

Occasional Paper

**An Auditor's View of
Commonwealth Asset, Including
Property Management**

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AN AUDITOR'S VIEW OF COMMONWEALTH ASSET, INCLUDING PROPERTY, MANAGEMENT

1. INTRODUCTION

In the ANAO's Audit Work Program¹ we have foreshadowed an updating of the current Better Practice Guide on asset management². Preliminary planning for this task is underway with our early work indicating that this guide has stood the test of time and still reflects good practice. However, it will need to reflect the results of our more recent audits and input from the Department of Finance and Administration (Finance). Because completion of a new guide is some way off, I felt it timely to publish a paper aimed at raising publicly the profile of a number of important issues associated with asset, including property, management in the federal government environment. This paper in no way replaces the proposed up-dated better practice guidance. Nevertheless, it reflects a consideration of some issues that are relevant to the latter's preparation, as well as some insights gained from our relatively recent audit reports.

In addition to the body of audit work referred to in this paper, there are two performance audits scheduled for tabling in the next few months - the results of these audits will also help to contribute to better practice as well as informing the preparation of the new guide. These two audits are as follows:

- The upcoming '*Property Management*' audit (concentrating on office accommodation) aims to assess whether the property management function (including the management of leases) is performed efficiently and provides value for money. A more detailed overview is provided later in the paper at page 19. This audit is scheduled for tabling in December 2003.
- A cross-agency performance audit of '*Intellectual Property Policies and Practices in Commonwealth Agencies*' which aims at assessing systems that agencies have in place to manage their intellectual property assets as well as highlighting areas for better practice. As part of the audit process seventy-two questionnaires were sent to selected agencies and, pleasingly, we received a 100 per cent response rate. This report is scheduled for tabling at the end of January 2004.

Turning now to the Occasional Paper, it focuses on five broad areas of concern, namely:

- **Asset Management** – Here I want to stress the importance of asset control, noting the view, held by some in the public sector, that: '*There are no prizes for managing assets well in the Commonwealth*'.³ As well, I want to refer to the guidance on asset management published by the ANAO⁴. Although published in 1996, it still is very much the 'touch stone' for good asset management practice.
- **Intellectual Property (IP)** – I have included this issue because, historically, IP development within public sectors has not been well recognised and '*many public sector entities do not know what they own in the form of intangible assets, such as*

intellectual property' ⁵. As one of Australia's largest users and managers of information, the Australian public sector is a significant contributor of IP, particularly in the area of systems development. In the past, this has not been well exploited for the benefit of the Commonwealth nor for the broader public good. The South Australian Auditor-General has also made a similar observation in his constituency:

'Intellectual property and government information represent major government assets. In many cases significant expenditure has been committed to the development of these assets and they should be managed in accordance with prudent commercial, financial and budgetary practices'.⁶

- **Private Financing Initiatives (PFI)** – This is an important topic because with the private sector building, owning and operating a facility (ie, a BOO arrangement) or building, owning, operating and then transferring the facility to the public sector at the end of the operating period (ie, a BOOT arrangement) there are a number of significant issues to be considered with this form of financing. These include the transfer of risk from the public to the private sector; how the PFI arrangements should be accounted for and reported in the public sector statements and budgets; and tax implications. In this discussion, however, I will focus on the risk and accounting aspects and leave the taxation matter to others. Nevertheless, I note there has been marked differences of views in the property, financial and State Government arenas about the proposed Federal tax changes to public-private partnerships.⁷ *The New Business Tax System (Taxation of Financial Arrangements) Bill (No 1) 2003* was introduced into the Senate on 24 June and referred to the Economics Legislation Committee. The Committee's report⁸ recommending that the Bill be passed was tabled on 13 August by Senator McGauran. I understand that it will be debated in the Senate shortly.
- **The Audit Mandate** – There has been some tension between an audit review of policy advice as an output and the related policy outcomes. This matter gained some prominence after our audit on government property sales, which provides a useful illustration of the issue.
- **Recent Audit Findings and Recommendations** – This section reflects the main themes from the more recent audits we have undertaken on property and related topics.

The Australian Federal Government owns and manages property within its borders and overseas. Property within Australia includes commercial office buildings, law courts, laboratories, and heritage properties, totalling over 165 properties valued at more than \$948 million. The overseas property consists of offices as well as residential properties primarily associated with Australia's diplomatic and consular activities and comprises 141 properties in 49 countries with an estimated market value of \$A1.19 billion.⁹

Day-to-day management of both the domestic and overseas property portfolio was outsourced in 2000 to a commercial service provider. Current contractual

arrangements are intended to give the government access to international best practice in the domestic property arena and meet set performance indicators to:

- maintain the condition of the portfolio to industry standards;
- meet the future needs of tenant agencies as agreed by government;
- pay dividends from operations; and
- make equity repayments to the Commonwealth from the divestment of property.¹⁰

Under their contract, the Department of Foreign Affairs and Trade, the agency responsible for overseas property, directly manages and measures the service provider's performance – its global portfolio management, long-term assets management, day-to-day property management, day-to-day facilities management, and management of the divestment program and capital works.¹¹

2. ASSET MANAGEMENT

If pressed to encapsulate my message on asset management within 45 words or less, I could do no better than refer to the following two observations:

*'Asset Management is a systematic, structured process covering the whole life of an asset. The underlying assumption is that assets exist to support program delivery'.*¹²

and,

*'Asset management is...not a goal in itself, but one important factor in an agency's total corporate governance'.*¹³

Asset management is not always given the importance it deserves in an agency's management responsibilities. I am taking this opportunity to again highlight the challenge of raising awareness of the importance of asset management within the public sector. As an aside, a former Defence colleague observed that, when the Naval store at Zetland (in Sydney) closed down, inventory items were discovered that related to ships that had long been retired from service – although not quite back to the first fleet. Or to use a property example:

