

REPORT OF PROCEEDINGS BEFORE

PUBLIC ACCOUNTS COMMITTEE

**INQUIRY INTO STATE FORESTS' PRACTICE OF
TRADING WITH CUSTOMERS WHO HAVE DEFAULTED ON
RENEGOTIATED REPAYMENT TERMS**

INQUIRY INTO THE FIRST HOME OWNER GRANT SCHEME

INQUIRY INTO THE MORTGAGE LOAN INVESTMENT SCHEME

At Sydney on Thursday, 24 October 2002

The Committee met at 9.30 a.m.

PRESENT

Mr J. G. Tripodi (Chair)

The Hon. Pam Allan

Mr B. J. Collier

Mr I. D. Glachan

Ms K. A. Hodgkinson

ANTHONY THOMAS WHITFIELD, Deputy Auditor-General, Audit Office of New South Wales, Level 11, 234 Sussex Street, Sydney;

JACK KHEIR, Director of Audit, Audit Office of New South Wales, Level 11, 234 Sussex Street, Sydney, and

SIVARAJAH JEYAPALAN, Audit Manager, Audit Office of New South Wales, 234 Sussex Street, Sydney, sworn and examined:

CHAIR: As you are aware, this morning's inquiry is into State Forests' practice of trading with customers who have defaulted on renegotiated payment terms, a follow-up of your report tabled in Parliament. We would like to spend most of our time focusing on State Forests' response to the audit report, so we would ask if you could be as brief as possible because we have had a lot of consultation. We will ask our questions to you generally and whoever is thought to be more appropriate may answer.

Are the practices adopted by State Forests, in the case of the two customers mentioned in your report to Parliament, unusual within Government trading enterprises? Have you seen these practices applied in other agencies?

Mr WHITFIELD: Yes, in our view they are unusual. We have not seen it practised in other agencies to any degree.

CHAIR: To the best of your knowledge, have these practices been applied to other customers within State Forests and, if so, were they successful in the recovery of any overdue balances?

Mr WHITFIELD: Yes, Chairman, they were applied to other customers, those ones being Fenning Timbers, Prime Pine, Penrose Pine Products and A A Summers. In the case of Prime Pine it appears to have been fully settled by September 2002. Maybe Mr Kheir or Mr Jeyapalan could comment on Penrose Pine and Summers.

Mr JEYAPALAN: I will comment on Penrose Pine--

CHAIR: One thing I failed to mention earlier: We do not want to cause any financial consequences for these firms, so we might keep it anonymous in terms of the firms. Obviously we do not want to cause any commercial disadvantage. The issue is more about the general practice. I am sorry for not explaining that earlier.

Mr COLLIER: What were your specific concerns about these trading practices and what risks, if any, did they create for the agency?

Mr WHITFIELD: Well, the specific concerns related to the fact that they were continuing to trade with these agencies allowing them to keep their debt going, not charging interest, so that it could appear that they were giving those customers a commercial advantage over other customers. In fact they were acting as a pseudo-banker for those particular customers. The risk that has come to bear is that ultimately a number of those debts had to be written off and not recovered.

Mr COLLIER: So you had a pseudo-banker not charging interest?

Mr WHITFIELD: Well, basically that is what was happening: You are trading with someone, they are in default, you are not charging them interest, they are using your money to continue their operation and there is a higher risk of being repaid.

Ms HODGKINSON: Do you believe that the environment in which State Forests operates justifies the use of these practices in certain circumstances?

Mr WHITFIELD: Could you clarify what you mean by "the environment"?

CHAIR: The financial environment.

Mr WHITFIELD: I would not like to express an opinion as to whether those particular trading terms are justifiable or not. That is a management and a policy decision, as I see it.

CHAIR: You said that the effect of what they were doing was to be a financier to the firms involved, but it would be fair to say that that is not the purpose of the credit. The purpose of the credit was primarily to allow them to continue trading.

Mr WHITFIELD: That is true.

CHAIR: And it does confer a financial advantage in consequence of that.

Mr WHITFIELD: That is correct.

CHAIR: But that is not the purpose of the credit.

Mr WHITFIELD: No, but a consequence of it.

Mr GLACHAN: The purpose of it is so that you do not lose a customer?

Mr WHITFIELD: Well, that is presumably the reason, yes.

Mr GLACHAN: And you know it is normal business practice.

Mr WHITFIELD: Yes, but you would need to still adhere to credit limits and other prudent commercial practice.

Mr GLACHAN: Subsequently how many of these companies did not pay and the debt was written off?

Mr KHEIR: One of the companies defaulted and I think their debt was extinguished to the value of \$1 million and the other one has racked up about \$6 million in debt. When we reported in 2001 the debt at 30 June had been about \$3.8 million and we advised State Forests that we thought that the terms that they had negotiated with this customer to repay the debt and to continue trading posed a risk to State Forests of losing that money altogether. However, a business decision was taken to keep trading with them and, as it turned out, the debt escalated to about \$6 million and that company is now in receivership.

Mr GLACHAN: And they will not get the \$6 million; it is done.

Mr KHEIR: We do not know at this stage whether they will or not, but they are, I suppose, working on it. The problem has been with the exceeding of credit limits and, in effect, propping up some of these customers has been a wish of State Forests itself, but that is a management decision.

Mr GLACHAN: Do you believe that State Forests has responsibilities to other businesses and the community that may justify such trading practices?

Mr WHITFIELD: Well, again, that is a question that I do not think is up to us to answer.

CHAIR: You would be familiar with their charter of operation, what their purpose of existence is. Are you aware of any policy objectives, for example, assisting local communities?

Mr WHITFIELD: I personally am not.

Mr KHEIR: I do not know that they are in the business of supporting local businesses, as it

were. My understanding is that they are in the business of cultivating and harvesting trees--

CHAIR: Commercial operation.

Mr KHEIR: Commercial operations.

Mr GLACHAN: So what you are saying is that, if there is a mill in a town and that is the sole employer in the district, it is not State Forests' responsibility to ensure that that mill continues to work even if it cannot trade satisfactorily?

Mr KHEIR: I would not have thought so under its commercial obligations.

CHAIR: With log allocations to customers, can they be valued in dollar terms, I suppose as goodwill, and are they transferable? Is there a market value? Can the allocation be transferred?

Mr WHITFIELD: My understanding is that when the log allocations are made there is no consideration received by State Forests for such an allocation. I am not aware that allocations are traded as a marketable commodity.

CHAIR: But they have value?

Mr WHITFIELD: Well, yes, they would have a value certainly. They could be capable of being traded if there was a policy to trade them.

Mr COLLIER: Do you know anything about calculating those values?

Mr WHITFIELD: Well, I would think that you would get someone who was a forestry expert to value the worth of those to a miller in carrying out his business.

Ms HODGKINSON: Are those values recorded anywhere in the financial statements or in the annual reports? In the case of one of the customers in question, State Forests' submission says:

Subsequent to the Auditor-General's report being issued, State Forests has negotiated a reduction to the customer's long term log supply allocation. The value of the log allocation reduction was independently determined and an amount equivalent to this value was credited to the customer. The agreement volume resumed by State Forests remains available for allocation to another customer at State Forests' discretion.

Mr WHITFIELD: My understanding is that, as I said earlier, when the allocations are made, there is no consideration passing hands for those allocations.

CHAIR: That does not mean it has not got value.

Mr WHITFIELD: No, that is true. In the case of that particular customer, they were not charged for that allocation in the first place and we are not aware of any allocations being traded. That does not mean that State Forests could not start to trade those allocations.

Mr GLACHAN: But the allocation has got value, has it not?

Mr WHITFIELD: It would have value to the miller or another miller if he needed a supply of timber.

Mr GLACHAN: Yes, so State Forests could then take the value of that as an offset against the debt?

Mr WHITFIELD: Well, if they were going to trade it or sell it to someone else. If they were just going to allocate it to someone for no charge, I have difficulty seeing how you could reduce someone's debt by that value unless you were going to receive something in kind.

Mr GLACHAN: In other words, it would be a forgiveness of debt.

Mr WHITFIELD: That is correct, and just to answer the earlier question, are they recorded at value in State Forests' books, my understanding is that they are not.

CHAIR: They would not be an asset - well, they could be.

Mr WHITFIELD: They would only be an asset if you were trading them, I would suggest.

CHAIR: Could I say that just because you give away the right for nothing does not mean it does not have value once the right has been issued.

Mr WHITFIELD: Certainly.

CHAIR: So customers do have, even though they are not recording it on their books, goodwill associated with that allocation and it is a valuable asset which can be transferred and does exist and actually legally exists and could, in effect, theoretically be used to reduce the debt.

