

# Commonwealth Guarantees, Indemnities and Letters of Comfort

## Performance Audit

Tabled 12 September 1996

Audit Report No. 6 1996-97

### Abbreviations

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<b>ASTA</b>	Aerospace Technologies of Australia
<b>AG's</b>	Attorney-General's Department
<b>ABC</b>	Australian Broadcasting Corporation
<b>ADI</b>	Australian Defence Industries
<b>AIDC</b>	Australian Industry Development Corporation
<b>ANAO</b>	Australian National Audit Office
<b>ANL</b>	Australian National Line
<b>ATO</b>	Australian Taxation Office
<b>ATG</b>	Australian Technology Group
<b>CAAMA</b>	Central Australian Aboriginal Media Association
<b>CAA</b>	Civil Aviation Authority
<b>CASA</b>	Civil Aviation Safety Authority
<b>CBA</b>	Commonwealth Bank of Australia

<b>CDB</b>	Commonwealth Development Bank
<b>CRS</b>	Commonwealth Rehabilitation Scheme
<b>CSS</b>	Commonwealth Superannuation Scheme
<b>CIS</b>	Commonwealth Indemnity Scheme
<b>DoCA</b>	Department of Communications and the Arts
<b>DoD</b>	Department of Defence
<b>DEETYA</b>	Department of Employment, Education, Training and Youth Affairs
<b>DEST</b>	Department of Environment, Sport and Territories
<b>DoF</b>	Department of Finance
<b>DFAT</b>	Department of Foreign Affairs and Trade
<b>DHFS</b>	Department of Health and Family Services
<b>DIMA</b>	Department of Immigration and Multicultural Affairs
<b>DIR</b>	Department of Industrial Relations
<b>DIST</b>	Department of Industry, Science and Tourism
<b>DPIE</b>	Department of Primary Industries and Energy
<b>PM&amp;C</b>	Department of the Prime Minister and Cabinet
<b>DSS</b>	Department of Social Security

<b>DoTRD</b>	Department of Transport and Regional Development
<b>Tsy</b>	Department of the Treasury
<b>DVA</b>	Department of Veterans' Affairs
<b>DAS</b>	Department of Administrative Services
<b>EFIC</b>	Export Finance and Insurance Corporation
<b>FMA</b>	Financial Management and Accountability Act
<b>GBE</b>	Government Business Enterprise
<b>HLIC</b>	Housing Loans Insurance Corporation
<b>ISC</b>	Insurance and Superannuation Commission
<b>LTCB</b>	Long Term Credit Bank (Japan)
<b>MOU</b>	Memorandum of Understanding
<b>PNG</b>	Papua New Guinea
<b>PSS</b>	Public Sector Superannuation Scheme
<b>PSO</b>	Public Share Offer
<b>PTE</b>	Public Trading Enterprises
<b>RBA</b>	Reserve Bank of Australia
<b>SMEC</b>	Snowy Mountains Engineering Corporation

**SBS** Special Broadcasting Service

**SMA** Statutory Marketing Authorities

**TOP** Tuggeranong Office Park

## Summary

### Introduction

1. Guarantees, indemnities and letters of comfort are instruments which can be used to facilitate the operations of the Government. They result in exposures and as such carry with them risks and obligations which may be called on in the future. Therefore they need to be carefully used with the resultant exposures monitored regularly. The treatment of each of the instruments in those respects may well differ but the general, in principle, concerns are broadly similar. <sup>1</sup>

2. The audit set out to quantify the Commonwealth's exposure to guarantees, indemnities and letters of comfort. In certain cases, the obligations arising from these instruments are represented as liabilities on the face of the financial statements of Commonwealth agencies. <sup>2</sup> However, in the overwhelming majority of cases these liabilities do not qualify for recognition on the face of the financial statements, consistent with accounting conventions. The probability of the Commonwealth being required to deliver on these instruments is assessed by the agency as being less likely than more likely.

3. These instruments have common characteristics and represent the large majority, by value and number, of explicit Commonwealth contingent liabilities. The audit focused on explicit guarantees, indemnities and letters of comfort provided by the Commonwealth under legislation, deeds, contracts and correspondence as at 30 June 1995.

4. In financial terms, the risk of having to make a payment for guarantees, indemnities and letters of comfort in most cases is considered to be remote in any one year. Nevertheless, the risks are not negligible, indeed a number of claims have been made against the Commonwealth in respect of such instruments in recent years. These claims include payments made under indemnification arrangements for the blood supply system involving outlays by the Commonwealth of some \$28.6 million between 1989 and 1995. Also, much larger payments have been made by the Commonwealth to the Export Finance and Insurance Corporation (EFIC) in respect of national interest loans and insurance contracts between 1990-91 and 1993-94 amounting to some \$563 million. <sup>3</sup>

### Audit objectives

5. The Australian National Audit Office (ANAO) objectives for the audit were to examine Commonwealth guarantees, indemnities and letters of comfort in relation to: the potential size of the Commonwealth's exposure to these instruments; the extent to which the overall exposures of the Commonwealth are managed and monitored; the adequacy of administrative reporting arrangements; areas of better administrative practice relating to their management; and to raise agencies' awareness of appropriate risk management and accountability practices in relation to these instruments.

## Audit approach

6. The major source of information for the audit was a census conducted by the ANAO of explicit Commonwealth guarantees, indemnities and letters of comfort as at 30 June 1995. The census canvassed the then 20 portfolio departments <sup>4</sup> in September 1995. As part of this audit, the ANAO did not independently verify the census information supplied by agencies on the number and value of instruments they had on issue as at 30 June 1995. Where inconsistencies with the agencies' information arose in the data collected from other sources, the ANAO attempted to resolve these inconsistencies with the agencies concerned. The agencies' information was checked for reasonableness.

## Governance framework

7. The current governance system applying to the issuing, management and reporting of Commonwealth guarantees, indemnities and letters of comfort relies on a legislative and policy framework which comprises Acts of Parliament; Finance Directions; guidelines issued under the *Audit Act 1901*; Finance Circulars, Government Business Enterprises accountability arrangements and other policy guidelines. An outline of the authority to issue that apply to these instruments is set out in Exhibit 1.

8. The ANAO found that the application of the governance framework varied significantly. For example, loan guarantees receive considerable attention; while letters of comfort are not explicitly covered, noting that letters of comfort are in most instances likely to be of less concern.

9. The disclosure and reporting requirements that currently apply to guarantees, indemnities and letters of comfort require judgments on what instruments are presented in agencies' financial statements and in the Minister for Finance's Aggregate Financial Statement. The current reporting arrangements result in the partial presentation of information of off-balance sheet <sup>5</sup> contingent liabilities.

### Exhibit 1: Category of instrument and authority to issue

Instruments	Total Specified Exposures	Authority
Loan Guarantees	\$13 004 m	Legislation
Non-loan Guarantees <sup>(a)</sup>	\$206 787 m	Legislation or Minister/Authorisation
Indemnities <sup>(b)</sup>	\$1 693 m	Legislation or Minister/Authorisation <sup>(c)</sup>
Letters of Comfort	\$180 m	Minister/Authorisation <sup>(d)</sup>

<sup>(a)</sup> The majority of indemnities identified in the audit did not have any specified value.

<sup>(b)</sup> All but one of the non-loan guarantees identified by the audit were set out in legislation. The exception was the guarantee of Telstra's performance in making payments to the Telecom Superannuation Fund. This performance guarantee was properly authorised.

<sup>(c)</sup> May be exercised by the Minister directly or by an officer duly authorised by the Minister.

<sup>(d)</sup> There is currently no explicit guidance as to who may issue letters of comfort on behalf of the Commonwealth.

## **Risk management**

10. Sound risk management arrangements was seen as crucial to the effective management of the Commonwealth's exposure to risk as a result of the issue of guarantees, indemnities and letters of comfort. The ANAO view was that a suitable system reflecting sound practice would be one that could clearly demonstrate links between an overall corporate risk management strategy and the risk management strategy applied to the management of these instruments.

11. Portfolio risk management was found to be deficient across the majority of departments in relation to guarantees, indemnities and letters of comfort. This was demonstrated by the fact that of the departments which reported using these instruments, only a small minority reported having a corporate risk strategy. Fewer still claimed there was a link between this strategy and their management of contingent liabilities, noting that these arrangements are not mandatory requirements.

12. This finding was exemplified by the shortcomings in risk exposure control practices of most agencies under the present arrangements. These shortcomings can be summarised as deficiencies in the instruments' preparation requirements, records management, document security and monitoring and review arrangements.

## **Risk treatment**

13. The ANAO considers that a wider examination of the issues of risk management would be a useful exercise for canvassing options that may enhance the Commonwealth's management of its off-balance sheet exposures.

14. Options were identified which outline a range of possible approaches for dealing with Commonwealth risk exposures from guarantees, indemnities and letters of comfort within a more commercially oriented framework of risk management and control. The managed insurance fund arrangements currently operated by the New South Wales and Victorian Governments are examples of arrangements that utilise in part some of these options in their management of risk.

## **Overall findings**

15. The ANAO considers that in most agencies there needs to be a marked improvement in management and administrative practices associated with off-balance sheet risk. As well, there needs to be greater public accountability at both agency and whole of government level through better reporting.

16. In terms of the objectives of the audit the ANAO found the following:

- *Potential size of the Commonwealth's exposure.* The ANAO considers that the

Commonwealth's gross exposure to these instruments verified by agencies amounts to at least \$222 billion at 30 June 1995; comprising contingent loan guarantees of \$13.0 billion (noting that liabilities are generally matched by assets); non-loan guarantees of \$206.8 billion; indemnities of \$1.7 billion; and letters of comfort of \$180 million. There is also a large number of indemnities and some letters of comfort which have no specified financial commitment.

- *Management and monitoring of the Commonwealth's exposures.* The management practices of the majority of agencies did not generally include appropriate corporate risk management plans which were integrated with the management of guarantees, indemnities and letters of comfort. In addition, there were significant deficiencies in agencies' compliance with Department of Finance guidelines and directions which impaired their capacity to manage and monitor properly the risks associated with exposure to guarantees, indemnities and letters of comfort.
- *Adequacy of reporting.* The accountability measures currently in place are not sufficient in certain cases to provide an informed basis for agency managers to manage appropriately the risks arising from guarantees, indemnities and letters of comfort. Nor do they provide a sufficiently comprehensive coverage for public accountability purposes at both agency and at a whole of government level. The need is for greater transparency of such arrangements for all stakeholders, including the Parliament.
- *Better administrative practice.* In the course of the audit the ANAO developed a set of better administrative practices and principles to assist agencies to manage Commonwealth guarantees, indemnities and letters of comfort more effectively. The development of these practices drew on examples of sound administration in a number of agencies. The Department of Communications and the Arts Commonwealth Indemnity Scheme embodies most of the characteristics of this approach and was a notable example of sound administrative practice found during the audit. Other examples of sound administrative practice included the central record keeping systems of the Departments of Finance and Primary Industries and Energy.
- *Options for the improved management of risk.* The ANAO has outlined a range of possible approaches dealing with the risk exposures from Commonwealth guarantees, indemnities and letters of comfort within a more commercially oriented framework of risk management and control. These options range from risk prevention measures to outsourcing risk to the private sector, albeit with attendant costs that need to be assessed realistically.
- *Agencies' awareness.* There is a need for an increased level of awareness across agencies of the commercial risk that attaches to Commonwealth off-balance sheet exposures and the options for treating that risk. Since the start of the audit, several agencies have made significant efforts to improve their management priorities with regard to guarantees, indemnities and letters of comfort. The ANAO considers that the Department of Finance is well placed, as coordinator of Commonwealth financial management practices, to take the lead in raising agencies' awareness and to coordinate enhanced public accountability, particularly in financial reporting.

17. The adoption of accrual reporting by agencies will provide more comprehensive

information for decision making and enhance the ongoing management and reporting of the Commonwealth's obligations in respect of guarantees, indemnities and letters of comfort. However, this audit has highlighted the need for early action to address shortcomings in existing management and administrative practices for these instruments which represent a very significant gross exposure to the Commonwealth.

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## **Key Findings**

### **Commonwealth exposure**

1. The ANAO's most probable estimate of the Commonwealth's financial exposure to guarantees, indemnities and letters of comfort as at 30 June 1995 was a minimum of \$222 billion, comprising contingent guarantees of \$13.0 billion, non loan guarantees of \$206.8 billion, indemnities of \$1.7 billion and letters of comfort of \$180 million. There is also a large number of indemnities and letters of comfort which have no specified financial commitment. These instruments usually do not meet the criteria for reporting on agencies' balance sheets.

### **Risk management planning**

2. The majority of agencies did not have risk management plans for the management of off-balance sheet liabilities. There is a need for agencies to develop explicit links between a risk management plan for off-balance sheet liabilities and their overall corporate risk management plan.

### **Central coordination**

3. There is no centrally coordinated strategy for the management of Commonwealth guarantees, indemnities and letters of comfort.

### **Records management**

4. All relevant agencies need to conduct a review of their records to ensure that they have a complete register of all Commonwealth guarantees, indemnities and letters of comfort on issue within their portfolio. The establishment of contract registers and improvements in physical security measures for the safe keeping of documents associated with these instruments would enhance agencies' records management of their contingent liabilities.

5. There were significant deficiencies in agencies' compliance with Department of Finance guidelines and directions, which impaired their capacity to manage and monitor the risks associated with exposure to guarantees, indemnities and letters of comfort.

### **Risk minimisation**

6. The Commonwealth may be exposed to unnecessary risk because agencies regularly issue instruments without setting financial limits, inserting termination clauses and/or imposing time limits. Moreover, subrogation <sup>6</sup> clauses, where applicable, need to be incorporated into indemnities as a means of managing and controlling the Commonwealth's financial exposure.

### **Reporting arrangements**

7. The partial presentation of off-balance sheet liabilities under current reporting arrangements does not provide sufficient and comprehensive information for informed



decision making.

### **Improved public accountability**

8. Subject to possible confidentiality and security issues and/or concerns, improved reporting to Parliament of the Commonwealth's exposure to off-balance sheet liabilities is required.

### **Risk pricing**

9. The practice of the Commonwealth not directly 'pricing' risk associated with most guarantees, indemnities and letters of comfort has the potential to produce unintended and possible unwanted consequences. The necessary incentives are not provided to agencies to effectively manage their liabilities so as to minimise ongoing Commonwealth financial commitments.

### **Risk transference option**

10. There may be risks currently covered by indemnities and letters of comfort issued by agencies which could be cost-effectively covered by commercial insurance.

### **Agencies' awareness**

11. There is a need for increased awareness of the commercial risk that attaches to Commonwealth off-balance sheet exposures and the options for treating that risk. In the course of the audit a number of agencies made significant efforts to improve their management with regard to guarantees, indemnities and letters of comfort.

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## **Recommendations**

*Set out below are the ANAO's recommendations with Report paragraph reference and abbreviated responses from agencies. More detailed responses and any ANAO comments are shown in the body of the report. The ANAO considers that agencies should give priority to Recommendations Nos. 1, 3, 4, 5, 6, 7, 12, 15 and 16.*

Recommendation No. 1 Para. 2.7	<p>The ANAO <i>recommends</i> that all relevant agencies conduct a review of their records to ensure that they have a complete register of all Commonwealth guarantees, indemnities and letters of comfort within their portfolio.</p> <p>Agree: DoCA, Tsy, PM&amp;C, DIST, DVA, AG's, DoF, DHFS, DAS, DoTRD and DPIE.</p> <p>Agree in principle: DEETYA and DoD.</p> <p>No comment: DEST and DFAT.</p>
Recommendation No. 2 Para. 3.27	<p>The ANAO <i>recommends</i> that the Department of Finance, initiate, in consultation with agencies, an awareness program concerning risk management of off-balance sheet exposures, notably those relating to indemnities and letters of comfort.</p> <p>Agree: DAS, DoCA, Tsy, PM&amp;C, DIST, DEETYA, AG's and DoTRD.</p> <p>Agree in principle: DoF.</p>

No comment: DoD, DHFS, DEST, DPIE, DVA and DFAT.

Recommendation  
No. 3  
Para. 3.34

The ANAO *recommends* that the Department of Finance, in consultation with agencies and cognizant of commercial sensitivities, reviews the disclosure and reporting arrangements of Commonwealth guarantees, indemnities and letters of comfort with the aim of ensuring their transparency and appropriate monitoring procedures.

Agree: DAS, Tsy, PM&C, DIST, DEETYA, DoTRD and AG's.

Agree in principle: DoF and DoCA.

No comment: DoD, DHFS, DEST, DVA, DPIE and DFAT.

The ANAO *recommends* that, where applicable:

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

Recommendation  
No. 4  
Para. 4.9

Agree: DoCA, PM&C, DIST, DVA, AG's, DAS, Tsy, DoTRD and DPIE.

Agree in principle: DoF, DoD, DHFS and DEETYA.

No comment: DEST and DFAT.

Recommendation  
No. 5  
Para. 4.21

The ANAO *recommends* that the Department of Finance Circular on Indemnities be revised to incorporate the concept of subrogation in regard to indemnities and that agencies should include such clauses in indemnities where applicable.

Agree: DAS, Tsy, PM&C, DIST, DEETYA, AG's, DoTRD, DoF and DoCA.

No comment: DoD, DHFS, DEST, DVA, DPIE and DFAT.

Recommendation  
No. 6  
Para. 4.32

The ANAO *recommends* that, where appropriate and commercially practical, time limits, termination clauses and financial limits should be stipulated by agencies when issuing Commonwealth guarantees, indemnities and letters of comfort.

Agree: DAS, Tsy, PM&C, DIST, DEETYA, AG's, DoF, DoTRD and DoCA.

Agree in principle: DPIE.

No comment: DHFS, DEST, DVA, DoD and DFAT.

Recommendation  
No. 7  
Para. 4.38

The ANAO *recommends* that agencies review their authorisation arrangements, particularly those relating to officers' authorisation to bind the Commonwealth to contractual arrangements pertaining to the issue of Commonwealth indemnities.

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

Agree in principle: DEETYA.

No comment: DEST and DFAT.

Recommendation  
No. 8  
Para. 5.9

The ANAO *recommends* that agencies consider introducing contract registers which are regularly monitored to facilitate and enhance the records management of their contingent liabilities.

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

Agree in principle: DEETYA and DoD.

No comment: DEST and DFAT.

Recommendation  
No. 9  
Para. 5.18

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

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

Agree in principle: DEETYA.

No comment: DEST and DFAT.

Recommendation  
No. 10  
Para. 5.24

The ANAO *recommends* that agencies regularly review the effectiveness of their reporting and monitoring arrangements for guarantees, indemnities and letters of comfort to ensure that the Commonwealth's interests are protected for the legal duration of the instruments.

