criteria', we are dealing here with small business, with taxpayers owing a certain minimum amount of money, the time lines, those sorts of issues.

Mr D'Ascenzo—That is right. We are providing that now. Can I say up-front that, as I mentioned earlier, I do not actually see this as telemarketing but rather as a last opportunity for us to try to make contact with the taxpayer to give them the opportunity of trying to put their tax affairs behind them in a way that suits their circumstances before we have to take more legal responses to an outstanding debt.

Ms Crawford—I think when you use the term 'telemarketing' you are actually referring to what the former commissioner described as piloting dialler technology, which is a form of technology—

Senator SHERRY—Whatever we call it—cold call canvassing.

Ms Crawford—that is really a productivity aid to the tax office. It helps connect our clients to a customer service officer and saves a lot of time and effort in contacting people that do not actually make contact. In terms of the criteria for selecting the population that we would be making calls to, you are correct in saying that we are largely focusing on the smaller business/micro segment. In particular, we are attempting to follow up with those taxpayers who fail to engage with us as a result of the small business debt assistance initiative, which was launched in the previous year. We are looking very much at taxpayers who have not responded to our efforts to make contact and obviously taxpayers who have debt that is now ageing, primarily debts between \$7,500 and \$100,000.

Senator SHERRY—This has commenced, obviously?

Ms Crawford—No. In terms of this particular pilot we are still working through the arrangements. We would hope to have it under way by about April this year or later maybe.

Senator SHERRY—What is the number of estimated taxpayers who will be attempted to be contacted in this way?

Ms Crawford—I am not exactly sure how many in this particular pilot. Obviously, there is a large number of taxpayers that meet those criteria that I provided, but I am not exactly sure what our particular target numbers are for this pilot.

Senator SHERRY—You say a 'pilot'. Is this random selection of the category of people in the group you have described?

Ms Crawford—We hope to actually select segments of population to attempt to contact through this way.

Senator SHERRY—What do you mean by ‘segments’? Is it geographically based or industry based?

Ms Crawford—Primarily again using the criteria that I have already referred to, the amount of debt outstanding, the amount of time that that has been outstanding, our previous efforts to contact people et cetera.

Mr D’Ascenzo—Are you referring to the dialler technology or are you referring to the after-hours contact pilot? There are two initiatives.

Senator SHERRY—The after-hours pilot.

Mr D’Ascenzo—I think Ms Crawford was talking about dialler technology.

Ms Crawford—There are in fact three pilots. The one under way at the moment is an after-hours one, which is using our own—

Senator SHERRY—That is under way?

Ms Crawford—That is under way. It commenced on 31 January.

Senator SHERRY—What is the approximate number of taxpayers to be contacted?

Ms Crawford—The aim in that pilot is to contact, I think we have, a population of 10,000 taxpayers. To date we have attempted to contact 2,800 and have actually made contact with a lesser number, just over 1,000.

Senator SHERRY—Just to clarify this, 10,000 are targeted in the pilot and there have been 2,800 attempted contacts?

Ms Crawford—So far.

Senator SHERRY—So far. Of that, 1,000 have actually been contacted?

Ms Crawford—Actual conversations that have engaged with the taxpayer and discussed payment arrangements or payment in full et cetera.

Senator SHERRY—In that attempt to contact the 1,000 contacted and spoken to, the 2,800 called, what is the number of calls? Presumably if you cannot make contact you go back again and again?

Ms Crawford—I am sorry; I may have confused you. When you say ‘telemarketing’, for me that is dialler technology. We are not using dialler technology for this after-hours pilot. We are just telephoning people in the normal way. The 2,800 are the client base that we have attempted to make contact with, and we have not been successful in all of those cases. As I say, we have been successful in contacting something over a thousand taxpayers.

Mr D’Ascenzo—The pilot in terms of after-hours contact started on 31 January, as Ms Crawford mentioned to you. The criteria were taxpayers with debts between \$7,500 and \$100,000. It was in relation to taxpayers that have a poor compliance history and have debts that are at least 180 days old, many in excess of 400 days. In the main, the contact will be with taxpayers that are in the micro market, taxpayers who have not responded to previous ATO contact via letters and phone and, as Ms Crawford said, taxpayers who have not responded to an initial interview in terms of the small business debt initiative. Of the 10,000, we are a third of the way through the pilot. We have had discussions with 2,880 people. In

fact, around 1,400 people—over a thousand—have entered into arrangements with us. We have collected \$3,800,000-odd from that exercise. We have had seven complaints.

Senator SHERRY—How many?

Mr D’Ascenzo—Seven. Of those seven, three have complained about the time of the call, one hung up after ATO identification, one taxpayer was unhappy—

CHAIR—There might not have been a complaint, if they hung up.

Mr D’Ascenzo—We just count it as a complaint. One taxpayer was unhappy about being called after hours and wanted to confirm that they were dealing with the tax office, which was proper enough. One taxpayer complained about the time of the call but went on to discuss matters with our officers and advised that he would contact the ATO after talking to their tax agents. One believed they had a nil debt, which we are following up to see whether or not that is true, and one complained saying that his tax agent did not advise him.

CHAIR—You are being a bit hard on yourself, Mr D’Ascenzo. Some of those are not really complaints about you at all.

Mr D’Ascenzo—We are conscious of the concerns and that is why I wanted to position this not in the context of trying to be hard on taxpayers but rather in the context of trying to give taxpayers a last opportunity to engage with us before we took more strident, firm legal action, which is going to be costly to taxpayers and much more onerous on them and costly for the Commonwealth as well.

Senator SHERRY—With respect to those you could not make contact with in the pilot program, was there any identification as to why that contact could not be made?

Mr D’Ascenzo—I am not sure, from my briefing.

Ms Crawford—There were certainly some issues with the currency of the information we have on our database about telephone numbers. The tax office previously has mostly communicated with taxpayers by mail and so unfortunately some of our telephone data is not as up to date as we would like.

Senator SHERRY—The non-contact category is a substantial proportion.

Ms Crawford—Obviously, it is because people are not home or not there when we ring, those sorts of things.

Senator SHERRY—Is more than one call being made if there is no answer?

Ms Crawford—I am not sure of that precisely.

Senator SHERRY—The ‘no contact’, is that simply no contact at all or is it someone answering and saying, ‘They don’t live at this address,’ or ‘You can’t speak to them’?

Ms Crawford—My understanding is there is no contact. In some cases, we have left messages on people’s answering machines and asked them to telephone us the next day, and some have.

Mr D’Ascenzo—The other point I suppose I should make is that, when we do make contact and people say, ‘This is not a convenient time for me,’ the offer is there for them to arrange a different time that is more convenient for them.

Senator SHERRY—Does this include mobile phone contact as well?

Ms Crawford—I do not have that information. I would doubt it.

Senator SHERRY—In terms of the data, the phone numbers, presumably you have obtained up-to-date phone number lists, cross-referenced to Telstra presumably and to other phone companies?

Mr Farr—Part of the problem we have in those areas generally is that a lot of the addresses et cetera that we have for taxpayers are by their tax agent, and it is actually making sure we have got the right person when the only address we actually have on file for them is that of their tax agent.

Senator SHERRY—So when there is an agent the address and phone number are not necessarily updated?

Mr Farr—Not readily available to us. We have to actually go—

Senator SHERRY—Not directly. It is an indirect obtaining of data?

Mr Farr—Yes.

Senator SHERRY—I cannot recall whether I needed to put my phone number on my tax return. Is it a requirement?

Mr D'Ascenzo—It is not a requirement, but there is a box that asks you to put in a contact number.

Senator SHERRY—Presumably you do have that data. However, a person may not update that through the tax agent?

Mr D'Ascenzo—That is right.

CHAIR—Do you have questions you wish to put on notice?

Senator SHERRY—I have a considerable number.

CHAIR—We can anticipate that. Mr D'Ascenzo, ladies and gentlemen, thank you very much for your attendance here this afternoon. You are excused. We will resume at 8 pm with the Australian Competition and Consumer Commission.

Proceedings suspended from 6.35 pm to 8.00 pm

Australian Competition and Consumer Commission

CHAIR—This hearing is resumed. I welcome to the table Mr Samuel, the Chairman of the Australian Competition and Consumer Commission, and officers of the commission. Mr Samuel, do you have an opening statement?

Mr Samuel—I do, Mr Chairman, but I will endeavour to make it slightly briefer than last time.

CHAIR—No, we enjoy your opening statements, Mr Samuel. Don't feel constrained.

Mr Samuel—If that is the case, I will make it substantially longer than last time!

Senator CONROY—He was joking. That was his sense of humour.

Mr Samuel—As some will remember, we last appeared before this committee on 21 November last year. There have been some significant developments of the ACCC since then. I will quickly summarise them. On 26 December, we launched the \$9 million consumer awareness campaign advising smokers that light and mild cigarettes are not a healthier option. That campaign included TV, radio, print and billboard advertisements that were aired nationally. As I said, they started on Boxing Day, and they will continue until the end of February. I think any objective observer of the campaign will be able to conclude that it has been relatively successful, on the basis that those campaigns can be successful.

On 9 February this year, we instituted proceedings against Toll Holdings Ltd in the Federal Court over a proposed acquisition of Patrick Corporation Ltd. The ACCC is seeking an injunction to prevent Toll acquiring any further interest in Patrick or taking any steps to acquire or exercise substantial influence or control over the business, assets or affairs of Patrick. At the same time, it is seeking from the Federal Court a declaration that, if Toll were to acquire shares in or assets of Patrick which would enable it to substantially influence or control the business, assets or affairs of Patrick, Toll would be in breach of section 50 of the Trade Practices Act. Without specific reference to the Toll-Patrick matter, I will be having some further words to say in relation to our merger processes and some of the issues that have arisen recently in relation to the informal clearance procedures that we adopt for merger clearances.

On 31 December last year, the Federal Court imposed a penalty of \$8.9 million on Australian Safeway Stores Ltd for price fixing and misuse of market power in the bread market. On 23 December last year, we initiated criminal proceedings in the Federal Court alleging that a Gold Coast based company and its managing director used misleading price comparisons in advertising diamond clearance sales across four states. We launched a public campaign in relation to advertising practices in the motor vehicle industry. I can say with some degree of satisfaction that the practices improved considerably following the concerns that were raised both privately and publicly by the ACCC. There was a rapid response by the industry in rectifying the concerns we had expressed.

I want to move now to three or four specific items and make some comments which I hope will indicate the attitude of the ACCC to a number of matters that are currently before us and that are coming up in the not-too-distant future. The first relates to mergers. As is well known, we have an informal clearance process which in October 2004 was subjected to a number of process improvements that were designed to bring about greater certainty, timeliness in decision making, efficiency, predictability and, above all, transparency and, with that, accountability on the part of the ACCC and merger parties in the way that the informal clearance process is conducted. We issued in October 2004 a guideline that set out the processes that we would be adopting from that date in relation to our informal clearance process. I should say that this process does evolve. It is not static. It evolves as the ACCC, business and advisers gain experience. It is designed around the best practice that has been developed by the member nations of the International Competition Network. Its foundation stone is transparency and accountability. We have a public register on our website which discloses, subject to confidentiality, all relevant factors, including time lines and competition issues of concern that arise during the process of an informal clearance.

We have now adopted the practice over the past 12 or 18 months of issuing competition assessments—that is, detailed explanations of the decisions we have made and the reasons for our decision. They go on our website. They are available there for perusal and examination by advisers and the business community. They provide a precedent as to our thinking in relation to competition markets, into the delineation and designation of market definitions. Of course, most importantly, they provide a measure of accountability as far as the ACCC is concerned for its decisions. While there was originally concern by practitioners and trade practice advisers about the adoption of the informal clearance process guideline, I think it is fair to say now that there is a widespread acceptance of and a welcoming attitude by the business community and advisers to the transparency and accountability associated with this process.

On 9 December last year, we issued a draft of new guidelines. ‘New’ is perhaps not the appropriate word because this is an iterative process. But it is a process of improving upon the informal clearance process that we have, based on producing greater certainty, timeliness, efficiency and transparency. We issued those new guidelines for comment. They were prepared after conducting an internal review of the operation of the informal process guideline over the previous 12 months.

The key amendments in the guidelines include an expansion of the types of mergers, including confidential proposals, for which processes are detailed in the guideline; clarification as to what process applies to the different types of mergers that the ACCC will review; new classifications for the various merger reviews undertaken by the ACCC; clearer and, I should say, shorter indicative time lines for informal reviews; an opportunity for merger and interested parties to provide a right of reply to an ACCC statement of issues; and the publication, subject to certain limitations, of those responses on the ACCC website.

Let me make it clear, because of some recent events, that, if the ACCC forms a view that an acquisition is likely to lead to a substantial lessening of competition, the standard process we adopt is that we will institute proceedings to seek an injunction. It is very rare indeed for us to proceed down the path where merger parties have to institute those proceedings for a declaration. That process did apply in relation to the proposed acquisition by AGL of Loy Yang in Victoria. It is very unusual. It is not a process that we would normally adopt. Our approach is that, if we consider that a party is likely to breach the Trade Practices Act, the obligation is on the ACCC to institute proceedings to prevent that breach occurring or to rectify any circumstances that may have arisen as a result of a breach that has already occurred. So it is not unusual for us to institute proceedings. It is the standard procedure.

If proceedings are instituted by the ACCC, they will be and always have been—and, in particular, will be in merger matters—instituted in a timely manner consistent, however, with adopting proper processes in accordance with the processes required by our court system. As a result, we will not have our time lines dictated to us by merger parties. We will not have them dictated to us by the media. We will adopt the appropriate process that ensures that, when we file a statement of claim, we have done the necessary preparatory work to ensure that a statement of claim and the necessary court documents have been prepared properly and properly signed off by counsel and that we present ourselves to the court in a proper, prepared manner. As I say, we will not be dictated to by merger parties or by the media.