Mr KHEIR: I suppose what we are saying is that theoretically it could have a value and if State Forests decided that, from here on, any allocations of high quality logs shall be sold to the highest bidder, for example, definitely there would be a value associated with that miller getting the right to receive the high quality logs in the first instance, but we have not seen any valuation in the past being associated with someone getting that right to receive the logs under the 20 year supply agreements. They were entered into originally to guarantee the millers a supply of high quality saw logs over a period of time, a minimum requirement every year, but there has never been any physical value attached. Certainly there would be a value to the person receiving the right to receive the logs because that means someone else is not able to get them.

Mr GLACHAN: But a value to State Forests too because they are taking that allocation away from someone who cannot pay them and giving it to someone who can produce the logs and pay them.

Mr KHEIR: I cannot see that because, as I say, when someone is unable to pay, it is just a case of a commercial decision: Well, I cannot supply them because they are not going to be able to pay me, I will give it to someone else who can. That is a nebulous sort of a connotation for a value, I would say, Mr Glachan.

CHAIR: If you have a non-performing customer and you transfer that right to a performing customer, it would increase the value of that allocation?

Mr KHEIR: It would in the sense that I am going to be getting something for the logs that I have sitting there that I cannot supply to this customer, but in effect that customer who has defaulted on their payment, I have lost that money. I am going to be able to sell in the future and get revenue that I would have been getting from that customer, but that amount that has gone I see as gone, I am not going to get something from a new purchaser to recompense me for that.

CHAIR: Would you generally agree with State Forests' assertion that recovery of customers' outstanding debts can be secured by the value of the log allocation and State Forests' right to reassign that allocation, that some of that debt can be recovered by reassigning the allocation?

Mr KHEIR: I think I have already said that my view is that it is not really security over the debt. Once the debt is defaulted and is gone, State Forests is not going to get that money back from someone else purchasing that allocation. They are only going to be in another business relationship with another customer. I cannot see it as security against--

CHAIR: It is not security, but it has value to the existing customer?

Mr KHEIR: To the existing customer, yes.

Mr COLLIER: Are you satisfied that State Forests is now taking appropriate steps to recover the balances?

Mr KHEIR: Yes, I think they are taking all reasonable steps to try to recover the balances. Whether they end up doing so or not is another matter, but I think we feel that they have been taking all the steps they can.

Mr COLLIER: What steps have they been taking?

Mr JEYAPALAN: My understanding is that they are talking to the purchasers of two mills which were wound up, trying to recover some money from the new purchasers.

Mr COLLIER: But that is all it is: Talking.

Mr JEYAPALAN: Yes, basically. They are in the process of discussing that matter and State Forests is not happy to tell us more.

Mr GLACHAN: How are they going to get money from the new purchasers?

Mr WHITFIELD: I would suggest that you would need to ask State Forests that question.

Mr GLACHAN: I will, yes, because I think if you buy a business you do not take on the debts.

Mr COLLIER: But you say that they are taking reasonable and appropriate steps, and then you say: Ask them the question. As an independent person, do you say that what they are doing is reasonable?

Mr WHITFIELD: Well, my understanding is that that particular action has happened subsequent to our completing the last audit. We have not been back and done any audit work in respect of that. There is some commercial confidentiality, we understand, in relation to that transaction which we are not party to at this point in time. That is why I say it is better to refer the question to State Forests. In terms of normal debt collection procedures, we understand that they are applying their policies as laid out in terms of credit limits and the like, so we can answer in respect of that.

Mr KHEIR: And I suppose with the company that is in administration at the moment, Mr Collier, the negotiations, as I understand, taking place between State Forests and the administrator would seem to be what normal processes are about, but yes.

Ms HODGKINSON: Have you had the opportunity to look at State Forests' new credit policy? If so, are you satisfied that the new credit policy is likely to improve the collectability of customer balances, the time in which they are collected and reduce credit risk?

Mr JEYAPALAN: I can answer that question: The current credit policy was developed in 1998 and State Forests is still developing their new credit policy which is still not ready for our review.

Mr GLACHAN: Did they comply with their previous credit policy? Did they stick to that?

Mr JEYAPALAN: They did, but there were instances where they did not and we reported that to management in last year's management letter and also reported in the statutory audit report to the Minister and the commissioner.

Mr COLLIER: From analysis of the State Forests 2000-01 annual report, cash and financial assets fell \$8 million between 30 June 2000 and 30 June 2001 despite the receipt of \$17.8 million in advance. Did the decision to continue trading with the two customers in question contribute around \$6 million to this deteriorating cash situation?

Mr WHITFIELD: My answer to that would be, given that the debts were uncollected of \$6 million, that would have to contribute to that situation. Having not received the money, it is going to cause them a liquidity problem.

Mr COLLIER: But did it contribute \$6 million? That was the question.

CHAIR: It has.

Mr WHITFIELD: It would have over that period, yes.

(The witnesses withdrew)

BOB SMITH, Chief Executive Officer, State Forests of New South Wales, 242 Pennant Hills Road, Pennants Hills, and

MALCOLM IAN CLINCH, General Manager Finance, State Forests of New South Wales, 423 Pennant Hills Road, Pennant Hills, affirmed and examined, and

GARY TAYLOR KEATING, General Manager Marketing, State Forests of New South Wales, Pennant Hills Road, Pennant Hills, and

RONALD VICTOR WILSON, Marketing Manager, Native Forest Products, State Forests of New South Wales, 423 Pennant Hills Road, Pennant Hills, sworn and examined:

CHAIR: As you are aware, we are doing a follow-up report to the Auditor-General's report into the trading practices with customers of State Forests. We have a series of questions and we will leave it to each one of you to determine between yourselves who is most appropriate to answer each question.

We have received your submission. Is it your wish that the submission be included as part of your sworn evidence?

Dr SMITH: Yes.

CHAIR: Do you wish to elaborate upon the submission?

Dr SMITH: No, not at all.

CHAIR: To quote from that submission:

It is frequently not appropriate for State Forests to immediately cease log supply to a customer once a payment is overdue. To do so may ...

There were a list of points and we are going to analyse each one of those points:

Reduce supply to customers that are not responsible for the failed payment.

Can you please explain why this is of concern to State Forests and whether, in practical terms, downstream customers can source their logs from alternative suppliers?

Dr SMITH: Well, we have a policy of basically looking at each customer individually within the overall credit policy and if we actually stop log supplies immediately basically we will disrupt their business and they will often go belly-up, so we attempt to actually find out the reasons, make an assessment of whether or not they can pay long-term and enter into an agreement on that basis.

CHAIR: Do you think there are any consequences for downstream customers if you were to take that policy of stopping supply?

Dr SMITH: Very much so. A lot of them actually have forward markets, forward sales, and any disruption could actually lead to losing that market, so we could actually start a knock-on effect if we are not careful.

CHAIR: So they enter forward contracts?

Dr SMITH: Yes, a lot of them actually have contracts for sale to timber merchants. A lot of them are now into value adding where they have actually got supply commitments, say, three or four months ahead, and some of them are actually in overseas markets.

Mr COLLIER: The second point spoke about:

Cause negative financial impact on independent harvest and haul businesses.

Why is State Forests responsible for the financial impact on independent harvest and haul businesses?

Dr SMITH: We are not responsible, Mr Collier, for the financial impacts, but with the introduction of log merchandising on the North Coast in particular - and I think it is important, and I will go through in more detail, if the Committee is interested, the various segments of the business because they all are different - with now the introduction of log merchandising a lot of the contractors supply to a number of the mills, and if one mill stops taking a supply, it can lead to an economies of scale problem with those individual contractors. So we attempt to manage the whole system of log growing, log supply, log cartage and log processing.

Ms HODGKINSON: Does State Forests have any contractual or any statutory obligations to these businesses or does it just perceive social obligations to them and the local community?

Dr SMITH: No. We have a contractual commitment and it varies depending on what segment the agreements are with. With the traditional hardwood industry, which is longstanding in New South Wales, where there has been a regular forestry agreement completed, the majority of our customers are on 20 year wood supply agreements and we have contractual commitments within those agreements for annual supplies and other responsibilities. With the softwood sector we have a mixture of very long-term agreements, 20 years plus with some of our customers, and some of our smaller customers are basically on annual parcels, so it is a mixture.

In terms of the social responsibility, we do take into account as an organisation consequences for local employment and we attempt to work with customers who have difficulties to see if we can help them to trade through those difficulties to minimise some of the social consequences, not only in that town but also in the downstream impacts.

CHAIR: Where does that sense of obligation arise from? Essentially that is what we are interested in.

Dr SMITH: State Forests actually has a charter that is a Government trading enterprise where we consider that we actually have a triple bottom line responsibility in terms of social, economic and environmental outcomes, and the social outcome we have is actually trying to work with our customers to ensure that they are sustainable.

CHAIR: And that can be identified in a document somewhere?

Dr SMITH: Yes, identified in our corporate plan.

Mr GLACHAN: It is normal business practice that you trade with people who owe you money to keep them going so you do not lose a customer. When they owe you money and you can see they are getting into trouble, what steps do you take to see they do not get into further trouble?