*'The [NSW] Auditor-General released a damning report which revealed that millions of dollars in government real estate had gone missing over the previous 13 years as shoddy government record keeping failed to properly register the property interest of NSW taxpayers. ...The Department of Public Works and Services estimated in 1996 that there was up to \$750 million in unrecorded assets. The property boom in NSW since would have pushed the land value well over \$1 billion'.*¹⁴

The ANAO's mission is to add value to public sector performance and improve accountability by encouraging a more efficient Commonwealth Public Sector through better practices in public administration. The ANAO suggests improvements to public administration and accountability largely through a program of performance

audits and Better Practice Guides. In undertaking performance audits ¹⁵ in the latter half of the 1990s, the ANAO found that there was very little specific policy or guidance for asset management. Our audit reports noted that State Government administrations were able to distinguish between providing high-level strategic asset management principles and guidance on specific asset management that is the responsibility of individual organisations. They also confirmed the advantages for central sponsorship of Strategic Asset Management within the Commonwealth sector consistent with the approach adopted by some States.

In line with our aim of improving public administration, by ensuring that better practices are promulgated to the whole of the public sector, the ANAO developed a *Better Practice Guide* and an *Asset Management Handbook* ¹⁶ in conjunction with our 1996 audit on Asset Management. The Better Practice Guide sets out the principles of asset management. A comprehensive Asset Management Handbook that provides practical advice and assistance to agencies complements this guide. The guide and handbook together continue to represent a key source of guidance for agencies' asset management practices. At this point it might be useful to restate the principles which are as follows:

- *asset management decisions are **integrated** with strategic planning;*
- *asset planning decisions are based on an evaluation of **alternatives** which consider the **'life-cycle'** costs, benefits and risk of ownership;*
- ***accountability** is established for asset condition, use and performance;*
- *disposal decisions are based on **analysis** of the methods which achieve the best available net return within a framework of fair trading; and*
- *an effective **control structure** is established for asset management.* ¹⁷

The Joint Committee of Public Accounts and Audit (JCPAA) in its 363rd Report observed that, if agencies are to meet the demands of the accrual-based framework, best practice principles for asset management need to be implemented.¹⁸ The Committee reinforced the value of the ANAO's Better Practice Guide by suggesting that:

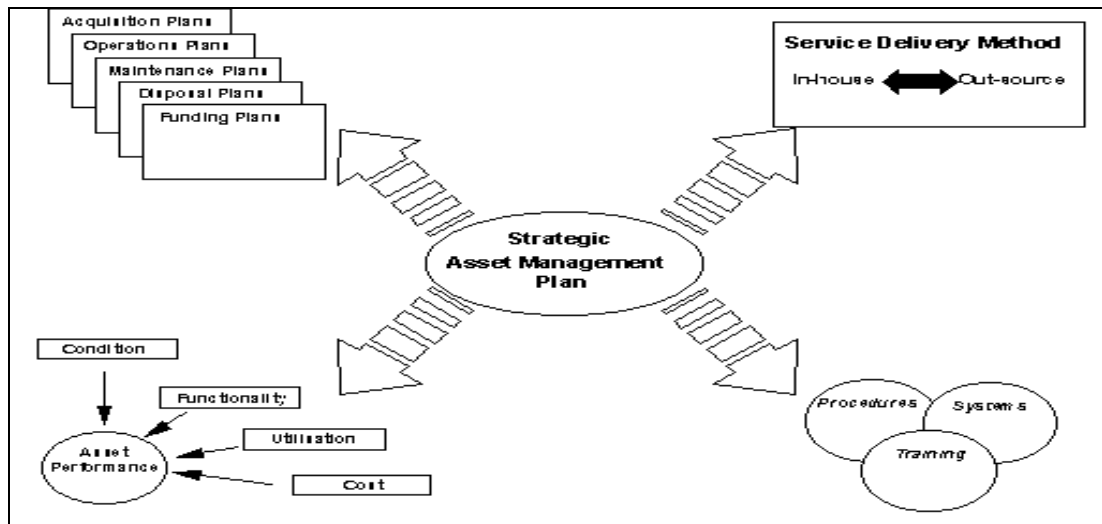
'Agencies should benchmark their asset management strategies and manuals against this document [Asset Management Handbook]' ¹⁹

The Report also included the telling observation that:

'Managing assets is a corporate activity. That is the most important thing I could say. It is not the role of the people who are physically managing assets; it is not the role of the bean counters. It has to have a corporate perspective and, if it does not ... what ever the organizations does it is probably not going to be fully effective' ²⁰

There is one specific issue, concerning fixed assets, which is presenting a particular challenge, that is, integrating asset planning into the strategic planning process using a ‘whole of life’ approach, particularly for those fixed assets with a long life. This is an important issue given that the corporate planning horizons for most Commonwealth agencies typically range from 3 to 5 years. The Handbook provides guidance on how to ensure assets are aligned with program delivery objectives and strategies. The elements of asset strategy are depicted in the following diagram.

DIAGRAM 1 – ELEMENTS OF AN ASSET STRATEGY



Source: Asset Management Handbook (page 28)

To demonstrate that more effort still needs to be devoted to proper asset management, I refer to a recent audit report ²¹ that highlighted the fact that asset management, particularly in relation to the maintenance of reliable asset registers, still continues to cause concern. The report found that previous concerns relating to:

- poor documentation relating to asset acquisition and disposals and such transactions not being recorded in a timely manner;
- assets on hand not being recorded on the asset register; and
- assets registers not being regularly reconciled to financial systems;

continue to be experienced in a number of agencies including: Defence; Treasury; Communications, Information Technology and the Arts; Veterans’ Affairs; and the Health Insurance Commission.