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

Agree in principle: DEETYA.

No comment: DEST and DFAT.

Recommendation  
No. 11  
Para. 5.30

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

Agree: DoD, DHFS, DAS, DoTRD, Tsy, PM&C, DIST, DVA, AG's,

DoF, DoCA and DPIE.

Agree in principle: DEETYA.

No comment: DEST and DFAT.

Recommendation  
No. 12  
Para. 5.38

The ANAO *recommends* that the Department of Finance prepare an explicit strategy to manage the Commonwealth's overall risk associated with guarantees, indemnities and letters of comfort.

Agree: Tsy, PM&C, DIST, AG's, DoTRD, DAS and DEETYA.

Agree in principle: DoF and DoCA.

No comment: DoD, DHFS, DEST, DVA, DPIE and DFAT.

Recommendation  
No. 13  
Para. 6.15

The ANAO *recommends* that the Department of Finance, in consultation with agencies, examine options for improved accountability practices which embody comprehensive recording of material Commonwealth guarantees, indemnities and letters of comfort.

Agree: Tsy, DoTRD, PM&C, DIST, DEETYA, AG's, DoD, DAS and DoCA.

Agree in principle: DoF.

No comment: DHFS, DEST, DVA, DPIE and DFAT.

Recommendation  
No. 14  
Para. 6.30

The ANAO *recommends* that agencies entering into any form of written commercial arrangement should undertake a formal process of contract vetting to ensure that the Commonwealth exposure to risk is minimised.

Agree: DHFS, Tsy, PM&C, DIST, DEETYA, DVA, DoF, DPIE, DoTRD, AG's and DAS.

Agree in principle: DoD and DoCA.

No comment: DEST and DFAT.

Recommendation  
No. 15  
Para. 6.43

The ANAO *recommends* that the Department of Finance, in consultation with relevant agencies, examine the application of appropriate risk based systems to the management and pricing of risk pertaining to Commonwealth guarantees, indemnities and letters of comfort.

Agree: PM&C, DIST, DoTRD, AG's and Tsy.

Agree in principle: DEETYA, DoF, DAS and DoCA.

No comment: DoD, DHFS, DEST, DVA, DPIE and DFAT.

Recommendation  
No. 16  
Para. 6.53

The ANAO *recommends* that the Department of Finance, in consultation with the Attorney-General's Department and other relevant agencies, review the merits of the Commonwealth carrying all the risk associated

with guarantees, indemnities and letters of comfort, given that there may be commercial options for the cost effective transfer of risk to other parties.

Agree: Tsy, PM&C, DIST, AG's, DoF, DoTRD and DAS.

Agree in principle: DEETYA and DoCA.

No comment: DoD, DHFS, DEST, DVA, DPIE and DFAT.

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1

Statement of Accounting Concepts 4, paragraphs 65-71. These sorts of contingent liabilities usually fail the criteria to be reported on the face of the financial statements of agencies in that they often cannot be measured reliably and/or the probability is too low that future economic sacrifice will be required because of them.

2

In cases such as the Commonwealth Superannuation Scheme and Public Sector Superannuation Scheme guarantees, the liabilities these guarantees represent have met the criteria for recognition in the Department of Finance's financial statements.

3

Audit Report No. 7 1994-95, *Department of Industry, Science and Technology, National Interest Export Finance and Insurance*, pp 4-5. National interest loans and insurance are provided through EFIC to support business in export activities and are approved by the relevant portfolio minister. The Commonwealth agrees to directly carry the risk associated with these transactions and makes payments to EFIC to cover any losses incurred.

4

There are now 18 portfolio departments.

5

The CCH Macquarie Dictionary of Accounting (1991) states that: '*...when not included in the balance sheet a contingent liability may also be called an off-balance sheet liability...*'

6

Colinvaux, R. (1984) *The Law of Insurance*, Sweet & Maxwell, London, states that: '*....Subrogation is a concept and practice which arises in insurance law. It involves the right of an insurer to assume the*

*position of the insured in a claim made against the insured, or to assume the legal rights of the insured against third parties...'* p139.

## 1. Introduction

*This chapter outlines the rationale, scope, methodology, objectives and overall conclusions for the efficiency audit into the management of Commonwealth guarantees, indemnities and letters of comfort.*

### Introduction

1.1. Guarantees, indemnities and letters of comfort are instruments which can be used to facilitate the operations of the Government. They result in exposures and as such carry with them risks and obligations which may be called on in the future. Therefore they need to be carefully used with the resultant exposures monitored regularly. The treatment of each of the instruments in those respects may well differ but the general, in principle, concerns are broadly similar. These instruments usually do not meet the criteria for reporting on agencies' balance sheets. <sup>1</sup>

1.2. For the purposes of this audit, guarantees, indemnities and letters of comfort were defined as follows:

- **guarantee:** A guarantee is a promise whereby one party promises to be responsible for the debt of, or performance obligations of another, should this party default in some way;
- **indemnity:** An indemnity is a promise whereby a party undertakes to accept the risk of loss or damage another may suffer; and
- **letter of comfort:** There are various definitions of what constitutes a letter of comfort. <sup>2</sup> The Attorney-General's Department advises that a letter of comfort is essentially an instrument which is used to facilitate an action or transaction but is constructed with the intention of not giving rise to a legal obligation.

1.3. Guarantees and indemnities may: arise under legislation (either explicitly stated in legislation or implied); take the form of deeds; be the subject of a contract or contractual clause; or can even arise out of correspondence. Letters of comfort encompass a wide range of media in addition to standard correspondence including facsimiles, e-mail and other forms of electronic correspondence.

1.4. The wide range of circumstances which eventually can be construed as establishing an obligation on the Commonwealth to meet a future contingency has meant that the audit has been unable to provide a definitive statement of the overall Commonwealth exposure from guarantees, indemnities and letters of comfort as at 30 June 1995.

### Audit rationale

1.5. This audit in part represents an extension of ANAO audit coverage of management and monitoring issues associated with Commonwealth contingent liabilities. <sup>3</sup> In the course of ANAO performance audit studies of asset sales it emerged that the issuing of guarantees and indemnities are recurrent issues which continues to have implications after

the sale. The ANAO was also aware of concerns by public sector managers regarding the risk management practices associated with agencies' off-balance sheet activities. Against this background, the ANAO has conducted this audit looking at a sub-set of these contingent liabilities, namely explicit Commonwealth guarantees, indemnities and letters of comfort.

1.6. The Commonwealth's gross exposure to these instruments amounts to at least \$222 billion as at 30 June 1995. There are numerous indemnities and letters of comfort which have no specified financial commitment.

1.7. The magnitude of the Commonwealth's exposure, coupled with the public policy objectives that these instruments seek to pursue and the potential for future calls on the Commonwealth's budget, makes it appropriate for the Government and the Parliament to expect that the risks which attach to these instruments are adequately managed and reported. In view of these factors there is a need for effective management by agencies of guarantees, indemnities and letters of comfort. This requires adequate documentation and records, effective management and monitoring in terms of appropriate risk management strategies and appropriate accountability mechanisms. The audit found that these essential features were absent from most agencies' management of these instruments.

1.8. The risk of having to make a payment because of a guarantee, indemnity or letter of comfort, in most cases, is remote in any one year. Nevertheless, the risk should not be dismissed as negligible. The sheer size of the Commonwealth's exposure warrants a level of disclosure and management that ensures that the risks are well understood and the instruments soundly managed. There has also been a number of claims made against the Commonwealth in respect of such instruments. These claims include payments made under indemnification arrangements for the blood supply system, which saw outlays by the Commonwealth of some \$28.6 million between 1989 and 1995. Also, much larger payments have been made by the Commonwealth to EFIC in respect of national interest loans and insurance contracts between 1990-91 and 1993-94, amounting to \$563 million. <sup>4</sup>

### **Audit scope**

1.9. The audit set out to quantify the Commonwealth's exposure to guarantees, indemnities and letters of comfort. In certain cases, the obligations arising from these instruments are represented as liabilities on the face of the financial statements of Commonwealth agencies. <sup>5</sup> However, in the overwhelming majority of cases these liabilities do not qualify for recognition on the face of the financial statements, consistent with accounting conventions, as the probability of the Commonwealth being required to deliver on these instruments is assessed by the agency as being less likely than more likely.

1.10. The audit generally focussed on a sub-set of contingent liabilities that have common characteristics and which also represent the large majority, by value and number, of explicit Commonwealth contingent liabilities. These were explicit guarantees, indemnities and letters of comfort provided by the Commonwealth under legislation, deeds, contracts and correspondence as at 30 June 1995.

1.11. Excluded from the audit were other contingent liabilities such as uncalled capital subscriptions for multilateral financial institutions such as the International Bank for Reconstruction and Development (\$3.44 billion as at 30 June 1995). To keep the audit

within manageable limits, the following instruments were also excluded:

- instruments issued by Statutory Marketing Authorities (SMAs) and Government Business Enterprises (GBEs) that did not explicitly involve the Commonwealth in a legal obligation;
- indemnification of Commonwealth employees (eg the indemnification of Commonwealth officers serving on SMA and GBE boards); and
- the Commonwealth's exposure from guarantees relating to financial derivatives.

1.12. The size of the gross exposure from financial derivatives for some Commonwealth entities enjoying Commonwealth guarantees is large. However, the actual net exposure will be more modest as the agencies who issue them frequently hedge their exposure.<sup>6</sup> Again, to keep the audit within manageable limits, this complex field of activity was not canvassed.

### **Audit objectives**

1.13. The ANAO objectives for the audit were to examine Commonwealth guarantees, indemnities and letters of comfort in relation to:

- the potential size of the Commonwealth's exposure to these instruments;
- the extent to which the overall exposures of the Commonwealth are managed and monitored;
- the adequacy of administrative reporting arrangements;
- areas of better administrative practice relating to their management; and
- raising agencies' awareness of appropriate risk management and accountability practices in relation to these instruments.

### **Audit methodology and criteria**

1.14. The ANAO made assessments of performance against specified audit criteria which were derived from regulations, directives, guidelines and examples of better practice. Several sources of information were drawn on in the course of the audit, including Finance Directions and other documents prepared by the Department of Finance to provide guidance to agencies on how to manage and report their contingent liabilities. The major source of information for the audit was a census conducted by the ANAO of explicit Commonwealth guarantees, indemnities and letters of comfort as at 30 June 1995. The census canvassed the then 20 portfolio departments<sup>7</sup> in September 1995, and was carried out in two stages. In the initial stage a questionnaire was developed and distributed to all departments. The questionnaire sought to establish how many guarantees, indemnities and letters of comfort existed as at 30 June 1995 and how many had been issued since 1 July 1992.

1.15. The ANAO did not independently verify the census information supplied by agencies on the number and value of instruments they had on issue as at 30 June 1995. However, other material including Department of Finance returns and published information such as legislation, Minister for Finance's Aggregate Financial Statements



and departmental annual reports were examined in the course of the audit. Where inconsistencies with the agencies' information arose in the data collected from other sources, the ANAO attempted to resolve these inconsistencies with the agencies.

1.16. In the second stage, the ANAO undertook field work involving examination of: a sample of responses selected for more detailed study; an assessment of agencies' management practices; discussions with the New South Wales and Victorian State Treasury staff; senior representatives of the insurance industry and all agencies participating in the audit. In addition, the ANAO wrote to portfolio departments in February 1996 seeking confirmation of the completeness of their previous returns and information concerning corporate risk management plans. Following this stage, the ANAO initiated a process of consultation with departments which included a round table meeting on 16 May 1996 which was addressed by the ANAO and representatives from the Departments of Finance, the Treasury and Attorney-General's.

1.17. The cost of the audit was approximately \$320 000. The audit conforms to the ANAO Auditing Standards.

### **Audit conclusions**

1.18. Overall the ANAO considers that there needs to be a marked improvement in most agencies' management and administrative practices associated with off-balance sheet risk. As well, there is a need for greater public accountability at both agency and whole of government level through better reporting.

### **Potential size of the Commonwealth's exposure**

1.19. The ANAO considers that the Commonwealth's gross exposure to these instruments verified by agencies amount as at the 30 June 1995, to at least \$222 billion at 30 June 1995; comprising contingent loan guarantees of \$13.0 billion; non-loan guarantees of \$206.8 billion; indemnities of \$1.7 billion; and letters of comfort of \$180 million.

1.20. It should be noted that there were large numbers of instruments, in particular indemnities, that did not have dollar values attached to them, but if called upon, had the potential to commit the Commonwealth to significant outlays.

### **Management and monitoring of the Commonwealth's exposures**

1.21. The management practices of the majority of agencies were inadequate; partly because they lacked corporate risk management plans which were integrated with the management of guarantees, indemnities and letters of comfort. In addition, there were significant deficiencies in agencies' compliance with the guidelines and directions which impaired their capacity to manage and monitor the risks associated with exposure to guarantees, indemnities and letters of comfort.

### **Adequacy of reporting**

1.22. The accountability measures currently in place are not sufficient in all cases to provide an informed basis for agency managers to appropriately manage the risks arising from guarantees, indemnities and letters of comfort. Nor do they provide a sufficiently comprehensive coverage for public accountability purposes at a whole of government level. The need is for greater transparency of such arrangements for all stakeholders, including the Parliament.

## **Options for the improved management of risk**

1.23. The ANAO has outlined a range of possible approaches dealing with the risk exposures from Commonwealth guarantees, indemnities and letters of comfort within a commercial framework of risk management and control. These options range from risk prevention measures to outsourcing risk to the private sector.

### **Better administrative practice**

1.24. In the course of the audit the ANAO developed a set of better administrative practices and principles to assist agencies to more effectively manage Commonwealth guarantees, indemnities and letters of comfort. The development of these practices drew on examples of sound administration in a number of agencies. The Department of Communications and the Arts Commonwealth Indemnity Scheme embodies most of the characteristics of this approach and was the notable example of sound administrative practice found in the audit. Other examples of sound administrative practice included the central record keeping systems of the Departments of Finance and Primary Industries and Energy.

### **Agencies' awareness**

1.25. There was a need for an increased level of awareness across agencies of the commercial risk that attaches to Commonwealth off-balance sheet exposures and the options for treating that risk. Since the start of the audit, several agencies have made significant efforts to improve their management priorities with regard to guarantees, indemnities and letters of comfort. The ANAO considers that the Department of Finance is well placed, as coordinator of Commonwealth financial management practices, to take the lead in raising agencies' awareness and to coordinate enhanced public accountability.

1.26. The recent decision to adopt accrual reporting by agencies to provide more comprehensive information for decision making has introduced a stronger discipline to enhance the ongoing management and reporting of the Commonwealth's obligations in respect of guarantees, indemnities and letters of comfort. However, this audit has highlighted the need for early action to address shortcomings in existing management and administrative practices for these instruments which represent a very significant gross exposure to the Commonwealth.

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## **2. Commonwealth Exposure Levels**

*This chapter outlines the findings of the ANAO census in regard to the overall Commonwealth exposures from guarantees, indemnities and letters of comfort as at 30 June 1995.*

### **Introduction**

2.1. The aim of this chapter is to quantify the Commonwealth's exposure to a limited range of explicit contingent liabilities, namely contingent loan guarantees, non-loan guarantees, indemnities and letters of comfort. It was found that most portfolio departments were unable, in a timely fashion, to present the ANAO with an accurate statement of the Commonwealth's exposure to these instruments in respect of their portfolios. However, it has been possible to give an indication of the number, nature and

value of a significant subset of the Commonwealth's contingent liabilities and some of the key issues associated with their management.

2.2. The ANAO conducted a census of portfolio departments in September 1995 to determine the nature and amount of guarantees, indemnities and letters of comfort on issue as at

30 June 1995, with responses requested by early October 1995. Of the 20 portfolio departments canvassed only one responded within the time frame requested, 15 replied within one month of the date requested and the remaining four within two months of this date, although not all returns were complete by this time.

2.3. Follow-up investigations by the ANAO uncovered additional information that was not forthcoming in the agencies' responses to the census. The ANAO was aware from other sources of the existence of numerous other instruments which were not reported at all in the census. The result of this work saw a four fold increase in the size of the Commonwealth's identified exposures to guarantees, indemnities and letters of comfort over that initially reported in response to the census.

2.4. The information requested from the portfolio departments was similar to that required to be recorded under the Finance Directions. An example of the indemnity census form is presented at Appendix 1. The inability of most departments to respond within the time frame requested, coupled with the subsequent increase of identified exposures, is seen as prima facie evidence of the absence of well maintained records on guarantees, indemnities and letters of comfort.

2.5. The wide range of circumstances which can be construed as establishing an obligation on the Commonwealth to meet a future contingency has meant that the audit has been unable to provide a definitive statement of the overall Commonwealth exposure from guarantees, indemnities and letters of comfort as at 30 June 1995.

2.6. Against this background, the ANAO's most probable estimate of the Commonwealth's financial exposure to these instruments as at 30 June 1995, was at least \$222 billion. This does not include a large number of instruments that did not have dollar values attached to them but, if called upon, have the potential to commit the Commonwealth to significant outlays.

### **Recommendation No 1**

2.7. The ANAO *recommends* that all relevant agencies conduct a review of their records to ensure that they have a complete register of all Commonwealth guarantees, indemnities and letters of comfort within their portfolio.

2.8. Agencies responded to the recommendations as follows:

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

2.9. Specific comments by departments are set out below.

- *DoF response:* Agree. Agencies are obliged, under Finance Direction 23, to keep a record of contingent liabilities. Agencies were reminded of this requirement late last year (see Finance Circular 1995/27 of 20 December 1995: "Recording of Loans, Guarantees and other Contingent Liabilities Entered into by the Commonwealth") when Finance was made aware of deficiencies in the maintenance of central records by agencies by the ANAO in the conduct of this audit. The Department itself has established an electronic register using information obtained during the course of this audit.
- *DPIE response:* Agree. The department maintains a central register, in accordance with Finance Directions 23C and 23D, and conducts an annual review as part of meeting reporting requirements under Section 50 of the Audit Act 1901. DPIE also noted that the ANAO considered that this Department's administrative practice was sound.
- *DHFS response:* Agree. Action is underway to improve centralised recording.
- *DAS response:* Agree. The Departmental Audit Committee has approved a review of contingent liabilities. This review has commenced and also encompasses later recommendations as appropriate.
- *DoTRD response:* Agree. But there is a need to ensure that the proposed registration responsibilities do not overlap those of Treasury, resulting in double handling of information.
- *DoD response:* Agree in principle. The size and geographic dispersion of the Defence organisation, and the short term nature of many indemnities issued by Defence, however, makes the establishment of a single, central register of indemnities impractical. Defence will nevertheless, ensure that Registers of Indemnities are maintained and that, in aggregate, these will constitute a single registry system.