I have to say that we have concern over a number of developments—five in particular—that have arisen as a result of the adoption of the transparency and accountability processes that we now pursue with some vigour and rigour in relation to informal merger processes. The first is our time lines. The time lines are put on the register in order that both the ACCC and merger parties can be transparent and accountable as to the time taken to deal with merger matters. The result has been a significant improvement on the part of both merger parties and the ACCC in the time lines involved in dealing with merger matters.

However, it is important to note that the time lines are indicative. We have found that, in some recent merger matters, the fact that a decision is not reached at a predicted time and date as specified on the website raises all sorts of speculation that maybe something has happened in relation to the merger that has meant that the decision has not been made—maybe the merger will lapse. There is a whole range of factors and speculation that occurs. I therefore need to indicate very clearly that the time lines are indicative. They are not sudden-death issues. They are not issues that preclude parties, whether they are merger parties or other stakeholders, from providing information to us, notwithstanding that the indicative time line set out on the register has since passed.

The second issue is the statement of issues. We issue now a statement of issues in complex mergers where we consider that there are matters on which we want to provoke and seek further information from stakeholders—that is, all interested parties. The statement of issues may contain a number of issues, which can be categorised in the broadest of terms under the following headings. First of all, there will be those matters where the commission will indicate that it does not have concerns on the information currently before it, and therefore these matters would not be relevant in ultimately determining whether or not there is likely to be a substantial lessening of competition. For convenience, I will call them the ‘green-light matters’.

There will then be those matters about which the commission will say, ‘We have concerns, although those concerns do not at this particular point of time lead us to conclude that there may be a substantial lessening of competition.’ But it may be that further information, particularly as a result of the publication of the statement of issues, will yield further information that might give rise to serious concerns that could lead us to conclude that those issues were matters that would lead to a substantial lessening of competition. I will call those the ‘amber-light issues’.

Finally, there are what I will conveniently call the ‘red-light issues’—that is, those matters that, on the information currently before us, lead us to at least a preliminary view or a preliminary conclusion that these issues are likely to lead to a substantial lessening of competition and therefore give rise to a breach of section 50 of the Trade Practices Act. For convenience, let me say this: a green-light issue does have the capacity to turn amber or red if further information is brought out as a result of the publication of the statement of issues. Likewise, an amber issue has the possibility of converting to either a green light or a red light, depending on what is brought out through the statement of issues. A red-light matter may well turn into an amber or a green light as further information is provided to us.

It is important that this is understood, because so often we find that matters that are, for example, amber lighted in a statement of issues are then discarded by the investment

community and by the media as being matters about which we have no concerns, and then surprise is expressed at a subsequent stage when it turns out that they become relevant factors in our final determination as to whether or not there is likely to be a substantial lessening of competition in relation to a proposed merger. The fact that an issue is or is not referred to in a statement of issues or is categorised in one manner does not preclude the issue being relevant or indeed vital in our final determination. But we have undertaken that there will be no surprises. We will revert to merger parties if new issues arise or if different positions—that is, different categorisations—develop concerning any particular issue.

The next issue I want to mention is the undertaking process. This is the process of dealing with undertakings that might lead to a conclusion that, subject to the provision of court enforceable undertakings under section 87B of the act, we will clear a merger to proceed which in the absence of the provisions—those 87B undertakings—would not be permitted to proceed and would not be cleared because it would breach the provisions of the act related to the substantial lessening of competition. In that context, let me quote from the media release we issued in relation to Toll and Patrick just a short while ago. We said this:

From late 2005 through to 13 January 2006, Toll put forward several versions of the undertaking in an iterative process with the ACCC. Toll's decision to lodge iterative undertakings caused substantial delays to the ACCC's consideration of the matter as, consistent with the Guideline for informal merger reviews, the ACCC needed to conduct an internal assessment as well as expose each substantive version of the undertaking to the market for consultation. The ACCC generally views such an iterative process as undesirable and inefficient.

I stress: 'The ACCC generally views such an iterative process as undesirable and inefficient.'

I have been endeavouring to explain to representatives of the business community and their advisers that the ACCC does not enter into negotiations in relation to 87B undertakings designed to avoid the application of section 50 of the Trade Practices Act—that is, the prohibition on a merger proceeding if it will substantially lessen competition. The ACCC is not in the business of entering into business negotiations where it reaches compromises. The ACCC's negotiating line in the sand is section 50 of the Trade Practices Act. Although that is not a fine line, it is not a very blurry line either. It is a line that is quite clear, subject to appropriate interpretations by the courts and appropriate definitions of markets and what might constitute a substantial lessening of competition.

Putting that aside, the ACCC do not have the flexibility or the mandate or remit to negotiate compromise positions in relation to 87B undertakings. Businesses either cross the line in relation to section 50 and provide undertakings that will satisfy us that a merger will not breach section 50—that is, will not be likely to have a substantial lessening of competition in the market—or they do not cross the line. As soon as business understands that the process we adopt in relation to undertakings is to explain what the issues are in relation to a potential breach of the act and to then say to merger parties, 'Provide us with undertakings that will bring you over the section 50 line', the easier it will be for business to perhaps move away from the iterative process and to recognise that it is undesirable, it is inefficient and that, frankly, the ACCC do not have the flexibility to reach compromise positions, as would occur in a normal business negotiating process.

The next item I want to mention is of increasing concern to us—that is, particularly with public takeovers involving publicly listed companies, we have noted that either on or off the record merger parties are making predictions via the media, and sometimes in statements made to their shareholders, regarding the ACCC's view on a merger proposal. Often these predictions can be very market-sensitive information. In our view, the predictions, where they are misleading, run the risk of significantly misleading the marketplace and significantly misleading shareholders. They are, in our view, a potential breach of part V of the Trade Practices Act relating to misleading and deceptive conduct. We are now taking the view that it may be our duty to inform other regulators or co-regulators—for example, the Australian Securities and Investments Commission and the Australian Stock Exchange—where we consider that, by one process or another, merger parties may be engaging in conduct that has the propensity to mislead shareholders and mislead the market as to the ACCC's view on a merger proposal or as to the prospects of the ACCC granting a clearance in relation to a merger proposal. I can only place that on the record and indicate to business that we are viewing these matters extremely seriously now. We consider it our duty to inform co-regulators where we consider that there is a possibility that the market is being misled.

Finally, there is the issue of confidentiality. Confidentiality is an important part of our merger process and, in particular, our informal merger process. However, we are finding ourselves at the present time subject at times to confidentiality imposed upon us unilaterally by merger parties in their communications. Those merger parties then ignore the confidentiality that they have imposed upon us and ignore it to their own advantage. The view of the commission now is that confidentiality in communications between merger parties and the ACCC will be preserved unless and until the party that has sought the confidentiality waives it by its own actions. In those circumstances, the commission will feel free at its discretion to disclose matters that might otherwise have been the subject of confidentiality.

I stress that we regard the issue of confidentiality as very important. We regard the ability of the ACCC to deal with merger parties on a confidential basis as a very important part of our informal clearance process. However, we are not prepared to see the commission's processes being gamed by parties that impose confidentiality on communications with the commission and then waive it by their own actions to their own advantage, hoping that the commission will let that waiver move through without response by the commission.

That is enough on mergers. I will now move to the issue of telecommunications. We have entered 2006 with a considerable workload in relation to telecommunications. Much of our telecommunications work is ongoing and subject to confidential processes, which means I cannot comment upon them in detail. That said, the current matters before the ACCC include the fixed services review, which was a broad-ranging strategic review that we initiated towards the end of last year that will examine the future regulation of certain key fixed network and wholesale services. The industry and public have until 17 February to respond to the discussion paper that we issued on this matter late last year.

We are dealing with the development of Telstra's operational separation model. We are doing that in conjunction with Telstra and the department. That also involves the development of an internal wholesale pricing regime. We will provide advice to the minister and her

department to assist in the consideration of the non-price aspects of Telstra's proposed operational separation plan when these become better known.

We have a number of arbitral disputes before us in relation to the unconditioned local loop and mobile services. We have the power to issue both interim and final determinations in relation to those arbitral disputes. We are dealing with Telstra's stated intention to charge \$30 for the unconditioned local loop. We are also dealing with its de-averaged ULL undertaking.

In early February 2006 Telstra announced its intention to charge users of the ULL a \$30 flat monthly national fee in two months, replacing the current fee that is de-averaged by geographical location. This pre-empted any decision by the ACCC in respect of Telstra's ULL undertaking that it submitted in late December 2005, which also proposed the uniform geographically averaged monthly ULL \$30 price. While the ACCC carefully assesses Telstra's new undertaking, ULL access seekers in dispute may notify the ACCC of that dispute. As I mentioned, we have the power to issue both interim and final determinations in relation to any dispute that is notified to us.

Finally, we have issued a consultation notice to Telstra in respect of its wholesale line rental. We are carefully considering material before us and expect to determine in a matter of weeks whether or not we will issue a competition notice to Telstra.

The next subject I want to cover is cartels. It goes without saying that cartel prevention and dismantling remains one of our highest priorities. We currently have 10 cases before the courts. Most recently instituted matters involve Visy Industry Holdings Ltd and others; Abalone Australia Pty Ltd and others; Auspine Ltd and others; Gullyside Pty Ltd; Barton Mines Corporation and others; and Anglo Estate Pty Ltd and others.

The immunity policy, which was developed in the middle of 2003, is a leniency policy and has now been developed into a full-blown immunity policy. It is working very well combined with the increased awareness, which we have deliberately brought about, of what cartels are about, where they can harm consumers, where they can harm the economy and where business might be harmed. We have developed a multimedia package concerning public procurement—that is, by government—and we are also developing a private procurement package and other specific initiatives to small business and consumers to promote the recognition, prevention and detection of cartels.

Since 5 September last year, which was the commencement of our new immunity policy, the ACCC has received a number of marker applications—that is, applications to put a marker down without actually providing detailed information about the possibility of the existence of a cartel—in order that a party can at least say, for a period of up to 28 days, that they were the first in the door and they put a marker in place. They then have a period of 28 days in which to come forward with a full immunity application. We have also received a number of immunity applications and a cooperation application. Details of all those applications are and will remain confidential.

We are particularly concerned not only about cartels but also other enforcement activity involving obstructive conduct that we are aware is being engaged in by businesses and some of their advisers. We are actively on the alert for any such conduct through our operations. Obstructive conduct includes lying to ACCC officers through informal interviews and lying in

section 155(1)(C) interviews, which of course are taken under oath and therefore that is perjury and non-compliance with section 155 notices. Under various provisions of the criminal legislation available in Australia, each of those activities can give rise to references to the DPP, prosecution and jail sentences of up to two and, in some cases, five years.

I should place on record that we are seriously considering the reference of some matters to the DPP in relation to obstructive activity that has taken place. We will certainly be making it very clear, and have already done so, in public statements and speeches that we have given that we intend to deal with obstructive activity very seriously indeed, with references to the DPP with a view to prosecution occurring and, if appropriate, jail sentences then being applied by the court.

Finally, let me deal with small business initiatives. We have long recognised that small business does not always have the same sort of resources as big business to spend on education and compliance. For some time now we have had a dedicated small business team to actively monitor the sector and identify education and compliance gaps and to develop and carry out educational campaigns and compliance actions designed to remedy the identified gaps, increase general awareness of the Trade Practices Act and maximise future compliance within the sector.

On 13 December last year, we launched our website, which is a small business easy access point. The link directs small business operators to the dedicated small business page, with all relevant information easily accessible to them. We provide up-to-date online information advertising warranties and refunds, dealing with other businesses, franchising, dispute resolution, product labelling and trade practice compliance programs. We have now a dedicated small business help line, which is separate from our normal info centre line, which is designed as part of our commitment to keep small business operators informed of their rights and obligations under the Trade Practices Act. It provides small businesses with a primary contact point to access information on their rights and obligations under the act as well as protections available to them. Small business operators can speak directly with staff who are highly trained in small business and franchising issues.

On 16 December last year we launched a streamlined authorisation process for small businesses in respect of standard collective bargaining arrangements. This came into effect on 1 January. You will be aware that for many years the ACCC has provided an accessible authorisation process for small business collective bargaining arrangements, allowing bargaining groups to form in areas as diverse as chicken growing, dairy farming, vegetable growing, concrete carting, pay television services and wagering. For some time we have promoted a simpler and more streamlined process, noting concern from small business over the time and cost involved in past authorisation applications. However, under the new streamlined process which commenced operations on 1 January this year, the ACCC will undertake to deal with applications for authorisation of collective bargaining arrangements by small business within certain timetables and with a better indication of likely outcomes, providing small business a greater certainty and a more timely process. We have undertaken to provide responses to interim authorisation requests within 28 days of receiving a request for interim authorisation. We have also undertaken to issue a draft determination within the first 28 days and a final determination within three months of receiving an application.

Applications for authorisation by small business in respect of collective bargaining arrangements are more likely to receive interim authorisation if they are voluntary, where the coverage of bargaining groups is limited and arrangements also have the support of the counterparty and are unlikely to be objected to.

Finally, let me make a comment in respect of unconscionable conduct. We are concerned that the issue of unconscionable conduct still raises some significant doubts in the minds of small business and their advisers, primarily as to the distinction between what is unconscionable conduct and what is otherwise tough or hard bargaining that would not otherwise be unconscionable conduct within the context of section 51AC of the Trade Practices Act. In recent times we have moved to prioritise from the mix of our cases investigations covering unconscionable conduct cases, particularly in the franchising area. The strong growth in this sector has the potential to attract unscrupulous operators. This makes it one of the areas that the ACCC targets, including the prospect of instituting criminal proceedings for misleading and deceptive conduct that may arise in relation to franchising matters.