Dr SMITH: We start to get a very close relationship with them. We try and negotiate a payments plan to get them over their difficulties. In a lot of cases we add a penalty interest to the outstanding amounts. Often times we will reduce log supply or stop log supply.

Mr GLACHAN: You do charge them interest if they owe you money?

Dr SMITH: Yes. It varies, but in the main, particularly in the last couple of years, there have been interest rate penalties put on our customers, and that rate varies considering what we consider to be the risk from that customer.

Mr COLLIER: So you are saying the higher the interest rate, the higher risk?

Dr SMITH: Yes, basically. There are some variations to that where it is stepped up in time depending what the debt is, but it is also matched against a guarantee. The majority of our customers have some form of cash guarantee that actually are in a risk category and, as I said, the fall-back position is basically the term agreement.

Mr GLACHAN: How do you explain that one of your customers owed you \$3.8 million and within a short time it went to something like over \$6 million? How do you explain that it galloped away like that?

Dr SMITH: Well, there was an assessment made - I am not sure it galloped away. We continued to supply logs at the negotiated rate, attempting to get them to trade through their difficulties, but we were using the long-term wood supply agreement to that company as a security, and that is the one that the Audit Office was talking about that is now under administration, and I can expand on some of the issues there for people if the Committee wishes.

Mr GLACHAN: What are the financial implications for State Forests of any negative financial impact on independent harvest and haul businesses?

Dr SMITH: What the consequences are, if one of the customers that that log company, harvesting haul company, is actually supplying is no longer taking logs, they actually have reduced revenue. So that is their major impact, and a lot of them actually have specialised equipment now where they are required to work at a certain capacity. So we try and keep that capacity operating within that company.

CHAIR: Any decision by State Forests to restrict or reduce the supply of logs would have pretty massive implications in terms of the financiers to the firms. They would be obviously quite concerned about that and they might actually quite quickly be put into administration.

Dr SMITH: Yes, that is true, but often when companies actually run into troubles, part of the negotiations are we also deal with the company's banks to actually ensure that there is a full exchange of information, that they are also fully aware of what is going on and some of the actions State Forests does take. State Forests does stop log supply in certain cases until an account is brought up-to-date, but it is normally the last resort that we do do it.

CHAIR: Just following up with the list of points that you provided to us in your submission, there was one point which says that a consequence would be to expose State Forests to compensation payments for failure to supply logs or failure to provide harvest and haulage work. Under what circumstances would such compensation payments rise and would they have been payable in the case of the two major customers referred to by the Auditor-General and in your submission?

Dr SMITH: To one of them, yes. One was a softwood processor and the other one was a hardwood processor up the north coast. In terms of the softwood processor, no, there was no form of compensation if we did not supply. There are some variations to that. We had a base agreement, which we have met, but because that company was going through difficulties, there were a number of agreements where basically we supplied to a level that we considered was appropriate.

The other company, which had a 20 year wood supply agreement, did run into some difficulties with supply and we had some difficulties supplying at a certain time. There was a financial arrangement come to to offset those difficulties, but in the main there are provisions within the agreement where we have to supply certain levels, but there also are some clauses that if we cannot supply for certain reasons, no compensation is payable. It becomes a fairly complicated process unfortunately.

Mr GLACHAN: In your submission you said that you want to avoid any handicap to State Forests' sales and operational viability. Does that mean that to maintain sales levels State Forests is prepared to accept the risk of continuing to trade with a customer who is in financial difficulty and has in fact defaulted on renegotiated repayment terms?

Dr SMITH: In that individual case, Mr Glachan, we made an assessment that they actually had a wood supply agreement. We purchased part of it back to offset a debt. We consider that to be an asset within the organisation now which is subject to reallocation and resale, that does have a commercial value.

Mr GLACHAN: So you can resell that allocation?

Dr SMITH: Yes.

Mr GLACHAN: And recoup the amount of the value of that?

Dr SMITH: Depending on the market rates at the time. We bought it at a market rate and when it is put back on the market we would expect to get the market rate for that volume of wood.

CHAIR: Do you have that as an asset on the balance sheet of State Forests?

Dr SMITH: I understand from talking to Malcolm that we are carrying that as zero value for accounting purposes.

Mr CLINCH: That is correct.

CHAIR: Why has it not got a value?

Mr CLINCH: Essentially, the component value is valued separately on our balance sheet. So we are already counting that value in the accounts somewhere else.

CHAIR: So there is only the value of the physical asset recorded in the books and not any goodwill component?

Mr CLINCH: That is right.

CHAIR: Is that consistent with accounting practice?

Mr CLINCH: Yes.

Mr COLLIER: You said the company went into liquidation that you charged that interest, is that right?

Dr SMITH: Yes.

Mr COLLIER: How long before it went into liquidation did you commence charging interest?

Dr SMITH: My understanding is from day one.

Mr KEATING: Yes. To my understanding, that is correct, we charged interest. What you may be referring to is the fact that penalty interest was applied on top of that interest when it became apparent that the initial payment plans that had been negotiated were not being honoured.

Mr COLLIER: When did that begin?

Mr KEATING: I think the company operated for four years. There was a slight hiccup after 12 months when there was a change of ownership of the company, but the major problems did not start until about late 2000, so about two years into the existence of the company.

Mr COLLIER: From that point on you were charging penalty interest?

Mr KEATING: That is right.

Mr COLLIER: Would you agree that the operational viability may be exposed to greater risk by continuing to trade rather than ceasing to trade with a customer that is in serious financial difficulties?

Dr SMITH: Yes, but from State Forests' point of view we made an assessment that we had a wood supply agreement with this company which actually had value, and we are currently negotiating with the administrator. We expect to get a significant proportion of that debt back as the company is restarted under new ownership, and that is in the process of being negotiated now.

Mr COLLIER: In hindsight, would it have been better to stop trading with it at the relevant time?

Dr SMITH: If you look at the marginal arrangement with that particular company, probably yes, but in terms of State Forests operations within Hume, and the way that that supply to that company was linked to the log merchandising to other major customers at Tumut, Tumbarumba, et cetera, probably no, and that is the basis we made the decision on.

Mr COLLIER: So you took a locally based decision rather than a holistic sort of approach?

Dr SMITH: No, we took a holistic approach associated with the financial outcomes associated with our Hume region, which is the plantations in the Murrumbidgee River, Murray River system.

Mr COLLIER: So the viability is based on a region by region basis, is it, rather than a whole overall basis?

Dr SMITH: No. Well, because our supply arrangements are basically regionally based, we account for our businesses at an individual business level. So the Hume region is actually a business unit within State Forests.

Ms HODGKINSON: Just following on from that same line of point ten of the submission, that it further reduced the ability of the customer to pay the overdue account, one of the customers in question owed \$3.8 million at the end of June 2001 and within six months that debt had increased to State Forests by another \$2.2 million and your submission states:

By the end of January 2002, the debt plus interest and penalties had reached a level such that State Forests judged it was unable to extend the interim arrangement any further. At this point, State Forests ceased trading with the company which was subsequently placed into voluntary administration.

Why did State Forests think that continued supply would enable this customer to pay for its current purchases as well as its overdue account? What made you think that it would be able to trade its way out of debt?

Dr SMITH: A couple of issues there. First of all, the company actually had two processing operations one at Bombala and one at Holbrook, and they were basically separate companies under that one ownership. What gave us hope that they could trade their way out of it, we had a number of submissions and requests from third parties that they were interested in financially guaranteeing performance of this particular company. One was an international company based in New Zealand; another was a major timber processor and merchant in Australia; but none of those actually came to fruition and when those particular options did not come off, that is when we took the decision that they were no longer viable.

CHAIR: So that was the trigger?

Dr SMITH: Yes.

CHAIR: When you realised those sureties were not coming?

Dr SMITH: Yes.

Mr COLLIER: The next point was not being appropriate to immediately cease log supply to a customer as to do so may trigger the collapse and failure of a business, especially during times of industry downturn. With the benefit of hindsight, do you believe that ceasing to supply this customer would have triggered its collapse or failure or was this simply inevitable?

Dr SMITH: I do not think it was inevitable. We were getting very strong signals, and backed up by the companies that were actually looking at this particular company with due diligence, that it was a viable business long-term. This company was also fully supported in a very major way by its financier, a bank, and we were in constant discussions with those banks. So basically the decision to continue trading was based on taking all those factors into account.

Ms HODGKINSON: Page 20 of your submission states:

State Forests continued to trade with the customer against security provided to State Forests by a Tripartite Agreement, which was entered into between the customer, its bank and State Forests.

What was the nature of the security provided to State Forests and the bank under the Tripartite Agreement and does the bank's claim on the company's assets rank higher than State Forests'?