2.10. The Department of the Treasury advised the ANAO that:

*'... it was concerned that the report could be interpreted as suggesting the Commonwealth has inadequate knowledge of or control over, contingent liabilities totalling at least \$222 billion, whereas:*

- *guaranteed obligations of the Commonwealth Bank (some \$93 billion) are subject to the reporting and prudential supervision requirements of the Reserve Bank, including risk capital requirements. As acknowledged in the proposed report, additional reporting and accountability requirements apply under the transitional guarantee arrangements following sale of the Commonwealth's remaining shareholding in the Bank;*
- *the operations of the Reserve Bank (which gives rise to contingent liabilities for the Commonwealth of some \$25 billion) are the subject of internal risk management; the Secretary to the Treasury is a member of the Reserve Bank Board;*
- *as a financial institution, The Home Loans Insurance Corporation (HLIC) with contingent liabilities of around \$36 billion, manages its commercial risk. Following the corporatisation process which is expected to take place later this year (subject to*

*passage of the necessary legislation), the HLIC will be subject to supervision by the Insurance and Superannuation Commission (ISC); and*

- *Commonwealth superannuation obligations comprise unfunded liabilities of more than \$60 billion (including defence schemes - see below). The relevant schemes are managed under trustee arrangements involving defined fiduciary responsibilities and reporting requirements and are subject to supervision by the ISC...'*

### **Nature of instruments**

2.11. Of the 20 portfolio departments involved in the census, six reported not having guarantees, indemnities or letters of comfort. <sup>8</sup> Information about the value of all instruments identified as at 30 June 1995 is set out in Exhibit 2.1.

The total list of instruments established by the audit as at 30 June 1995 is shown at Appendix 2. Four broad categories of instruments were identified by the census, namely: contingent loan guarantees; non-loan guarantees; indemnities; and letters of comfort. Within these categories there was a wide variation in the nature of the instruments reported, both in terms of potential value and purpose.

### **Exhibit 2.1 Portfolio departments' guarantees, non-loan guarantees, indemnities and letters of comfort as at 30 June 1995**

<u>Contingent loan guarantees</u>	\$m
Communications and the Arts	940.3
Defence	313.5
Employment, Education and Training	560.6
Environment, Sport and Territories	428.7
Industry, Science and Technology	6 577.0
Primary Industries and Energy	3 252.7
Prime Minister and Cabinet	0.7
Transport	918.7
Treasury	12.1
<b>Sub-total</b>	<b>13 004.3</b>
<u>Non-loan guarantees</u>	
Communications and the Arts	947.0
Finance	43 400.0
Foreign Affairs and Trade	192.4
Industry, Science and Technology	3 772.0
Treasury	158 476.4
<b>Sub-total</b>	<b>206 787.8</b>

<u>Indemnities</u>		
Administrative Services		u.v.
Attorney-General's		5.4*
Communications and the Arts		745.1
Defence		45.0*
Employment, Education and Training		u.v.
Finance		u.v.
Housing and Regional Development		l.v.
Human Services and Health		888.0*
Primary Industry, Science and Technology		u.v.
Primary Industry and Energy		u.v.
Transport		u.v.
Veterans' Affairs		9.5
<b>Sub-total</b>		<b>1 693.0</b>
<u>Letters of comfort</u>		
Transport		180.0*
Finance		u.v.
<b>Sub-total</b>		<b>180.0</b>
<b>Total</b>		<b>221 665.1</b>

Notes: u.v. unspecified value instruments reported.

\* specified value and unspecified value instruments reported.

l.v. low value - instruments reported with a value less than 0.1\$m.

2.12. Some 144 000 guarantees, indemnities and letters of comfort were reported in the census. This total reflects those instruments current as at 30 June 1995 and also those issued between 1 July 1992 and 30 June 1995. Due to the number of instruments and the dispersion of documents, the Department of Defence was unable (without undue effort) to supply information regarding the number of instruments that they had issued between these two dates and therefore this figure is somewhat understated. However, it should be noted that the total figure is inflated significantly by 141 918 Austudy/Abstudy supplements covered by a guarantee which were reported by the Department of Employment, Education, Training and Youth Affairs, 444 Commonwealth Rehabilitation Service indemnities reported by the Department of Health and Family Services and 1 368 Insolvency and Trustee Service indemnities reported by the Attorney-General's Department.<sup>9</sup>

## Commonwealth financial exposure

2.13. The total Commonwealth exposures for the instruments examined in the audit as at 30 June 1995 were at least \$222 billion comprising: <sup>10</sup>

- contingent loan guarantees of \$13.0 billion;
- non-loan guarantees of \$206.8 billion;
- indemnities of \$1.7 billion; and
- letters of comfort of \$180 million.

2.14. The total value for the Commonwealth's guarantees and indemnities reported by the National Commission of Audit <sup>11</sup> was \$168.7 billion as at 30 June 1995. <sup>12</sup>

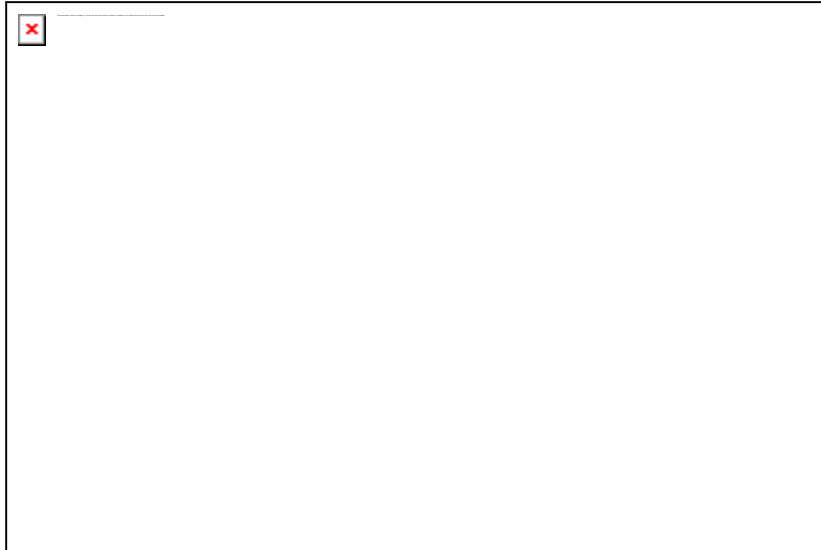
2.15. Exhibit 2.2 indicates that there has been an increase since 1992-93 in the value of Commonwealth guarantees, indemnities and letters of comfort as reported in annual Minister for Finance Aggregate Financial Statements, from \$21 billion in 1991-92 to \$132 billion in 1994-95.

2.16. The Department of the Treasury advised the ANAO that:

*'...the [ANAO Audit] report blurs the distinction between contingent and actual liabilities of the Commonwealth. For example, an amount of \$43 billion is included as a contingent liability in respect of the CSS and PSS whereas that amount is also included as an (unfunded) liability in the Commonwealth's balance sheet. (The Commonwealth's statement of assets and liabilities as at 30 June 1995 shows total unfunded superannuation liabilities of \$65.7 billion arising under CSS, the PSS and schemes related to defence personnel). In addition, some \$5 billion of the estimated \$13 billion in contingent loan guarantees relates to liabilities of PTE's that are already included in the consolidated balance sheet of the Commonwealth non-financial public sector...'*

2.17. The Department of Finance advised the ANAO in the audit census of the \$43.4 billion of guarantees relating to the CSS and PSS. The superannuation liabilities of the Commonwealth are not fully funded, but as of 30 June 1995 these liabilities are now recognised in the Department of Finance's financial statements. With regards to Commonwealth loan guarantees to PTEs, these are separate transactions from those recorded as on-balance sheet liabilities in the accounts of the PTEs but do not add to the Commonwealth's whole of government obligations.

## **Exhibit 2.2 Reported value of instruments 1991-92 to 1994-95**



SOURCE: Minister for Finance's Aggregate Financial Statements (Table 13) various years.

### **Contingent loan guarantees**

2.18. The contingent loan guarantees considered in the audit amounted to \$13.0 billion which is separate from the recognised loan liability of the Commonwealth debt, which amounted to some \$105.5 billion as at 30 June 1995. <sup>13</sup>

2.19. Contingent loan guarantees are issued under the express authority of an Act of Parliament. There are some 130 instruments on issue and they vary considerably in size. Examples include the \$1.6 billion Wool Guarantee (issued to guarantee debt accumulated by the former Australian Wool Corporation under the reserve price scheme) managed by the Department of Primary Industries and Energy, and the Department of Communications and the Arts' Special Broadcasting Service guarantee for some \$39 million in regard to the purchase of its Sydney premises.

### **Non-loan guarantees**

2.20. The non-loan guarantees considered in the audit amounted to \$206.8 billion and constitute the overwhelming proportion of the Commonwealth's total exposure in explicit monetary values.

2.21. This category of instruments is dominated by a small number of guarantees which relate to financial institutions. The guarantees for the Commonwealth Bank of Australia (CBA) <sup>14</sup>, HLIC, Reserve Bank of Australia (RBA), EFIC and the Australian Industry Development Corporation (AIDC) account for some three quarters of the total amount. The exposure from the CBA will decrease following the invoking of the sunset clause commencing three years after the sale of the bank.

### **Indemnities**

2.22. The size of indemnities issued varied considerably from both within and between programs. For example, the ANAO found that the Department of Communications and the Arts had issued indemnities to cover artistic activities and exhibitions, with limits ranging from a few thousand dollars to half a billion dollars.



2.23. In contrast, one portfolio department was obliged to issue indemnities to the value of \$300 million to cover that department's loss of financial instruments in connection with the sale proceeds of an asset. Different again was the Qantas Commonwealth Tax Indemnity which was established in connection with a dispute between Qantas and the Australian Taxation Office (ATO) where by the Commonwealth has agreed to reimburse Qantas for any payment to the ATO that may arise. <sup>15</sup>

### Letters of comfort

2.24. Eight letters of comfort were reported in the ANAO census and, of these, only one had an amount specified. This was the Australian National Line instrument which enabled the company to trade in an orderly manner following its withdrawal from sale. The value of the contingent liability arising from this letter of comfort was capped at \$180 million.

2.25. The instruments reported were generally expedient or interim documents of short duration which provided a level of assurance to a person or organisation to cover a period of uncertainty. A notable example was the letter of comfort provided in the lead up to the establishment of the Civil Aviation Safety Authority. This letter was designed to assure entities involved that the indemnity which existed to cover air safety matters under the Civil Aviation Authority would be honoured pending the preparation of a new indemnity.

---

1

Statement of Accounting Concepts 4, paragraphs 65-71. These sorts of contingent liabilities usually fail the criteria to be reported on the face of the financial statements of agencies in that they often cannot be measured reliably and/or the probability is too low that future economic sacrifice will be required because of them.

2

The United Kingdom Treasury Manual 'Government Accounting' describes the instrument in the following terms. *In the private sector the phrase typically refers to a letter issued by a parent company to a creditor of a subsidiary or associate company to give reassurance that the parent company is aware of financial obligations being assumed by the subsidiary or associate. In certain cases an indication may be given or implied as to the parent company's likely reaction should a subsidiary or associate subsequently fall into financial difficulties. But the essence of the letter of comfort is that it is intended to give some reassurance to the creditor without the parent company being legally bound to stand behind the subsidiary's obligations. While the private sector may be able to sustain a position in which it is bound morally but not legally, a public sector body, which is ultimately dependent on Government credit, is unlikely to be able to issue a document of this kind without effectively committing government credit and having to meet the obligation if it should materialise. Moreover, although a letter of comfort has no automatic legal effect, it could lead to a threat of legal action, which might have implications for Government credit.*

3

Audit Report No. 29 1992- 93, *Aggregate and Departmental Financial Statements 1991-92.*

4

Audit Report No.7 1994-95, *Department of Industry, Science and Technology, National Interest Export Finance and Insurance*, pp 4-5. National interest loans and insurance are provided through EFIC to support business in export activities and are approved by the relevant portfolio minister. The Commonwealth agrees to directly carry the risk associated with these transactions and makes payments to EFIC to cover any losses incurred.

5

In cases such as the Commonwealth Superannuation Scheme and Public Sector Superannuation Scheme guarantees, the liabilities these guarantees represent have, since 30 June 1995, met the criteria for recognition in the Department of Finance's financial statement.

6

The Commonwealth Bank of Australia and the Australian Industry Development Corporation had face value exposures as at 30 June 1995 of \$209.2 billion and \$7.24 billion respectively; although the risk may be reduced because of limitations on the amount of net open exposures.

7

There are now 18 portfolio departments.

8

The Departments of Foreign Affairs and Trade, Immigration and Ethnic Affairs, Industrial Relations, Social Security, Tourism and Veterans' Affairs.

9

The names of some departments changed during the course of the audit however, the current names are used throughout this report from this point.

10

Excludes Commonwealth guaranteed securities on issue of \$105.5 billion.

11

National Commission of Audit Report to the Commonwealth Government, June 1996 p 267.

12

The main difference in reported identified exposures as at 30 June 1995 between the ANAO census and the National Commission of Audit numbers relate to the inclusion in the ANAO audit of: Commonwealth Superannuation Scheme and Public Sector Superannuation (CSS/PSS) guarantees. In addition, there were differing reporting numbers on: the CBA and Telstra superannuation guarantees; the Northern Territory loans; EFIC; and AIDC.

13

Total face value of Commonwealth borrowings as at 30 June 1995 represented by securities and other borrowings which includes \$8.15 billion of State and Territories borrowings. *Source* : Annual Report of the Department of the Treasury 1994-95, Note 13: Borrowings, p.141.

14

CBA on-balance sheet exposures only.

15

QANTAS Public Share Offer Prospectus, p.104.

### **3. Governance Framework**

*The purpose of this chapter is to examine the governance framework applying to Commonwealth guarantees, indemnities and letters of comfort.*

#### **Introduction**

3.1. The current governance system applying to the issuing, management and reporting of Commonwealth guarantees, indemnities and letters of comfort relies on a legislative and policy framework which comprises Acts of Parliament; Finance Directions; guidelines issued under the *Audit Act 1901*; Finance Circulars, Government Business Enterprises accountability arrangements and other policy guidelines.

3.2. An outline of the governance arrangements that apply to loan guarantees, non-loan guarantees and letters of comfort is set out in Exhibit 3.1. The Department of Finance advised the ANAO that:

*'...the recommendations need to be set in the context of the actual exposures of the Commonwealth and the prudential and risk management frameworks that are in place to avoid giving a misleading impression merely by reference to gross exposures...'*<sup>1</sup>

3.3. In summary, the ANAO found that the application of the governance framework varied significantly. For example, loan guarantees receive considerable attention; while letters of

comfort are not explicitly covered, noting that letters of comfort are in most instances likely to be of less concern.

**Exhibit 3.1: Category of instrument and authority to issue**

Instruments	Total Specified Exposures	Head of Power
Loan Guarantees	\$13 004 M	Legislation
Non-loan Guarantees <sup>(a)</sup>	\$206 787 M	Legislation
Indemnities <sup>(b)</sup>	\$1 693 M	Legislation or Minister/Authorisation by Minister <sup>(c)</sup>
Letters of Comfort	\$180 M	Minister/Authorisation by Minister <sup>(d)</sup>

(a) The majority of indemnities identified in the audit did not have any specified value - ie. specified financial limit.

(b) All but one of the non-loan guarantees identified by the audit were set out in legislation. The exception was the guarantee of Telstra's performance in making payments to the Telecom Superannuation Fund. This performance guarantee was appropriately authorised.

(c) May be exercised by the Minister directly or by an officer duly authorised by the Minister. Also issue of the ostensible authority of public servants in the carrying out their duties to bind the Commonwealth.

(d) All letters of comfort identified in the audit had been issued with the authority of Ministers. However, public servants, exercising ostensible authority, may also issue letters of comfort.

**Commonwealth framework**

3.4. Details of the legislative and policy framework are outlined in Exhibits 3.2 and 3.3. The current framework will be altered, both in requirements and nature, when the proposed new financial management legislation is enacted. This legislation comprises bills covering the proposed Auditor-General Act, Financial Management and Accountability Act and the Commonwealth Authorities and Companies Act. In anticipation of these bills becoming law, the Department of Finance has prepared model Chief Executive Instructions which address, among other things, risk management and guidelines for the management of indemnities. The Department of Finance advised that they have urged departmental secretaries to promulgate the model Chief Executive Instructions immediately, despite the delay in the passage of the new legislative package. For the purposes of this chapter it is the current framework which is described, since it is this system with which portfolio departments must currently comply.

3.5. The Constitution, together with the *Audit Act 1901*, provides the legal framework for the financial management of the Commonwealth. In particular, Section 83 of the Constitution provides that no money shall be drawn from the Treasury except under appropriation made by law. Finance Regulation 127A authorises the Minister for Finance or the Secretary of the Department of Finance to issue Finance Directions, and Section 72 of the *Audit Act 1901* and Regulation 127A together give the Finance Directions the status of regulations.<sup>2</sup> Section 50AA of the *Audit Act* authorises the Minister for Finance to issue guidelines to departmental secretaries regarding the content of departments' annual financial statements.

**Exhibit 3.2: Legislative and policy framework**



Source: Department of Finance July 1996

**Exhibit 3.3: Summary of applicable legislation and policy guidelines**

Instrument	Section 70B Audit Act 1901	Finance Direction 23C	Finance Direction 23D	Finance Direction 23E	Departmental Financial Statement Guidelines <sup>3</sup>	Finance Circular 1989/11 Policy Guidelines
Loan Guarantees	*	*	-	*	*	-
Non Loan Guarantees	-	-	*	*	*	-
Indemnities	-	-	*	*	*	*
Letters of Comfort	-	-	..	..	..	-

Note: .. indicates that coverage can be implied.

**Loan guarantees**

3.6. Various Acts provide the authority for the issue of Commonwealth guarantees under specified circumstances in respect of the borrowings of certain entities. In addition, there are also the specific borrowings the Commonwealth undertakes which are automatically underpinned by Commonwealth guarantee. The following discussion is concerned with the first category of contingent loan guarantees as opposed to the Commonwealth's own borrowings, which are separately recognised as liabilities of the Commonwealth.

### **Issued by instrument**

3.7. Section 70B of the *Audit Act 1901* prohibits the issuing of a loan guarantee by or on behalf of the Commonwealth unless expressly authorised by an Act.<sup>4</sup> Most Commonwealth statutes which govern the issuing of such Commonwealth guarantees confer the authority to give them upon the Treasurer, who may delegate his powers.