We are also currently reviewing case materials with a view to potentially taking some more unconscionable conduct cases right through to court and with a view to clarifying unconscionability criteria provided by the Trade Practices Act. I think we would like to have some greater clarification, if that were possible, giving the specificity of the facts relating to specific unconscionable conduct cases to get some greater clarity from the court as to what is unconscionable conduct on the one hand and what is simply tough or hard bargaining on the other. It may assist us to administer those provisions and perhaps utilise them more effectively to assist businesses that feel they have been subjected to unconscionable or harsh and oppressive conduct on the part of large businesses with whom they are dealing. On that I will stop my introduction.

CHAIR—I have one question before I invite Senator Conroy to ask his questions. I want to take you back to your observations about undertakings concerning possible breaches of section 50. I thought it was a very adamant view you were expressing on behalf of the commission, especially your comments that the line beyond which one trespasses in breaching section 50 is not a particularly blurry line. That troubles me a bit, Mr Samuel, because it is not as if section 50 is a provision the language of which is particularly specific. Nor is it the case that there is a substantial body of case law that has built up over the years to interpret what section 50 means. I challenge how the ACCC can be quite so dogmatic and quite adamantly against some sort of negotiation in relation to undertakings on the assumption that you assert—that is, that the meaning of section 50 is tolerable clear.

Mr Samuel—Let me make it clear. I did indicate that the line in the sand is section 50. Section 50 is not a very fine definitive line. It has some blurry aspects, which I indicated were related to market definitions and to perhaps both legal and economic interpretations of what might constitute a substantial lessening of competition. Let me put it in these terms. That line is there. It is not a line where we can say, ‘Well, we do not have to worry about ‘substantially’. There’s a lot of movement.’

I perhaps liken it to these terms: if I have a house to sell and I say, ‘Look, my selling price is \$500,000,’ it would not be an unusual practice for a buyer to come along and say, ‘I’ll offer

you \$300,000 for the house.’ I would then say, ‘I’m not prepared to do that but I’ll drop down to \$450,000 or \$400,000’—or whatever it might be, and then we would meet in the middle. That is not the way that we can work in relation to section 50 of the Trade Practices Act. The \$500,000, to use my analogy, is pretty inflexible. It could move up to \$510,000 or \$520,000. It might drop back to \$490,000 or \$480,000. But it has not got that extent of movement that permits parties to say, ‘Why don’t we offer them \$300,000 and see if we can get them to come down from where they are.’

It is a matter of economic and legal advisers forming a view in their minds as to what the issues are—and we endeavour to help by providing both public and private comments to parties about the issues of concern to us in terms of a potential breach of section 50—and then, using the same economic and legal advice and expertise that they have available to them, determining what would deal with those concerns. It is not a matter of saying, ‘Let’s see if we can get away with offering this. If that’s not enough, we’ll offer a little bit more and then we’ll offer a little bit more and keep on moving it up.’

I might say that it is also not assisted by public comments such as, ‘We have been pinned to the wall by the ACCC on this,’ or ‘This is the final offer that will be made’ and then a week later another offer is made of an improved undertaking. That just simply becomes an inefficient and time wasting process.

CHAIR—I can understand perfectly why you have set your face against getting into a haggling situation, but my point is a slightly different one. I think it is illustrated starkly by the fact that you chose as a metaphor a quantitative example. Quantitative examples are easy. But the test in section 50 does not lend itself to ready quantitative comparison. Indeed, can you readily think of many cases where the legal and economic determination of what constitutes substantially lessening competition in a particular market has not been a matter of controversy among the experts?

Mr Samuel—It will always be a matter of controversy, but what happens is that—

CHAIR—That is my point. That is why I think it is a bit hard for you to be too dogmatic about it. Just because the ACCC takes one bit of advice does not mean that a firm under investigation, in stating a position which is at variance from the position the ACCC states on the basis of its advice, is merely haggling.

Mr Samuel—I think I need to put it in these terms. I will not deal with specific cases because it is not appropriate to, particularly a more recent one which is currently before the courts.

CHAIR—You understand my point, don’t you?

Mr Samuel—I do. Perhaps I will try to explain the point that we would like to make. So often these matters can actually come down to numbers—that is, if there is a bulk of assets that are being purchased, how many might be divested? Should it be five, should it be 10, should it be 15 or should it be 20? That will be a haggle. I am trying to emphasise that this is not a haggling process. There will be a line that may specify that, for example, 20 particular sites or 20 assets of a particular form need to be divested. There may be some movement in relation to that because maybe it can be determined that one or two of those sites will not necessarily give rise to a substantial lessening of competition. I guess the best practical

example is one that has now concluded, and that was the Woolworths proposed acquisition of Foodland stores. As it turned out, we—

CHAIR—Yes. But that was pretty easy. On the facts, that was a pretty easy case, which is no doubt why you choose it.

Mr Samuel—I would like you to have a discussion with some of our investigators on that as to how easy it was. There was an enormous amount of research. Keep in mind that that was a matter where a statement of issues indicated that there were seven or eight sites to be perhaps disposed of or which could not be acquired. As a result of the statement of issues, I think all of those sites were cleared in the end.

Mr Grimwade—That is correct.

Mr Samuel—It is a matter that can be the subject of clarification as a result of the statement of issues. Let's take a hypothetical example. Let's say that Woolworths said to us—this did not occur—'Look, we'll sell two sites.' We say, 'Twenty is what is needed.' 'Tell you what: we'll make it five. C'mon, come down to 15 and we'll see if we can reach a deal halfway.' It just does not work that way because what happens is we will analyse each site. We may come to different conclusions in relation to each site. But it is not a question of, 'We'll go to five. C'mon, come down to 15,' and then, 'Sure, we can strike a deal halfway in between. We know we're going to end up at around 10.' That is the haggle.

CHAIR—That is obviously haggling. My point is an earlier point. The definition of the line which may not be crossed does not seem to be nearly as exact a science as you seem to be suggesting it is.

Mr Samuel—Perhaps I have not explained myself adequately, Mr Chairman, but I am not suggesting it is a very specific line—in fact, I indicated that it was blurred. It was blurred by both economic definitions as to markets and the delineation of markets and as to what might constitute a lessening of competition in the market. They are both economic and legal interpretations as imposed by the Federal Court.

CHAIR—And for a firm to take a different position from yours is not necessarily haggling.

Mr Samuel—I guess I am indicating to you that we have indications from undertaking the negotiation process that business enters into a haggle. I guess I am encouraging business not to do that.

CHAIR—I do not think we can usefully pursue the dialogue any further.

Senator CONROY—Really? I could not agree with you more.

CHAIR—Senator Conroy, if you had been listening, you might have been illuminated. But it is your turn now.

Senator CONROY—I am advised that my office thinks you are right, actually, in the argument.

CHAIR—It is your turn now.

Senator CONROY—Thank you. My officer is on your side. I have a number of questions about the conduct of proceedings relating to Telstra's appeal to the ACT of the ACCC's

decision on pricing for the line sharing service. There have been some media reports today that the ACCC has chosen to accept Telstra's position on the network costs associated with the line sharing service, thereby avoiding scrutiny of this issue in the ACT. Is this an accurate characterisation of the ACCC's conduct in the case?

Mr Cosgrave—No, that is not an accurate characterisation of what has occurred before the Competition Tribunal. I will give you some background in relation to that matter. Telstra has appealed an ACCC decision to reject Telstra's access undertaking for the line sharing service. That undertaking expires on 30 June 2006. The tribunal indicated that it would need to determine its review prior to the expiry date of the undertaking, which self-evidently was fixed by Telstra when it lodged the undertaking.

Telstra's appeal raises quite a number of issues relating both to the specific costs of the service and to some issues in relation to network costs. However, the issues in relation to the network cost claim amount to less than seven per cent of Telstra's total claim costs for those services. So in order to ensure that the tribunal was able to make the determination by 30 June—and self-evidently there is a vast amount of material that would need to be considered in determining network cost issues—the ACCC undertook that, in the event that those claimed network costs would become important to the final decision, which is to accept or reject the undertaking, it would not contest Telstra's claim in these proceedings. It is extremely important to emphasise that the position was taken solely to facilitate the tribunal review in circumstances where it was otherwise uncertain that a meaningful decision could be reached. The position does not bind the ACCC, or indeed any others, in any other matter.

Senator CONROY—Does the ACCC need Telstra's consent to procedurally concede this issue?

Mr Cosgrave—No. It was a matter put to the tribunal. I think the commission sought whether Telstra was prepared to consent to remove certain paragraphs from its application. Telstra chose not to do so.

Senator CONROY—Could Telstra have contested this had they wanted to?

Mr Cosgrave—Telstra, recognising the timing imperatives the tribunal was under, could have chosen to withdraw its claim in relation to those network costs and chose not to do so.

Senator CONROY—If the ACCC has accepted Telstra's network costs in the LSS dispute, what issues are still in contention between Telstra and the ACCC?

Mr Cosgrave—It is accepted for the purposes of these proceedings that it will not contest their reasonableness for the purposes of those proceedings. The issues that remain are issues in relation to the specific costs for that service and over what services those costs should be spread, in summary.

Senator CONROY—What would be the impact of the ACCC's decision to accept Telstra's network costs on potential future challenges to decisions of the ACCC, such as ULL?

Mr Cosgrave—None.

Senator CONROY—What kind of precedent value does this LSS appeal to the ACT have for other potential ACT appeals of ACCC decisions?

Mr Cosgrave—None.

Senator CONROY—I also note that Telstra made the following comment about the ACCC's decision on its network costs:

The ACCC should allow the umpire to make a ruling, not leave the field just before full time.

Has Telstra ever left the field just before full time?

Mr Dimasi—Telstra did withdraw from a process before, yes. And that involved a full evaluation of the network costs.

Mr Cosgrave—The network costs have previously been the subject of an appeal, I think, in 2001-02, and that was ultimately withdrawn by Telstra.

Senator CONROY—So Telstra have done this themselves—left the field a few times?

Mr Cosgrave—Telstra withdrew their application.

Senator CONROY—Fair words, Mr Cosgrave. You are being very generous. Is the commission aware of the half-price bundled broadband offer introduced by Telstra in November last year?

Mr Cosgrave—Can you be more specific?

Senator CONROY—Half-price broadband for 12 months, a \$129 discount on installation costs for customers who sign a 24-month contract and operate a Telstra home phone.

Mr Cosgrave—The commission is aware of offers in relation to broadband put by Telstra into the retail market, yes.

Senator CONROY—Does the ACCC believe that reducing retail prices by between—I think these are estimates—\$308 and \$908 per customer over the life of a plan without reducing corresponding wholesale prices has the potential to constitute a price squeeze?

Mr Cosgrave—The ACCC is currently investigating the matter around broadband pricing to determine whether it raises concerns under the act.

Senator CONROY—Presumably if you are investigating it, the answer to my question is yes, it has the potential.

Mr Cosgrave—We are yet to reach a decision, but we are investigating it.

Senator CONROY—If you did not think it had the potential, you would not be investigating it.

Mr Cosgrave—I generally agree with that proposition.

Senator CONROY—Did Telstra give notice of this pricing to the ACCC as required under the terms of Telstra's settlement of last year's broadband competition notice with the ACCC?

Mr Cosgrave—Telstra gave notice under the notification protocol, yes.

Senator CONROY—What was the ACCC's response to this notice?

Mr Cosgrave—The ACCC indicated that it may have some concerns in relation to the matter.

Senator CONROY—I think, Mr Samuel, you indicated you might be looking at a competition notice in relation to this.

Mr Cosgrave—That relates to another matter.

Senator CONROY—Are you considering taking action along similar lines?

Mr Cosgrave—The ACCC is examining the matter.

Senator CONROY—It is interesting that under this wonderful settlement you reached with them, even if you did not like what they were proposing to put out after they told you, they could still go ahead and do it. Sounds pretty toothless.

Mr Cosgrave—The notification protocol fundamentally provides—

Senator CONROY—This is a key part of the settlement that you need—

Mr Cosgrave—for Telstra lodgement on an ex ante basis. The commission puts its point of view in relation to retail prices being put into the marketplace. It is then a matter for Telstra to determine whether it will put the price into the marketplace.

Mr Samuel—You must remember that the purpose of the protocol established as a result of that settlement as you have described it was to enable the ACCC to receive prior notification of actions proposed to be taken by Telstra that might give rise to us taking steps under part 11B in relation to potential breaches of the competition rule and anticompetitive conduct. I would think it highly unlikely that any business in this country would agree to give a formal undertaking to the ACCC that says that, if the ACCC does not like what they are going to do, they will not do it. That is effectively a cease and desist order, which of course is not currently contained in the Trade Practices Act.

Senator CONROY—You opposed getting that, didn't you?

Mr Cosgrave—I might add that clearly the ex ante notification under that protocol is something that is not available under any legislative instruments.

Senator CONROY—How long ago did they give you notice? When did they first raise it with you?

Mr Cosgrave—I cannot provide you with a precise date off the top of my head.

Senator CONROY—Roughly?

Mr Cosgrave—Certainly in the fourth quarter of last year.

Senator CONROY—It is mid-February now.

Mr Cosgrave—Correct.

Senator CONROY—I remember commitments that you would be into these competition notices a lot quicker than 10 weeks. One of the purposes of this notification process was presumably to allow you to take speedy action. This is longer than the last one.