3. INTELLECTUAL PROPERTY

Intellectual property and government information represent major government assets and need to be managed in accordance with prudent commercial, financial and accounting practices. Hence the pro-active management of intellectual property (IP) in a more results oriented environment is becoming an increasingly important consideration for public sector agencies and other bodies in maintaining their capabilities to achieve required outputs and outcomes. The benefits of strategic IP

management have been well outlined in a recent article, which stresses the need for the approach to be part of an overall business strategy.²² The authors go on to note that:

*IP audits are not yet a commonplace management activity within business or government.*²³

They conclude with the observation that:

*A systematic approach to IP governance is integral to achieving..... success, and the logical starting point is the conduct of an IP audit*²⁴.

General obligations are imposed on Commonwealth agencies in relation to the management and control of public assets under the *Financial Management and Accountability (FMA) Act 1997*. In particular, the Act requires that chief executive officers manage their agencies in such a way that promotes the efficient, effective and ethical use of the resources for which the agency is responsible. These obligations extend to intellectual property assets which means we cannot afford to ignore addressing this issue as the APS has a considerable amount of intellectual assets and the capacity to turn these into valuable IP. This is particularly applicable to the highly developed and sophisticated information systems that exist in government departments that could, in some cases, be commercialised.

This potential has been recognised at the Federal level. The Prime Minister's 1997 statement '*Investing for Growth*'²⁵ made a commitment to developing guidelines to assist the information industry commercialise IP, particularly IP created under Government IT contracts. The "*Commonwealth IT IP Guidelines*"²⁶ issued in 2000 state that its objective is to "Maximise the benefits from Commonwealth Information Technology (IT) related Intellectual Property (IP) for the Australian Community as a whole"²⁷. The document aims to be a practical guide to improving the awareness of available options; to assist managers to identify IP issues early and accurately; and to balance ownership and licensing rights between agencies and the private sector. The guidelines are a step in the right direction, highlighting the importance of IP and providing guidance on this complex management issue.

It is recognised that public sector agencies seeking to capitalise on their intellectual property must do so within the APS legal and financial framework. The Commonwealth's Information Technology IP Guidelines provide a succinct statement on the issue:

*The Government's objective is to maximise the net national benefits from the development and ownership of IP as it requires. Careful consideration should be given on a case by case basis to the interests of all prospective beneficiaries including Australian industry, the commonwealth agency or agencies concerned and the taxpayer as reflected by the impact on consolidated revenue.*²⁸

IP developments within State government jurisdictions

As with the Australian Public Service (APS), the issue of managing intellectual property has been gaining increasing attention across State government jurisdictions. The following are some examples of state government initiatives.

Western Australia began addressing the subject in 1997 when it produced a series of IP policy documents and established a Government Intellectual Property Policy Council. The focus and the role of the Council has extended and developed and in 2000, the WA Cabinet approved the *Government Intellectual Property Policy 2000*²⁹. The Policy seeks to 'ensure the effective management of IP in the public sector and to support the use and commercialisation of public sector intellectual property for the benefit of the state'³⁰.

South Australia issued a policy relating to IP in Government software in 1996. The South Australian Auditor-General has taken a keen interest and has produced a series of annual reports dealing with IP-management issues with a specific focus on IT. The reports provide some very useful guidance on managing IP, particularly when involved in arrangements with third parties.³¹

The Audit Office of New South Wales conducted a performance audit in 2001 examining the management of intellectual property.³² The audit found that:

- some agencies do not understand what IP is and are not aware of IP assets under their control;
- most agencies do not maintain a register of their IP assets;
- many agencies do not have adequate policies and systems to manage IP;
- few agencies recognise or reward innovation leading to IP; and
- most agencies have not allocated adequate resources for management of IP³³.

The report made several recommendations to assist agencies manage IP more efficiently and effectively. This included recommending an integrated whole-of-government framework to help improve the management of IP. Namely, the framework should:

- establish a cross-agency task force to champion the implementation of the IP policy framework;
- integrate IP management with other management and whole-of-government policies including risk, information, procurement and human resource management;
- improve coordination among key agencies responsible for developing an integrated approach to IP;
- establish accountability for the development of whole-of-government guidelines to assist agencies manage IP;
- provide the public sector with a 'model IP policy' or IP guidelines to support the management of IP by agencies;

- clarify the mandate of agencies to commercialise IP;
- require each CEO to establish appropriate accountability arrangements for the management of IP;
- require each agency to develop policies to manage IP in accordance with the agency's major functions;
- require agencies to maintain a register of IP assets, and where appropriate, to account for those assets;
- ensure that legal and commercial IP expertise is readily available to help agencies manage IP; and
- establish systems to foster and encourage innovation across the public sector.³⁴

The NSW Audit Office also issued a better practice guide dealing with the management of IP³⁵. The guide draws on the audit report and contains a checklist to assist agencies develop policies and procedures to manage IP more efficiently and effectively.

Whilst the level of detail and comprehensiveness of policy documents vary across the states, there are some underlying principles that are common to the majority of these policies, including:

- public authorities should exercise due care and diligence in the management of IP assets owned or used. This includes taking appropriate steps to identify, secure, maintain and preserve IP;
- public authorities should endeavour to commercialise IP, but only if it doesn't interfere significantly with their operational activities;
- commercialisation should be no more than an ancillary activity of the public authority and not become part of their core business;
- public authorities should take a risk-based approach to IP management particularly in relation to commercialisation where the public authority should not be exposed to unnecessary or disproportionate risk; and
- given the complexities associated with IP assets, assistance should be sought from experts particularly when considering commercialisation.