Dr SMITH: Yes, the Tripartite Agreement was guaranteed by the bank and they actually guaranteed the performance of the company for the payment of its debt. Under that Tripartite Agreement we had obligations also to continue to supply under that agreement. My understanding is in terms of the hierarchy of debt, State Forests is an unsecured creditor. The bank actually has a higher level of priority.

CHAIR: So State Forests is taking the risk, it is the lower quality of debt?

Dr SMITH: Yes, but our supplier and our continued arrangement were not based on that. This company had a timber supply agreement, which we know has got value, and in negotiation with the administrator and potential purchasers of those two operations, all the indications are that we will get back a significant proportion of that debt from the new owners of those contracts.

CHAIR: But that asset is diminishing in value, is it not, your asset, the supply contract?

Dr SMITH: No, not from our point of view. Again, probably a bit of detail here. With our softwood agreements, often those agreements are actually entered into on a tender basis, where a company will come forward, submit a proposal, where the value of that agreement is captured in the royalty, and classic cases are Weyerhaeuser contracts or old CSR contracts which are part of that. So when that agreement is re-assigned to a new customer, a new royalty or stumpage rate is applied, which part of it in this case will actually go back to retire the debt that is outstanding against the old company.

CHAIR: As time goes by, the 20 year allocation diminishes in value?

Dr SMITH: That is true.

CHAIR: You amortise it?

Dr SMITH: Yes.

CHAIR: So you are transferring some value to the firm over time?

Dr SMITH: Yes.

CHAIR: And that loss of value is in effect being placed at risk by continuing to trade. I

understand the fact that you are of the view that it can trade out of its difficulties and you take that risk calculated on your assessment, but nonetheless there is value loss by taking that risk.

Dr SMITH: Yes, very much so, and also a lot of these contracts have roll over provisions. They are often say a 20 year agreement with an option for another 20 years. So people make that assessment.

Mr COLLIER: Is it common for you to give credit without security? Is it common for you to be an unsecured creditor?

Dr SMITH: We do not take security out over the physical assets of a company. What we do in the majority of the cases, depending on the credit reliability, is actually have a guarantee which is basically a company guarantee or a bank guarantee which covers a proportion of the outstanding accounts basically. Now, a lot of our bigger customers that have high credit ratings are not on guarantees, but they are risk managed that way. Some of our smaller customers are cash on delivery. So it is a mixture how we do it.

Mr COLLIER: What about your big customers, you take a bigger risk with your bigger customers I take it?

Dr SMITH: Yes, the majority of the big customers are what we call category 1 customers and a lot of them do not have guarantees. They have a trading performance with us. We consider that they are a minimal credit risk to us.

CHAIR: With one particular company you are working with the administrator to try to recover your money. In that situation, the fact that you have chosen to continue to work with that administrator, would that indicate that you believe that that business is viable under a different management to the management that has been replaced?

Dr SMITH: All the indications are - on one of the processing plants we have actually offered to a successful company a new wood supply agreement and part of that is recovery of the debt. With the other processing plant negotiations are still continuing. The administrator has two viable companies which he considers can operate commercially.

CHAIR: Is there any value that you could attach to those businesses' capitalisation?

Dr SMITH: Very very small to my understanding.

CHAIR: They are small anticipated margins?

Dr SMITH: Yes.

CHAIR: Marginal operations?

Dr SMITH: Yes.

Mr COLLIER: How many times were repayment terms negotiated with the company and who approved the repayments of them?

Dr SMITH: Are you talking about the company that is in administration?

Mr COLLIER: Yes.

Dr SMITH: I cannot give you the exact number. Gary Keating might be able to give you more detail.

Mr KEATING: I believe we had six repayment plans in all and they were approved initially at my level, but my delegation only goes so far, so as the debt became more significant the CEO was

involved.

Ms HODGKINSON: Your submission asserts that State Forests can terminate a contract and sell the resource to a third party. Are there any instances where State Forests has sold the log allocations to other log processors? Is there any instance where State Forests has redirected those log allocations?

Dr SMITH: Not to date. We actually have one at the moment where we have bought back part of an allocation which we will be looking to reassign. In the past we have not had to do it, but the capacity is there to do it, and that is actually what has occurred. In the case of the company that is under administration, that agreement is actually basically passed back to the State Forests and we are in the process of reassigning. So basically we are on-selling.

CHAIR: So the purchaser of the allocation would then pay you, State Forests?

Dr SMITH: Yes.

CHAIR: And how do you value it, how do you value this sale?

Dr SMITH: In the case of administration, the administrator, it would be basically with negotiation. It becomes a fairly complex business where if a company is willing to pay a certain amount for the business and the various components of that business are the physical processing, the goodwill associated with the customers of that business, and also the value of our wood supply agreement, it becomes a negotiation between us and the administrator about who gets the share and what the new company is willing to pay.

CHAIR: So the purchaser is not buying the allocation, he is buying the old business?

Dr SMITH: Yes, he is buying the old business, but to run that business he or she needs to get a wood supply agreement from us, which is completely separate from administration. The two assets are handled differently. The administrator has no control over the wood supply agreement.

CHAIR: Is the value of that reallocation separate from the value of the business?

Dr SMITH: Yes.

CHAIR: It is identifiable?

Dr SMITH: Yes.

CHAIR: And quantifiable?

Dr SMITH: Yes.

CHAIR: In your submission the following comment was made:

Subsequent to the Auditor-General's report being issued, State Forests has negotiated a reduction to the customer's long-term log supply allocation. The value of the log allocation reduction was independently determined and an amount equivalent to this value was credited to the customer.... The agreement volume resumed by State Forests remains available for allocation to another customer at State Forests' discretion.

Once again, just to revisit this, the Audit Office may be of the view, or any observer may be of the view, that this in effect is forgiveness of debt, because the asset is the value of the contract, plus there is actually money owing. You would concede that that is the case?

Dr SMITH: No, not at all. There was an independent valuation made. Again, part of the process was that a detailed business planning process was conducted with the company and with their financiers about what they needed to restructure their business to enable them to have some chance of surviving in the long-term. Part of that was that they offered to retire, for us to re-purchase 15,000

cubic metres of wood, which we did, and that purchase was based on an independent valuation. That asset now is held with us. We expect to reassign that, and if that is reassigned, there will be an up front payment associated with the transfer of that asset, in addition to the continuing levels of royalty.

I could also state, just for clarification, there is a substantial trade in hardwood supply agreements between saw millers, where they do on-sell part of their agreements or even the whole agreement. So there is a significant trade in these wood supply agreements.

Mr CLINCH: An important issue, if I could add to that, is that if State Forests wishes to retire any of these agreements at any time, they need to step into that commercial market and pay the price that two commercial customers will pay each other, or two people will pay each other, in the commercial market. To retire, even though it has not got value in their hands, is the only way that we can get them back out of that market. So that is an important aspect.

Mr COLLIER: The accounting policy note for receivables in State Forests' financial statements, Note 1(b), states:

All trade debtors are recognised at the amounts receivable as normal settlement terms are normally within 30 days of the date of delivery or completion of services performed.

State Forests' credit policy states:

Standard payment terms are 14 calendar days from the date of invoice issue.

For the last two years the average days to collect debtors, excluding balances provided for as doubtful, have been 57 days in 2001 and 59 days in the year 2000. Why is the average debtors' collection period so much longer than State Forests' payment terms?

Mr CLINCH: I think what it is important to differentiate there is that the total debtors are what the 56 or 57 days are calculated on whereas, on the other hand, you are talking about wood supply for the 14 or 28 days, so out of our total turnover of about \$180 million only \$110 million is for wood. There are a whole range of other debtors in those accounts. In addition to the standard terms, with particularly some of the larger customers, there are specific negotiated terms. Some of the large public companies we trade with may have specific payment terms.

CHAIR: So the average debtor period is extended by the fact that there are other forms of sales in your revenue figures?

Mr CLINCH: Yes.

CHAIR: Primarily that explains it?

Mr CLINCH: A component of that is because of that. On the other hand, there are some major customers who have longer trading terms negotiated with them.

CHAIR: Is that normally a few major customers or is it many smaller customers?

Mr CLINCH: I think the former. It is generally a small number of big customers. We only have about 500 or so customers on our accounts and it is probably the top 20 or 30 where you would have the bulk of that effectively.

Ms HODGKINSON: In your submission you talk about a variation agreement between State Forests, the Minister and the customer for the principal debt to be discharged by the valuation of the reduction in quota sawlogs. Can you provide the Committee with a copy of this agreement?

Dr SMITH: Yes.

Ms HODGKINSON: How often are credit ratings, credit limits, breaches of credit limits

and compliance with payment terms reviewed and by whom, please?

Mr KEATING: It depends on the performance of the customer. The instrument they hold with State Forests, the nature of the wood supply agreement we have between us, is a factor. If they are on a long term wood supply agreement and they are trading satisfactorily then it might be years between reviews. In another case where we are dealing on parcel sales that are not necessarily ongoing we would review the credit of the customer prior to every sale in the sense that we operate in a very cyclical market, a very volatile market in the sense of housing and economic factors can influence the demand for sawn timber enormously, so we have to look at it in the context of the market we are in at the time and the customer.