3.8. The Department of the Treasury advises that provisions providing for Commonwealth guarantee of entities' borrowings have become less common in recent years as the concept of competitive neutrality has gained prominence.<sup>5</sup> For example, the guarantee powers have already been removed from the legislation governing a number of GBEs, including Telstra and Australia Post.

3.9. Under processes administered by the Department of Finance, detailed scrutiny is undertaken of the benefits and risks associated with borrowing proposals of the Commonwealth, Commonwealth statutory authorities and Commonwealth owned companies.<sup>6</sup>

### **Statutory guarantees**

3.10. There are some statutory agencies that have guarantees which are not issued on a case by case basis. Instead they enjoy automatic guarantees which are set out in legislation and which may include a guarantee of the agencies' borrowings.<sup>7</sup> EFIC and the AIDC are examples of entities which enjoy such arrangements. For example, as at 30 June 1995, EFIC's borrowings underpinned by statutory guarantee totalled some \$3.35 billion. However, EFIC's statutory guarantee is far wider than simply a guarantee of its borrowings and extends to all of its liabilities.

### **Non-loan guarantees**

3.11. Guarantees other than loan guarantees are also provided by the Commonwealth. Non-loan guarantees are used for a variety of purposes and range from clauses in contracts guaranteeing performance to legislative guarantee of the liabilities of the CBA. The issuing of loan guarantees by the Commonwealth is controlled via legislation, but this is not always the case in regard to other types of Commonwealth guarantees.

### **Non-statutory guarantees**

3.12. There is no legislative prescription as to who has the authority to give undertakings such as performance guarantees on behalf of the Commonwealth. There are also no policy guidelines or general oversight procedures applying to these types of guarantees. Such guarantees can bind the Commonwealth to make significant payments. In connection with the 1994 sale of the Moomba to Sydney gas pipeline, the Commonwealth was obliged to make compensation payments in order for parties to agree to surrender special rights.<sup>8</sup>

### **Statutory non-loan guarantees**

3.13. As at 30 June 1995, the aggregate value of non-loan Commonwealth guarantees automatically provided under statute exceeded \$162 billion.<sup>9</sup> The \$43.4 billion liability arising from the guarantees underpinning the CSS and PSS is not included.

3.14. The guarantee applying to the liabilities of an entity such as the CBA is set out in legislation and automatically applies without the need for specific instruments to be issued. Currently under the *Commonwealth Banks Act 1959*, in relation to CBA, the Commonwealth Development Bank and the

Commonwealth Bank Officers' Superannuation Corporation, the Commonwealth guarantees all moneys that are, or at any time may become, payable to a person other than the Commonwealth. As at 30 June 1995, the value of each of these guarantees was as follows: CBA \$91.3 billion (on-balance sheet); <sup>10</sup> Commonwealth Bank Officers' Superannuation Corporation \$3.97 billion and Commonwealth Development Bank \$1.59 billion.

3.15. The Commonwealth Bank Public Share Offer dated 5 June 1996 states that under the provisions of the *Commonwealth Bank Sale Act 1995*, the Commonwealth will continue to guarantee:

- the due payment of any amount that is payable by the Commonwealth on a demand deposit for three years from the date at which the Commonwealth's shareholding falls below 50 per cent of the total number of Commonwealth Bank shares on issue (the 'Effective Date');
- the due payment of any amount that is payable by the Commonwealth Bank on a term deposit, until maturity, outstanding at the Effective Date or made during the three years following the Effective Date;
- the liabilities of the Commonwealth Bank Officers' Superannuation Corporation (or the superannuation fund) for a person who was a member, retired member or beneficiary before the commencement of the relevant provisions of the Act; and
- all other liabilities and off-balance sheet obligations, until maturity, outstanding at the Effective Date. <sup>11</sup>

3.16. Accordingly, the CBA guarantee will continue while the Commonwealth will have a diminished capacity to directly manage this exposure. The primary means of managing this exposure following the sale are through the Reserve Bank's prudential supervision arrangements (see Chapter 6) and under the terms of the agreement concluded between the Commonwealth and CBA. Under this arrangement, CBA is to provide an annual report to the Commonwealth on the amount and maturity profile of liabilities which are guaranteed. <sup>12</sup>

## Indemnities

3.17. Finance Circular 1989/11 attaches policy guidelines for the issuing of indemnities and the essential features of these policy guidelines are discussed in subsequent chapters. Indemnities are issued for a wide range of purposes and expose the Commonwealth to varying levels of risk. These instruments are often issued by the Commonwealth in place of purchasing commercially available insurance policies; as it is usual practice that the Commonwealth carries its own risk. Options for risk transfer using commercial approaches for managing risk are discussed in Chapter 6.

3.18. The general rationale for issuing an indemnity relates to the need for the advancement of the Commonwealth's interests to outweigh the costs which the Commonwealth would otherwise be assuming. <sup>13</sup> Indemnities are issued by a Minister or a person authorised by a Minister. However, indemnities may also exist in the form of a statutory instrument. An example appears in the *Audit Act 1901*, which provides an automatic indemnity to any persons appointed by the Auditor-General to carry out audit functions on his behalf.

## Letters of comfort

3.19. The ANAO found that there was little understanding within agencies of the concept of letters of comfort. This lack of understanding of what constitutes a letter of comfort does not engender confidence that the ANAO census and audit field work was successful in capturing the full range of such documents on issue. Letters of comfort are also often issued with an intention of giving comfort for a short period of time (ie. the number current at a point in time may be low but their issue may not be uncommon).

3.20. The Finance Directions do not mention letters of comfort explicitly and, unlike indemnities, no specific policy advice in the form of a Finance Circular and/or policy guidelines has been issued. Therefore, at present, minimal guidance is provided to agencies regarding who may issue letters of comfort on behalf of the Commonwealth, the risks to the Commonwealth in issuing them and how the Commonwealth's position can be safeguarded.

3.21. The ANAO acknowledges that it is difficult to accurately define what is encompassed by a letter of comfort. However, the absence of any discussion or policy guidance concerning letters of comfort is undesirable. The objective in issuing a letter of comfort should be to provide some assurance to the recipient while not actually legally binding the Commonwealth in any way. There is no absolute assurance that such a result can be achieved no matter how well informed the officer providing the instrument and/or how carefully the letter of comfort is drafted. In the absence of appropriate guidance, the risk that such letters will inadvertently give rise to legal obligations on the Commonwealth's behalf is even greater.

### **Decision to issue**

3.22. A letter of comfort may lead to an actual liability either through a court finding that the party receiving the letter was entitled to rely upon its contents, or through a moral obligation for the Commonwealth to make good on assurances. In discussions with the ANAO, the Attorney-General's Department outlined its policy of advising agencies to avoid issuing letters of comfort if at all possible. <sup>14</sup> The Attorney-General's Department advised that when requested to draft letters of comfort for agencies it pays close attention to ensure that the Commonwealth is exposed to minimal risk.

3.23. The apparent lack of understanding within agencies of the concept of letters of comfort highlights the risk that such documents are being issued without appropriate recognition of the legal and financial risks involved. If agencies are unaware that documents they are being asked to issue amount to letters of comfort, they are unlikely to obtain legal advice.

3.24. Agencies also need to avoid issuing letters which although not intended as comfort letters, may be interpreted as inferring a degree of assurance. Examples of such documents are letters to financial institutions or their agents which comment on, and thereby acknowledge, the financial arrangements proposed in particular cases but exclude actual statements of assurance.

3.25. The eight letters of comfort reported in response to the ANAO census had all been drafted by the Attorney-General's Department. However, given the current lack of guidance to agencies regarding letters of comfort, it is likely that agencies may have issued such letters without being aware of it.

3.26. Overall, the ANAO found that letters of comfort are not well understood by departmental officers and are not covered specifically in the current guidelines on contingent liabilities provided by the Department of Finance.

### **Recommendation No 2**

3.27. The ANAO *recommends* that the Department of Finance, initiate, in consultation with agencies, an awareness program concerning risk management of off-balance sheet exposures, notably those relating to



indemnities and letters of comfort.

3.28. Agencies responded to the recommendation as follows:

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

3.29. Specific comments by DoF are set out below.

- *DoF response:* Agree in principle. DoF proposes to update and re-issue Finance Circular 1989/11 relating to the issue of indemnities by late 1996. Relevant issues concerning guarantees and letters of comfort will be included in that circular.

### **Reporting process**

3.30. The Finance Directions require departmental secretaries to arrange for a record to be maintained of the details of all the guarantees and contingent liabilities given by the Commonwealth in regard to their department. <sup>15</sup>

3.31. Letters of comfort may constitute contingent liabilities or undertakings, but are not explicitly considered in the Finance Directions. The same applies to guarantees other than loan guarantees which are also not explicitly discussed in the Finance Directions.

3.32. Under the Finance Directions, departments are obliged to submit annual returns to the Departments of Finance and the Treasury each year concerning the details of their loan guarantees and contingent liabilities. <sup>16</sup> The stated purpose of this reporting is to enable the full extent of the Commonwealth's potential risk exposure to be established and to provide the basis for a strategy to manage that risk. <sup>17</sup> The Department of the Treasury advised the ANAO that:

*'...Treasury has no central agency role in the ongoing monitoring and reporting of contingent liabilities. We make little, if any, operational use of the reports provided directly to us. There would [therefore] seem to be a case for discontinuing the present requirement...'*

3.33. The ANAO considers that the Department of Finance needs to review the current disclosure and reporting arrangements pertaining to guarantees, indemnities and letters of comfort. This issue is also canvassed further in Chapter 6.

### **Recommendation No 3**

3.34. The ANAO *recommends* that the Department of Finance, in consultation with agencies, and cognizant of commercial sensitivities, reviews the disclosure and reporting arrangements of Commonwealth guarantees, indemnities and letters of comfort with the aim of ensuring their transparency and appropriate monitoring procedures.

3.35. Agencies responded to the recommendation as follows:

- *Agree:* DAS, Tsy, PM&C, DIST, DoTRD, AG's and DEETYA.
- *Agree in principle:* DoF and DoCA.

- *No comment:* DoD, DHFS, DEST, DVA, DPIE and DFAT.

3.36. Specific comments by departments are set out below.

- *AG's response:* Agree. Any disclosure requirements should recognise the commercial nature of any guarantee or indemnity and thus it may be appropriate to aggregate the information for a department rather than separately identifying each undertaking.
- *DoF response:* Agree in principle. DoF will-examine the requirements in the Minister for Finance's financial statement guidelines as to whether they might best be redrafted to require specific reporting of guarantees, indemnities and letters of comfort (rather than the present requirement to report guarantees and undertakings); a better approach may be to provide guidance as to what type of instruments comprise 'undertakings'. This would ensure that the reporting of contingent liabilities is not limited only to those covered by this audit. The guidelines are prepared in accordance with Australian Accounting Standards and in consultation with the ANAO. Agencies also need to take into account issues such as those discussed in relation to Recommendation No.13.
- *DoCA response:* Agree in principle. The Department would, however, oppose a requirement publicly to disclose the indemnity values of specific art exhibitions indemnified under the Commonwealth Indemnity Scheme since this could increase the security risk associated with the exhibitions. The department has no difficulty in disclosing specific exhibition values on a confidential basis to the Department of Finance (this information is already provided to DoF as a matter of course) nor in making aggregated indemnity values publicly available.

3.37. *ANAO comment:* The ANAO appreciates that commercial considerations should be taken into account in the reporting and disclosure arrangements where they may adversely affect the Commonwealth's interests.

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## 4. Risk Planning and Control

*This chapter discusses the procedures involved in the issuing and execution of guarantees, indemnities and letters of comfort within a framework of risk management.*

### Introduction

4.1. Once the decision has been made to issue a guarantee, indemnity or letter of comfort, there are procedures which are required in the preparation and authorisation of the instrument so that the Commonwealth's interests are protected.

4.2. Guidelines for the issuing of indemnities require that the rationale for issuing any indemnity must be that the particular need for the advancement of the Commonwealth's interests outweigh the level and cost of the risk which the Commonwealth would be assuming.<sup>18</sup> These guidelines refer specifically to indemnities but the principles outlined therein are also relevant to guarantees and letters of comfort.

4.3. The ANAO considers that the administrative processes associated with the initiation of instruments in the majority of cases are soundly based. The ANAO census indicated that departments usually documented the rationale for issue. However, the ANAO found that the preparation and authorisation arrangements by most agencies were deficient in some areas. Notably, risk management

practices of departments revealed significant deficiencies which have the potential to increase the exposure of the Commonwealth to risk.

### Agency risk management planning

4.4. The audit sought to determine the extent of risk management that was applied to guarantees, indemnities and letters of comfort. The ANAO considers that a suitable system reflecting sound practice would clearly demonstrate links between an overall corporate risk management strategy and the risk management strategy applied to the management of these instruments. Despite the fact that there is no formal requirement to have corporate risk management strategies, the ANAO considers that corporate level support for such a system would provide the incentive and encouragement to assist effective risk assessment.

4.5. A fundamental component in the initiation procedure is sound risk assessment which is inherent in virtually all commercial dealings. There are several administrative means by which the level of risk may be assessed effectively. These include: <sup>19</sup>

- **Establishing the context:** Guarantees, indemnities and letters of comfort can present considerable risks to the Commonwealth. Sound management of these risks requires an awareness of the context in which such contingent liabilities are managed.
- **Identifying risks:** Possible sources of risk and their potential effect are important considerations in protecting the interests of the Commonwealth. It is necessary to identify the parties which could claim under an instrument, the kinds of events that would have to occur for claims to proceed, and the nature and management of the entity in respect of which the contingent liability is being assumed. To consider such factors effectively, information needs to be available which is accurate, comprehensive and timely.
- **Analysing the risks:** Extremely low risks can be screened out at the outset, but it is necessary to document the rationale for excluding them in order to demonstrate how comprehensively the analysis has been performed. <sup>20</sup> It is important that part of the analysis deals with the possibility of having to make future payments. Risk analysis needs not only to address the type of risk the instrument is to cover initially, but also the risks that could result from changing situations. To fulfil the latter requirement, the procedure needs also to include a system of review to enable managers to monitor the level of risk and ensure that the management procedures remain appropriate in changing circumstances. Ideally, this review will occur periodically throughout the life of the instrument.

4.6. The ANAO census and field work revealed that, at a program level, departments performed varying levels of risk analysis. For example, the Department of Communications and the Arts undertakes detailed risk management as part of the Commonwealth Indemnity Scheme. Loan guarantees also had received consideration of the risks attached to the issue of the instrument. However, the ANAO noted that the extent to which systematic assessment was carried out varied considerably both within and between departments, as well as across instruments.

4.7. The ANAO received responses from portfolio departments to a request in February 1996 for advice on whether or not they had a corporate risk management strategy and whether this was linked to the department's management of guarantees, indemnities and letters of comfort. The responses indicated that, of the 14 departments that then reported having these instruments <sup>21</sup>, only a minority claimed to have a corporate risk management strategy and of these, a smaller minority reported that

the strategy was linked in some way to the management of contingent liabilities.

4.8. The ANAO found that portfolio departments' risk management practices in regard to guarantees, indemnities and letters of comfort were not generally part of a comprehensive corporate risk strategy.

#### **Recommendation No 4**

4.9. The ANAO *recommends* that, where applicable:

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

4.10. Agencies responded to the recommendation as follows:

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

4.11. Specific comments by departments are set out below.

- *DAS response:* Agree. Noted that the recommendation is 'where applicable' and it may not be applicable for agencies with very limited or no exposure.
- *Tsy response:* Agree. Noted that, within the Treasury portfolio, the bulk of contingent liabilities derive from statutory guarantees of the obligations of Commonwealth owned financial institutions which are variously subject to risk management, prudential supervision and reporting requirements.
- *DPIE response:* Agree. The Departmental Corporate Fraud Control Plan, Part 1, approved by the Commonwealth Law Enforcement Board, is based on risk assessment of program and core business activity.
- *DoD response:* Agree in principle. The assessment of risk (and its management) will be complex and subjective in relation to many Defence activities, such as military training. Other matters, such as recruiting and industry displays or the work training of apprentices and medical personnel do not pose the same problems.
- *DHFS response:* Agree in principle. The issue of risk management planning will be considered in the context of the Department's current corporate planning processes.
- *DEETYA response:* Agree in principle. The Department is in the process of reviewing risk management practices. This issue will be included.

#### **Risk controls**

4.12. To ensure that the position of the Commonwealth is adequately protected, it is essential that measures be employed in the preparation and issuing of guarantees, indemnities and letters of

comfort to control the Commonwealth's risk exposure.

### **Legal advice**

4.13. The Finance Directions recommend, in regard to the Commonwealth's contingent liabilities that:

*'...departments consider the need to obtain appropriate legal advice in accordance with the Government's Directions for the Provision of Legal Services to Government Departments and Agencies, to ensure that these commitments both achieve and are limited to the objectives decided among the parties...'* <sup>22</sup>

4.14. The Department of Finance guidelines on the issuing of Commonwealth indemnities also suggest that departments seek the advice of the Attorney-General's Department whenever required. <sup>23</sup>

4.15. Where agencies are issuing indemnities for a specific range of purposes on a regular basis it may be unnecessary to seek legal advice on every occasion one is to be issued. An example of such a case is the indemnities issued routinely by the CRS. These indemnities are issued in order to cover a gap in coverage between the *Commonwealth Employees Rehabilitation and Compensation Act 1988* and Queensland's workers' compensation legislation for employers in that State taking on clients.

4.16. In circumstances such as these, the ANAO considers it important that agencies obtain adequate legal advice when drafting pro forma deeds of indemnity and remain aware of the need to obtain further legal advice if circumstances change or the original pro forma instrument does not cover the particular situation.

### **Terms and conditions**

4.17. The terms and conditions attached to guarantees, indemnities and letters of comfort are of considerable significance in safeguarding the Commonwealth's commercial interests. Finance Directions note that the parties to a transaction need to understand the commitments and possible consequences that may arise from it, specifically in regard to loans. The terms and conditions will inevitably vary among instruments but, as a general rule, the ANAO considers that effective administration and management of guarantees, indemnities and letters of comfort require a number of formal arrangements.

### *Subrogation*

4.18. An issue which is not addressed in the Department of Finance Circular guidelines is that of subrogation. Subrogation is a concept and practice which arises in insurance law and involves the right of an insurer to assume the position of the insured in a claim made against the insured, or to assume the legal rights of the insured against third parties. <sup>24</sup> Consequently, if the insured party has litigation brought against it, for a matter covered by the insurance contract, the insurer has the right to take over the conduct of the litigation in order to protect its own interests. Alternatively, if the insured party suffers damage covered by the insurance contract, and has an action against a third party to recover all or part of the losses suffered, the insurer assumes the insured party's rights to pursue that action.