As an end comment - the efficient and effective agency management of IP has the potential to maximise the benefits to the Commonwealth or as a commentator for the Canberra Times observed earlier this year:

*'... [an] agency should establish a clear policy direction for its staff outlining how IP fits into the overall fabric of the organization, how the agency is expected to address ownership of IP, the need for disclosure of IP, its approach to protection of IP and enforcement strategies. These will assist managers to properly allocate resources to manage IP to the degree that fits the overall risk profile of the agency'*³⁶

4. PRIVATE FINANCING INITIATIVES (PFI)

Increasingly, governments here and overseas have been exploring the potential benefits that can flow from private sector involvement with the delivery of government outcomes. As the UK Prime Minister has said:

*'most people don't care who builds and services public projects, so long as they're on cost, on budget and helping to deliver a better NHS and schools'*³⁷

Private financing represents a form of government procurement involving the use of private sector capital to fund an asset (to deliver program outcomes) that would otherwise have been purchased directly by the Commonwealth. Private financing is generally an option to be considered for major asset and infrastructure procurements recognising it can provide significant benefits to the public sector by way of specialist expertise, innovation, and the opportunity to transfer risk to those better able to manage it.

The Department of Finance and Administration has published principles for using private financing³⁸ and, in addition, established a Private Financing Branch to assist agencies considering private financing proposals.

The Commonwealth has yet to undertake a major procurement using private financing. However, the proposed joint operational Headquarters Australian Theatre (HQAST) for Defence is being examined as a possible private financing initiative. I understand that a recommendation will be going to Cabinet in the near future.³⁹ Private financing was seriously considered for an earlier Defence project when, in announcing the tender for the Patrol Boat Project in July 2001, the then Minister for Defence stated that the Government was keen to pursue the project under private financing arrangements, but that the Government must be satisfied it would receive the best outcome for the investment of taxpayer dollars.⁴⁰ However, in announcing the shortlist for the tender in June 2002, the current Minister for Defence stated that:

*'After evaluating two possible procurement options, the Government has decided to directly purchase the boats. The use of private financing to deliver the boats and associated through-life support was also considered. However, advice provided to the Government indicated that there was uncertainty about whether the requisite capability could be provided on a value for money basis while also ensuring that the transaction would be classified as an operating lease for accounting purposes'*⁴¹

The assessment of the procurement method for the Navy's patrol boat project pointed up accounting and taxation barriers to the use of private financing in Commonwealth procurement.⁴² These barriers include the lack of an Australian Standard that specifically deals with the accounting treatment of private financing and give rise to uncertainty as to whether private financing schemes should appear on, or off, the balance sheet. The only jurisdiction we know of that has developed detailed guidance on how to account for the complex risk allocations that arise under private financing

arrangements is the UK, which has made extensive use of such arrangements for the provision of public infrastructure and services.

Application Note F to UK Accounting Standard Financial Reporting Standard FRS5 'Reporting the Substance of Transaction: Private Financing Initiative and Similar Contracts' was issued in response to a range of concerns about the reporting of private finance initiative arrangements. These UK government guidelines (FRS5) allow for private financing transactions to be excluded from government borrowings on the grounds that they involve sufficient risk transfer to warrant the project being viewed as 'off balance sheet'.⁴³ Any deficiencies or inadequacies in this respect have obvious transparency limitations.

The Australian Standards Board, with representatives from Treasury, has established a working group to determine how these PFI projects should be treated in the government accounts. A Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) public-private partnership sub-committee has recently recommended that a standard similar to the UK's FRS5 be adopted for PFI and similar arrangements in Australia.⁴⁴

Currently there is no specific Australian Accounting Standard which deals with risk allocation issues associated with private financing. However, as transactions involving the delivery of infrastructure can have the characteristics of a lease agreement, governments have utilised Australian Accounting Standard 17 *Accounting for Leases* (AAS17) in accounting for PFI-type transactions. Hence, AAS17 (leases) is relied upon to categorise PFI arrangements requiring that leasing-type arrangements be classified as either operating or finance leases, with the degree to which ownership risk is transferred between the lessor and lessee being the critical variable.

However as Australian Accounting Standard 17 is not designed for this purpose it can lead to PF leases being characterised as finance leases (recognised on the lessee's balance sheet) rather than operating leases (which are treated as an expense) despite significant risk being transferred to the private sector. This is a disincentive to both the private and public sector to use private financing initiatives.⁴⁵ In this regard, it has been said that:

*'Critics of PPPs [private funding initiatives] claim that governments can use PPPs to understate debt by not recording in the balance sheet the total value of payments payable to the private sector providers, that is, PPP obligations are 'off balance sheet'.*⁴⁶

An alternative view is that the underlying rationale for PFI is not the achievement of off-balance sheet borrowing, but rather that they offer value for money. For example, the NSW Treasury has said in respect to the recently released NSW and Victorian policies on PFI:

...the policies require that privately financed options demonstrate superior value-for-money to the Government and community compared to conventional, publicly funded approaches to infrastructure provision. This is the sole reason for considering private financing and delivery – with both States having low debt

*levels, off-balance sheet borrowing is not an attraction in its own right.*⁴⁷

The South Australian guidelines on PFI note that, while the accounting standards attempt to create a clear distinction between operating and finance leases, for evaluation purposes most service contracts with the private sector under consideration by agencies will fall somewhere between the strict definitions of operating and finance leases. In this regard, the guidelines advise that:

*Agencies should keep in mind that there is a fundamental tension between meeting the requirements of [Australian Accounting Standard 17 Accounting for Leases (AAS17)] for operating leases and achieving value for money. The fundamental objective of the partnerships procurement process is to achieve an efficient allocation of risk, not simply to transfer as much risk as possible in order to achieve an operating lease classification.*⁴⁸

It is worth noting that attempting to transfer inappropriate risk to the private sector will add unnecessary cost to a PFI agreement, thereby undermining value for money in determining the best procurement method. A recent article in *The Public Sector Informant*⁴⁹ examined some generic lessons to be learnt from the Australian and UK experience with PF initiatives and public/private partnerships. The allocation of risk was a key feature - we await with interest the HQAST decision referred to earlier.