Mr GLACHAN: We understand that you request security such as bank guarantees from some customers. How do you determine which customers require bank guarantees or similar security and what is the level of that security?

Mr KEATING: There are four categories under our credit policy. In the top category, if you have the sufficient instrument of contract between yourselves and State Forests and the independent assessment which we commission from somebody like Dunn and Bradstreet, for example, indicates that you trade satisfactorily with the rest of the world, then there is no guarantee required. That is the category 1 customer that Bob referred to before. Categories 2 and 3 both require some form of cash security. Category 2 typically would be that your rating by that independent assessment and by our own trading experience with you suggested that you had a good record but not sufficient to give us absolute confidence, so typically four weeks' log supply, the value of that would be secured in the guarantee.

Just as an aside I would mention that log merchandising, as we call the harvesting and haulage of logs - and some customers buy on a delivered basis, we deliver logs to their mill. Obviously our exposure to them is greater than a customer who buys on the stump and they do the harvest and haul, so the value of four weeks' log supply can vary significantly according to factors like that.

Category 3 requires full security, as we put it, and that is we are prepared to trade with you on credit terms, but you would require typically eight weeks' log supply as your cash guarantee and, category 4, you fail to measure up to the minimum score for any credit trading with State Forests and we only trade with you on a cash in advance basis.

Mr GLACHAN: But in the other cases a bank guarantee is all you require?

Mr KEATING: That is right.

CHAIR: And once you have secured it it does have implications for the credit limit, so if they do provide the guarantee obviously they get better credit terms?

Mr KEATING: Well, they get some credit terms, yes. If you are in category 2 and category 3 and cannot come up with a bank guarantee then you would default to category 4.

Mr COLLIER: Were credit assessments done for the two customers in question? If so, what credit grading were they assigned from categories 1 to 4 and can you provide copies to the Committee?

Mr KEATING: It is going back a while and I do not recall the exact category that was apportioned to the two companies. The company in administration I think would have at best been category 3, but I would need to confirm that. The other I am not sure. Our business with them goes back a long way and in each case we had the security of the wood supply agreement, so I am not sure that the credit rating was the overwhelming consideration in that case.

Mr GLACHAN: Can you later give us details of that?

Mr KEATING: Yes.

Ms HODGKINSON: What guarantees did you actually seek from those customers?

Mr KEATING: With the company in administration we sought the maximum guarantee we could get and that triggered some negotiations which basically saw us getting not much more than a token guarantee, I would have to say, in bank guarantee terms, but that was a consideration against the fact that it was a greenfield business; they were reviving two dormant log licences and timber allocations and it was a regional enterprise where we had an interest in getting them up and running, so you make some trade-offs.

I think one of the themes of our submission is the interdependence between ourselves and customers. There are not a lot of customers; there are not a lot of log suppliers and we are the dominant ones, so in a case where we are looking to them to make significant regional investment sometimes the outcome of the negotiation is that we intend to build the guarantee over a period rather than start with a maximum guarantee on day one.

Mr GLACHAN: You can give us details later of the arrangements?

Mr KEATING: Yes, I will.

Mr GLACHAN: So what you are saying really is that you take a bit more of a risk to achieve certain outcomes?

Ms HODGKINSON: To get a commercial operation up and running rather than knocking them back.

Mr KEATING: Well, any greenfield operation is tougher, yes. Like any negotiation, we start with our requirements in full, but we listen to the other side's case and we try to understand their businesses. In the old days I suppose it would have been very easy to be dictatorial and choose to trade or not trade. These days the revenue demands on State Forests are more onerous than they have been historically, I suspect, and certainly our understanding of our place in the value chain is more sophisticated than it used to be, so it is not win/lose outcomes with customers, it is working together to ensure that what is a very competitive industry performs strongly right up the value chain. For example, softwood timber competes with steel in house framing, so it is in our interests to make sure that the timber processing industry of New South Wales is competitive.

Mr GLACHAN: You are developing a new credit policy?

Mr KEATING: That is correct.

Mr GLACHAN: When will you have that finalised?

Mr KEATING: It has been with the senior management team and it is being finalised now, so I suspect a couple of months would certainly see the end of that, but one comment I would make is that current indications are that it will not be a radical departure from the former credit policy in the sense that we feel as though that policy has served us well. The only comment is that with log merchandising, the harvest and haulage added to it, our exposure to companies is greater and debts can run up quicker, so we need to have in place pretty clear and rigorous procedures to make sure that the right people know about the situation at the right times.

Mr GLACHAN: Can we get a copy of the policy when it is finalised?

Mr KEATING: Most definitely.

Mr GLACHAN: When do you think that might be?

Mr KEATING: Well, I am saying a couple of months. We may be able to do it sooner than

that. The bulk of the work has been done.

CHAIR: In relation to the most recent management letters from the Audit Office, is it possible for you to supply us with a copy of those?

Dr SMITH: Yes.

CHAIR: Is there anything you would like to say in response to the Audit Office's submission to us or generally on these issues that we have covered?

Dr SMITH: The only comment that I would make on the presentation this morning is that we have no quibbles with the Audit Office's letters and other correspondence. I think there needs to be greater clarification on the various segments of the business within State Forests and what actually has value in term agreements and the private market which is in particularly hardwood long term agreements and also the different business relationships and contractual relationships we have with the large softwood companies. They are basically completely separate contractual instruments.

Mr GLACHAN: Would you see State Forests as being a bit different from a lot of other government agencies in that, although you are a government agency with almost a monopoly on supply, you are dealing with private enterprise to a very large degree which makes you different to other government agencies?

Dr SMITH: Very much so, yes.

Mr GLACHAN: So you are really a commercial operation?

Dr SMITH: Yes.

Ms HODGKINSON: You run yourself more as a business.

Mr GLACHAN: Rather than providing a service, as most government agencies do, you are running more as a business?

Dr SMITH: We hope we do actually, that is the business we are trying to be in.

(The witnesses withdrew)

ANTHONY THOMAS WHITFIELD, Deputy Auditor-General, Audit Office of New South Wales, Level 11, 234 Sussex Street, Sydney, on former oath:

CHAIR: Do you wish to respond to any of the evidence?

Mr WHITFIELD: There are two points that I would like to make. One is that, whilst State Forests have said that they apply interest to some of the debts, we would say that their application of that interest policy is inconsistent in that it is not applied uniformly across all debtors in default, and by that I mean they apply interest to some and not others and then with the ones they do apply interest to they seem to have different starting dates from when they start to apply interest.

Mr GLACHAN: That would be normal business practice.

Mr WHITFIELD: I would have thought that, if you had a policy that says if a debt is in default interest will apply, it usually comes in, where I have seen it, on a uniform basis.

Mr GLACHAN: You look at your customer and your policy varies with the customer and your assessment of the customer's ability to finally pay, the way their business is running. You have to be very flexible because you do not want to lose a customer.

Mr WHITFIELD: I understand that.

Mr GLACHAN: You have to hang on to a customer as long as you can. If you think there is a chance that they will eventually be able to pay you keep them as long as you can because you do not want to lose that customer.

CHAIR: But nonetheless it is noteworthy.

Mr WHITFIELD: Yes.

The second point that I would like to make is that - and not being a lawyer - under the wood supply contracts they have, if you are in default in terms of paying your debt, I would suggest that it is more than likely you would lose the right to your allocation. Whilst we have seen allocations being taken back, we have not seen any evidence that allocations, whilst they may have a value, have ever been sold to another party and whilst there may be a market, a downstream market between millers trading off their allocations between themselves, we have not seen State Forests participate in that market.

CHAIR: But that would be because there is still money owed, so they are trying to get them to trade out of their situation. I accept what you are saying--

Mr WHITFIELD: Yes, I am just saying where they have, using their words, renegotiated the allocation downwards, they have not sought to trade that allocation elsewhere or charge for it.

CHAIR: But that is because they are owed money. If they were to transfer the allocation somewhere else, the chance of recovering the money lessens and it evaporates.

(The witness withdrew)

(Short adjournment)

ANTHONY THOMAS WHITFIELD, Deputy Auditor-General, Audit Office of New South Wales, Level 11, 234 Sussex Street, Sydney, on former oath, and

ERIC LUMLEY, Assistant Auditor-General, Audit Office of New South Wales, 234 Sussex Street, Sydney, and

GEOFFREY PAUL WHITE, Senior Audit Manager, Audit Office of New South Wales, 234 Sussex Street, Sydney, sworn and examined:

CHAIR: As I mentioned earlier, in relation to the Audit Office questioning we have had plenty of time to liaise with you and you have assisted us in the preparation of our questions, so we would just like you to give concise answers.