Mr Samuel—If I might say so, you would have to rely on the comments made by Mr Cosgrave. These matters are being investigated. How do I put it? These are not always open and shut cases, as may appear on the surface or on the basis of information that can be provided by one party. Often a number of other factors have to be taken into account. We do

not liberally throw competition notices any time you get a whiff of smoke. We do regard them seriously. They have a serious consequence.

Senator CONROY—Never mind the whiff of smoke—what about the smell test? I was actually with a provider the day it went out and they were having a coronary at how it was going to impact on their business. The smell test says, ‘Whoa, just a minute.’ And now it is a decaying odour after 10 weeks or so. We still do not have a decision.

Mr Samuel—We probably have to adopt a slightly more rigorous test than a smell test. It is called the legal test.

Senator CONROY—Yes, and you promised the legal test would not take 10 weeks like last time.

Mr Samuel—I think that involves us going into the nature and details of the investigation that we are currently undertaking. I do not think that is appropriate.

CHAIR—The length of time is a function of the complexity of the issue, isn’t it?

Mr Samuel—I think that summarises what I am trying to say. Thank you, Chairman.

Senator CONROY—You should hire him again as your barrister. Could you provide the committee with an update on a consultation notice issued by the ACCC over Telstra’s price increases for wholesale line rental?

Mr Cosgrave—Simply that we issued a consultation notice. Telstra were given an opportunity to respond to that consultation notice. They have done so. We have received other material during that time and we are considering that material. I think the chairman gave some indication around a possible time frame for a decision in his opening comments.

Senator CONROY—And that was?

Mr Cosgrave—Within weeks.

Senator CONROY—Does the ACCC see a relationship between Telstra’s price increases for wholesale line rental and the price reductions for broadband when bundled with voice mobile services that we discussed earlier?

Mr Cosgrave—I do not want to comment on the details of our investigation.

Senator CONROY—I asked you a factual question; I did not think it was—

Mr Cosgrave—But it is relevant to the detail of our investigation.

CHAIR—What is the question?

Senator CONROY—I am asking them the questions, not you.

CHAIR—But the gentleman objected to answering it. I am trying to give you a fair go. I was not listening properly. Ask the question again and I will tell you whether the objection is properly taken.

Senator CONROY—I asked whether the ACCC sees a relationship between Telstra’s price increases for wholesale line rental and the price reductions for broadband when bundled with voice mobile services, as we discussed earlier.

Mr Cosgrave—The point I made was that that may involve revealing details of the nature of our investigations.

Senator CONROY—I am not trying to probe into your investigation. I am just asking what I thought would be a factual question. Either you do see a relationship or you do not.

Mr Samuel—I think the question, unfortunately, is not so much a question of fact as to seek a view about the current opinion of the ACCC in those matters. That itself would be getting into the details of our investigation. I think you asked whether the ACCC sees a connection. That is asking for a description of the ACCC's current opinion on its investigation. I think that is what Mr Cosgrave is objecting to at this stage.

Senator CONROY—I will try to slightly work around your constraints. Does the ACCC believe that two smaller price squeezes on two products within a bundle could have a greater cumulative anticompetitive effect? I am not talking about any particular investigation. I am just talking about a general view.

Mr Cosgrave—Could you repeat the question?

Senator CONROY—Does the ACCC believe that two smaller price squeezes on two products within a bundle could have a greater cumulative anticompetitive effect?

Mr Samuel—That is a hypothetical question. It would depend on all the circumstance. Can I emphasise that external observers, based on superficial information—or information which they may not regard as superficial but having regard to information that is before us—may have superficial solutions to given sets of circumstances that exist in the telecommunications sector. You may rest assured that we are closely monitoring all the activities to which you are referring and all the activities that I have described. I think I have indicated to you that there are a number of matters currently before us which impact upon both the specifics of those issues you are detailing and the generality of the regulatory environment in which we are operating in relation to fixed services, the ULL and the like. I indicated in my opening statement that we have a number of tools at our disposal to deal with these issues ranging from the broad fixed services review through to some arbitral disputes that are currently before us, which lend themselves—

Senator CONROY—I surrender. Stop talking.

Mr Samuel—Sorry?

Senator CONROY—I surrender. Stop talking.

Mr Samuel—Okay.

Senator CONROY—Would Telstra's increases in wholesale line rental prices that the ACCC believes to be potentially anticompetitive be prevented under the government's operational separation model?

CHAIR—Isn't that a policy question?

Senator CONROY—I am entitled to ask the ACCC, an independent statutory authority, a question. I appreciate it if the minister stopped whispering about what Mr Samuel can and cannot answer.

CHAIR—Hang on a second.

Mr Samuel—Let me assure you, Senator, I am capable of providing my own answers.

Senator CONROY—I know you are. And the minister should understand that.

Mr Samuel—I think that the minister's brief comments certainly would not reflect the rather lengthy answers I am providing to you.

Senator CONROY—That is entirely correct.

CHAIR—I am sure the minister is just trying to be helpful. But, as you know, Senator Conroy, the rule about not asking officers to comment on policy extends to all officers, including officers of statutory authorities.

Senator CONROY—It does not. I am sorry, George, but you cannot make up rulings. It is an independent statutory authority.

CHAIR—Privilege resolution 1(16) of 1988—

Senator CONROY—I am sure Mr Samuel will manage to wend his way through this.

CHAIR—Senator Watson, did you want to say something?

Senator WATSON—Rather than getting into semantics, it is up to the witness whether they want to answer the question. They are not compelled to answer.

Senator CONROY—This is about the application of the law, not the policy.

CHAIR—Why don't you repeat the question, Senator Conroy.

Senator CONROY—Would Telstra's price increases in wholesale line rental—price increases that the ACCC believes to be potentially anticompetitive—be prevented under the government's operational separation model? It is a question of application; it is not a policy question.

Mr Samuel—I have three answers. The first is that the operational separation model is currently in the stage of development, so I cannot provide an answer based on the current stage of development. Secondly, it needs to be made clear that the operational separation that has been proposed is an evidentiary facilitation process. It is not a process that makes legal or illegal certain activities. I had three answers. I will stop at two because I cannot remember the third.

Senator Coonan—That will do.

Senator CONROY—Now that the ministerial determination for operational separation and Telstra's draft plan are publicly available, let's have a discussion about the regime. You outlined to the Senate committee at the time of the introduction of the operational separation legislation that there were five matters that still needed to be resolved with respect to operational separation before you could be confident that the regime would deliver transparency and equivalence. The scope of the services that would be included in the operational separation regime, which goes to this issue of wholesale line rental being included in the regime, was one of the issues you raised. Now that you have seen the list of designated services that has been developed by the minister, what is the ACCC's view of the adequacy of this list?

Mr Dimasi—On the specific question of the services, we are of the view that the services that the minister has included are the core services that we were most concerned about. We are generally satisfied that—

Senator CONROY—So no other services should have been included?

Mr Dimasi—They were the main services that we were concerned about. In particular, we thought there was a significant benefit in including the transmission service, which has been included. There is a mechanism there for including further services if they are declared by the ACCC. So we are satisfied that the process is adequate to cover the services that are important to be dealt with through operational separation.

Senator CONROY—So you did not think the wholesale line rental service that you have just issued a consultation notice on should have been included?

Mr Dimasi—The fact that there might or might not be competition concerns does not necessarily mean that they are services that would form part of the operational separation plan. Our view is that the list is generally adequate.

Mr Cosgrave—There is also currently a review of the local carriage service, which effectively involves wholesale local calls, in which the question of the declaration of the wholesale line rental service is being considered.

Senator CONROY—Some parties have argued that Business Grade DSL should have been included or that the definition of wholesale ADSL should have been broader. Do you share those views?

Mr Cosgrave—I repeat Mr Dimasi's answer, which is that effectively we think the determination covers the core services which we are concerned about.

Senator CONROY—I am asking these questions now because, as I am sure you will appreciate, the first determination of designated services is extremely important as it is the only time a non-declared service can be included without Telstra's approval. So, if the ACCC wants additional services to be subject to the requirements of operational separation and they are not included in this determination, the ACCC will have to go through the declaration process for the service. What is the ACCC's view on this process for determining designated services?

Mr Dimasi—I am not sure about the question of the process. The answer I would give is that generally the services that are likely to give greatest concern are those where the criteria for declaration is likely to apply. In general we are satisfied that having the mechanism to include services once they are declared is an adequate way to go through. We do not have any great difficulty with the process as it has been set out.

Senator CONROY—Another of the five issues that you raised at the Senate hearing was the precise details of the operational separation plan. Again, now that the ministerial determination and Telstra's draft plan are out, do you have any problems with the precise details of the plan?

Mr Dimasi—We think that the ministerial determination requires the issues that we believe ought to be dealt with be dealt with. So the capacity to get an operational separation plan that we consider satisfactory is possible as a result of the ministerial determination. But it is too

early to say whether we have an adequate operational separation plan, of course, because there has been a draft. We have seen comments about that draft from the industry and that will have to be worked through. I think the scope is there to achieve an adequate operational separation plan, but the process is yet to be completed. I might add that there is a process under way involving the ACCC, the department and Telstra to develop internal wholesale prices to be used for the plan. That is not complete yet, so that would also have to be completed before we could give you a concluded assessment about the potential of the operational separation plan.

Senator CONROY—It seems to me there has been something of an exodus from Telstra's wholesale division in the last six months. There has been a shift and a whole range of other senior executives has moved on. It seems that responsibility for pricing, marketing and development decisions has been removed from Telstra. Do you think that the details of the operational separation plan are effective in requiring Telstra to maintain its wholesale division as an autonomous entity with incentives to maximise wholesale revenues?

Mr Dimasi—I think the ministerial determination requires a wholesale group to be maintained.

Senator CONROY—Do you think that is what Telstra is doing? Are you actually watching what they are doing? They gutted it.

Mr Dimasi—I could not give you an assessment of what Telstra is doing.

Senator CONROY—They have gutted it. All you have to do is pick up a newspaper and see that Telstra are gutting their wholesale division. Mr Samuel, have you noticed?

Mr Samuel—I can only see what I have seen in the newspapers, and that is hardly an appropriate basis for us to be making judgments about what they have done in relation to an operational separation plan.

Senator CONROY—You are saying no-one has bothered to ask them what they are doing to the wholesale division?

Mr Samuel—It is a bit premature. At this point we do not have an operational separation plan that has been fully developed. The point at which the operational separation plan has been developed and signed off by the minister is the point at which we will then examine—and the minister of course will examine—whether or not it is being implemented. It is a bit premature to be doing it at this stage based on some newspaper reports as to management changes within Telstra.

Senator CONROY—Given you actually do not have any policing role at this early stage, Minister, are you keeping an eye on Telstra and what they are up to? You have actually written yourself into this process. Are you keeping an eye on what Telstra wholesale are up to?

Senator Coonan—Well, you had Telstra. You asked them the question, didn't you?

Senator CONROY—I am asking you. Obviously, you have not read your own law.

Senator Coonan—I am interested. I thought you asked Telstra the question.

Senator CONROY—You have the first policing role under your operational separation.

Senator Coonan—I do.

Senator CONROY—You wrote yourself into it.

Senator Coonan—I did.

Senator CONROY—So the question is: are you paying attention to what is going on in Telstra's wholesale division?

Senator Coonan—Absolutely.

Senator CONROY—What is going on, Minister?

Senator Coonan—What happens with its wholesale business unit is something that obviously we need to look at when we finalise the plan. It is out for consultation at the moment. I have until 31 March, if I am not mistaken. The final draft of the plan is not due until 31 March.

Senator CONROY—The ministerial determinations produced by the minister seem to create a number of layers of bureaucracy for Telstra. There are requirements for service quality strategies, information equivalence strategies, information security strategies and customer responsiveness strategies. Do you think the imposition of box-ticking strategies on Telstra is a genuine substitute for properly reorganising its business to improve wholesale incentives?

Senator Coonan—Is that question to me?

Mr Samuel—Whom is the question directed to?

Senator CONROY—To the ACCC.

Mr Dimasi—The intent, as we understand it, of that part of the determination is to provide equivalence to the non-price terms and conditions to Telstra's competitors. We agree with that objective. Whether in the end that is an effective way of doing it, we will see when the operational plan comes about.

Senator CONROY—So are you confident these strategies are going to make any difference to Telstra's behaviour at all?

Mr Cosgrave—It depends what is in the strategies.

Senator CONROY—Oh, dear. Are you sure you did not have one of those tall blacks as well? Another of the five issues you raised was the enforcement regime associated with noncompliance with operational separation. What is the ACCC's view of the enforcement regime that will govern the operational separation regime?

Mr Cosgrave—The ministerial determination deals with the enforcement regime. The commission has consulted on that determination and is comfortable with the provisions in the determination in relation to that matter.

Senator CONROY—Let's just reiterate. The minister is the first port of call as watchdog.

Mr Cosgrave—What was put on a previous occasion was that the commission's powers—and this was separate to the minister's powers—in relation to the plan needed to be fleshed out or clarified.

Senator CONROY—It has been fleshed out now, though, hasn't it?

Mr Cosgrave—That has been done in the determination. As to the information-gathering and investigative role of the commission, the commission was consulted and is comfortable with the provisions that have been inserted.

Senator CONROY—The final issue you raised about the adequacy of the operational separation regime is the development of internal wholesale pricing and the pricing equivalence regime.

Mr Cosgrave—Correct.

Senator CONROY—From my perspective, this is probably the most important aspect of the regime. What is your view of the progress at the moment? Genuine transfer of pricing has been ruled out. That pretty well scotches the ACCC's past demands for the divisions to:

Deal with each other on a commercial, arms-length basis, including explicit pricing, invoicing and billing

and—

Maintain fully separate accounts and reporting systems, capable of capturing all transactions between the businesses

We are not even close, are we?