5. THE AUDIT MANDATE

Performance audits are the main vehicle by which my Office evaluates the economy, efficiency and effectiveness of the management of public sector entities. This entails: the examination and assessment of resource use; related information systems; outputs and outcomes, including performance targets, indicators, assessments and measures; monitoring systems; and legal compliance. There are three fundamental principles that underpin public audit, namely:

- *the independence of public sector auditors from the organisations being audited;*
- *the wide scope of public audit that is covering the audit of financial statements, legislatively (or legality), propriety (or probity) and value for money; and*
- *the ability of public auditors to make the results of these audits available to the public, and to democratically elected representatives.*⁵⁰

While the ANAO's performance audits can, and do, evaluate how effectively and efficiently government policy has been implemented, there can be at times a perception of an audit commenting on policy, particularly where the implementation performance reflects a problem with the policy itself rather than with its delivery.

One particular challenge in the current environment is the increasing tension regarding the role of Auditors-General and the boundaries between government policy and its implementation. The issue was given some prominence following the

publication of two performance audits my Office undertook in the past two years - property sales and IT Outsourcing.⁵¹ The nub of the issue is summed up by Professor Richard Mulgan:

'The principles of performance auditing allow the Auditor-General to assess whether government policy has been efficiently and effectively implemented but they require him to take government policy as given. Had the Auditor General crossed the line [in these two audits] which bars him from questioning government policy? Certainly the Opposition treated the report as providing ammunition not only against [the Department of] Finance but also against the Minister and government policy. On the other hand, the Auditor General was clearly aware of the potential difficulty and his report takes care to confine the audit to claim that his audit was confined to implementation and administration. Criticism is aimed exclusively at Finance and the substance of its advice to government'...

and

'On the whole, public opinion, as expressed in media comment, seems to side with the Auditor-General. He was exercising his time-honoured role as investigator of government inefficiency and guardian of the public purse. Pointing out that public funds would be wasted by a particular method chosen for selling governments properties could hardly be beyond the purview of the public's financial watchdog'.⁵²

I responded to Professor Mulgan's article, making the point that:

'Policy advising is an output of Finance and it is clearly within the mandate of the Auditor-General to review how effectively the department delivered its output. That the government subsequently may have endorsed a policy based on such advice does not take away from the mandate of the Auditor-General to review the department's development of the advice nor its possible implications'.⁵³

Clearly, it is Ministers (politicians) not public servants who take responsibility for policy and it is for this reason that performance audits are restricted to the efficiency, effectiveness and propriety with which policy is implemented. As I noted earlier, they are not extended to cover the merits of the policy itself. However, problems can arise where policy is difficult to separate from implementation, for example as in the subject matter of the above comments:

'What was the policy in this case [that is, property sales] ? To maximise long-term benefit to the Commonwealth by selling buildings only where it is profitable to do so? In this case, the Auditor General, had every right to indicate where financial losses were likely. Such losses would indicate that the policy was badly implemented. Alternatively, the policy may have been to divest the

government of a large number of buildings within a stated time, even if the long-term effects on the Commonwealth were doubtful...In this case, the Auditor-General could be seen to be on more dangerous grounds in questioning the criteria for putting buildings on the market or suggesting that prospective sales should have been reconsidered if the price was inadequate'.⁵⁴

One 'positive' to come out of this tension is the recognition that government policy objectives need to be stated in less ambiguous terms with the lines between policy and implementation made reasonably clear.

'Performance audit assumes a clear distinction between policy objectives (set by elected governments) and policy implementation (carried out by servants or contractors). Auditors are assumed to leave the objectives to government and confine themselves to the efficiency, effectiveness and probity with which these objectives have been implemented'.⁵⁵

That said, the performance audit mandate has become an essential element in the accountability process of any public jurisdiction, especially the new public management environment. It is not a static process and there will be a continuing emphasis on improving the service to Parliament. Conflict and controversy may be inevitable. However, as one senior Australian bureaucrat remarked:

The bulk of performance audits are good at working out what is happening in a field, giving a useful report on it and striking an appropriate balance in not dabbling in policy and seriously discussing how implementation is going.⁵⁶

With that observation, I will now move on to the issues arising out of our audit reports.

6. RELEVANT AUDIT FINDINGS AND OBSERVATIONS

The Commonwealth has substantially changed its management of property, moving away from a centralised, highly regulated approach. The main effects have included the sale of significant portions of the Commonwealth estate, the devolution to agencies of responsibility for property management and leasing and the outsourcing of property management functions.

The importance of good management of the Commonwealth's real property and its property leases is indicated by the total capital value of the portfolio and by the magnitude of impact of the Commonwealth's activities in the office rental market. In total, at June 2002 Commonwealth agencies and authorities were responsible for the management of Commonwealth land and buildings valued at nearly \$19 billion, returning net rental revenue in excess of \$250 million.⁵⁷ Agencies were also responsible for payments of rent and outgoings under commercial leases in the order of \$500 million. Importantly, the Government's decision that the Commonwealth should own property only where the long term yield rate exceeded the social

opportunity cost of capital (or where it was otherwise in the public interest to do so) led to Finance conducting sales of Commonwealth property returning sales revenue of \$1.4 billion during the period July 1997 to June 2002.