4.19. The Attorney-General's Department advises that its commercial practice is to include subrogation clauses in the Commonwealth's agencies favour, where appropriate in indemnities which it drafts. Accordingly, the pro forma deeds of indemnity used by the CRS and the Commonwealth Indemnity Scheme include such clauses. Of the remaining indemnities examined by the ANAO in the course of field work, only two other indemnities, also drafted by the Attorney General's Department, plus an additional two drafted by a private legal firm, contained subrogation clauses.

4.20. The ANAO considers that subrogation clauses should, where applicable, be incorporated into indemnities as a means of managing and controlling the Commonwealth's exposure.

### **Recommendation No 5**

4.21. The ANAO *recommends* that the Department of Finance Circular on Indemnities be revised to incorporate the concept of subrogation in regard to indemnities and that agencies should include such clauses in indemnities where applicable.

4.22. Agencies responded to the recommendation as follows:

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

4.23. Specific comments by departments are set out below.

- *DoF response:* Agree. The revised guidelines on indemnities will include explicit guidance on subrogation.
- *DoCA response:* Agree. The legal instrument currently used by the Commonwealth Indemnity Scheme includes a subrogation clause.

#### *Time limits*

4.24. The guidelines for indemnities state that *no indemnity is to operate indefinitely, and the instrument of indemnity should include a termination clause.*<sup>25</sup> The ANAO considers that, where appropriate, this advice should also apply to guarantees and letters of comfort. Follow up work conducted by the ANAO revealed that about one-third of loan guarantees, two-thirds of non-loan guarantees and almost one-half of indemnities examined did not include time limits.

4.25. The Department of Defence's training and recruiting indemnities are an instance of arrangements where time limits have been set in the drafting of the agreement regarding the period during which events leading to loss or damage are indemnified. However, legal liability for possible claims relating to that period remain after the activity indemnified has been completed, and cannot be set aside by the inclusion of time limits in the agreement.<sup>26</sup> Notwithstanding this legal situation, wherever possible, agreements should not operate any longer than necessary as they expose the Commonwealth to additional risk and increase administrative overheads due to ongoing management requirements.

4.26. Termination clauses are of particular importance in those cases where it has been decided that a time limit on the operation of the instrument is either impractical or undesirable. However, in the case of some indemnities which cover only brief periods of time and have clearly specified time limits, a separate termination clause may be unnecessary.

4.27. The ANAO recognises that in some circumstances it may not be possible or appropriate to include time limits or termination clauses in indemnities. However, the ANAO considers that the Commonwealth may be exposed to unnecessary risk and administrative overhead because a considerable proportion of the instruments examined had no set time limits and/or termination clauses but the insertion of such terms may have been appropriate.

#### *Financial limits*

4.28. To ensure minimum exposure to liability, the guidelines for indemnities advise *that the appropriateness of setting maximum limits on financial liability must be considered in any contract of indemnity.* <sup>27</sup> In the ANAO's follow-up investigations two-thirds of both indemnities and non-loan guarantees examined had no specified financial limits.

4.29. It was common for agencies to claim that it was impractical to set a financial limit on certain indemnities. However, the non-loan guarantees which did not have financial limits were provided by statute rather than by individual instruments.

4.30. Sound administrative procedure requires that the process of attempting to measure the possible financial costs of an indemnity should be an integral part of assessing risks before entering into an instrument. Where a financial limit is impractical, for example instruments that indemnify individuals against the possibility of unspecified civil claims, regular review and careful monitoring of the situation is of particular importance in protecting the interests of the Commonwealth. Apart from the merits of specifying financial limits to protect the Commonwealth's interest, accepting liability without financial limits also contributes to the difficulties of assessing and reporting accurately the Commonwealth's total exposure to such contingent liabilities.

4.31. The ANAO considers that the Commonwealth may be exposed to unnecessary risk because portfolio departments regularly issue instruments without including time limits, termination clauses and financial limits.

### **Recommendation No 6**

4.32. The ANAO *recommends* that, where appropriate and commercially practical, time limits, termination clauses and financial limits should be stipulated by agencies when issuing Commonwealth guarantees, indemnities and letters of comfort.

4.33. Agencies responded to the recommendation as follows:

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

4.34. Specific comments by departments are set out below.

- *DoF response:* Agree. Current guidelines on issuing indemnities (Finance Circular 1989/11) include reference to these issues; the revised circular will discuss agencies' responsibilities to consider relevant time and financial limit issues when developing contracts, or deeds which include indemnities, or letters of comfort. Draft legislation containing guarantees can be monitored for the same sort of inclusions.
- *DoCA response:* Agree. The legal instrument currently used by the Commonwealth Indemnity Scheme includes time limits, termination clause and financial limits.
- *DPIE response:* Agree in principle. The department will, where possible, include the recommended limitations when issuing Commonwealth guarantees, indemnities or letters of comfort.

### *Authorisation*



4.35. The final step in the preparation of these instruments is their authorisation, which varies between instruments. Loan guarantees, because they can only be issued under the express authority of an Act, may only be executed by the party so authorised by that legislation or by a duly appointed delegate of that party.

4.36. A legal opinion was provided in 1989 to the effect that the power to issue indemnities rests with each individual Minister acting within the scope of his or her legal responsibility. Ministers may not delegate authority to issue an indemnity to officers of their Department. However, they can authorise an officer or officers to exercise this power on their behalf. This is possible because of a common law principle, frequently referred to as the *Carltona Principle*.<sup>28</sup> Under the *Carltona Principle* it is not a strict requirement that Ministers issue formal instruments authorising officers to issue indemnities on their behalf. However, the Attorney-General's Department advises that it is better practice to do so.<sup>29</sup> There is often no limitation placed on the value of the indemnity that may be authorised.

4.37. The ANAO considers that portfolio departments need to maintain current registers of those individuals authorised to issue indemnities, set limits on the amount an officer may authorise, and also ensure the periodic review of these arrangements. In the course of the audit the ANAO found examples of officers who had unlimited authorisations to bind the Commonwealth. This contrasts with the standard practice adopted in most systems of authorisations (and delegations) whereby limitations are established as a means of ensuring that authorisations are exercised appropriately.

### **Recommendation No 7**

4.38. The ANAO *recommends* that agencies review their authorisation arrangements, particularly those relating to officers' authorisation to bind the Commonwealth to contractual arrangements pertaining to the issue of Commonwealth indemnities.

4.39. Agencies responded to the recommendation as follows:

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

4.40. Specific comments by departments are set out below.

- *DoF response:* Agree. Although a matter for each agency, revised guidelines on issuing indemnities will mention the need for review.
- *DoCA response:* Agree. The Department is in the process of reviewing all delegations within the department. There are no delegations in respect of the Commonwealth Indemnity Scheme.
- *DPIE response:* Agree. The Department undertakes a full review of officers' delegations annually.

4.41. Loan guarantees can only be issued under the express authority of an Act, and indemnities must be authorised by a Minister or their representative, is testimony to the importance attached to their issue (see Chapter 3). However, there is no legislative prescription as to who may give performance guarantees or letters of comfort on the Commonwealth's behalf, nor any specific



policy advice on this issue.

4.42. The ANAO's field work and census revealed that all loan guarantees were undertaken in accordance with the provisions of an Act, and most indemnities examined were signed by a duly authorised person. However, the number of census returns in relation to indemnities that had to be followed up because questions were answered incorrectly, the answers unknown, or the agreements incorrectly authorised, was an indication of departments' uncertainty about procedural requirements regarding indemnities.

4.43. The ANAO found initiation and authorisation procedures relating to the issue of indemnities and letters of comfort in particular were not always well understood by agencies. This matter should be addressed in the context of a Department of Finance awareness-raising campaign regarding the management of these off-balance sheet exposures. (see Recommendation No 2 in regard to the awareness program).

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1

For example: '*...the GBE accountability arrangements involve ongoing monitoring of GBEs by the Minister for Finance and portfolio ministers, including reports to the government on a six monthly basis detailing performance and risk, including financial exposure.....in 1995 the Department of Finance conducted surveys of GBEs to ascertain the extent of explicitly guaranteed (on and off balance sheet) exposures and the level of financial derivative activity. The results of the survey were reported to government. The Department is undertaking a survey of the trends in liabilities and use of derivatives by non-GBE organisations [regarding specific organisations]...the risk exposure under the National Interest activities of EFIC is required to be reported regularly to Cabinet and Cabinet also determines the exposure limits within which EFIC must operate. The Commonwealth Bank and Commonwealth Development Bank(CDB) are also subject to the prudential supervision of the Reserve Bank, as is HLIC by the Insurance and Superannuation Commission. The contingent liability of the Commonwealth in relation to the CSS/PSS funded benefits are managed by trustees with clear fiduciary responsibilities in respect of these schemes...*'

2

Finance Regulations are issued under Section 72 of the *Audit Act 1901*

3

These guidelines are issued by the Minister for Finance to guide departmental secretaries regarding those matters to be included in Departmental Financial Statements. Clause 27 states a requirement to report in the notes to the financial statements any material guarantee or undertaking given by the Commonwealth which does not qualify for recognition in the body of the financial statements.

4

Section 70B of the Audit Act requires guarantees to have a statutory basis which is not replicated in the proposed replacement legislation. Under the proposed new FMA Regulations, *Regulation 20A - Giving Loan Guarantees*, this regulation has been included in recognition of the proposed removal of Section 70B and requires the authorisation of the Treasurer in the giving of loan guarantees on behalf of the Commonwealth.

5

Competitive neutrality aims to ensure that Commonwealth entities do not enjoy a competitive advantage when operating in the commercial environment simply because of their ownership by the Commonwealth.

6

Most agencies including GBEs are currently subject to these processes. The Department of Finance is currently developing new systems of borrowing approval and prudential supervision of all Commonwealth entities.

7

For example, Section 62 of the *Export Finance and Insurance Corporation Act 1991* and Section 35 of the *Australian Industry Development Corporation Act 1970*.

8

Audit Report No.10 1995-96.

9

This figure includes the Commonwealth guaranteed non-loan liabilities of the following entities: Commonwealth Bank; Commonwealth Bank Officers Superannuation Corporation; Commonwealth Development Bank; Reserve Bank; Export Finance and Insurance Corporation; Australian Industry Development Corporation; and Housing Loans Insurance Corporation.

10

Commonwealth Bank Public Share Offer 5 June 1966 p60.

11

Ibid p 108.

12

Ibid p 108.

13

Finance Circular 1989/11 Guidelines for the Issuing of Commonwealth Indemnities.

14

This view is supported by the United Kingdom Treasury Manual which advises that departments should approach any request for the issue of a letter of comfort with a strong disposition to reject it.

15

Finance Directions 23C and 23D.

16

Finance Direction 23E, noting that the report to Treasury need only include details of loan guarantees, which is a reflection of Treasury's major role in the execution of loan guarantees as opposed to the management of other contingent liabilities.

17

Finance Directions Section 23, paragraph 23.12.

18

Finance Circular 1989/11 - Guidelines for the Issuing of Commonwealth Indemnities.

19

The following discussion draws on the Management Advisory Board and its Management Improvement Advisory Committee publication - *Managing Risk - Guidelines for Managing Risk in the Australian Public Service. Exposure Draft July 1995* and AS/NZ 4360: 1995 *Australia/New Zealand Standard Risk Management Standards Australia*.

20

MAB/MIAC paragraph 11 .

21

The portfolio departments of Foreign Affairs and Trade and Veterans' Affairs have subsequently reported having such instruments.

22

Finance Directions Section 23, paragraph 23.10.

23

Since 1 July 1995, departments have been able to seek legal advice from sources other than the Attorney-General's Department for certain purposes.

24

Colinvaux, R. *The Law of Insurance*, Sweet & Maxwell, London (1984) p139.

25

*op cit* Finance Circular , paragraph 8.

26

Legal liability for any claims by third parties against the indemnified party under these indemnities remains at least until the relevant statute of limitations expires.

27

*op cit* Finance Circular paragraph 7.

28

*Carltona Ltd v Commissioners of Works*, [1943] 2 All ER at 563. The *Carltona Principle* acknowledges that in the absence of specific delegation or appointment provisions, it may be necessary for Ministers, and others with similar responsibilities, to act through duly authorised officers in order to ensure that actions are conducted in a timely and effective manner. Accordingly, for administrative practicality, Ministers commonly authorise certain officers, or the officers performing the functions of particular appointments, to issue indemnities on behalf of the Commonwealth.

29

Attorney-General's Department Presentation , Government Lawyers Workshop, 3 April 1996.

## **5. Management and Monitoring Arrangements**

*This chapter discusses the management of guarantees, indemnities and letters of comfort after their authorisation and issue.*

### **Introduction**

5.1. The effective management and monitoring of off-balance sheet exposures is a key element in the control of future Commonwealth financial commitments. Sound

management practices contribute to limiting the Commonwealth exposure and potentially large demands on Commonwealth budgets. If there are appropriate management and monitoring arrangements in place then options for risk reduction can be considered; ranging from a commitment for increased resources to fund new risk reduction measures, greater regulatory oversight through to early settlement of claims (thus removing the need for prolonged and expensive litigation).

5.2. This chapter is concerned with four key aspects of management, namely: the need for effective records management which enhances visibility and accountability; appropriate internal and external reporting arrangements; appropriate review and evaluation practices that contribute to on-going risk management; and central coordination on a whole of government basis.

### **Records management**

5.3. Sound records management ensures that visibility and accountability requirements are able to be achieved; and therefore is a fundamental requirement for the effective management of the Commonwealth's off-balance sheet exposure. Two matters of particular importance are the availability of records and the adequate safe keeping of documents which may be required in future commercial proceedings. These matters are discussed below.

### **Register requirement**

5.4. Finance Directions require that all departments maintain a register of their contingent liabilities to facilitate good record keeping.<sup>1</sup> Such registers are intended to enable the departments to provide accurate and complete information annually to the Department of Finance, allowing it to comprehensively report to the Parliament the extent of the Commonwealth's potential risk exposure. The importance of sound record keeping arrangements is also relevant to the introduction of agency and whole of government accrual reporting.

5.5. The ANAO found that, as at 30 June 1995, the majority of portfolio departments which manage guarantees, indemnities and letters of comfort did not have a register for their instruments, in contravention of the Finance Directions.

5.6. The Department of Finance was informed of the deficiencies in regard to the maintenance of records and during the audit promulgated Finance Circular 1995/27 reminding agencies of their responsibilities to maintain comprehensive records of contingent liabilities in accordance with Finance Directions.

5.7. These off-balance sheet instruments can arise as the result of legislation, deeds, contracts and correspondence. It is the latter two forms which pose the greatest risk of not being reported adequately. In the commercial sector it is normal practice to maintain registers which include the details of those occasions on which organisations' seals are used, thereby capturing details of all contracts entered into by an entity.

5.8. The ANAO considers that agencies will be assisted in enhancing their capture of off-balance sheet exposures if they maintain a contracts register; and if they include on the register the details whether individual obligations have guarantees, indemnities or letters of comfort attaching.

## **Recommendations No 8**

5.9. The ANAO *recommends* that agencies consider introducing contract registers which are regularly monitored to facilitate and enhance the records management of their contingent liabilities.

5.10. Agencies responded to the recommendation as follows:

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

5.11. Specific comments by departments are set out below.

- *DoF response*: Agree. Finance Circular 1995/27 reminded agencies of their responsibility to record contingent liabilities. The broader issue of contract registers will be considered.
- *DPIE response*: Agree. The Department's program areas maintain contract registers which have been developed to meet external reporting requirements. These are periodically reviewed in accordance with corporate reporting, audit and risk assessment requirements.
- *DoD response*: Agree in principle. As the Commonwealth's largest buyer of goods/services, Defence enters into over 50 000 contracts with a value of greater than \$2 000 each year. The necessity to record details in a contract register sufficient to identify every contract containing indemnities or guarantees would impose an inappropriate resource burden on defence. Defence is prepared, however, to consider establishing a register applying to contracts over \$5 million, which is shortly to become the Commonwealth definition of a 'major contract'. Such contracts, while few in number (about 120 per annum across the APS), account for a significant part of the total value of contracts.

## **Security and control of documents**

5.12. Security and control of the documentation associated with contingent liabilities is a significant management issue. The instruments may record matters of import that warrant a higher level of protection than routine measures would normally provide. The majority of portfolio departments did not treat the documentation concerning these instruments with any special consideration. As mentioned previously, most portfolio departments did not have a register which is stipulated in the Finance Directions. As a result, some portfolio departments had considerable difficulty finding their documents for the ANAO census.

5.13. The ANAO found instances where the loss, destruction or misplacing of financial documentation has placed the Commonwealth at a disadvantage. In one case, a party, which had provided negotiable financial instruments to the Commonwealth under a purchasing agreement, had to be indemnified against unauthorised presentation of these

instruments when it was discovered that the agency concerned had misplaced them. Such an incident serves as an example of the problems that can arise when documents are inadequately controlled.

5.14. Unlike negotiable financial instruments, many of the instruments considered in this report have no currency value in themselves. However, they are important for other reasons. For example, indemnities, even those which last only a few hours, need to be kept for evidentiary reasons in case of possible future litigation. Even though the likelihood that a claim will be made against one of these documents may be low, they should not be treated as routine documents that have no relevance after the activity indemnified has taken place.

5.15. The Attorney-General's Department advised the ANAO that they have a document security arrangement that allows agencies to deposit and register their important documentation which would offer an option for safeguarding original instruments that need additional security measures. This system is known as the Commonwealth Security System. From anecdotal evidence it was apparent that it was not well known to agencies.

5.16. The ANAO is conscious that unnecessary and costly administrative arrangements can result from the over-classification of material. However, the ANAO considers that current practice errs on the side of too little rather than too much control.

5.17. The ANAO found that guarantees, indemnities and letters of comfort were generally not accorded any special treatment above normal routine measures in terms of their security and control.

### **Recommendation No 9**

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

5.19. Agencies responded to the recommendation as follows:

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

5.20. Specific comments by departments are set out below.

- *DoF response:* Agree. This is a matter for individual agencies to take up.
- *DoCA response:* Agree. The Department lodges original copies of the legal instrument providing indemnity under the Commonwealth Indemnity Scheme with the Commonwealth Securities Register in Attorney-General's Department.
- *DPIE response:* Agree. The Department is currently undertaking a review of its physical security measures.
- *DEETYA response:* Agree in principle. The issue is of only minor importance in

the Department.

## Reporting arrangements

5.21. There is a need for departments to ensure that arrangements are in place to require recipients of these instruments to report any relevant changes in circumstances to them. In addition, there needs to be an effective accountability mechanism to provide Parliament with comprehensive and accurate advice regarding the Commonwealth's contingent liabilities.