Mr Dimasi—There is work in progress to determine the internal wholesale pricing regime that applies. That is under way; it is not complete yet.

Senator CONROY—We had Telstra before us the other night—I am sure someone was assigned to watch it. We were chatting about transfer pricing. I asked Dr Warren a couple of questions on backhaul, for instance. He said:

Telstra does not charge itself for backhaul. What Telstra does is incurs the national—that must be 'notional'—

cost of supplying the backhaul network, so the visibility of that is the total cost of transmission to the—it says 'national' again; I am reading from the *Hansard*. It continues:

What we do is charge ourselves the total. We don't charge ourselves; we don't have internal transfer pricing, and what we do, senator, is we, the company, incur the cost of supplying transmission to every exchange in Australia, and that is the cost, if you like, that we incur. No, we don't have a price.

That does not come close to what Mr Samuel said:

...deal with each other on a commercial arm's length basis, including explicit pricing, invoicing and billing; maintaining fully separate accounts and reporting systems capable of capturing all transactions between the businesses...

Mr Dimasi—Those sorts of issues are what the internal wholesale price is intended to deal with so that we have an internal wholesale price which can be used to assess how Telstra treats itself compared with its competitors. That is the purpose of the work that is being done.

Senator CONROY—So you add your mother's age and divide by three?

Mr Dimasi—There is a bit more science to it than that. But I grant you these are contentious issues.

Senator CONROY—They are very contentious, which is why Dr Warren's answers are very illuminating. I read him a statement and he gave me an answer. I will read it to you:

Thank you for that. Given Telstra's fondness for cross-subsidy, it is entirely possible that Telstra might be cross-subsidising the costs of regional backhaul routes with the profits it makes on the other higher volume backhaul routes? Is that plausible? You would not actually know, would you? You do not know what the price is.

Dr Warren replied:

No. Good answer to your question.

They do not know their price. That must be a fascinating haggle. You are trying to get them to come to a price they do not even know.

Mr Dimasi—But the notion of the internal wholesale price is that you find a price that is appropriate to use. That is the whole point; if they do not know, you need an internal wholesale price that is payable for—

Senator CONROY—How about a real operational separation? You never know, you might just get one then. Why on earth are we having to calculate this? Why aren't we just getting some real operational separation, as you described yourselves?

Mr Samuel—That is a matter that should be addressed to the minister, because that is a policy matter.

Senator CONROY—You just told me you are actually involved in the negotiations.

Mr Samuel—But the policy parameters in respect of operational separation that have been set out in the legislation are established by the minister, so it is a policy matter that ought to be addressed by the minister, not by the ACCC.

Senator CONROY—I will take that as your having folded already.

Mr Samuel—No. I will repeat what I said before. This is a policy matter that is determined by government. It has been set out in the legislation, which has now passed through both houses of parliament. It is a matter that is ultimately determined by the minister. It is not a matter for determination by the ACCC.

Senator CONROY—In this regard, now that the way that the pricing equivalence framework will operate is becoming clearer, do you now agree that the government's operational separation regime falls far short of the ACCC's past demands?

Senator Coonan—That is not really something for—

Mr Samuel—Again, it is a policy issue. It is not appropriate for us to comment on policy matters.

Senator CONROY—I am asking about the ACCC's policy.

Mr Samuel—But you are not. You are asking about government policy.

CHAIR—You are asking them to comment on government policy.

Senator CONROY—I am asking them to comment on their own policy.

CHAIR—That is not what you asked.

Senator CONROY—Stop protecting the government. The minister is perfectly capable of doing that for herself. How do you reconcile your past benchmarks that the commission described as ‘a must’ with your current position of silence?

Mr Samuel—If I might say so, what you are quoting there are public speeches made some time ago during the course of the debate about operational separation. Ultimately, these matters are determined by government. The silence, as you describe it now, is adopting the appropriate protocol in respect of Senate estimates committees and other committees, which is that we do not comment upon policy matters.

Senator CONROY—Okay. Let’s keep going with all your previous pronouncements, because I have quite a few. In addition to the comments I quoted earlier, the ACCC have also stated that in the commission’s view operational separation should include ‘at a minimum’:

Robust separation of key business units—rather than theoretical commitments to provide equivalence...

The commission says it will be unacceptable to have theoretical commitments to provide equivalence. Since we are not getting a transfer pricing regime, isn’t this exactly what we are getting?

Mr Samuel—Again, you could quote from many speeches that I and others in the commission have given over the past one or two years. In fact, I could give you many other quotes from several years back that relate to issues such as horizontal and vertical separation, all of which are not relevant for comment at this time because the matter has been determined through legislation that has passed through both houses of parliament. It is now a matter of government policy. I think you should address these questions to the minister.

Senator CONROY—I do not think that is right, Mr Samuel. You have a responsibility under an act of parliament.

CHAIR—Senator Conroy, I—

Senator CONROY—Can you shut up and let me ask my question!

CHAIR—Order! Senator Conroy, behave! It is not for you to lecture Mr Samuel on his statutory obligations.

Senator CONROY—You are the most biased chair in this parliament.

CHAIR—Mr Samuel and the other officers at the table perfectly well know—

Senator CONROY—You have been rolled again today by Harry and you are at it again.

CHAIR—what their statutory obligations are, and you well know that they cannot comment on matters of government policy.

Senator CONROY—I am perfectly entitled to pass my view on Mr Samuel’s statutory obligations and I do not need you covering for the government.

CHAIR—I will not have witnesses who are reputable people face this arrogant behaviour. The officers at the table were the subject of gratuitous offence by you, Senator Conroy.

Senator CONROY—This sort of arrogant behaviour from the chair is typical. You have the numbers; now you think you can just be as arrogant as you want.

CHAIR—Ask a proper question. We are adjourning for the evening break at 9.30 pm. You have 10 minutes. Ask a proper question.

Senator CONROY—Can I get your views on a few quotes that I think are quite relevant to the debate. The first is this:

The key reform ... was the introduction of ... separation to give greater transparency to Telstra's wholesale and retail operations. In terms of telecommunications competition policy ... separation is now the main game in town.

Does that sound like a reasonable statement?

Mr Samuel—I presume it is a quote of something that I or a member of the commission has—

Senator CONROY—No, the good news is that it is a government quote. He used to be the minister; his name was Alston. He was talking about accounting separation. How about this one:

...separation will assist in identifying whether Telstra is discriminating between itself and its competitors in relation to price or non-price terms and conditions of supply...

Is that reasonable?

Senator Coonan—Chair, this is not a proper basis for a question.

CHAIR—I think we all know that, Senator Coonan.

Senator Coonan—It is not the role of these witnesses to comment on statements that might have been made years ago by people and ask them in isolation if it is reasonable.

Senator CONROY—I am saying that Senator Alston's—

CHAIR—That is undoubtedly true, Minister. I do not think I could have made myself clearer. I do not think Mr Samuel could have made himself clearer. If Senator Conroy wants to waste the next eight minutes of his time asking questions that cannot be answered properly, that is a matter for him.

Senator Coonan—Insofar as there is any implication that the witnesses are being uncooperative, I think that would not be a fair way to characterise their responses. If they do not answer, there should not be any adverse inference drawn.

CHAIR—There can be no sensible suggestion—

Senator CONROY—We are having a great conversation here. You are wasting everybody else's time.

CHAIR—that the witnesses are being other than fully responsive to proper questions.

Senator CONROY—Why don't you ask the minister another question? Minister, do you want to editorialise for another five minutes?

Senator Coonan—No, Senator Conroy, I just wanted to make that point because I think it is a legitimate one.

CHAIR—Senator Conroy, you have the call. Ask some more questions. If they are proper questions, they will be answered. If they are not reasonable, they will not be answered.

Senator CONROY—Proper questions—how decent of you. As I said, I am actually being transparent. I have indicated where the quotes came from and what they were in relation to. The ACCC said last year:

Accounting separation only requires a notional allocation of costs across wholesale and retail operations, and as such does not provide a strong means to detect and remedy anti-competitive conduct.

You did say that? Does that sound familiar?

Mr Samuel—I cannot recall whether I said it or one of my colleagues said it.

Senator CONROY—What will be different this time? That is all we are getting this time?

Mr Samuel—I am sorry, but you are asking—

Senator Coonan—We do not know what we are getting yet because it is not completed.

Senator CONROY—Don't let the minister talk over you, Mr Samuel. You were in the middle of a sentence.

Mr Samuel—I am sorry, but I am feeling a little frustrated by this whole process because you are asking me in every question one way or another to comment upon issues of government policy. It is not appropriate.

Senator CONROY—I am asking you to actually perform your statutory obligations.

CHAIR—Senator Conroy, do not speak to Mr Samuel like that.

Mr Samuel—With respect, Senator—

Senator CONROY—Why can't you just stop being so biased in the chair? You are the greatest—

CHAIR—Senator Conroy, if you choose to approach questions in a way that you well know the witness cannot properly answer—

Senator CONROY—If you want to be a judge, resign and put a wig on.

CHAIR—If you choose to ask questions that cannot properly be answered because they necessarily invite comment on policy, you can expect no other answer than the answer Mr Samuel is quite properly giving.

Senator CONROY—Mr Samuel is doing fine giving the answers he wants to. He does not need you continually interjecting.

CHAIR—Mr Samuel was saying he is frustrated by the process. Do you want to say anything more?

Mr Samuel—No. All I can say is this: I am absolutely willing and able to answer any question with absolute frankness and forthrightly relating to the administration—

Senator CONROY—Except if—oh, my God—it might be critical of the government.

CHAIR—Don't interrupt him! Mr Samuel, you have the call.

Mr Samuel—I will continue the sentence—thanks, Chair. I will answer questions in relation to the administration of the Trade Practices Act and the conduct of the activities of the ACCC; I am not able to answer any questions in relation to matters of government policy.

Senator CONROY—No, you are unwilling to. You are unwilling—

Mr Samuel—It is not a matter of willingness at all.

CHAIR—Don't interrupt him, Senator. Senator Conroy—

Senator CONROY—You are unwilling to stand up to your own policy.

CHAIR—Senator Conroy, Mr Samuel has the call. Mr Samuel, would you care to finish what you were saying, please.

Mr Samuel—It is not a case of being willing or unwilling. As you are well aware, I approach Senate estimates committees and questions put by you and other members of the committee with every intention of answering those questions frankly, fully and forthrightly.

Senator CONROY—Except if the government will not like them.

Mr Samuel—I am sorry, but I will not and cannot answer questions that relate to matters of government policy.

Senator CONROY—These are about applying operational separation.

CHAIR—Senator Conroy, move to your next question, please.

Senator CONROY—I was actually in the middle of a question. If you would stop being so biased and arrogant from the chair, we might make some progress.

CHAIR—Ask your next question, please.

Senator CONROY—Accounting separation required Telstra to provide the ACCC with its current cost and historical cost accounts and a reconciliation between the two. The ACCC published an imputation analysis based on information provided by Telstra which assumes that Telstra purchases the core interconnect services at the price that it charges and Telstra publish information comparing its actual performance in supplying core services to itself and to external access seekers in terms of key non-price terms and conditions. Given that the pricing equivalence framework will not include transfer pricing but will only be required to provide public assurance that Telstra is behaving legitimately in the pricing of relevant eligible services supplied to customers of a retail business unit when compared with the prices at which Telstra provides designated services to wholesale customers, how is the pricing equivalence framework different to accounting separation?

Mr Dimasi—That process has not concluded yet. We just cannot answer that question until we see what does emerge in terms of the whole operational separation—

Senator CONROY—One minute it is a government policy and one minute it does not exist yet. It is a fascinating process.

Mr Samuel—Forgive me, I will explain. If you are asking us how the operational separation model will work in terms of facilitating the provision of evidence as to whether or not there has been a breach of part 11B, which is what it is all about, the answer has to be that we will be able to explain that and explain our ability to use those provisions of the act and regulation for the operational separation model that is developed once it has been developed. It is too early at this point to be able to deduce that. But when operational separation has been developed, we will be able to provide frank and forthright answers to you—

Senator CONROY—Except if they are critical of the government.

Mr Samuel—Excuse me—as to the ability of the ACCC to administer part 11B of the act as assisted by the operational separation model that has been developed. You will get at that time frank and forthright answers as to the adequacy or otherwise of the model that has been developed in permitting us to administer those provisions of the act.

Senator CONROY—The ACCC's primary criticism of accounting separation was that it requires:

... only a notional allocation of costs across the wholesale and retail businesses ...

and that—

... the arrangements do not require the carrier to reorganise its internal affairs and operate as if it were running two or more discrete businesses.

How is this going to change under operational separation?

Senator Coonan—We will have the actual wholesale prices.

Senator CONROY—Sorry, I was asking Mr Samuel or Mr Dimasi, not just the chattering of the minister.

Mr Dimasi—I would rather wait to see what we end up with in the operational separation plan before answering that question.

Senator CONROY—Has the ACCC been following the way that BT approached operational separation in the UK when it was preparing its operational separation plans?

Mr Dimasi—We have. We have been in discussion with the regulator, Ofcom. We have been over there and talked to them, so, yes, we are familiar with what they have done.

Senator CONROY—It looks like there might actually be a few things Telstra would like to emulate from what BT has done. BT has had an eight per cent growth in revenues and a two per cent increase in profits since its implemented its operational separation. This has largely come on the back of an explosion of sales for its wholesale division. It seems like BT's wholesale customers are expanding their businesses on the back of the increased certainty provided by the operational separation regime. It is clear that this decline in retail revenues for BT has been more than compensated for by the new wholesale revenues and increased overall growth in the broadband market.

Senator Coonan—What is this—some sort of essay? Is that a question?