Commonwealth Property Requirements and Guidelines

Generally speaking, the legislative and administrative framework currently governing Commonwealth property management has four main components:

- The *Land Acquisitions Act 1989* requires authorisation, by a delegate, of acquisitions and disposals of interests in land, *including* leases.
- The *Financial Management and Accountability Act 1997* (the FMA Act) and regulations provide agency chief executives with autonomy in their financial management. The FMA Act requires all chief executives to promote the effective, efficient and ethical use of Commonwealth resources for which they are responsible. In addition, before a lease is signed, a suitably authorised officer must approve the proposal to spend public money (consisting of the rent and other amounts payable under the lease) in accordance with the FMA Regulations.
- The *Commonwealth Procurement Guidelines* (CPGs) set out the Commonwealth's purchasing policy, and the Guidelines specifically apply to operating leases on real property. The FMA Regulations require that an official performing duties in relation to the procurement of property and services must have regard to the CPGs, and must make written records of any actions that are not consistent with the Guidelines and reasons for doing so. The Guidelines do not prescribe the procurement method but set out the core procurement policies of value for money; open and effective competition; ethics and fair dealing; accountability and reporting.
- Finally, the Commonwealth Property Principles (CPPs) promote the Commonwealth's ownership of property in only exceptional circumstances. The Principles state that the costs of property use (whether owned or leased, domestic or overseas) should be fully reported by the using agency or program, to encourage efficient, effective and transparent decision-making and accountability. The Principles also state that the Commonwealth should own property only where the long-term yield exceeds the social opportunity cost of capital, or where it is otherwise in the public interest to do so. Public interest considerations include circumstances where the property has national security requirements or strategic significance to future government use.

In addition to these general requirements, legislation may also place particular obligations on agencies in respect of their management of property as, for instance, in the case of the enabling legislation of the Defence Housing Authority.

In general, the current legal and administrative framework places responsibility for managing the Commonwealth's land, its buildings and its property leases with agencies, with key responsibilities allocated to particular agencies. From November 2001, the Department of Foreign Affairs and Trade has been responsible

for managing the Commonwealth's overseas properties, including embassies and official residences. It does so mainly through a contract with PricewaterhouseCooper Process Solutions.

Domestically, the Department of Defence is responsible for managing the land and buildings it uses across Australia and has engaged a private sector firm to manage its property leases. The Defence Housing Authority has separate statutory responsibility for managing residential properties for Defence personnel. From November 2001, the Department of Finance has been responsible for the management of the remainder of the Commonwealth's domestic non-defence property portfolio. Finance does so primarily through a contract with PricewaterhouseCooper Process Solutions. Finally, individual agencies are responsible for managing land, buildings and leases of property in support of their own operations.

Audit Observations

Significant aspects of agencies' responsibilities for property and property management have been the subject of recent performance audits, specifically: the audits of:

- *Defence Housing and Relocation Services – No 51 of 2002-2003;*
- *Defence Property Management – No. 58 of 2001-2002;*
- *Commonwealth Management of Leased Office Property – No. 53 of 2000-2001;*
- *Commonwealth Estate Property Sales – No. 4 of 2001-2002; and*
- *Property Management – Currently being undertaken.*

The general theme which emerges from the audits to date is that while agencies have taken up the challenge of better managing property, there is still some way to go in fully addressing the CPPs and CPGs, notably in respect of improving asset accounting and reporting; improving the management of property leases, both as landlord and as tenant; and in assessing whole-of-life costs, particularly in respect of sale and lease-back arrangements. It is worthwhile briefly illustrating these themes with some recent findings.

Defence Housing and Relocation Services

At June 2002, Defence and DHA were managing \$12 billion dollars worth of land and buildings returning almost \$84 million in net rental revenue. Nearly \$78 million of the net rental revenue was in respect of housing managed by the Defence Housing Authority for Defence Force personnel.⁵⁸ The recent audit of *Defence Housing and Relocation Services*⁵⁹ observed that the Services Agreement did not meet the responsible Ministers' requirements that it must be a properly constructed commercial contract, reflecting in an unambiguous manner the risks and obligations of each party.

Before Defence signed the Agreement, its legal advisers expressed strong reservations advising that the Agreement would not meet Defence's objective of putting arrangements with DHA on a more commercial footing thus significantly limiting the advantages Defence could otherwise obtain from a commercial arrangement and leaving Defence with an unsatisfactory level of risk. The risk-sharing concepts lacked clear responsibility; raised potentially serious risks to

Defence's interests on issues such as performance quality and budgetary control, and additionally, lacked normal terms about failure to perform, the right to withhold money payable, record-keeping and audit requirements.⁶⁰

These aspects of the legal advice were not included in the summary of the advice that Defence provided to the Ministers who endorsed the Agreement, and to the Secretary and the Chief of the Defence Force, who signed it. A factor in Defence's acceptance of the Agreement was its view that DHA was part of the same Department whereas DHA is, in fact, a statutory corporation at arm's length from the Department and with its own statutory obligations.⁶¹

The ANAO considers that it would have been preferable had Defence done more to meet the Ministers' request for a properly constructed commercial contract and to act on legal advice that the Agreement would not adequately protect Defence's interests. The Ministers and the Defence heads should have been informed of the extent of the legal advice before they were asked to endorse and sign the Agreement. Defence needs to appreciate that DHA is not part of the Department, but a GBE that provides housing services on a commercial basis and as an entirely separate and independent entity.⁶²