In your opinion, what risks, if any, does New South Wales carry, acting as the agent for the Commonwealth in managing this program?

Mr WHITFIELD: The risks that we see acting as an agent carrying out the program would be that the State may be liable to the Commonwealth if they had paid out grants to ineligible people. The other risk is that, if that had been done in any significant way, there would be damage to the reputation of the Office of State Revenue.

CHAIR: OSR considered it essential that an audit review be undertaken to assure management of the integrity or otherwise of the program. The review was included in the internal audit plan for 2000-2001 which commenced in April 2001 with a final audit report being issued in September 2001. The report identified a number of control weaknesses which, if taken at face value, indicated the "potential for unlimited loss of grant funds through fraud, error and duplicate payments". Would you agree with these audit observations and implications?

Mr WHITE: I do not think the risk was as broad as they indicated because I do not think they took into account some of the mitigating inherent controls that are there in terms that there was a structure set up for the payment of the grants which involved legislation and it was publicised that if people incorrectly applied for grants there were penalties and it was also publicised that the Office of State Revenue was going to conduct audits of those grants, so in some way that would have mitigated the risk of fraud in that a lot of people would be unlikely to try and defraud the OSR if they knew that they could be caught. Also they had a computer system into which there were controls built in terms of duplicate payments and it required that certain criteria had to be met before an application could be approved and also they had an agreement with the agents that if they did wilful wrongful acts or neglected to do their duty they were indemnified, OSR was indemnified.

CHAIR: That was from the financial institutions?

Mr WHITE: Yes. So to a certain extent that sort of mitigates the risk in that financial institutions are unlikely to--

CHAIR: Take that risk themselves?

Mr WHITE: Yes.

CHAIR: So was there a dialogue between the different financial institutions?

Mr WHITE: Between the financial institutions? I could not answer that question. I presume there would have been. The other thing too is that the people who were engaged as agents were well known, reputable, like banks and mortgage brokers, so there is a sort of inherent control there.

CHAIR: So in essence that internal report overstated the risks that were involved?

Mr WHITE: I think the report was fair in that those measures should have been taken, but I think it is probably a bit far to go to say that there was potential for major fraud because if there had been major fraud I am pretty sure it would have been well known to most people anyway, it would have been sort of screamed from the rooftops, if you like.

Mr LUMLEY: We thought it was a worst case scenario, the assessment, and probably the weight given to the mitigating controls did not come through in the assessment. As I say, it was a worst case scenario sort of a Greenfield's approach without perhaps due consideration being given to some of these mitigating controls which Geoff enumerated.

The Hon. PAM ALLAN: In your opinion, were they potentially very high risks?

Mr LUMLEY: If it occurred to the extent that the report said, it could have been, but subsequent reviews by both the compliance people and ourselves did not disclose these risks as actually occurring or happening, so the incidents they were trying to portray were not actually happening in reality.

CHAIR: But there was a potential that there were high risks?

Mr WHITFIELD: I think it is fair to say that there was the potential for high risk, but the likelihood of them occurring was probably low.

CHAIR: Because of the mitigating controls?

Mr LUMLEY: Yes.

CHAIR: Now the internal audit report was issued 15 months after the scheme started and action to address the potential risks has been taken on a progressive basis. Do you believe that the delay in implementing these subsequent controls did cost or will potentially cost the Government?

Mr LUMLEY: Well, that would not appear to be the case on the basis of our reviews and the reviews of the compliance people from OSR. As I say, the incidents were not coming through as problems being there, so on the basis of that you would have to say no.

The Hon. PAM ALLAN: Has the Audit Office tested the controls implemented since the audit report was issued to determine whether they are operating effectively and continuously?

Mr WHITE: Yes, we have tested those, those controls that have been implemented in the last financial year, and they were the ones mainly dealing with compliance activities because a lot of the other ones have only been implemented since 30 June 2002, so we have looked at the compliance activities certainly, but a lot of the other ones require renegotiation of agreements by other States and things of that nature.

Mr COLLIER: Looking ahead, are you satisfied that the controls that you have put in place will provide the assurance needed that fraud, error or even duplicate payments will not occur or remain undetected in the future?

Mr WHITE: Yes, certainly they will, but they do need to address the other issues like getting some assurance from the people who operate the database. They need to have a contract that allows for audit of the database and the people who actually operate the system. Until they get that there is still going to need to be testing done to ensure that controls have not been breached.

CHAIR: So the Audit Office has not obtained any audit assurance to satisfy itself about this outsource provider?

Mr LUMLEY: We have through our alternative procedures. We sat down with the people involved with the implementation of the system and were responsible for implementation testing and we discussed the controls and the system with them and saw their acceptance reports. We have done

our own procedures since, checked eligibility and duplication of payments, et cetera, and we have not found anything of moment from our reviews and neither have the compliance review people either.

The Hon. PAM ALLAN: Recommendations 19 and 20 of the internal audit report suggest that legal advice be sought with regard to the deed of arrangement between the OSR and financial institutions; a memorandum of understanding between jurisdictions; support services agreement and Telstra agreement to ensure OSR's interests are protected legally and operationally. Have you sighted any of these advices or made any assessment of their impact on the organisation and your audit?

Mr WHITE: I have sighted all of those except the one between Telstra and the Victorians, I think it is, and they basically come to the same conclusions as us in terms of the service agreement, that the contract that was entered into was lacking in terms of its ability for people to audit the system, to get external comfort that the system was working correctly. The memorandum of understanding did not cause us too many problems because basically, from what I read of the Crown Solicitor's opinion, it is not legally binding until such time as it is signed, but certainly the ones I read supported our findings in terms that when they renegotiate these agreements there should be proper procedures put in there for audit and things like protection of intellectual property and that type of thing.

CHAIR: Just as a general overview of the issue, would it be fair to say that the original problems arose because there was not a clear ownership of the task of the outsourcing agent, the agent themselves? Because it was collectively organised between the States, probably the original problems arose because no one was individually responsible and identifiable with the securing of that service?

Mr LUMLEY: I think the Victorian office, and Geoff might correct me here, were responsible for the management.

CHAIR: The Victorians?

Mr LUMLEY: Yes, and then it shifted I think at some point in time to Western Australia.

CHAIR: So there was not a collective ownership, there was an identified owner of that function?

Mr LUMLEY: Yes.

Mr WHITE: The agreement is with Victoria and the service provider on behalf of the other States.

CHAIR: And you are reasonably happy with the remedial action which has been taken at this stage?

Mr WHITE: Well, what has been done to date, but there are still a lot of things that need to be done in terms of renegotiating some of those arrangements so they can get independent confirmation that the controls are working. That is sort of the major area that is still outstanding from our point of view. Also, in terms of following up on people who have the grants where they have not met the residency criteria, that needs to be sorted out.

(The witnesses withdrew)

PETER CHARLES ACHTERSTRAAT, Executive Director, Office of State Revenue, 132 Marsden Street, Parramatta,

MICHAEL GEOFFREY KENNEDY, Chief Information Officer, Office of State Revenue, 132 Marsden Street, Parramatta,

EDWARD JOHN WITHERS, Director of Compliance Division, Office of State Revenue, 132 Marsden Street, Parramatta,

GEOFFREY JAMES UNDERHILL, Deputy Director, Audit and Revenue Support, Office of State Revenue, 132 Marsden Street, Parramatta, and

ANTHONY JOHN NEWBURY, Director Client Services, Office of State Revenue, 132 Marsden Street, Parramatta, sworn and examined:

CHAIR: In relation to the submission that we have received, is it your wish that the submission be included as part of the sworn evidence?

Mr ACHTERSTRAAT: Yes.

CHAIR: Would you like to add to or elaborate on it?

Mr ACHTERSTRAAT: Would it be appropriate for me to give you a thumbnail sketch of the submission?

CHAIR: We are reasonably familiar with it, so make it short.

Mr ACHTERSTRAAT: Okay. When it was announced in 1998 that there would be a first home owners grant and that it would be administered by the Offices of State Revenue in the various jurisdictions, we needed to determine the best way to administer the system. There were a couple of considerations that it was necessary to take into account. One was we wanted to make it as uniform as possible across the country, even though each State was administering it; we wanted to have the greatest degree of co-operation of the States and the Territories as possible; we wanted to make it as cost effective as possible; we wanted to have high integrity; and also wanted to ensure that there was speedy delivery of the grants.

On that basis a decision was made that instead of each jurisdiction building their own computer system, which would cost between one and two million dollars, there was to be a joint system developed and built which all jurisdictions would have input into, and as far as possible we wanted to have the same procedures, so that first home buyers in various States would have the same rules and regulations. To that end one of the parliamentary counsels in one of the States was commissioned to draft the legislation. That was in another State other than ours. That was drafted and most of the States picked up that legislation and the procedures were roughly the same.