CHAIR—It is a long preamble, obviously, to a question. I think we should hold our breath and wait to see what the question is.

Senator CONROY—Does the ACCC agree that revenues from Telstra's wholesale division might be a good proxy for judging the success or otherwise of the operational separation regime?

Mr Samuel—It is beyond our expertise to be able to make any comment on that.

Mr Dimasi—We could not answer that question.

Senator CONROY—I am asking these questions, Mr Samuel, because the issues are still very highly relevant. The operational separation regime has not yet been bedded down. There is still time to get it right. I wish you luck in your ongoing deliberations.

Mr Samuel—And I am sure that once it has been bedded down by the next Senate estimates hearing or whenever, you will be able to ask us questions as to the effectiveness of the operational separation plan. Having a plan before us, we will then be able to give you some indications as to the particulars.

Senator CONROY—No doubt by then it will be too early to tell.

CHAIR—Senator Conroy, it is after half past nine. Is that the end of your questions? Do you want to put further questions on notice?

Senator CONROY—Am I only allowed until half past nine?

CHAIR—That was the arrangement made with your colleagues.

Senator CONROY—I am just trying to find out.

CHAIR—You indicated to me that you would not go beyond nine o'clock.

Senator CONROY—That was at the beginning—no offence to Mr Samuel—before Mr Samuel's lengthy 35-minute statement.

CHAIR—I took that into account and it is now half an hour after nine o'clock. The arrangement with your Labor Party colleagues was that the markets group of Treasury would come back at 9.30. I invite you to put any further questions you have on notice.

Senator CONROY—No problem.

CHAIR—Thank you. Mr Samuel and officers, thank you for your patience and courtesy. We will see you in May.

Mr Samuel—We look forward to it, Chairman.

Proceedings suspended from 9.31 pm to 9.44 pm

CHAIR—The hearing is resumed. Senator Wong has some questions for the officers of the Financial Reporting Council.

Senator WONG—I think Mr Murphy is it, because we have no chair again. I understand he is overseas. Could the deputy chair not attend, or was that not considered?

Mr Murphy—Elizabeth Alexander is the deputy chair. She was unable to attend as well.

Senator WONG—Is the FRC conducting a review of audit independence regulation?

Mr Murphy—We have established a committee to review audit independence. We have hired a consultant and a subcommittee is handling that issue. Elizabeth Alexander is the chair of that subcommittee. At the moment they are working up policy papers. It is a live issue for the FRC. The consultant is an experienced auditing professional. They are working up policy papers for reporting back to the Financial Reporting Council.

Senator WONG—Who is the consultant?

Ms Wijeyewardene—The consultant is Bill Bartlett.

Senator WONG—What is Mr Bartlett's background? Is he currently a practising auditor?

Ms Wijeyewardene—I do not think he is a practising auditor at the moment, no.

Senator WONG—Was he previously?

Ms Wijeyewardene—I do not have his details. The FRC secretary could probably help you.

Mr Murphy—We will check that out for you.

Senator WONG—What was the process of decision making to appoint this particular consultant?

Ms Wijeyewardene—We went through a tender process. I think it was an open tender process.

Senator WONG—Can you confirm that?

Mr Murphy—Page 155 of the annual report of the FRC for 2004-05 deals with the auditor independence report. I cannot recollect whether there was a tender. The annual report reads:

The purpose of the consultancy is to assist the FRC in the performance of the auditor independence functions conferred on the FRC by the CLERP Act. Before retiring as a partner of accounting firm Ernst & Young in June 2003, Mr Bartlett spent 35 years working in the accountancy field, including as auditor of firms in the financial services industry. He is presently a director of a number of Australian public companies and also a company which is listed on the New York Stock Exchange.

As to the process of his appointment, we will take that on notice and get back to you.

Senator WONG—Sure. I think Ms Wijeyewardene was saying she thought it was by tender.

Ms Wijeyewardene—Yes. It was either an open tender—

Senator WONG—Please let me know about that.

Mr Murphy—Yes.

Senator WONG—When did Mr Bartlett last work for Ernst and Young?

Mr Murphy—He retired as a partner in June 2003.

Senator WONG—Thank you. There were some media reports shortly after the last estimates that stated the FRC was investigating whether the audit independence changes were too prescriptive. Is that the nature of the inquiry?

Mr Murphy—No. The report is to develop the most efficient way the program of auditor independence should be conducted. Regarding auditor independence, the issue that people feel is too restrictive concerns—

Ms Wijeyewardene—Basically, the work that the FRC has been doing is pursuant to its obligations under the Corporations Act, which is to monitor auditor independence in Australia. So its report is the first report looking at the auditor independence arrangements in Australia and what the firms are doing. As to it being restrictive, I think the issue is that the Corporations Act or CLERP 9 put in place a new auditor independence framework which previously did not exist. It is the first time that area had been looked at in 40 years. There are a range of new requirements which perhaps in some eyes are seen as prescriptive.

Senator WONG—Perhaps I did not make myself clear in the question. It was reported in the *Financial Review* that the FRC was going to investigate whether the audit independence provisions are too prescriptive. I am asking whether that is the tenor of the inquiry—that there is a view within the FRC that they might be and that is why they are being investigated.

Ms Wijeyewardene—I do not know that the FRC is actually conducting an investigation into that. I am not quite sure and I do not have the report in front of me. That might have been an observation they made from having spoken to the profession. I would say that the FRC is not conducting an inquiry into the regulatory arrangements.

Senator WONG—So what is the FRC conducting?

Ms Wijeyewardene—It undertakes an annual review of auditor independence in Australia. Going forward, it has recently called for tenders so that it can examine things like professional ethics.

Senator WONG—I want to get a bit of structure to this. Mr Murphy indicated there is a subcommittee which is to look at audit independence provisions. What is the name of the subcommittee?

Ms Wijeyewardene—It is the auditor independence subcommittee. Basically, that is just a subcommittee of the FRC—

Senator WONG—I understand that.

Ms Wijeyewardene—It is tasked to look at that area and report back to the full FRC.

Senator WONG—And that is the one that has contracted with Mr Bartlett?

Ms Wijeyewardene—The FRC has contracted him.

Senator WONG—What is the status of that report? What is the process there?

Ms Wijeyewardene—Each year it will undertake a review of auditor independence and it will look at its other functions under the act. This year it looked at auditor independence. Going forward, it will be looking at professional ethics.

Senator WONG—So it is an ongoing annual review of different areas of auditor activity. Is that a reasonable way to describe it?

Ms Wijeyewardene—I think that is a reasonable way to describe it. The forward work program may be better dealt with by my colleague.

Mr del Busto—Yes. As Ms Wijeyewardene was saying, one of the responsibilities of the FRC—

Senator WONG—I understand that. I am actually interested in the forward work program. I am interested in understanding what the audit independence subcommittee has done to date, what reports are being published and what it is intending to do over the next two or three years.

Mr del Busto—With respect to what it has done, the last report is the one produced for the 2004-05 financial year which Mr Murphy referred to. As for the forward work plan for the current financial year, the FRC is currently engaging short-term consultants to assist in some of the specific functions they have been given as per CLERP 9. Three areas in particular are

going to be examined with the assistance of these consultants. One is a review of the quality review programs of the professional accounting bodies, which is one of the functions of the FRC. That will be undertaken in more depth. Another is a review of the disciplinary procedures of the professional accounting bodies.

Senator WONG—Would it be possible for you to provide on notice an indication of this information? I would like in a written form an indication of the forward program.

Mr del Busto—Yes, most definitely.

Senator WONG—I would appreciate that. The report for 2004-05 has already been published. Is that the one in relation to audit independence?

Ms Wijeyewardene—That is right. That is in the FRC's annual report.

Senator WONG—In 2005-06?

Mr del Busto—The 2005-06 report will be submitted to a minister and tabled in parliament in September or October. That is the deadline.

Senator WONG—What is the topic of that inquiry?

Mr del Busto—It will be the 2005-06 annual report on auditor independence. It will report on the further activities that the council has done with respect to these specific functions.

Senator WONG—I am perhaps misunderstanding. Mr Bartlett was involved in which project?

Ms Wijeyewardene—He was involved in the auditor independence report in the 2004-05 annual report.

Senator WONG—Do we know who the current consultants in the 2005-06 year are?

Mr del Busto—Mr Bartlett's contract is for 18 months. It runs from December 2004 until June 2006, so he is currently engaged. There is an option to extend his contract by mutual agreement, but it has not yet been addressed. Mr Bartlett's main function is to provide advice to the subcommittee on the performance of the auditor independence function.

Senator WONG—Are there any other consultants engaged by the FRC in this area currently?

Ms Wijeyewardene—No. We are just going through this tender process for the short-term consultants on the projects just mentioned—on the quality review and on professional ethics. I think they were looking at three. There are three tenders out at the moment.

Senator WONG—Perhaps I could have details on that—I would appreciate it—and the amounts of the contracts. I cannot recall which of you raised it, but has there been concern raised by the profession with the FRC regarding the audit independence regime?

Ms Wijeyewardene—I think the profession is starting to be comfortable with the new regime. Basically, the FRC's review was done at a time when the requirements had just come in. They were new. People were settling into them. I would say yes, there are teething problems and we have been looking at them. I would say that industry is embracing them.

Senator WONG—Would you describe the audit profession as generally being supportive of the audit independence regime?

Ms Wijeyewardene—Yes. I think that is fair.

Senator WONG—The article in the *Australian Financial Review* of 4 November describes the comment from the FRC that I outlined earlier—that is, that it would investigate whether the changes were too prescriptive. Can you identify for me where they came from? Is that from a report or a media statement?

Ms Wijeyewardene—I am not sure if it is in the FRC's actual report. I would have to take that on notice.

Senator WONG—Has the council formed a view that any changes to the audit independence laws are necessary?

Mr Murphy—Not at this stage, no. I think what will happen is that the council will see next year's report and then make some considerations and provide advice to government if there seems to be any need to do so.

Senator WONG—Has government sought any advice as to changes to the audit independence regime from the FRC?

Mr Murphy—No. Not specifically. But the FRC has a wide mandate in this area and it can report.

Senator WONG—I understand Treasury is examining possible cooperative arrangements between ASIC and foreign audit regulators. Does the FRC have any role in that?

Ms Wijeyewardene—This is really an arrangement that is between ASIC and the PCAOB, which is the Public Company Accounting Oversight Board, in the US. The FRC has an interest in this in the sense that the arrangement relates to inspection regimes for auditors. This is an area that the FRC is interested in. It has a specific role in relation to auditor independence. But the arrangement per se does not necessarily impact on the FRC's work.

Senator WONG—But has the FRC been asked to provide any input into that review?

Ms Wijeyewardene—The FRC has put in a submission.

Senator WONG—Is that public? It is to Treasury, presumably?

Ms Wijeyewardene—It is to Treasury, yes. Usually with our submissions we say that they are public unless the person making the submission asks for them to be confidential.

Senator WONG—Is the FRC's submission public?

Ms Wijeyewardene—We have not had a request to release it.

Senator WONG—Could you provide it. Thank you. This may not be the appropriate location, but are you able to tell me what the status of that government review is?

Ms Wijeyewardene—On the ASIC-PCAOB inspections?

Senator WONG—Correct.

Ms Wijeyewardene—We released a consultation paper in September. Consultations closed in November. We are currently going through the submissions and discussing the issues with industry. We have been holding meetings with the professional accounting bodies and the audit firms and we are looking to introduce a bill hopefully before the end of March.

Senator WONG—Before the end of March—on cooperative arrangements?

Ms Wijeyewardene—On the cooperative arrangements.

Senator WONG—Will that require changes, therefore, meaning there will be legislative proposals to alter our current arrangements in relation to auditors?

Ms Wijeyewardene—No. It is really mainly giving ASIC the ability to enter into an arrangement with a body such as the PCAOB. The PCAOB is not an agency of the US government. It is a private sector body, so ASIC needs specific power to be able to enter into an arrangement with that body. It also looks at the information gathering powers of ASIC. It allows ASIC to share information with the PCAOB and basically has some reporting requirements in-built for transparency.

Senator WONG—Has the FRC had any role in terms of consulting regarding this review?

Ms Wijeyewardene—The FRC has provided a submission so it has—

Senator WONG—I am sorry. I should have said, ‘consultation with stakeholders.’

Ms Wijeyewardene—The FRC itself has not. Really this is an arrangement between two regulators. So, while the FRC has an interest, it is not a direct player.

Senator WONG—Thank you very much. Mr Murphy, this is the second estimates hearing where neither the chair nor the deputy has appeared. I appreciate on this occasion a letter was provided to the committee. But the deputy is not here. On the last occasion we requested that Mr Macek attend. He was not in attendance. I hope at some estimates in the near future the chair of the FRC will attend the estimates hearings.

Mr Murphy—Yes.

Senator WONG—Obviously it is beneficial for us to actually question the council as opposed to Treasury officers in relation to these matters.

Mr Murphy—I would make the point that Mr Macek is on government business. He is attending the Financial Stability Forum. That is why he cannot be here tonight. We have spoken and he is appreciative of his role in attending estimates. He is disappointed not to be here.

Senator SHERRY—I do not have any questions of this group. I have a very brief question in 3.1.1 and some questions in 3.1.2, 3.1.3 and 3.1.4.

CHAIR—So there are no questions to output 3.1.1?

Senator SHERRY—Only a very brief question, I suspect.

CHAIR—If you deal with that first, we can send those people away.

Senator SHERRY—With respect to foreign investment policy advice, has any examination been carried out on the impact of foreign investment and ownership as it increases, as I understand it is, in the Australian economy?

Mr Antioch—Not in recent times. The foreign investment policy has not changed for quite a while. That is what I am emphasising. It has been in place for quite a while. That is probably why there is not a contemporary study as such.