5.22. Significant changes in the status of instruments need to be reported to departments to ensure effective monitoring by them as part of their overall financial planning, periodic review and evaluation processes.

5.23. The ANAO field work found that, in respect of a significant number of the instruments examined, there were few obligations placed on entities and individuals receiving these guarantees, indemnities and letters of comfort to report to the issuing department regarding changes in circumstances.<sup>2</sup> In these circumstances, departments' capacities to effectively monitor the instruments they have on issue for their entire legal duration may be reduced. Strengthening of this aspect of management should also improve overall risk management.

## Recommendation No 10

5.24. The ANAO *recommends* that agencies regularly review the effectiveness of their reporting and monitoring arrangements for guarantees, indemnities and letters of comfort to ensure that the Commonwealth's interests are protected for the legal duration of the instruments.

5.25. Agencies responded to the recommendation as follows:

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

5.26. Specific comments by departments are set out below.

- *DoF response*: Agree. This point will be included in DoF's revised guidelines on issuing indemnities, guarantees and letters of comfort.
- *DoCA response*: Agree. There is ongoing monitoring of arrangements, particularly regarding transport and security, throughout the period of indemnity for exhibitions indemnified under the Commonwealth Indemnity Scheme.
- *DPIE response*: Agree. The Department regularly reviews information required to meet its reporting requirements under Section 50 of the Audit Act 1901, and implements any changes necessary to improve the accuracy of the information maintained.
- *DEETYA response*: Agree in principle. The issue is of only minor importance in



the department.

## **Review and evaluation**

5.27. The ANAO considers it is important that the instruments are reviewed on a periodic basis to ensure that circumstances have not changed in a material way as to expose the Commonwealth to greater risk. Follow-up investigations revealed that of all non-loan guarantees examined, about one-third of loan guarantees and slightly less than half of indemnities had been subject to some form of periodic review.

5.28. In addition to periodic review, the ANAO found that the appropriateness of instruments, and whether they are effective in achieving the purpose for which they were issued in the first place, should be evaluated as a matter of course. This would help limit any tendency to issue such instruments without due consideration of alternative measures.

5.29. The ANAO found that guarantees, indemnities and letters of comfort were not always reviewed and/or evaluated as part of normal management practice.

## **Recommendation No 11**

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

5.31. Agencies responded to the recommendation as follows:

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

5.32. Specific comments by departments are set out below.

- *DoF response:* Agree. The purposes of effective risk management, review and evaluation of exposures is essential. These mechanisms could be developed by each agency in implementing Recommendation 4.
- *DOCA response:* Agree. Legal instruments used by the Commonwealth Indemnity Scheme are in the process of being reviewed.
- *DPIE response:* Agree. The Department has received favourable comment from the ANAO on its sound administrative practices, which includes effective review of risk exposures.
- *DEETYA response:* Agree in principle. The issue is of only minor importance in the Department.

## **Central coordination**

5.33. The Department of Finance plays a prominent role in the central management of guarantees and indemnities, particularly in the preparation of regulations and guidelines and the central management of reporting requirements. The Department of the Treasury

and the Attorney-General's Department are also involved, but their roles are largely restricted to providing expertise and advice in the preparation of the agreements.

5.34. The Department of the Treasury advised that while they will maintain a strategic interest in the broader direction of guarantees, indemnities and letters of comfort, their role is diminishing as the Commonwealth moves away from providing explicit guarantees to agencies. At present the Department of the Treasury remains responsible for certain loan guarantees under legislation but it has no direct role in monitoring and reporting on individual instruments.

5.35. The ANAO found that management of guarantees, indemnities and letters of comfort would be improved if the central agencies, notably the Department of Finance, played a more active role in encouraging higher standards. This matter was raised with the Department of Finance which advised the ANAO that it was aware of the problem but cautioned that it has no authority to compel departments to comply with regulations and so has a limited capacity to improve management standards. In this context, the Department of Finance pointed out that the legislative package that will replace the *Audit Act 1901* is expected to be a useful vehicle in encouraging departments to manage their responsibilities more effectively.<sup>3</sup>

5.36. The reporting process stipulated in the Finance Directions for contingent liabilities is intended to provide information to enable the full extent of the Commonwealth's potential risk exposure to be established, and provide a basis for a strategy to manage the risk.<sup>4</sup> The Department of Finance advised the ANAO that:

*'...the major exposures subject to guarantees are centrally monitored and assessed and the risks associated them are regularly reported to cabinet...'*

5.37. Notwithstanding this advice, no explicit strategy has been developed which draws the attention of agencies to the need for transparent risk management of Commonwealth guarantees, indemnities and letters of comfort.

## **Recommendation No 12**

5.38. The ANAO *recommends* that the Department of Finance prepare an explicit strategy to manage the Commonwealth's overall risk associated with guarantees, indemnities and letters of comfort.

5.39. Agencies responded to the recommendation as follows:

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

5.40. Specific comments by departments are set out below.

- *DAS response:* Agree. The strategy should account for the differing exposure of differing agencies.
- *DEETYA response:* Agree. Such a strategy should not be too restrictive in that it should recognise that agencies need to manage these risks in the most appropriate

way given the environmental circumstances they operate in.

- *DoF response:* Agree in principle. The first step is to bring together for effective analysis, accurate and timely information on the Commonwealth's overall risk exposure. In this regard, each portfolio Minister has the capacity (derived from Constitutional authority) to commit the Commonwealth via indemnities which relate to his or her area of responsibility. Appropriate legislative means (eg, a Finance Regulation or Direction) may need to be created to require agencies to furnish the relevant data. At this stage it is not clear what strategic approaches may be warranted. Before embarking on significant moves for both Finance and agencies in response to the audit recommendation, further thought needs to be given to ways of progressing this matter.
  - *DoCA response:* Agree in principle. Proposed that DoF establish an inter departmental committee comprising departments with expertise in this area such as the Department of Communications and the Arts to develop the strategy and any associated risk management guidelines.
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1

Finance Directions 23C and 23D.

2

For example, one-third of both non-loan guarantees and indemnities and three-quarters of loan guarantee agreements examined in field work contained no reporting requirements.

3

Auditor-General Act Bill, Financial Management and Accountability Act Bill, and the Commonwealth Authorities and Companies Act Bill.

4

Finance Directions Section 23, Paragraph 23.12.

## **6. Options for the Future**

*This chapter outlines options for enhancing public accountability and improving risk management practices for Commonwealth guarantees, indemnities and letters of comfort.*

### **Introduction**

6.1. This chapter addresses initially, the wider issues of public accountability and then outlines options for introducing a more commercial framework in considering issues associated with the application of risk transfer and risk pricing. In addition, a framework

of better administrative practice is set out which encapsulates all the major requirements considered by the ANAO to be necessary for improved administration of the Commonwealth's guarantees, indemnities and letters of comfort.

### **Accountability practices**

6.2. In accordance with Finance Directions, departments are required to maintain accurate records of all their guarantees and contingent liabilities and report them annually to the Department of Finance. However, ANAO field work found examples of instruments which were not reported by portfolio departments either specifically to the Department of Finance or routinely in their annual reports; or which were reported in such a general way as to not reveal the nature and magnitude of the contingent liability involved. There were numerous unreported indemnities and letters of comfort which often had no specified value but could have a potential exposure for the Commonwealth. These instruments included indemnities for legal expenses, damage caused by training activities, injury on work training, as well as liabilities associated with adverse contractual outcomes.

6.3. The disclosure and reporting requirements that currently apply to guarantees, indemnities and letters of comfort require judgments on what instruments are presented in portfolio departments' annual reports and in the Minister for Finance's Aggregate Financial Statements. These reporting arrangements, while reflecting current Australian Accounting Standards, result in only the partial presentation of information on off-balance sheet liabilities. <sup>1</sup> Thus departments' annual financial statements <sup>2</sup> and the Minister for Finance's Aggregate Financial Statement (Table 13), are not a comprehensive reflection of the Commonwealth's exposure to guarantees, indemnities and letters of comfort; noting that these statements do not purport to be a complete list of the Commonwealth's exposure to these instruments.

6.4. The ANAO has previously reported a series of concerns in regard to the completeness and accuracy of Table 13. <sup>3</sup> and recommended that the Department of Finance implement an internal quality assurance program for the preparation of Table 13. This recommendation was agreed to and letters were sent to all departments by the Department of Finance in July and August 1993. These letters required agencies to lodge a report of their guarantees and contingent liabilities in a certified return for use in compiling the Minister for Finance's Aggregate Financial Statement. This was complied with but the ANAO found that there were still major shortcomings in the reporting by agencies.

6.5. The number of potential exposures arising from guarantees, indemnities and letters of comfort are of such a scale that the ANAO considers that it is administratively impractical (and potentially misleading) to externally report all such contingent liabilities given the very low risk and materiality levels which some of these instruments may involve. However, there is uncertainty in portfolio departments regarding what should be reported for different levels of potential liability and risk.

6.6. The ANAO considers that the Department of Finance should clarify for departments its requirements for reporting such exposures having regard to possible commercial and security implications in this regard (see also Recommendation No 2).

6.7. The ANAO has identified deficiencies in the management practices of agencies under the present system that can be summarised as follows:

- imprecise recording and reporting requirements which prevented full disclosure;

- inadequate registration and recording of the instruments issued which reduces their visibility; and
- incomplete reporting to the Parliament, which has reduced the visibility of the Commonwealth's exposures.

6.8. These deficiencies coupled with a partial presentation of information of off-balance sheet liabilities under current reporting arrangements contributes to a form of public accountability reporting that does not provide sufficient and comprehensive information to allow an informed basis for decision making. The National Commission of Audit Report to the Commonwealth Government recommended that economic and fiscal outlook reports should be published at budget time and at mid year, and that these reports should include information on 'risks' or emerging pressures on the fiscal outlook.<sup>4</sup> The Department of the Treasury advised the ANAO that these recommendations are currently being considered by the Government in the context of the Charter of Budget Honesty.

### **Selected overseas practice**

6.9. The public accountability mechanisms for reporting contingent liabilities in New Zealand and the United Kingdom are examples of comprehensive reporting arrangements to Parliament. Both the United Kingdom and New Zealand systems have a requirement for Parliament to be informed of all material potential liabilities.

#### *New Zealand practice*

6.10. The New Zealand Government approach to accountability in the management of their contingent liabilities is comprehensive, visible and accountable to Parliament. In particular, the requirements regarding the public reporting of contingent liabilities under the *Public Finance Act 1989 New Zealand* is an approach that may have applications for portfolio departments in their examination of better practice in the Australian context.

6.11. The provisions of the New Zealand system comprise essentially two tiers. First, a requirement that:

*'... the Minister shall as soon as practicable for guarantees and indemnities that exceed \$10 million, publish the details in the Gazette and lay before Parliament a statement that such a guarantee or indemnity has been given...'*

Second, a departmental requirement that specifies that annual financial statements include:

*'...a statement of contingent liabilities of the Crown as at the balance date including any guarantees or indemnities given under the Act...'*

#### *United Kingdom practice*

6.12. The United Kingdom Treasury guidelines are also comprehensive, requiring that:

*'...where a non-statutory liability could exceed 100 000 pounds and has received Treasury approval, the department proposing to give such a guarantee or indemnity must lay before the House of Commons a Minute describing the amount and duration of the instrument, and those involved as well as any other relevant information. Where the potential liability cannot be accurately quantified an estimate is required. Moreover, in*

*particularly large or complex cases the relevant Minister concerned may also be required to make a statement to Parliament supplementing the information contained in the Minute...'*

6.13. The ANAO considers that off-balance sheet instruments, including those instruments that do not specify a financial limit, should be comprehensively reported where this does not involve possible adverse commercial and security risks to the Commonwealth. The Department of Communications and the Arts advised the ANAO that the Commonwealth Indemnity Scheme's guidelines and legal arrangements require that:

*'...the organisation managing the exhibition to keep the value of the exhibition confidential and request the organisation to try to deflect media speculation on the value...'*

6.14. While overseas experience is worthy of consideration, the ANAO favours an arrangement which builds on current reporting practice with specific minimum disclosure and reporting thresholds in the portfolio departments annual financial statements. Where appropriate (for specific and large instruments) Ministerial disclosure in Parliament would also be desirable. To ensure sound accountability and management practice, such a system would require portfolio departments and agencies to maintain and monitor a comprehensive list of instruments (summarised where appropriate) which could be subjected to public scrutiny except where excluded under public interest considerations.

### **Recommendation No 13**

6.15. The ANAO *recommends* that the Department of Finance, in consultation with agencies, examine options for improved accountability practices which embody comprehensive recording of material Commonwealth guarantees, indemnities and letters of comfort.

6.16. Agencies responded to the recommendation as follows:

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

6.17. Specific comments by departments are set out below.

- *DoD response:* Agree. The reference made to 'material' should, however, be clarified by a financial limit, as materiality in the defence context might not meet the objective sought by the ANAO.
- *DAS response:* Agree. Particularly in light of the ANAO preferred option outlined in paragraph 6.14 which builds on existing reporting arrangements, rather than introduce additional requirements.
- *DoCA response:* Agree. In respect of each exhibition indemnified under the Commonwealth Indemnity Scheme, the Department of Communications and the Arts already provides a copy of the legal contract to the Department of Finance. It was also noted that in order not to increase the potential security risk for

indemnified exhibitions, only consolidated indemnity figures are revealed in the Department's annual report ie the total indemnity value for the year and contingent liabilities as at 30 June. Indemnified exhibitions are listed without individual values.

- *DoF response:* Agree in principle. The question of the detail and extent of reporting of contingent liabilities on a consolidated basis should, as is the case for any external financial reporting, have regard to the usefulness of the information for accountability and decision-making purposes. Reporting of gross exposures needs to be set in the context of the net financial position of the entities whose liabilities are subject to guarantee (or indemnity). DoF will further examine this issue in consultation with the ANAO as part of the current trial of consolidated financial statements.

### **Options for managing exposures**

6.18. The ANAO has found that the current systems for managing the Commonwealth's guarantees, indemnities and letters of comfort have numerous inadequacies. The current administrative practices are generally characterised by:

- the need for improved recording and reporting of Commonwealth exposures;
- minimal risk management and risk transference actions aimed at limiting future Commonwealth exposures as a result of these instruments; and
- the absence of positive economic incentives for agencies to apply formal management principles to controlling risk exposure.

6.19. The ANAO found that risk management was deficient across the majority of portfolio departments in relation to guarantees, indemnities and letters of comfort. This was demonstrated by the fact that of the departments which reported having guarantees, indemnities and letters of comfort, only a small minority reported having a corporate risk strategy and fewer still claimed there was a link between this strategy and the management of contingent liabilities.

6.20. Some State Governments have introduced systematic risk management programs that incorporate the management of contingent liabilities. For example, the New South Wales Treasury Fund operates a risk management system that accords with the Australian Standard for Risk Management and includes:

- identification of potential loss exposures;
- measurement of the losses associated with these exposures;
- determining strategies to manage the identified exposures;
- implementation of improved management strategies; and
- monitoring of the effectiveness of the steps taken.<sup>5</sup>

6.21. The ANAO considers that it is also important to address the wider issues of risk management with a view to considering some options that may enhance the Commonwealth's management of these instruments. Moreover, the differing nature of risk

exposures that arise from these instruments require a variety of approaches to management and control of the risk within this overall system.

6.22. The following options seek to outline a range of approaches for dealing with Commonwealth risk exposures from guarantees, indemnities and letters of comfort within a commercial framework of risk management and control. The options canvassed included:

- privatisation;
- risk prevention;
- risk pricing; and
- outsourcing risk.

### **Privatisation**

6.23. Restructuring Commonwealth entities, including the sale of assets, may reduce the Commonwealth's exposure by reducing the number of contingent liabilities overall. An asset sale may provide an opportunity to curtail if not transfer contingent liabilities to another party. For example, in the sale of the Moomba to Sydney Gas Pipeline the Commonwealth was able to divest itself of all significant obligations relating to the pipeline system.

6.24. However, it is not always the case that a privatisation process will leave the Commonwealth in a position where little or no contingent liabilities remain. With regard to the sale of CSL Ltd, the Commonwealth has provided indemnities for claims arising from the use of some CSL Ltd products both pre and post sale. However, the total Commonwealth exposure was still able to be reduced to some degree. In the course of completing asset sales, it is not uncommon for the Commonwealth to provide a range of indemnities and guarantees to facilitate the sale process.

6.25. The recent sale of the final tranche of the CBA release is the Commonwealth from a substantial exposure when the sunset clause commences to have effect three years after the effective date of the sale.

### **Risk prevention**

6.26. In the course of the audit examples were found of instruments which were issued without due consideration of the risks attached to the instrument. This has generally been a reflection of deficient risk management arrangements.

6.27. The ANAO was informed during the course of the audit of cases where indemnity agreements exposed the agency to more risk than was necessary by failing to hold the agency harmless for events outside the intended terms of the contract. Occurrences of this kind can be minimised by informed vetting of agreements.

6.28. To limit risks in areas of government activities both the New South Wales Treasury Fund and the Managed Insurance Fund in Victoria have appointed a professional fund manager to provide a range of risk management services including the risk vetting of commercial agreements.



6.29. The ANAO has previously suggested that all instruments be subject to legal scrutiny before issue, to minimise the risk exposure to the Commonwealth. This is a form of contract vetting and forms part of the risk prevention process.

#### **Recommendation No 14**

6.30. The ANAO *recommends* that agencies entering into any form of written commercial arrangement should undertake a formal process of contract vetting to ensure that the Commonwealth exposure to risk is minimised.

6.31. Agencies responded to the recommendation as follows:

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

6.32. Specific comments by departments are set out below.

- *DoF response:* Agree. This is a matter for each agency. Our revised guidelines on issuing indemnities will be re-emphasise the importance of legal advice in ensuring deeds of indemnity minimise the Commonwealth's risk exposure.
- *DPIE response:* Agree. The Department has 'in house' legal advisors for contract vetting and other legal requirements.
- *DAS response:* Agree. Subject to appropriate risk management procedures.
- *DoD response:* Agree in principle. It would be impractical and unwarranted (and very costly in a regime of user pays for legal services) to formally vet the 100 000 or so contracts (over \$2 000) entered into by the Commonwealth each year. In any case, many of these contracts would have been made against Common User Arrangements and other Standing Orders whose terms and conditions will have received prior legal scrutiny. Any formal vetting process should be restricted to major contracts (say \$5 million and above) where risk exposure would be greatest. In the case of Defence, all major capital equipment and facilities purchases proceed according to well-trying and structured processes. For example a risk management plan is included in the Equipment Acquisition Strategy and Facilities Acquisition Strategy undertaken as part of the procurement process. For complex procurement, the risk management process is detailed in policy documents and manuals, and the completion of a risk management plan is recommended. Also, every major contract within Defence obtains legal clearance before it is signed.
- *DoCA response:* Agree in principle. The Commonwealth Indemnity Scheme uses standard legal contracts drafted by Attorney-General's Department and it is not considered necessary to seek legal advice before each contract is signed. Legal advice is, however, sought on any proposed variation to the contract for a specific exhibition. The standard form legal contract is currently under review in consultation with the Department's Legal Branch. It was also stated that

Telecommunications Industry Division agrees in principle but considers that additional information should be provided on the scope of the proposed 'formal contract vetting' process to ensure that it does not constrain the commercial operations of Australia Post and Telstra. This is particularly so, as there is likely to be little call on the Government from either as a result of their borrowings.