The audit findings underline the need for Defence to endeavour to manage the arrangements strategically and ensure that services both meet requirements and provide value for money. Additionally, Defence should also seek to implement the Service Agreement's provisions for programs of continuous improvement and cost control, which, although not clearly expressed, offer the prospect of better value for money for the taxpayer.⁶³

A second agreement - the Relocations Services Agreement - for other DHA housing services, signed in 2002 was more satisfactory than the 2000 Services Agreement but involved far less monetary value.⁶⁴

This audit received moderate media coverage including the following comment:

*'The Auditor-General has criticised the department for ignoring the ministers' instructions that the agreement should be a properly constructed commercial contract, reflecting ..the risks and obligations of each party. This failure had cost the considerable funds, including \$20 million for dead rent in 2001-02, a problem that was supposed to be fixed under the agreement'.*⁶⁵

Defence Property Management

In respect of other Defence property, this audit examined the management of the land buildings and infrastructure that Defence uses across Australia, apart from that managed by DHA to accommodate Defence personnel. To support its primary outcome, Defence is responsible for some three million hectares of land, 360 separate owned properties and numerous property leases. Much of this property portfolio is used exclusively for defence purposes, though some is leased to certain service providers and others. Such a diverse portfolio poses particular challenges and, at the time of the audit in June 2002⁶⁶, ANAO found that Defence had yet to fully address

the *Commonwealth Property Principles*, particularly in relation to assessing the long-term yield, or public interest consideration, of Defence's properties; and in respect of fully disclosing the costs.

The audit found that Defence's management of its property would benefit from a more structured approach. In particular, there were opportunities to improve property information and management information; to formalise customer service agreements with Defence business units; to improve procedural and policy guidance to Defence staff responsible for property management; and to improve the management of outsourced contracts for the management of leases. At the time of the audit, Defence was in the process of implementing an improved asset management and reporting framework, intended to be substantially integrated into its financial planning and reporting by June 2003.

Commonwealth Management of Leased Office Property

The devolution of greater financial management responsibilities to agencies under the *Financial Management and Accountability Act* and the issuing of the *Commonwealth Property Principles* has effectively devolved to agencies responsibility for their own property lease management. At June 2001, the Commonwealth was estimated to occupy up to 10 per cent of available leased office space in metropolitan Australia, and may well be the largest single occupier of leased office accommodation nationally. In 1999-2000, the cost to the Commonwealth was in excess of \$485 million in rent and outgoings.

The audit of *Commonwealth Management of Leased Office Property*⁶⁷ found that the effectiveness of agencies' management of their leasehold property varied. While some were effectively managing their property and leases, there were opportunities for agencies to improve: their strategic property and business continuity planning; the procurement and management of outsourced property managers; and the terms of leases. The ANAO found that in addition to the more than \$474 million spent during 1999-2000 by respondent agencies on rent and outgoings, such as cleaning and maintenance costs, agencies also allocated in excess of \$11 million to managing their property portfolios. This was spent on services provided both in-house and by outsourced property management service providers.

In particular, the audit found that many agencies were paying above benchmark rentals, that many might be renting space in excess of their needs and that most leases included *ratchet* clauses, effectively preventing rents from falling during the term of a lease. The audit found that ratchet clauses applied to all reviewed properties previously owned by the Commonwealth and then leased back after sale.

Commonwealth Estate Property Sales

In the 1996-97 Budget context, the Government took a number of decisions which significantly affected the management of Commonwealth owned and leased property. A set of Commonwealth Property Principles (CPPs) was endorsed by the Government in July 1996, setting the framework for decisions to retain or dispose of Commonwealth property. Finance's subsequent sales of property from the Commonwealth's *Commercial Office* and *Special Purpose and Industrial Estates*

during the period 1997-1998 to 1999-2000 were in accord with the principle that the Commonwealth should own property only where the long term yield rate exceeded the social opportunity cost of capital (or where it was otherwise in the public interest to do so).

The audit of *Commonwealth Estate Property Sales*⁶⁸ found that the gross sale revenues of properties from the *Commercial Office Estate* of \$983 million to April 2001 exceeded revenue targets by \$130 million. However, the audit also found that Finance's divestment strategy was mainly predicated on a hurdle rate of return of 15 per cent. The practical effect of adopting a rate which exceeded the prevailing normal commercial yields was that, in respect of deciding whether to retain or divest property, it would be unusual to find a Commonwealth property achieving such a yield and, consequently, unusual for the Commonwealth to continue to own such property. Financially, setting such a high hurdle rate increased the likelihood of the sales delivering the Commonwealth a less than optimal result, especially as ANAO found that the initial decision to divest was not reviewed in the light of later decreases in the estimated price that certain of the properties might fetch at sale. By comparison, the rates of return on investment achieved by Finance on its property assets were 11.2 per cent in 2000-2001 and 5.5 per cent in 2001-2002.

The audit also found that, for a number of important properties, the whole-of-lease-term costs for the sale and long-term leaseback could result in a potential negative financial return to the Commonwealth within the lease period. For instance, the Australian Geological Survey Organisation property (sold for \$152.4 million) and RG Casey Building (sold for \$217.3 million) were both estimated to reach a possible financial break-even point in Year 11 of their lease term and Discovery House (sold for \$30.5 million) in Year 8, after which the Commonwealth could be paying more in rent than it could receive if it invested the sale proceeds at the Commonwealth Treasury Bond rate. While Finance did not agree with the recommendations arising from that audit, updated CPPs were subsequently issued in May 2002, including a revised hurdle rate of 11.2 per cent.

While the ANAO's report on *Commonwealth Estate Property Sales* has been a significant contributor to the asset sales debate and is often quoted, I must stress again that my role and mandate is confined to reporting on policy advising and implementation by agencies not on the policy itself.