Senator SHERRY—You get off lightly. That is all I have.

CHAIR—Thank you, Mr Antioch. You are excused.

Senator SHERRY—I have some questions on financial system corporate governance. I am sure some of these will overlap with some issues of consumer advice. Firstly, there has been a lot of debate and discussion about red tape generally.

Mr Murphy—Yes.

Senator SHERRY—But in particular certainly a focus on red tape in respect of the financial services sector. Has any analysis been carried out of ‘red tape’ in the financial services sector and its impact and implications? I am not sure whether the recent inquiry into red tape has finished. Was a submission presented to that inquiry?

Mr Murphy—Yes. There is considerable concern in the business community and from consumers about excessive red tape, for want of a better description. The short answer is yes, it is a concern. I think you will find that in terms of priority lists for government action or government reviews red tape is right up there, if not the main one at the present time. The committee that was announced by the Prime Minister and the Treasurer and which was set up before Christmas to look at the impact of regulation throughout the economy is the Banks committee. It is chaired by Gary Banks from the Productivity Commission. They have finalised their report, met the reporting timetable, which was 31 January, and given their report to the government.

Senator SHERRY—That has not been released yet, though, has it?

Mr Murphy—No. It has not been released.

Senator SHERRY—In respect of the finance sector, was a report developed by staff or officers in your output group and submitted to the Banks inquiry?

Mr Murphy—No. A number of submissions from industry were made to the Banks inquiry. Without forecasting what was in the report, one of the key issues for the Banks inquiry was corporate and financial sector regulation. This group assisted that inquiry with information and policy advice on those issues. We did not make a formal submission to the inquiry, but we worked pretty closely with them to give them information and comment on various submissions.

Mr Legg—It is also relevant that we seconded staff to the secretariat, as did Revenue Group.

Senator SHERRY—How many seconded staff were there?

Mr Legg—There was one from our area and one from Revenue Group. They provided the conduit, if you like, between the task force secretariat and the group.

Senator SHERRY—Was that because one of the main focuses was ‘red tape’ in the financial services sector?

Mr Legg—I think it was recognised at the start that they would need expertise on the secretariat that went to those issues as well as other things. I am not quite certain how large the secretariat was.

Mr Murphy—About 15 people.

Mr Legg—Nonetheless, we provided people who were quite senior and experienced.

Senator SHERRY—So they had a specialist background and experience as well as perhaps some generalist knowledge, depending on how it was used by the Banks inquiry?

Mr Legg—That is right.

Senator SHERRY—I will not go to the inquiry outcomes. Obviously they have to be released whenever.

Mr Murphy—Shortly.

Senator SHERRY—In tandem with this, have you been liaising with ASIC in respect of the licensing of financial planners?

Mr Murphy—There is a free flow of information between Treasury and ASIC on various aspects of things. Once it gets to the stage of licensing, it is within their province to conduct licensing.

Senator SHERRY—Of course. I understand that. But there was a highly critical ANAO report. Are you familiar with it?

Mr Murphy—Yes.

Senator SHERRY—It went to aspects of ASIC's licensing of not just planners but other licence holders. Are you aware of that?

Mr Murphy—Yes.

Senator SHERRY—Obviously you do not have a legal role in the sense of saying to ASIC, 'You must do this. You must do that.' But in a case like that where significant issues were raised—I am not sure whether you personally have read it; you are obviously aware of it—do you liaise with ASIC; in this case on that issue?

Mr Murphy—From our analysis of the report, we are not that critical of ASIC. When you are introducing a new program—licensing a part of the financial sector—it is difficult to predict the number of licences you will have to issue. Oftentimes people come in at a very late stage to either get a new licence or renew a licence, so it is not as easy as one would expect. We made sure that ASIC had additional funding to conduct the program. What we do now is—

Senator SHERRY—I will just stop you there on the funding issue. The observation was made by the Audit Office that ASIC had to reallocate funding to this process away from surveillance. Did ASIC make a request for additional funding to handle this additional workload? I know they got additional funding.

Mr Murphy—Yes. They got \$50 million over four years for it.

Senator SHERRY—But once it became apparent that there was this build-up of workload and the diversion of resources from surveillance, did they make any additional requests for funding?

Mr Murphy—I cannot recollect whether they made additional requests.

Mr Brine—Two years ago they made a bid for an increase in general funding of \$60.1 million over four years. That was to strengthen their ability to meet increased demand for core operations. One aspect of that was the fact that they had underestimated the magnitude of this task.

Senator SHERRY—What was the figure you said was advanced to them?

Mr Murphy—It was \$52 million over four years. We meet quarterly with ASIC and APRA to talk about these types of issues. But it seems that it is hard to get licensing exactly right in terms of matching the resources you need and the time with the people coming through the door.

Senator SHERRY—Another issue raised was streaming or streamlining; I forget the exact terminology. Existing operators could gather together the information—prima facie it was accepted—for a significant number of persons who were given a licence. I have spoken to some people who have actually been involved in this process in the industry. They have admitted to me that there were some details in that process of streaming which were wrong. Some of the wrong data given was minor. Other errors were reasonably serious. But it was just wrong because it was a compilation of existing data checked by the providers seeking licences. It was checked to varying degrees and, in some areas, was inaccurate. Clearly ASIC could not check all the details on every licence application. That just did not happen. I am not suggesting it should, by the way, because it would have been a truly monumental task. What is your understanding of situations where a person is granted a licence and the data provided was not all checked?

Mr Murphy—As to the conduct of the issuing of licences, I think, to be fair, that question should be directed to ASIC.

Senator SHERRY—It certainly will be.

Mr Murphy—All I will say is that to some extent you are damned if you do and damned if you do not if you are ASIC. They must rely to the greatest extent possible on the information that is provided by professional people. They must verify to the level they think they need to the information provided. Just as a general comment, it is pretty poor if people say, ‘Oh, we knew we provided false information and we got a licence and now we are implying that the process of issuing the licence was not as robust as it should have been.’

Senator SHERRY—The information given to me was that when they streamed in their information and gathered everything together, with some existing providers they just did not check it in some areas. There were errors that were put in. Some of them were minor things. Others were of greater significance.

Mr Murphy—When you are introducing new regimes, one would think the licensing gets tightened up over time. You have initial hurdles. Supposedly people who have qualifications are competent and meet the criteria. But the granting of a licence is not carte blanche for the rest of your time in the industry. These licences are dealt with on a regular basis. It also gives ASIC the opportunity—this is why you introduce licensing regimes—to get information about people, get it onto a database and then start checking through it. If you put it to ASIC, I think you will find it is an ongoing process for them to verify the information and to check the credibility of the people who have been issued with the licences.

Senator SHERRY—I certainly will raise it with ASIC. They are on tomorrow. I just wondered about the extent, given licensing is an important aspect—

Mr Murphy—It is.

Senator SHERRY—of the safety of the financial system and the process. The ANAO report was reasonably critical.

Mr Murphy—Yes. But the ANAO's job is to really find issues.

Senator SHERRY—Of course. I think I am being relatively restrained in saying it was reasonably critical. There were some pretty sharp criticisms in that document.

Mr Murphy—And that is good. There is an independent person casting an eye over this. From my notes here I think there were seven recommendations, and ASIC accept the recommendations and will improve in the future.

Senator SHERRY—But it is the consequence of that. That is an issue. There are possible consequences that flow on if mistakes are made and things are not picked up by ASIC. But that is primarily an issue for ASIC.

I asked earlier about this 'red tape' issue. The PDS regime has been very heavily criticised in terms of the size of the documents that have been produced. They are of significant size. The argument right across the spectrum, even from the consumer organisations, has been that they are unreadable and they cannot be understood. Therefore, they are of little use when it comes to protection. Has there been any specific study of the readability of these PDS documents? Has there been consumer testing, for example?

Mr Murphy—Mr Love will make some comments on the changes. I suppose we do not resile from the fact that the FSR regime was implemented and the final outcome of it was a great disappointment from the policymakers' point of view. As to the PDS, we have made changes with the parliamentary secretary on the retirements package.

Senator SHERRY—I am aware of that.

Mr Murphy—We accept criticism that we did not move sooner. We would say that it is surprising the way, to some extent, it was handled by industry.

Senator SHERRY—In terms of the complexity and length of the document?

Mr Murphy—Yes. It was doing no-one any favours. It did not help the consumer. It was a cost burden on the industry itself. It is quite surprising that we got that result.

Senator SHERRY—Why were you surprised at that result?

Mr Murphy—The law is reasonably straightforward. You would think there would be concepts of reasonableness and materiality and that they would overlay the law so that people would actually provide information that was useful to the consumers. There are 100-page documents for someone opening a bank account. A CEO of a bank said he was required to give one to a person just opening a deposit account. That is ridiculous. I put that to him and he would not back down. He said, 'That's what the law requires me to do.'

Senator SHERRY—That is what their legal advisers require them to do based on the law.

Mr Murphy—Well, they can drop out the legal advisers. We would say that was not what was required, but that is the outcome you get.

Senator SHERRY—That is the outcome you get.

Mr Murphy—Yes. That is why you have to work at trying to get a better result for the consumers. The cost impost on industry is one thing, but it is actually the people you are trying to help who are losing out. Mr Love might want to comment on where we have got to with that.

Mr Love—To answer your initial question, as part of our policy analysis and the work that was done, we certainly got considerable feedback from industry and consumer groups on the length of product disclosure statements. Some work was done, particularly in the area of superannuation product disclosure statements. ASIC conducted work on the readability of those documents. It became clear to us, as Mr Murphy has already suggested, that a very legalistic approach, I suppose, to the interpretation of the law had led to unintended consequences. It was clearly moving away from what had been intended by the legislature when it passed its legislation.

So part of the refinements project conducted last year on the financial services was to give much clearer guidance in relation to product disclosure statements and provide for what is called now a short form PDS. That is basically saying that essential information should be handed over in a printed form but this does not cut down the class of overall information that has to be put out into the public space. All the information that is currently required can be basically provided through, for example, an electronic means on a website. The issuers of financial products now have the option of basically providing what we would describe as core information in a printed form. Investors and their advisers can still get access to all the information that was previously required to be in the printed document.

Senator SHERRY—I will go back a step. Was any research carried out with consumers in the real life world of draft documents under the initial disclosure regime, the PDS regime?

Mr Love—There was work done by ASIC with regard to superannuation product disclosure statements.

Senator SHERRY—That was the only area, wasn't it?

Mr Love—Yes. That was an area of probably greatest interest and was a fairly representative area.

Senator SHERRY—Certainly there is superannuation, but I got complaints across the board. They weren't just about superannuation.

Mr Love—But similar issues were—

Senator SHERRY—Very similar issues right across the finance sector.

Mr Murphy—You are going back a fair way there.

Senator SHERRY—I know. I could not recall asking this. I do not think I did. Why wasn't a consumer test done originally? Was a consumer test done of what you call refinements and enhancements? That is the latest jargon from a political perspective. I am not suggesting you

are being political, but that tends to be the modern political form of it. Was any consumer testing done in respect of the latest set of changes?

Mr Love—With regard to the latest set of changes, the proposals went out for very extensive consultation right through the community, including the consumer groups. We did not prepare a dummy form of a short form PDS to actually test with people. Part of the feedback you get is if you specifically ask people, ‘Do you find this 100-page document difficult to read?’, they say yes. But if the questions then lead on to, ‘Do you want to know about this, this, this and this?’ people will say yes. If you follow the logic of that, you end up with a very long document once again.

Senator SHERRY—Surely there is consultation with people ‘in the know’, such as industry people, consumer organisations and their people, who are generally specialists in the area of financial services or who certainly have a good working knowledge. I am very surprised and puzzled as to why draft documents in both the processes were not shown to the ordinary punter, if I can use that expression.

Mr Love—For a start, the government and ASIC do not produce these documents.

Senator SHERRY—I know that.

Mr Love—It is industry. The onus is on industry. We have told them clearly, ‘You have to produce documents which people can read and understand.’

Senator SHERRY—I know that. But you are giving the advice that sets down the basis of the rules which form the basis of the documentation. It seems to me there is a good argument to work backwards here and find out what people will actually read and comprehend.

Mr Murphy—I am not certain what consumer testing was done with the original FSR regime. The FSR has been running for a couple of years, and there was a two-year moratorium before it commenced. You are going back about four or five years. But we can check that out for you if you wish. I think it is a good point. We do to some extent, from the government’s point of view, rely on industry and institutions to do their own testing and to come back to us to tell us what they think works in terms of readability and comprehension.

Senator SHERRY—I accept that is valid. That should occur.

Mr Murphy—The other angle, which is not a specific answer, is that the government has established the financial literacy program.

Senator SHERRY—I am going to get to that.

Mr Murphy—Other than that, the answer is what Mr Love has given.

Senator SHERRY—So in terms of the average length of documents now under this refinement process have you done any work on what is emerging?

Mr Love—The law just came into effect on 20 December. It is not mandated that it is an option for industry to choose. The feedback at the moment coming from industry is that they are examining this and seeing how they can make best use of the greater flexibility that the law now provides. Some players believe that they can achieve much shorter documents. People talk about 100-page documents, for example, with managed investments and superannuation products. We found that 60 per cent of this type of document was actually not

mandated by law but included dealing with investment options and all those sort of things, which is totally in the hands of the industry to decide on.

Senator SHERRY—But the reality is that that is overwhelming for many people. If you give them a document of that size, they just shake their head. I was in the Commonwealth Bank a couple of weeks ago at the inquiry counter. A person came up to open a bank account. Correctly—I am not sure if the attendant knew I was standing there—the attendant passed over the PDS. It was this incredible document. The poor fellow standing next to me sort of looked at it and said, ‘Gosh, have I got to read all that?’ And it was very obvious he was not going to. To varying degrees, we are all involved in these issues and the minutia and the detail, but unfortunately the considerable majority of people in the community are not. They find it very difficult.