### **Risk pricing**

6.33. The Commonwealth has a general policy of self insurance. This has meant that, regarding the risk associated with the issue of guarantees, indemnities and letters of comfort, there is less incentive for agencies to consider risk retention or risk transfer. Department of Finance advised the ANAO that this statement could be misleading as:

*'...it implies that the Commonwealth's policy of non-insurance has been a catalyst in poor risk management. We are unaware of any evidence that this has been the case. The non-insurance policy reflects the view that is more cost effective for the Executive Government of the Commonwealth, comprising all departments of State and other agencies which form the one legal and financial entity, to meet its risks when and if they arise rather than paying premiums to commercial insurers to cover risks which may not eventuate. Although agencies do not generally have the options of immediate risk transference via commercial insurance regarding the risk associated with the issue of guarantees, indemnities and letters of comfort, the potential risks to the Commonwealth should still be established before they are accepted. Agency managers are responsible (and accountable) for such decisions. The fact that agencies are usually expected to at least contribute towards losses should act as an incentive for agency managers to minimise the exposure, (although the efficacy of this incentive is debatable, especially in the face of a major loss)...'*

There are exceptions to the Commonwealth's general policy of non-insurance; notably in the Veterans Affairs' portfolio, where the Defence Service Homes Insurance Scheme purchases commercial reinsurance cover; and with the Department of Administrative Services businesses that operate under its Business Services Trust Account which purchase general insurance cover.

6.34. The ANAO considers that there are measures that could be taken by the Government to effectively price the risk assumed by agencies when issuing guarantees, indemnities and letters of comfort. One option could be the introduction of a universal payment system for contingent liabilities which would assist in establishing a more equitable and efficient mechanism for sharing and pricing the risk that the Commonwealth can be exposed to from these instruments. In 1986-87, the Commonwealth levied a charge on borrowings that were explicitly guaranteed by the Commonwealth of selected Commonwealth entities (notably non-financial institution GBEs). The levy was extended in 1987-88 to off-budget borrowings of Commonwealth GBEs to cover the guarantees either provided explicitly or implicitly by them in their function as government owned entities.

6.35. The 1996-97 Budget estimates that the guarantee levy of 0.125% on selected government enterprises' borrowings will raise revenue of some \$8.1 million, of which Telstra provides the major share. In regard to the Commonwealth Borrowing Levy arrangements, the Department of the Treasury advised the ANAO that:

*'...the main purpose is to enhance competitive neutrality by offsetting the benefits that*

*commercial entities receive in financial markets, in terms of lower borrowing costs, from government ownership. Following a review of the borrowing levy arrangements in the context of the Competition Principles Agreement, an enhanced borrowing levy, at levels which take account of the value of any explicit Commonwealth guarantee or perceived implicit support, will be applied to all GBE's from 1 July 1997, with consideration being given to broader coverage where appropriate...'*

6.36. If the levy coverage was extended to a wider selection of GBEs, notably those GBEs involved in the financial sector and to all statutory authorities, then there would be a quantum increase in current revenue levels.

6.37. Another option could be along the lines of risk weighting the various instruments and applying an ad valorem charge. While noting that the level of risk varies considerably across guarantees, indemnities and letters of comfort, the ANAO, nevertheless, considers that sound practice dictates that effective and visible risk assessment should be applied to all instruments. The ANAO considers that the management of guarantees, indemnities and letters of comfort would be enhanced by a system that applies a risk weighting to the instruments which could be used as an indicator of the risk attaching to the Commonwealth.

6.38. In the late 1980s the RBA introduced a risk based approach along these lines for the supervision of the banking industry. The RBA uses a risk based measurement of the capital adequacy of banks which incorporates balance sheet and off-balance sheet exposures, such as performance related obligations associated with guarantees. Balance sheet assets and off-balance sheet exposures are weighted according to broad categories of relative risk, based in large part on the nature of the counter party. The greater the risk, the greater is the capital backing required by the bank.

6.39. The sum of the risk weighted assets plus risk assessed off-balance sheet items require individual banks to maintain a minimum capital adequacy requirement. The primary focus of the RBA risk based system is on the potential risk of default by a borrower or counter party. The merits of a measurement system along the broad lines of that developed by the RBA for weighing up the relative risks of Commonwealth provided guarantees, indemnities and letters of comfort may recommend the wider use of such a system in controlling the overall risk exposure of the Commonwealth. The Commonwealth's guarantees, indemnities and letters of comfort are essentially provided 'free of charge', which fails to provide a strong incentive for agencies to carefully assess the risk attached to the issue of these instruments. The Department of Finance disagreed with this notion and advised the ANAO that:

*'...an agency is not literally "charged" for an indemnity it issues, officers are charged with ensuring their proposals to commit the Commonwealth accord with Commonwealth policy which in case of indemnities dictates that benefits are expected to outweigh potential costs to the Commonwealth. As mentioned above, there is an incentive for agency managers to act prudently...'*

6.40. This is particularly relevant in view of Department of Finance guidelines for the issue of indemnities which require that departments entering into contracts of indemnity be aware of the possibility of having to make future payments as a result of these contracts. The same guidelines also note that it would be necessary for claims against indemnities to be met from portfolio appropriations of the Minister issuing the indemnity.

6.41. The Department of Communications and the Arts advised the ANAO that it has no appropriation for the Commonwealth Indemnity Scheme and is unable to fund either claims or insurance premiums. The Department also advised that the size of the premiums for reinsurance of major exhibitions could potentially undermine the objectives of the Scheme, namely, to facilitate public access to significant national and international cultural heritage by minimising insurance costs. The Department of Finance advised the ANAO that:

*'...funds cannot be appropriated unless they have a specific purpose (which does not include risks which may not eventuate). Indemnities provided on behalf of the Commonwealth, such as the Scheme administered by the Department of Communications and the Arts, commit the Commonwealth, rather than just the agency concerned. If unforeseen claims were to be made with respect to indemnities issued under this Scheme, the Department would not be solely responsible for the costs of the claims, although it may be required to contribute to these by finding some offsetting savings in the funds allocated to the portfolio...'*

6.42. The ANAO found that, as a principle, the practice of not pricing risk has the potential to produce unintended and unwanted consequences.

### **Recommendation No 15**

6.43. The ANAO *recommends* that the Department of Finance, in consultation with relevant agencies, examine the application of appropriate risk based systems to the management and pricing of risk pertaining to Commonwealth guarantees, indemnities and letters of comfort.

6.44. Agencies responded to the recommendation as follows:

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

6.45. Specific comments by departments are set out below.

- *Tsy response:* Agree. Noted that the bulk of recorded contingent liabilities relate to the obligations of Commonwealth owned financial institutions and public sector superannuation schemes, and that these obligations are variously subject to risk management, prudential supervision and reporting requirements.
- *DoF response:* Agree in principle. The risk-based pricing approach suggested needs to take into account the financial structure of the Commonwealth and the financial relationships of the entities that comprise it. For example, there is a need to distinguish between those transactions that a department carries out on its own behalf ( corresponding to 'departmental' (or running costs) transactions in the reporting guidelines) and those it undertakes in a fiduciary capacity on behalf of the Commonwealth (corresponding to 'administered' transactions in the reporting guidelines). For a pricing arrangement to work there needs to be a clear distinction between the payer and payee (ie. a purchaser/provider relationship). Such an arrangement is in place (for competitive neutrality reasons) in respect of

guarantees provided to most GBEs. However, in many cases, this distinction would not clearly apply and such an arrangement - which could involve significant costs of administration - would be unlikely to provide an incentive to change behaviour.

- *DAS response:* Agree in principle. Noted that there were practical issues to consider: in some cases risk may be of such an unusual nature that it may be difficult to price; and there may be cases where the government may have assumed the risk, simply because the price was too high for another party to accept the risk.
- *DoCA response:* Agree in principle. Proposed that the Department of Finance establish an Inter-departmental Committee comprising departments with expertise in this area such as the Department of Communications and the Arts which among other things would examine the applications of appropriate risk based systems to the management and pricing of risk pertaining to Commonwealth guarantees, indemnities and letters of comfort. Note that under the Commonwealth Indemnity Scheme the Department of Communications and the Arts already applies a deductible amount or excess payable by managing organisation in respect of each exhibition as an incentive to minimise risk. The indemnity is therefore not provided 'free of charge' (see paragraph 6.39).

### **Outsourcing risk**

6.46. In the context of this discussion, outsourcing refers to such measures as transferring Commonwealth risk to some form of commercial insurance. The general Commonwealth policy is not to insure risk at any level.

6.47. However, there are notable exceptions. One example of an agency having general insurance cover for some of its operations is the Department of Administrative Services' businesses which it operates under its Business Services Trust Account. These businesses have made commercial decisions in recent years to purchase a range of insurance. Another form of approach to transferring some of the risk is the Department of Communications and the Arts requirement that managing organisations in the Commonwealth Indemnity Scheme pay a deductible or excess in respect of each exhibition as an incentive to minimise risks.

6.48. The Commonwealth's risk exposure as a result of its guarantees, indemnities and letters of comfort range from low value high frequency risks to high value low frequency risks. The latter can include events such as the loss of a major art exhibition. The broad range and nature of the risks associated with the instruments issued by the Commonwealth make it unlikely that, in all cases, the Commonwealth would be able to access traditional commercial insurance to cover all its exposures. This situation is sometimes used as an reason for not considering the option of commercial risk transfer.

6.49. The ANAO acknowledges that it is probably inappropriate, if not impossible, to transfer all the risk to commercial insurance. However, there are options which can be explored by applying a strategic approach to risk and risk transfer through accessing commercial reinsurance arrangements. Regarding the commercial insurance option, the Attorney-General's Department advised the ANAO that:

*'...the Commonwealth can lose control of the conduct of claims by and against it, and the conduct of legal proceedings instituted by or against it, in relation to matters covered by*

*the insurance. This arises from the normal provision in an insurance policy that the insurer has control of all claims covered by the policy (ie. subrogation). However, there is a potential concern that the insurer's legitimate commercial interests will not always coincide with the Commonwealth's broader governmental and public interests...'*

6.50. The adoption of a more commercially oriented approach to the management of broad risk exposures can be found in the managed insurance fund arrangements currently operated by the New South Wales and Victorian Governments. The Victorian Government Managed Insurance Fund operates to cover a range of eventualities from relatively low level risks (retained as self insurance in the form of a normal deductible or excess) to catastrophic low frequency events covered by commercial reinsurance.

6.51. The ANAO considers that there are other less complex circumstances for outsourcing. The Department of Defence pro forma indemnities are a case in point. These indemnities occur frequently, carry significant and ongoing administrative overheads if managed properly, and are issued for circumstances that may be able to be covered under public liability insurance. Initial discussions with industry sources indicate that, for some agencies, insurance under these circumstances may be a more feasible cost efficient option than current practices.

6.52. The ANAO considers that there may be numerous risks currently covered by indemnities and letters of comfort issued by agencies that could be covered by commercial insurance and suggests that this matter warrants further examination.

### **Recommendation No 16**

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

6.54. Agencies responded to the recommendation as follows:

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

6.55. Specific comments by departments are set out below.

- *DoF response:* Agree. Although the flexibility sought by the ANAO currently exists-exceptions to the non-insurance policy can be made where the Commonwealth as a whole will achieve better value for money or to ensure competitive neutrality - Finance agrees that the options for the cost effective transfer of risk to other parties may need to be reviewed. To identify the nature and scope of any such review, Finance will consult forthwith relevant agencies.
- *DAS response:* Agree. Noted that only certain risks may be capable of being dealt with through a commercial option.
- *DoTRD response:* Agree. Noted that at least one case (the Commonwealth

Indemnity of CASA's safety regulatory functions), the indemnity was provided by the Commonwealth because there were compelling reasons why commercial insurance arrangements were inappropriate.

- *DoCA response:* Agree in principle. Proposed that the Department of Finance establish an inter-departmental committee comprising departments with expertise in this area such as the Department of Communications and the Arts which among other things would review the merits of the Commonwealth carrying all the risk. Any review of commercial options should take account of the objectives of the Commonwealth Indemnity Scheme and the effectiveness of the Scheme's current administrative arrangements in minimising risk to the Commonwealth.

### **Better administrative practice**

6.56. In the course of the audit the ANAO developed a set of better administrative practice principles to assist agencies to more effectively manage Commonwealth guarantees, indemnities and letters of comfort. The development of these practices is premised on the current governance framework and drew on examples from a number of agencies.

6.57. The Department of Communications and the Arts Commonwealth Indemnity Scheme embodies most of the characteristics of this approach. This scheme is outlined in Exhibit 6.1. Other examples of sound administrative practice include the central record keeping systems of the Departments of Finance and Primary Industries and Energy.

6.58. The principles and procedures referred to in this report are set out in the following better administrative practice principles at Exhibit 6.2. It should be noted that this approach is proposed as a generic example of sound management practice and should be tailored to individual needs.

### **Exhibit 6.1 The Commonwealth Indemnity Scheme**



The Commonwealth Indemnity Scheme <sup>6</sup> embodies most of the elements of sound management outlined above and is an example of how sound management measures can be applied in practice.

The Scheme's guidelines cover policy and procedures and layout the sequence of events to be followed when an indemnity is issued so that from the outset, the managing organisation knows the requirements for obtaining and administering an indemnity. The Scheme also provides procedural guidelines and detailed guidance to all parties, from curators to couriers. The essentials of the Scheme are set out below.

#### **Decision to issue an indemnity**

The Minister may approve an indemnity after receiving a comprehensive assessment by the Department of a proposal. The assessment covers:

- the eligibility of the exhibition, in terms of cultural, diplomatic or national value;
- the total value of exhibits;
- the individual value and authenticity of objects to be indemnified;
- the level of indemnity needed ;
- security issues; and

- transport and handling issues.

**Preparation of an indemnity**

The terms and conditions of the Scheme cover :

- the limits of the indemnity;
- minimum and maximum limits of indemnity cover;
- the period of the indemnity;
- exclusions;
- procedures in the event of a claim;
- time limits on a claim;
- contingency arrangements in the event of loss, damage or destruction of indemnified objects;
- the obligations and responsibilities of all the parties concerned, including third parties; and
- ending the agreement.

**Management accountability**


The respective obligations of all parties are set out in the policy and procedural guidelines and specified in the Deed of Indemnity which is the legal instrument. When an indemnity expires, the managing organisation provides the Department with a project report which includes audited financial statements. The Department reports on the Scheme in its annual reports and the indemnities are included in its financial statements and in Table 13 of the Minister for Finance's Aggregate Financial Statement.

**Security and control**

Considerable care is taken in looking after the Deed of Indemnity. The original is sent to the managing organisation and a copy is sent to the Department of Finance. Another copy of the Deed is sent to the Attorney-General's Department for registration as a Commonwealth security.

**Exhibit 6.2 Better Administrative Practice**





- A comprehensive risk management plan which links to the management of agencies' contingent liabilities. Managing these risks involves:
  - establishing an awareness of the agency environment;
  - identifying the risks;
  - analysing the risks;
  - assessing the risks;
  - treating the risks (such as they are retained, reduced, eliminated, controlled or



transferred); and

- monitoring and reviewing the risks. <sup>7</sup>



- When preparing a guarantee, indemnity or letter of comfort, the rationale for issuing the instrument must be that the Commonwealth's interests are advanced sufficiently to outweigh the level and cost of the risk which the Commonwealth would be assuming. The specific rationale behind issuing particular instruments should be adequately documented to ensure:
  - transparency in the decision-making process;
  - the instruments are issued for sound reasons; and
  - original justification for the issue of the instrument will be available for review and evaluation.
- Legal advice and contract vetting is needed when agencies enter into any form of written commercial arrangement, to ensure that the Commonwealth is exposed to the minimum risk necessary to achieve the particular objective. As a general rule:
  - routine instruments can be issued on the basis of generic advice provided that additional advice is sought where circumstances change or the specifications for the instrument fall outside the parameters of the generic advice;
  - individual advice should be sought for all other instruments; and
  - documents intended as letters of comfort need to be subject to specific legal advice to avoid inadvertently exposing the Commonwealth to a contingent liability.
- Terms and conditions need to be considered and should canvass the following :
  - setting a time limit on the operation of the instrument when this is practicable to minimise the Commonwealth's exposure to risk;
  - inclusion of a termination clause, where appropriate, so that when the need for the instrument has ceased to exist the Commonwealth has the option to terminate the arrangement;
  - setting, where possible, minimum and maximum financial limits on claims which can be made under the instrument;
  - the inclusion of subrogation-like clauses and clauses giving the Commonwealth the right to take over any litigation related to the indemnity; and
  - ensuring that the instrument (notably indemnities) does not cover damage resulting from malicious or reckless acts by the indemnified party.



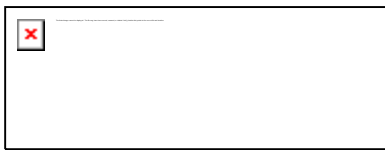
- The person issuing an instrument on the Commonwealth's behalf needs to be properly authorised to do so. Considerations should include:
  - Section 70B of the *Audit Act 1901* requires that specific authority exist under legislation for the issuing of loan guarantees. The person issuing a loan guarantee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



- Sound management of guarantees, indemnities and letters of comfort requires effective records management. Key characteristics of records management are:
  - the effective capture of information;
  - compliance with legislative and policy requirements;
  - appropriate security classification of documents;
  - systematic registration of documents within the agency;
  - accessibility, and
  - secure storage.<sup>8</sup>
- Agencies should maintain:
  - a register which is accessible to the staff who require the information (see Department of Finance register data base proforma at Appendix 3); and
  - a contract register for tracing contractual obligations for Commonwealth guarantees, indemnities and letters of comfort.