The second fundamental decision was to involve financial institutions in administration of the grant. Indeed, we convened a meeting here downstairs to bring the financial institutions on board, because we thought there was considerable merit for both the people buying their first home and also cost savings for us if we could involve the financial institutions. So we met with them in this building. We got most of them on side and the others got on side afterwards and said, yes, they wanted to be involved in this.

Subsequently, the scheme got up and running on 1 July 2000. It worked very effectively. After it had been going for six months or a bit longer, we commissioned an internal audit report to see if there were ways we could improve the system and just to test the integrity of the system. The internal report was done by OSR. It took some time to do, mainly because there was toing and froing between the internal auditors and the business to determine wording and things like that.

Many of the recommendations that subsequently came out were in fact adopted during the course of the audit, so we did not necessarily wait until the end of the audit. At the end of the day, of the 35 recommendations, 34 were accepted by us. 29 have been fully implemented now and there is action on the way on some of the others.

That is a brief thumbnail sketch.

CHAIR: As we go along with the questions, we will leave it to you to determine between yourselves who is the most appropriate person to answer them. Did New South Wales have any specific and exclusive responsibility in the process?

Mr ACHTERSTRAAT: The tasks were allocated through the commissioners to various jurisdictions, one State for the building of the system, one drafted the legislation. In New South Wales, I came into the chair half way through the process, so the decision was where could we be involved in the best way. We were involved in liaison with financial institutions. I convened the meeting here to bring them on board, although each State had their own meeting locally with their local State banks.

We have responsibility, as all jurisdictions do, to administer the Act. The Act is a New South Wales Government Act passed by the New South Wales Parliament. We have responsibility to ensure that the correct payments are made, that there is service provided, that there is a compliance approach.

CHAIR: But there was no specific responsibility that you had in setting up the system?

Mr ACHTERSTRAAT: I cannot recall any specific.

Mr NEWBURY: No, the lead for the system was taken by Victoria, the lead for the legislation was taken by South Australia and the lead for the forms I believe was taken by Queensland.

CHAIR: What risks, if any, does New South Wales carry in acting as the agent for the Commonwealth in this program?

Mr ACHTERSTRAAT: I guess the first question to ask is: Are we acting as the agent of the Commonwealth? There are a couple of views on that. The legislation is New South Wales legislation. The risks we have in implementing the legislation are, as the Audit Office has indicated, the risk to our reputation if we do not do it correctly. There is also a risk of overpayment. If payment is made to inappropriate people, there would be certainly a risk there. There are other risks of inefficient use of resources; there are risks of not providing a good service to clients, et cetera.

CHAIR: So reputation and financial risks are the two biggest risks?

Mr ACHTERSTRAAT: Absolutely.

The Hon. PAM ALLAN: How did you plan the development and implementation of the system and associated infrastructure; the establishment of the agency-based network of financial institutions; the policy of the legislation; the compliance strategy; and the preparation of training materials and operational procedures?

Mr ACHTERSTRAAT: Many of those things were discussed at interjurisdictional level and a first home owners grant national committee was established to address many of those issues, things such as involving building the system, et cetera. We had eight jurisdictions having input into the checks and balances that they wanted, et cetera, and we had various interstate representatives on those.

In relation to involving the financial institutions, again, at a national role I took a bit of a lead on that, but then each of the jurisdictions liaised with institutions which dealt specifically in their jurisdiction. As far as training is concerned, each of the jurisdictions has a training program for their own staff, but, equally importantly, we have training arrangements with the financial institutions to

ensure that they are keying the correct data and administering the system correctly.

The Hon. PAM ALLAN: Were the compliance strategies uniform across the jurisdictions?

Mr ACHTERSTRAAT: There is an interjurisdictional compliance committee and there is a subcommittee on the first home owners grant in that. Each jurisdiction looks at best practice in the other jurisdictions to determine the appropriate level of compliance activity. In our situation, we have formed a compliance approach. There are some steps before payment is made; some after payment is made. Some of the uniform compliance approaches are that in fact under the system, if a person applies for a first home owner's grant and they have already applied for one and been paid in another State, then the system automatically rejects that. So that is a uniform compliance approach, and that is one of the benefits of having a national program.

There are other checks and balances within the system which are uniform. However, each jurisdiction has different criteria for measuring risk. In New South Wales, our risks have been assessed internally as to which of the particular clients have the highest risks. For example, if someone is purchasing a home worth more than a certain figure, in New South Wales the risk might be lower than if someone was purchasing a home for that figure in another State. So we have been able to allocate and in fact devote more resources to homes at a greater level, and also the age of the person and other risks assessments, but the risks are different.

In summary, there are some standard risk processes. Each office has their own tailored one, but we certainly share with each other the various approaches.

Mr COLLIER: Is a risk assessment performance part of the planning process? If so, when did this occur, who was it prepared by and what risks were identified?

Mr NEWBURY: I would say that whilst this was definitely part of the thinking of all jurisdictions going forward with this scheme, there was no formal risk assessment process in place at that time in any jurisdiction. We now have one, for example, in New South Wales, but at that time it was probably more ad hoc.

Mr COLLIER: When was that done?

Mr NEWBURY: As part of the process of the system design, the system build, acceptance testing.

Mr COLLIER: Can you give us a date or an approximate time?

Mr NEWBURY: The system was designed from I think December 1999 through to about April 2000.

Mr COLLIER: And that is when the risk assessment was done?

Mr NEWBURY: Yes.

Mr COLLIER: Who prepared that?

Mr NEWBURY: That would have been done by the officers on the national jurisdictional committee.

Mr COLLIER: At a national level it was done?

Mr NEWBURY: Yes.

Mr COLLIER: What were the risks identified?

Mr NEWBURY: The major risk was that we could pay grants to people who in fact were

not entitled to receive a grant.

CHAIR: Was that risk assessment documented?

Mr NEWBURY: It was probably documented as part of the process. I cannot guarantee that.

Mr COLLIER: Can you find out?

Mr NEWBURY: Yes.

Mr COLLIER: And if there is documentation, can you provide it to this Committee?

Mr NEWBURY: Yes.

The Hon. PAM ALLAN: Your submission states that your office considered it essential that an audit review be undertaken to assure management of the integrity or otherwise of the program. The review was included in the Internal Audit Plan of 2002/2001, commenced in April 2001 with a final audit report being issued in September 2001.

The report identified a number of control weaknesses, which, if taken at face value, indicate the "potential for unlimited loss of grant funds through fraud, error and duplicate payments". Do you agree with these audit observations and implications?

Mr ACHTERSTRAAT: The OSR, as you mentioned, commissioned the report to ensure we were doing things correctly and that all the systems and checks and balances were in place. When the report was completed, we accepted 34 of the 35 recommendations, and I think it would be fair to say that there was not agreement or endorsement of all the words in that report. There was a bit of argie-bargie and negotiations between the internal audit and the business, and at the end of the day, while we endorsed the 34 recommendations, we did not necessarily endorse every statement that was made in the report. The report still came to the audit committee of OSR and that was a reflection of our corporate governance approach to have all reports come before it.

The Hon. PAM ALLAN: Why were the potentially very high risks not subject to some form of mitigation strategy or internal control checks?

Mr ACHTERSTRAAT: Again, we agreed that the 34 recommendations would in fact help us in the operation of the system. To say that none of the risks had been addressed before that is probably drawing a long bow. We believe that the risks did have mitigating strategies during the period before the audit, but, as it was said in the audit report, some of them could be tightened up more.

We do not necessarily accept all the statements, the comments and implications in the report, as is the case in a number of audit reports we get. We do not necessarily, at the end of the day, agree with all the conclusions, but we decide which of the recommendations to endorse.

Mr COLLIER: If the work had been done retrospectively to determine whether fraud, error or duplicate payments had occurred, what are the results of that work?

Mr ACHTERSTRAAT: I am sorry, Mr Collier, I cannot -

CHAIR: Has there been any retrospective work done on determining whether there has been fraud or other irregularities?

Mr ACHTERSTRAAT: Clearly, what we have done is put in a comprehensive compliance program.

Mr WITHERS: In the early days of the compliance activities, we focused very much on

looking at individual claims for grants, and we moved later on to look at a number of financial institutions and controls that were operating there, and that is continuing. To date, the examinations we have carried out with the financial institutions have satisfied us that their controls are reasonable and that there is no major opportunity for fraud within those organisations we have looked at, and that has given us a lot more confidence than we might have had before. I think that is also backed up by the fact that as we have looked at individual grant applications, we have not looked at them particularly, I gather, as to whether they are lodged through a financial institution or lodged directly with us, but the rate of non-compliance is quite low and it is no higher with the financial institutions than it is with the applications lodged directly with us.

The Hon. PAM ALLAN: Are you satisfied that the controls now in place will provide the assurance needed that fraud, error or duplicate payments will not occur or remain undetected in the future?