Property Management

The ANAO is currently undertaking a Business Support Process Audit titled '*Property Management*'. The objective of this audit - which is concentrating on those property holdings or part of holdings (owned, controlled or leased) used primarily as office accommodation - is to assess whether the property management function, including the management of leases, is performed efficiently, provides an effective level of support for the delivery of the organisation's services (outputs) and delivers value for money. The audit is evaluating property management policies and practices across the following dimensions:

- framework and planning;
- information and performance management; and

- business processes and practices

Within each of these areas, a series of evaluation criteria have been developed by the ANAO, using material gathered from our research in various Australian public sector jurisdictions and from international sources. The evaluation criteria are as follows:

Framework and planning

- *Strategic planning* - the direction of the Property Management function is driven by a strategic planning process demonstrating a clear relationship to the organisation's Corporate Plan (or equivalent). The development of the strategic plan is fully informed by risk management processes and a program to monitor if property is being effectively utilised and meeting the needs of the organisation.
- *Operational planning* - the strategic plan is underpinned by a structured and fully integrated operational planning process, which directs the management and delivery of individual property management functions on a day-to-day basis.
- *Policy and procedures* - policy and procedural documentation, which provide clear linkages between operational responsibilities and the approved property management strategies and objectives has been developed and is readily available to all staff.
- *Accountability and responsibility* - roles, responsibilities and accountabilities are clearly defined and understood throughout the organisation, and staff has access to tools to enable them to meet their responsibilities and accountabilities.

Information and performance management

- *Property Management Information* - the organisation maintains information on its property portfolio and its property-operating activities in a manner which is readily accessible, easy to use and assists decision-making. Alternatively, the organisation obtains from external service providers information useful to assist it in the delivery of property management functions.
- *Performance measurement and reporting* - performance against targets and plans is regularly measured and reported to those staff with property management responsibilities and to senior management.
- *Benchmarking* - the organisation has developed and periodically measures its performance against a series of performance benchmarks or periodically benchmarks its procedures and practices against other organisations.

Business processes and practices

- *Financial management* - budgets are prepared and approved for property management activity and all outlays are managed and approved in accordance with the organisation's and the Commonwealth's financial management requirements.
- *Lease management* - organisations are familiar with their responsibilities under property leases (as a tenant and where relevant, as a landlord) and do not unnecessarily assume those responsibilities or costs which relate to the duties of the other party. Where an organisation has undertaken work that relates to the duties or responsibility of the other party, then appropriate compensation is provided.
- *Contract management* - the organisation actively manages the provision of services by contracted service providers and has processes to ensure that contractual terms and conditions are clearly defined and understood. It also ensures that services are delivered in accordance with contractual requirements or service level agreements to an acceptable level of performance.
- *Repairs and maintenance (R&M)* - R&M activity is clearly aligned to the achievement of strategic objectives, is undertaken in accordance with a predefined plan and its continued effectiveness is actively monitored.
- *Cleaning* - cleaning activities are clearly aligned with approved strategies and compliance with approved performance standards is actively monitored. Cleaning activities should be based on a mix of recurring and periodic tasks.
- *Health and Safety* - policies and procedures associated with the creation of a safe and healthy workplace and the management of associated health and safety issues are closely integrated with property management functions.

Audit fieldwork has been undertaken in five organisations with the audit report scheduled to be tabled in the Parliament in December 2003. While I cannot give an advance notice of the audit findings, I have included comment on this 'audit in progress' to give an indication of the comprehensive criteria against which the ANAO evaluates property management. In addition, they provide a useful template for property managers to follow.

7. CONCLUDING REMARKS

The management of the Commonwealth's sizable assets and property presents real challenges with property managers being accountable for achieving results and supporting the delivery of agency programs, clearly:

*'The asset management strategy is not simply a summation of the individual plans developed for each phase of the asset life cycle. It must be consistent with corporate objectives and integrated with other management strategies'.*⁶⁹

The principles of asset management apply equally to all assets including intellectual property and the critical issue for management is translating these principles into management action. I would like to emphasise again the importance of the principles and behaviours that underpin better practice in asset and property management. These are:

1. *asset management decisions are integrated with strategic planning;*
2. *asset planning decisions are based on an evaluation of alternatives which consider the 'life-cycle' costs, benefits and risk of ownership;*
3. *accountability is established for asset condition, use and performance;*
4. *disposal decisions are based on analysis of the methods which achieve the best available net return within a framework of fair trading; and*
5. *an effective control structure is established for asset management.*⁷⁰

Because of the changing business environment we face in the public sector, managers need access to better practice, leadership and guidance to ensure that their own business strategies are effectively determined and put in place. The ANAO's statutory independence, as well as our expertise and experience across all Commonwealth departments and agencies, provides us with a unique position within the accountability framework to publish guidance on better practice. It is crucial, therefore, that we continue the assurance and advisory roles for which we are well known and respected, with the assistance of agencies and our colleagues in other jurisdictions. We recognise the importance of being active in providing guidance to agencies on selected areas of government administration that are highlighted during our performance audits – asset and property management is but one example. I also draw your attention to the Queensland Audit Office's Better Practice Guidelines for Non-Current Assets issued in March 2003.⁷¹

To conclude, Dr Shergold⁷² recently made the observation that two of the capabilities the APS requires in facing the major challenges ahead are:

- ***re-embracing management*** – he spoke of project, contract, records, financial, relationship and performance management, to which I add, asset management; and
- ***a bias for action*** – finding solutions, not just identifying problems; doing, not just knowing; and acting, not just analysing.

These observations struck a chord with me and underpin the purpose of this Occasional Paper, which I hope will create some discussion and consideration by agency management, particularly in the context of our current related audits and planned Better Practice Guide on Asset Management.

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