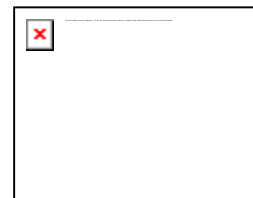
- Effective procedures should be in place to ensure that records, both electronic and paper are protected. Measures need to include:
  - considering the agencies' overall records management strategy for the storage and retrieval of the instruments and associated documentation, taking into account the long term and/or indefinite nature of some of the obligations; and
  - the appropriate indexation and storage of the instruments themselves and associated documentation including consideration of secure storage such as the Commonwealth Security System provided by the Attorney-General's Department for valuable, long term or otherwise significant instruments.



- To ensure sound measures of public accountability are in place agencies should (subject to possible confidentiality and security implications):
  - accurately and comprehensively report in their annual financial statements those instruments which meet the criteria for inclusion;
  - in accordance with the disclosure requirements; accurately and comprehensively report, on an annual basis, to the Department of Finance a listing of instruments current as at the end of the financial year; and
  - compile a comprehensive list of contingent liabilities (summarised where appropriate) which can be produced for public scrutiny, except where excluded under public interest considerations.



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



1

The CCH Macquarie Dictionary of Accounting (1991) states that: '*... when not included in the balance sheet, or statements of assets and liabilities for Commonwealth agencies, a contingent liability may also be called an off- balance sheet liability...*'

2

Statement of Accounting Concepts 4 Paragraph 65 states: '*A liability should be recognised in the statement of financial position when and only when; (a) it is probable that the future sacrifice of economic benefits will be required; and (b) the amount of the liability can be measured reliably.*' Paragraph 71 of the same reference states that: '*Liabilities that are not recognised because they cannot be measured reliably may also warrant disclosure in the notes in the financial report because knowledge of the liabilities is considered to be relevant to the users of financial reports in making and evaluating decisions about the allocation of scarce resources.*'

3

Audit Report No. 29 1992-93, Aggregate and Departmental Financial Statements 1991 - 92, pp xvi and 17.

4

National Commission of Audit Report to the Commonwealth Government, June 1966  
Recommendations 11.5, 11.6 and 11.20.

5

GIO Brochure in regard to the NSW Treasury Managed Fund.

6

The Department of Communications and the Arts advises that the objective of the Scheme is to provide public access by Australians to significant international and national cultural heritage exhibitions. Some of these exhibitions may be included in bilateral cultural agreements with other countries. Managing organisations apply to the Department for indemnity of particular exhibitions within a total indemnity limit administered by the Department.

7

Alexander & Alexander brochure, *Public Liability Insurance, Issues and Benefits for Government*, p8.

8

## Appendix 1 - ANAO Census Form - Indemnities

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

(a) The name of the person, organisation or authority whose actions were indemnified;

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.....

(b) The name of the person, organisation, or authority to whom or to which the indemnity was given;

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.....  
.....

(c) The purpose of the indemnity;

.....  
.....  
.....  
.....

(d) The amount of the contingent liability arising from the indemnity (if relevant);

.....  
.....

(e) The legislative authority, if any, that gives rise to this indemnity;

Act:

.....  
.....

Section:

.....  
.....

(f) Who approved the arrangement;

.....  
.....  
.....  
.....

(g) The period to which the indemnity relates (date of issue and date of termination);

.....  
.....  
.....

.....

(h) Does this indemnity contain a subrogation clause? (ie allowing the Commonwealth to substitute for the other party):

.....  
.....

(i) Relevant Files (Name and Number);  
and.....

.....  
.....  
.....  
.....  
.....  
.....  
.....  
.....

(j) Any other relevant details with regard to the indemnity

.....  
.....

**Appendix 2 - Guarantees, Indemnities and Letters of Comfort as at 30 June 1995**

<b>LOAN GUARANTEES</b>	<b>Value (\$)m</b>
<u>DEPARTMENT OF COMMUNICATIONS AND THE ARTS</u>	
ABC Yen 3 billion term loan	40.0
ABC \$53 million domestic bond	53.0
ABC \$200 million commercial paper facility	5.5
ABC eurobond issue	100.0
SBS building loan	39.0
Telstra bonds (25)	408.1
Telstra Floating Rate Bond	45.1
Telstra Euro Yen Bonds	166.4
Telstra Yen Private Loans	83.2
<b>Total</b>	<b>940.3</b>
<u>DEPARTMENT OF DEFENCE</u>	

Defence Housing Authority	313.5
<b>Total</b>	<b>313.5</b>
<u>DEPARTMENT OF EMPLOYMENT, EDUCATION AND TRAINING</u>	
Schools - Canterbury Christian School (LG-22) - Glenaeon School (LG-4) - International Grammar School (LG-21) - Macarthur Region Anglican School (LG-14) - Radford College (LG-10) - Radford College (LG-20) - Redlands College (LG-23) - St Paul's Grammar School (LG-16) - St Paul's Grammar School (LG-19) - Southside Montessori School (LG-18)	4.0
Austudy/Abstudy Supplement (141 918 in total)	556.6
<b>Total</b>	<b>560.6</b>
<u>DEPARTMENT OF ENVIRONMENT, SPORT AND TERRITORIES</u>	
Northern Territory Loans guaranteed by the Commonwealth (No. 1-40)	428.7
<b>Total</b>	<b>428.7</b>
<u>DEPARTMENT OF INDUSTRY, SCIENCE AND TECHNOLOGY</u>	
AIDC	3 223.0
EFIC	3 354.0
<b>Total</b>	<b>6 577.0</b>
<u>DEPARTMENT OF PRIMARY INDUSTRIES AND ENERGY</u>	
Australian Wheat Board	1 482.8
Queensland Fish Management Authority	14.0
Snowy Mountain Hydro-Electric Authority, July 1993 and July 1992 borrowings	137.9
Wool International	1 618.0
<b>Total</b>	<b>3 252.7</b>
<u>DEPARTMENT OF THE PRIME MINISTER AND CABINET</u>	

ATSIIC guarantees	0.7
- Cummeraragunga Pty Ltd	
- AD & YD Lester	
- Balranald Aboriginal Corp	
- A Eldridge Royce Enterprises	
- M Anderson & J Williamson	
- Nyampa Aboriginal Housing Company	
- M Campbell T/A AB-OZ Pty Ltd	
- Barriekneal Housing & Community Ltd	
- Jumbun Pty Ltd	
- Morr Morr Pastoral Co	
- Seisa Hire Car	
- H & E Rix	
- A & M Bon	
- Yanangu Stores	
- CAAMA	
<b>Total</b>	<b>0.7</b>
<u>DEPARTMENT OF TRANSPORT</u>	
ANL (P-Note)	45.0
Australian National Railways Commission Act 1983:	
-National Australia Bank (26/6/95 - 17/7/95)	14.9
-Hambros (17/3/95 - 23/3/98)	100.0
-J B Were (6/6/95 - 31/7/95)	19.8
-J B Were (30/5/95 - 29/8/95)	19.6
-J B Were (25/5/95 - 21/8/95)	19.6
-Public Issue (13/11/92-15/6/02)	49.5
-Public Issue (13/11/92-15/6/02)	6.3
-Public Issue (13/11/92-15/06/02)	21.5
-Public Issue (Unknown - 4/12/95)	3.5
-Public Issue (Unknown - 1/6/96)	0.1
-Public Issue (Unknown - 15/9/96))	2.4
-Public Issue (15/1/91 - 22/1/01)	97.0
-Yasuda (1/9/89 - 4/9/97)	125.5
-LTCB (19/5/89 - 24/5/99)	123.2
-J B Were (4/7/95 - 9/10/95)	17.6
-Commonwealth Bank (4/7/95 - 27/9/95)	19.6
-Public Issue (19/2/92 - 25/2/99)	50.0
-Public Issue (1/2/90 - 7/6/02)	50.4
Civil Aviation Authority (Issued 29/6/1995)	23.8
Civil Aviation Authority (Issued 15/1/1991)	100.0
Civil Aviation Authority (Issued 15/1/1990)	9.4
<b>Total</b>	<b>918.7</b>
<u>DEPARTMENT OF THE TREASURY</u>	
PNG Loans Guarantee	12.1
<b>Total</b>	<b>12.1</b>



## NON-LOAN GUARANTEES

<u>DEPARTMENT OF COMMUNICATIONS AND THE ARTS</u>	
Deed of Guarantee between Commonwealth and Telecom Super Pty Ltd (Telstra)	947.0
<b>Total</b>	<b>947.0</b>
<u>DEPARTMENT OF FOREIGN AFFAIRS AND TRADE</u>	
Austrade	192.4
<b>Total</b>	<b>192.4</b>
<u>DEPARTMENT OF FINANCE</u>	
Commonwealth Superannuation Scheme (CSS)	40 000.0
Public Sector Superannuation Scheme (PSS)	3 400.0
<b>Total</b>	<b>43 400.0</b>
<u>DEPARTMENT OF INDUSTRY, SCIENCE AND TECHNOLOGY</u>	
AIDC	815.0
EFIC	2 956.0
Agreement for the sale of shares in SMEC	1.0
<b>Total</b>	<b>3 772.0</b>
<u>DEPARTMENT OF THE TREASURY</u>	
Commonwealth Bank of Australia (on-balance sheet)	91 299.3
Commonwealth Bank Officers Superannuation Corporation	3 975.5
Commonwealth Development Bank	1 588.6
Reserve Bank of Australia	25 607.0
Home Loans Insurance Corporation	36 006.0
<b>Total</b>	<b>158 476.4</b>

## INDEMNITIES <sup>1</sup>

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<u>ATTORNEY-GENERAL'S DEPARTMENT</u>	
Australian Federal Police (8 aggregated for confidentiality)	Unspecified
Australian Protective Service (2 aggregated for confidentiality)	Unspecified
Insolvency and Trustee Service, Australia - Section 305 Approval (1339 )	5.4
<b>Total</b>	<b>5.4</b>
<u>DEPARTMENT OF ADMINISTRATIVE SERVICES</u>	
Tuggeranong Office Park ("TOP") Deed of Indemnity - Australian Estate Management	Unspecified
<u>DEPARTMENT OF COMMUNICATIONS AND THE ARTS</u>	
Barking Gecko Theatre Company	
Belvoir St Theatre	
CIS: Matisse exhibition	
Dance North	
Deed of Indemnity between Optus Communications Pty Ltd and the Commonwealth of Australia (2)	
Festival Gippsland	
Meryl Tankard Australian Dance Theatre	
Northern Australian Regional Performing Arts Centres Association Inc and the Queensland Arts Council	
Outback Arts Committee	
Performing Lines	
South Australian Country Arts Trust	
Sydney Dance Company	
The Bell Shakespeare Company	
The State Opera of South Australia and The Lyric Opera of Queensland	
Theatre Royal Management Board	
<b>Total (aggregated for confidentiality reasons)</b>	<b>745.1</b>
<u>DEPARTMENT OF DEFENCE</u>	
ADI Deed of Indemnity 3 May 1989	Unspecified

Port of Melbourne Authority	Unspecified
Queensland Sugar Corporation	10.0
Keppel Cairncross Shipyard Ltd	10.0
Industrial Computer Products, Pagewood	Unspecified
Bruttour International Pty Ltd	Unspecified
Western Australian Police	Unspecified
Bungey Silo - invoked when training courses active	Unspecified
Local Landowners - Singleton Area - invoked when training courses active	Unspecified
Local Landowners - SME - invoked when training courses active	Unspecified
Qantas Jet Base, Warragamba Dam and Caltex Refinery - Search Advisers Course (invoked when training courses active)	Unspecified
Telstra	Unspecified
Southland Shopping Centre	5.0
Use of civil shipping resources for Defence purposes ( MOU 8 - invoked on an as required basis)	Unspecified
Use of civil airline resources for Defence purposes (MOU 2 - invoked on an as required basis)	Unspecified
BP Australia Limited (MOU - invoked on an as required basis)	Unspecified
Corio Village Shopping Centre	5.0
Conditioning, monitoring and preparation for shipment of radioactive waste from St Mary's	Unspecified
Reciprocal agreement with Singapore on medical and dental services.	Unspecified
Esso	5.0
Use of the WA Police forward command post by SASR	5.0
ADI's St Mary's property	Unspecified
Hydrographic Service	5.0
Australian War Memorial (painting) - value less than 0.1	
<b>Total</b>	<b>45.0</b>

<u>DEPARTMENT OF EMPLOYMENT, EDUCATION AND TRAINING</u>	
Indemnity arrangements for owners of sites to be used for microwave path	Unspecified
Deed of Indemnity - International College of English	Unspecified
<u>DEPARTMENT OF FINANCE</u>	

Qantas Trade Sale - Tax Liability	Unspecified
Catering Service - Settlement Balance Sheet	Unspecified
Catering Service - Taxation Liability	Unspecified
Catering Service - Directors loss of office	Unspecified
Catering Service - Superannuation Entitlements	Unspecified
Catering Service - Conduct before sale	Unspecified
ACT Residential Mortgages - Excess Credits	Unspecified
ACT Residential Mortgages - Variable Rates	Unspecified
Separate Airlines Sales - Financial Adviser	Unspecified
Qantas PSO - Mk1 Joint Lead Managers indemnities	Unspecified
Directors of Hogan Marketing Service and Directors of Ashcove Pty Ltd	Unspecified
Qantas PSO Mk1 Financial Adviser	Unspecified
Combank 2 - International Briefings	Unspecified
Qantas Trade Sale - C of A Performance	Unspecified
Qantas PSO - Debt Assumption Agreement	Unspecified
Qantas PSO - Mk2 Hogan Marketing Services	Unspecified
Qantas PSO - Withholding Tax Indemnity	Unspecified
Toronto Dominion Bank of Canada	Unspecified
CSL Float - protection for litigation costs Potter Warburg/Price Waterhouse (PW/PW)	Unspecified
Arthur Andersen - to provide consultancy services as Investigating Accountants for the CSL float	Unspecified
Commonwealth - Breach of confidentiality in connection with CSL	Unspecified
Reserve Bank Australia, Drawing Account	Unspecified
Australian Airlines board members and officials	Unspecified
Australian Airlines Ltd - employees	Unspecified
Citibank - London	Unspecified
Nations Bank of USA	Unspecified
ASTA Sale - Protection for the costs of asbestos, pollutants or other contaminants	Unspecified
ASTA Sale - Prior to closing date warranties	Unspecified
ASTA Sale - Protection from liability under the Income Tax Act 1936	Unspecified
ASTA Sale - Protection from liability arising from R and D Claims	Unspecified
<b>DEPARTMENT OF HOUSING AND REGIONAL DEVELOPMENT</b>	
Albury-Wodonga Development Corp. - Bank Accommodation Guarantee Indemnity	

(value less than 0.1)	
<u>DEPARTMENT OF HEALTH AND FAMILY SERVICES</u>	
Indemnity agreement between the Commonwealth of Australia and CSL Ltd	Unspecified
Diagnostic products agreement between Commonwealth of Australia and CSL Ltd	Unspecified
An agreement between the Commonwealth of Australia and CSL Ltd (plasma fractionation)	Unspecified
Exchange of letters with State Health Authorities, Minister for Finance and Attorney-General's (ARC)	Unspecified
Deeds of Indemnity for Commonwealth Rehabilitation Service Work Training Employees (444 in total)	888.0
Health Insurance Commission to the Reserve Bank of Australia	Unspecified
Health Insurance Commission to the National Australia Bank	Unspecified
Health Insurance Commission to HSBC Management	Unspecified
Health Insurance Commission to JP Morgan Investment Management Australia	Unspecified
Health Insurance Commission AMP Investment Australia Limited	Unspecified
Health Insurance Commission to CFM	Unspecified
Health Insurance Commission to indemnify the Manager	Unspecified
<b>Total</b>	<b>888.0</b>
<u>DEPARTMENT OF INDUSTRY, SCIENCE AND TECHNOLOGY</u>	
Bloomberg contract	Unspecified
Indemnity of ATG	Unspecified
<u>DEPARTMENT OF PRIMARY INDUSTRIES AND ENERGY</u>	
The Pipeline Authority	Unspecified
<u>DEPARTMENT OF TRANSPORT</u>	
Indemnity for ANL Board	Unspecified
Civil Aviation Authority Deed of Agreement - Indemnity (indemnity for air safety functions)	Unspecified
<u>DEPARTMENT OF VETERANS' AFFAIRS</u>	
Indemnity created by Section 38H of the Defence Service Homes Act 1918	9.5

<b>Total</b>	<b>9.5</b>
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### LETTERS OF COMFORT

<u>DEPARTMENT OF FINANCE</u>	
Australian Airlines Trade Sale - Commercial Paper	Unspecified
Australian Airlines Trade Sale - Settlement Period	Unspecified
Qantas Trade Sale - BA Commercial tie-ups	Unspecified
Australian Airlines	Unspecified
Qantas Airways Ltd/ Commonwealth Government	Unspecified
<u>DEPARTMENT OF TRANSPORT</u>	
Comfort Letter for ANL Financiers	180.0
Federal Airports Corporation	Unspecified
Department of Transport/CAA/CASA Deed of Agreement - indemnity	Unspecified
<b>Total</b>	<b>180.0</b>

Note: 'Unspecified' is used in the above listing of instruments in all circumstances where no dollar value is specified as a financial limit.

### Appendix 3 - Department of Finance Contingency Data Base

Division:

Contact Officer:

Type of Contingency:

Name of Guaranteed/Indemnified  
Organisation:

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

Type of Contingency:

Purpose of Contingency:

GUARANTEE ONLY
Type of Financial Instrument:
Total Principal Amount
Interest Payment Arrangements
Outstanding Balance
Period of Financial Instrument FROM: TO:

INDEMNITY, LETTER OF COMFORT & UNDERTAKING ONLY
Amount of Contingent Liability arising from Indemnity, Letter of Comfort or Undertaking.

INDEMNITY ONLY
Subrogation Clause: Details:

Legislative Authority

Who approved the arrangement

Date of Issue (Extension Date)

Date of Termination

Registry Files

Other Details

Source: Department of Finance - DOF Contingency Database

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## **Appendix 4 - Related Performance Audits**

*Set out below are the titles of reports of the main performance audits by the ANAO which address Commonwealth guarantees and indemnities.*

Audit Report No 8 1994-95

*Aggregate Financial Statement - Prepared by the Minister for Finance year ended 30 June 1994.*

Audit Report No. 10 1995-1996

*Sale of the Moomba to Sydney Gas Pipeline.*

Audit report No. 14 1995-96

*The Sale of CSL - Commonwealth Blood Product Funding and Regulation.*

Audit Report No. 15 1995-96

*Aggregate Financial Statement - Prepared by the Minister for Finance year ended 30 June 1995.*

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Totals for indemnities reflect only those instruments for which a financial limit has been specified.