Mr Love—Bank products have now been exempted from the product disclosure statement regime. Banks are still required to provide information on fees and charges. But their PDS requirements have been—

Senator SHERRY—It was a pretty thick old document that was being passed across the counter.

Mr Love—We took the point that it was not necessary for a bank account.

Senator SHERRY—The critical point is that this is the protection for consumers in Australia. Primarily it is the protection.

Mr Love—The information is still out there. We are still mandating that you provide this information and put it out there in the public space. The issue has been whether or not individuals assimilate this information. We are not just relying on the product disclosure statements to provide information to people. You cannot ram information down people’s throats if they do not want to read it. There are two other parts to the equation. There is the work that has been done on financial literacy more generally to sensitise people and the role that financial advisers are playing now in mediating and explaining products.

Senator SHERRY—Our consumer protection and financial service in this country are centred on disclosure.

Mr Murphy—Yes. But as well as that there is the overlay of the whole regulatory regime. We have a well-resourced independent regulator. They are well resourced relative to other institutions. You have a licensing regime. You have very strong prohibitions in the law if you break the law. Then you have disclosure.

Senator SHERRY—But it depends on the strength of the law. I will not go into this with you today. There is one issue that I will be examining with ASIC, and I want to ask you about it in particular. It is this issue of commission based selling. It is all disclosed but it is still going on and there still seem to be some people getting burnt as a consequence.

Mr Murphy—Commission based selling is not prohibited.

Senator SHERRY—No, it is not.

Mr Murphy—It has been the policy of the government that it should not be.

Senator SHERRY—But that is why this disclosure regime is supposed to work. People are supposed to be competitive, lay four or five of these PDSs down and say, ‘Ripper. That’s the best one. I know what the fees are, know what the projected rate of return is, perhaps, and I’ll make an informed decision.’ The very significant problem is that consumers cannot understand or do not read what is presented to them. That is the central protection in our system.

I want to raise one issue specifically. It is the issue of Westpoint. I will be raising it obviously with ASIC tomorrow. Was there ever any complaint or correspondence drawn to the attention of the department in respect of any aspect of Westpoint over the last few years that was subsequently conveyed by the department to ASIC?

Mr Murphy—I am not aware of any particular ministerial or complaints coming in from an investor. Mr Love, are you aware specifically about Westpoint?

Mr Love—Not from investors. The complaints that have come from investors have been very recent in the form of ministerial correspondence. That is really since about November. ASIC itself has been closely—you can explore this with them—monitoring Westpoint for a considerable time. It was issuing, for example, media releases warning about the dangers of high-risk products back in May 2004.

Senator SHERRY—Towards the end of last year, did complaints flow through to ministers’ offices or, in this matter, the parliamentary secretary’s office and the department which were then passed on to ASIC, or were there direct complaints received by the department that were referred on? Obviously ASIC is the body that had the primary regulatory carriage. I am talking about written complaints. Were they passed on by the department, which is what I would expect, to ASIC with a, ‘Please explain. What is this all about? There’s a communication. What is your response?’ You have not had anything of that nature?

Mr Murphy—If we get ministerials on that type of matter—and we can go through our list—we would go to ASIC and get advice.

Mr Love—Westpoint related concerns and complaints did not arise until late last year. We are talking about November last year, when we started seeing the ministerial correspondence on the issue.

Mr Murphy—There was some dispute earlier as to whether in the newspaper talk around it ASIC was being too strident in their actions against Westpoint. It was an evenly balanced argument. It is only in more recent times that people feel Westpoint has been seen to be possibly stretching the law or engaging in conduct which is—

Senator SHERRY—That is the subject of litigation. We have a whole combination of factors now. The planners are blaming Westpoint, because they think they were misled. The planners are blaming the accounting firm for signing off. The planners are blaming the ‘independent’ research house, to the extent it was independent. Westpoint is blaming the planners for pushing money in. Everyone is blaming everyone else. But at some point in time—

Mr Murphy—We will get to the bottom of it. Our job, if there is an identified gap in the law or, alternatively, an identified gap in the way the system works, is to try to remedy that.

Senator SHERRY—I think there will be a considerable flow of consequences from this particular case.

Mr Murphy—Yes.

Senator SHERRY—It is significant. The volume of correspondence and complaints on it is increasing significantly. Another issue, and I have touched on it with the tax office, is that, again, it is an unknown proportion. ASIC might have some idea about it when I question them tomorrow. Certainly a significant slice of the investment was carried out through small managed superannuation funds. I raised it with the tax office today; they are the regulator of this area.

Mr Murphy—Yes.

Senator SHERRY—I was a little surprised that there had been no direct exchange between the persons regulating this area in the tax office and ASIC—according to the tax office today—given what I think is likely to involve a very substantial number of people and a substantial amount of money flowing through that form of superannuation fund. You have had no communication with the tax office on this issue of Westpoint?

Mr Murphy—No. We can check, but not that I am aware of.

Senator SHERRY—As a matter of interest, I have not asked the Financial Literacy Foundation any questions at estimates. Is this the area where they are located?

Mr Murphy—Financial literacy?

Senator SHERRY—Yes.

Mr Murphy—Yes. It is within the markets group. Peter McCray is the head of that area.

Senator SHERRY—Thanks. Has any research been carried out by the council on the levels of financial literacy in the community?

Mr McCray—There has been a range of research, most prominently in recent years conducted by the ANZ Bank.

Senator SHERRY—That is not what I am going to. I am familiar with that research. Has the foundation commissioned any research?

Mr McCray—We are in the process of undertaking some significant research into the awareness of literacy, levels of literacy and impediments to literacy. The intention is to conduct this survey on an annual basis. We are about to do the first such survey.

Senator SHERRY—That is good to hear. The obvious question to me would seem to be that, whatever work you are doing in this area, it is useful to know the size of the problem, where it is and what its causes are.

Mr McCray—Exactly.

Senator SHERRY—I accept the ANZ and others have done some useful work here. But at the end of the day—I will not say they have a vested interest—they are not independent in that sense.

Mr McCray—Sure.

Senator SHERRY—When will your first results be available on this survey?

Mr McCray—In the latter part of the year. At this stage, the planning is for the survey itself to be conducted in March and the results to be produced in a report probably around June or July.

Senator SHERRY—Will that be made publicly available?

Mr McCray—Our intention is to release the results of the survey, yes.

Senator SHERRY—You mentioned it will be an annual survey.

Mr McCray—That is the intention, yes.

Senator SHERRY—I assume there is a consultancy firm of some sort doing this for you?

Mr McCray—There is.

Senator SHERRY—Who is that?

Mr McCray—It is a market research firm from Melbourne called DBM.

Senator SHERRY—And the approximate size of the budget for the project?

Mr McCray—It will be in the order of \$300,000.

Senator SHERRY—Is that a one-off for this year or is there an ongoing contractual arrangement?

Mr McCray—We have a one-off contract with DBM to conduct this year's survey, but obviously, being a longitudinal study in a sense, the intention is that the same questionnaire or a very similar questionnaire will be revisited each year so you get consistent results. There is no commitment that we will continue to have a commercial arrangement with DBM.

Senator SHERRY—Are you located here in Canberra?

Mr McCray—Yes.

Senator SHERRY—Presumably the members fly in?

Mr McCray—The advisory board?

Senator SHERRY—Yes.

Mr McCray—The advisory board meets quarterly. Our practice has been to conduct board meetings in each of the state capitals. One of the rationales associated with the board meeting is that we have tended to have a gathering with members of the business and education communities in each city to get their input on the issues and to give them feedback on what our plans are going forward. So we have moved around the country. We have had three board meetings so far and a fourth is coming up in Hobart in March.

Senator SHERRY—Thanks for that. I have a couple of very brief questions for actuarial services officers, who I can see are sitting patiently at the back of the room.

CHAIR—Does that mean everybody else can go?

Senator SHERRY—Yes.

CHAIR—Gentlemen, you are excused. Thank you very much. We will see you in May.

Senator SHERRY—I have only a couple of questions. It is at least a year or 18 months since I checked the staffing levels in actuarial services. What is the current status?

Mr Martin—We have four qualified actuaries, three analysts and an office manager. As well as that, we call on another actuary on a very casual basis once or twice a fortnight.

Senator SHERRY—Do the analysts have any particular qualifications?

Mr Martin—All of them are partly qualified actuaries. I would expect a couple of them to qualify in the next year or two.

Senator SHERRY—You use this description ‘analyst’—I was just not sure what it meant. Has the actuary’s office been consulted about any aspects of the Future Fund?

Mr Martin—We have been asked about the design of aspects of the legislation, in particular those bits that refer to the designated actuary.

Senator SHERRY—I have not read that section of the bill yet. It will enter the Senate in the next sitting week, so I had better do so. Who is to be the designated actuary? This is for valuation purposes going forward and projections, presumably.

Mr Martin—I understand it is a matter for the Minister for Finance and Administration.

Senator SHERRY—So the minister can designate the actuarial firms? It will not be the Government Actuary?

Mr Martin—It is up to the minister for finance. He could designate the Government Actuary.

Senator SHERRY—I am surprised it would not be the Government Actuary and it is not designated as such. It would seem logical to me. What do we have you for but to do this sort of work? Given the importance of an actuarial assessment, what is your understanding of the regularity of an update of the actuarial assessment of the fund?

Mr Martin—Of the Future Fund specifically?

Senator SHERRY—Yes.

Mr Martin—You could carry out an assessment every three years with some approximate updates in the intervening years.

Senator SHERRY—Why do you say every three years?

Mr Martin—That would give you some consistency with the arrangements for other superannuation funds.

Senator SHERRY—My understanding is that the projected growth of the fund through to balance date—I use the term balance date to mean the balance and the date when it will be balanced with liabilities—is predicated on a conservative investment return of the bond rate, I think.

Mr Martin—I am not sure that that is right. I have read that as well, but I think the investment mandate is more in the nature of a real return of about five per cent.

Senator SHERRY—No, I am going to the initial projected rate of return that was used with the announcement of its establishment in the budget. I think it will be something

different going forward. In fact, it seemed pretty clear to me at other estimates that that would be the case. Do you know what the figure is?

Mr Martin—I do not, no.

Senator SHERRY—I am a little surprised at that because I thought you would have been consulted about it.

Mr Martin—No. I indicated that we were asked about actuarial aspects of the legislation.

Senator SHERRY—Going forward, it is predicated on X rate of return over the years. My understanding is that it is a conservative rate of return; it is not a market rate of return. It is related to the bond rate. But if, as you say, there is an actuarial assessment carried out every three or five years and it becomes apparent that the fund is in surplus—or deficit for that matter, but it seems to me more likely it will be in surplus given the conservative projection made on the rate of return—what happens to the surplus?

Mr Martin—The legislation will set down when and for what purpose funds can be applied. I am not sure that the issue of surplus has been specifically addressed in the legislation.

Senator SHERRY—It seems to me—and I would value your opinion because you are an expert in this area—it is highly unlikely that at X date it will be spot-on. It may be over or under depending on that long-term rate of return. It is highly unlikely it will be spot-on, and spot-on, when you are dealing with these sorts of figures, may be a billion. It may be \$20 billion in surplus; it may be under. If there is a surplus, it sits in the fund, presumably, until such time as a decision is made to take it out of the fund, if it is excess to meet liability.

Mr Martin—At 2020 or an earlier time, if the fund is fully funded then draw-downs can commence.

Senator SHERRY—Is that a provision of the bill at the moment? Once equilibrium is reached, that can happen if it happens earlier?

Mr Martin—That is my understanding. I have not looked at it, to be honest, in the last little while.

Senator SHERRY—That was not clear on the advice I was given, but I will check that aspect of it. Do you think the actuarial assessment will be every three to five years?

Mr Martin—The main Commonwealth schemes for public servants and the military are reviewed every three years, so it makes sense to align the review of the Future Fund with that.

Senator SHERRY—Is the three-yearly review a statutory requirement or is it just a practice or policy that has developed?

Mr Martin—I think it is a statutory requirement for at least one of the funds.

Mr Burt—It is a statutory requirement under the SIS legislation—the superannuation industry supervision legislation. It is every three years, or at no more than three-yearly intervals.

Mr Martin—SIS applies to at least the PSS. The other schemes are all doing that.

Senator SHERRY—I was not aware of that requirement in SIS. Is that for all defined benefit funds?

Mr Burt—The rules used to be that way, but it is a bit more complicated these days. It is now annually unless you are allowed to have three-yearly valuations. I cannot remember the exact provisions of the rules, but I think that decision may be APRA's, but please do not quote me on that. It is appropriate to read the legislation before quoting me on that.

Senator SHERRY—I will check with APRA. That would not apply legally to exempt state protected schemes, would it? They may apply it, but it is not legally enforceable if they chose not to.

Mr Burt—I think that is correct. They are expected to follow the same underlying principles with SIS, so effectively there is what I call a moral obligation on them to do it at least every three years. But there may be some sort of heads of government agreement covering this, the details of which I am not familiar with, I have to say.

Senator SHERRY—Just to conclude, Mr Martin, is the three-year provision in the Future Fund in legislation? Can you recall?

Mr Martin—I cannot recall.

Senator SHERRY—I will check it myself. Thanks.

CHAIR—Thank you very much, Senator Sherry. Thank you, gentlemen. The proceedings are adjourned until 9.00 am tomorrow morning. We will resume with questions to the Australian Securities and Investment Commission.

Committee adjourned at 10.50 pm