Mr ACHTERSTRAAT: You can never give a blanket assurance that there will never be fraud or never be anyone speeding or anything like that. We are satisfied that the controls we have in place are appropriate to cover all the risks and that we will be able to detect risks or any fraud. So we are satisfied with the controls we have put in place.

Mr UNDERHILL: The recommendations have been implemented along the lines of the action plan that we negotiated with the clients through OSR and we are happy with the progress that has been made on implementation of those audit recommendations.

CHAIR: Are those internal controls being tested externally or internally by auditors?

Mr UNDERHILL: Sorry?

CHAIR: The new controls?

Mr UNDERHILL: The controls have been tested by internal auditors.

CHAIR: Not by external auditors?

Mr UNDERHILL: I am not privy to that, but I assume - for one thing, they look at all our working papers. We provide every assistance to them in the conduct of their audit. We provide copies of the report and so forth. But I am not privy to their mode of operation.

CHAIR: Mr Achterstraat?

Mr ACHTERSTRAAT: No, I am not either.

Mr COLLIER: Where is the central computerised data base located?

Mr ACHTERSTRAAT: I will ask Mr Kennedy to answer that.

Mr KENNEDY: The physical computer server that it sits on is actually a Telstra hosting facility in Sydney.

The Hon. PAM ALLAN: Does New South Wales maintain the data base?

Mr KENNEDY: No.

The Hon. PAM ALLAN: Who maintains it, the data base?

Mr KENNEDY: The data base itself? If are you talking about maintenance, is the data base performing to its capacity, is there any fault in terms of software maintenance, that is actually done by Spherion on behalf of the revenue offices. If you are talking about the actual server itself, it is maintained by Telstra.

The Hon. PAM ALLAN: So it is the one maintained on behalf of all States?

Mr KENNEDY: Correct, that is right.

The Hon. PAM ALLAN: What is the name of the company?

Mr KENNEDY: It is called Spherion. It was formerly called Interim Technology and part of the Computer Power Group.

The Hon. PAM ALLAN: So they operate it and maintain it?

Mr KENNEDY: It probably depends on what you call operating it. What Telstra do is they have a server there, like they have many other servers in various organisations, and they connect those servers and secure those servers, but they do not do anything with what is on the servers. So they are a hosting facility. What Spherion do is they monitor what is on the server in terms of the data base; they monitor to make sure that it is working and that it is performing to the performance levels that we have agreed between the agencies.

The Hon. PAM ALLAN: Who keys in and who gets a new line? Do you do that?

Mr KENNEDY: No. Well, it is either ourselves or the financial institutions. Spherion have no responsibility for capturing of data or validating or anything like that. They just make sure it keeps working. The other thing they do is when the various revenue offices via the national faults committee ask for enhancements, so it might be, "Can we have a new report? Can we change this screen? Could we have compliance?", whatever, they will actually make changes to the application, but on a day-to-day basis the maintenance is making sure that it keeps working within the performance tolerances that have been agreed.

The Hon. PAM ALLAN: Recommendations 19 and 20 suggest that legal advice be sought with regard to the deed of arrangement between you and financial institutions, the memorandum of understanding between jurisdictions, support services agreement and the Telstra agreement to ensure OSR's interests are protected legally and operationally. Has this been completed? If so, briefly, what was the outcome and can copies of legal or other advices be provided to the Committee?

Mr NEWBURY: We sought Crown Solicitor's advice on the deed of arrangement twice, first when it was being put together back in May, June, July of 2000, but each jurisdiction did the same thing, so what happened was we had eight Crown Solicitors' advices to deal with, and the final deed of arrangement was in effect our view of what was best practice out of all those advices. Subsequently, earlier this year, we sought advice on whether the deed of arrangement covered privacy sufficiently. The Crown Solicitor's advice was that he felt that it needed to be beefed up in that area and we have taken that advice on board. In fact, Victoria, on behalf of the other jurisdictions, are drafting another document to go with the deed of arrangement, which will be signed by each of the financial institutions involved. So that advice was taken up.

On the memorandum of understanding, we sought particular advice as to whether New South Wales should sign the memorandum of understanding on the basis that there was a clause in there concerning indemnity. So if someone took action against the Victorian office in relation to their administration of the system side, how would that be dealt with between all the jurisdictions? We were not happy with that indemnity. We sought Crown Solicitor's advice. Crown Solicitor said do not sign it and we did not. We subsequently went back to the Victorians and said that we are not prepared to sign it, we need to talk about this more. That process is still going on, but that offending clause was in fact taken out and subsequently the Crown Solicitor advised that we could sign the memorandum.

Mr ACHTERSTRAAT: Would we be able to get copies?

Mr NEWBURY: I can provide copies of those agreements. I might hand over the advice in relation to Spherion to Mike Kennedy.

Mr KENNEDY: We sought advice on the Spherion two contracts. There are actually two contracts involved there. We provide them the original build, engagement contract and a subsequent support services contract. The advice that we received was predominantly that the original build contract was based on a known Government standard, what they call GITC2, and that was okay. The support services contract though had some gaps in it, especially around things like IP and so forth. So even though they are to be read together and they actually have reference to one another, there were some gaps, and the advice is that we should beef up some of these areas when we renegotiate the new support services agreement, which is due to go to tender and be resolved by June 2003. As part of our tender committee that is putting this tender together, we have taken that advice on board, and when we go out and get a new support services agreement to the winning tenderer, we will have included those advices.

CHAIR: And the Telstra agreement?

Mr KENNEDY: The Telstra agreement was also looked at. The Telstra agreement is quite tight. Having said that, the issue that has been raised is: Is New South Wales protected? And this was raised with respect to Spherion as well. If it was signed by Victoria, what sort of come back do we have? That is the same on both of them, because it is being done by a consortium, and that was a general overview comment, that it is a consortium of OSR's and that does leave some exposures. What is the solution going forward? Do we all sign it? The jury is still out on that. That has actually been canvassed in the current tender negotiations and there has been a view put forward on how to deal with that.

CHAIR: Looking at some of the specific risks, one being the fraudulent misappropriation of funds, OSR has no control over the processing of applications from financial institutions, is that correct?

Mr ACHTERSTRAAT: 70 percent of the applications are done through financial institutions and 30 percent through our office. The financial institutions have all signed the deed of agreement. They have trained their staff. The staff in financial institutions key the data in and then that is it, they cannot touch the data after it is keyed in.

Mr NEWBURY: There are controls in this sense, that in the deed of arrangement there are clearly specified requirements in relation to privacy, security, to storage of documents, and there is a whole range, a whole raft of things included in that deed of arrangement, but, yes, it is true to say that we do not sit down with each financial institution doing the application. There is always an element that the FIs are on their own there, but each FI is signing the deed of arrangement which indemnifies OSR if there is any fraud on behalf of their employees.

CHAIR: They have transferred the risk to the financial institution through that agreement. What do they need to do to get this accreditation, to be an accredited financial institution?

Mr NEWBURY: It depends what sort of an FI they are, and there are various rules, which I can go through the detail if you like, but basically they must satisfy us that they are a bona fide FI. Can I just have a look and perhaps I can give you the information. If they are an authorised deposit taking institution, an ADI, they are okay to be agents because they have already passed other tests to be able to do that, if they are a mortgage originator, then they have to have a long term credit rating of AAA, and it goes on.

CHAIR: Each time you test for the financial worthiness of that provider of that institution?

Mr NEWBURY: Absolutely. And the second tier to that is that they must be prepared to sign the deed of arrangement. If that they are not prepared to sign that, then that tightens the control over them, because if they are not prepared to sign that, then they are not part of the scheme.

CHAIR: And how many are there at the moment, accredited institutions?

Mr NEWBURY: In New South Wales there are 124; nationally there are 280.

The Hon. PAM ALLAN: The report states that to date seven financial institutions have been audited, including one of the larger organisations. What was the outcome of these audits? Did they highlight any areas of concern and, if so, what were those concerns?

Mr ACHTERSTRAAT: Basically the outcomes were that there was no fraud detected. There were keying errors and minor procedures which were not adopted.

Mr WITHERS: Just to follow-up on that, the issues that we identified were minor and none of those were sufficient to raise any concerns in our minds about whether the financial institution should be permitted to remain part of the scheme. Where we had those minor concerns we wrote back to the financial institution at the conclusion of the audit, pointed out what those concerns were and indicated in each instance what we felt needed to be done to address the concerns that we had.

The Hon. PAM ALLAN: Can you provide us with a written summary of the compliance audit findings?

Mr WITHERS: Certainly, yes.

Mr ACHTERSTRAAT: Some of the things, for example, from memory, were that on occasions instead of keying the date of the applicant, how old the person was, they would key in today's date, and so it would automatically come out that the person was under 16 years of age. There were all sorts of keying issues, but certainly we will have a summary.

The Hon. PAM ALLAN: How long is the turnaround time for processing applications?

CHAIR: Within OSR.

Mr NEWBURY: It basically depends if the application is lodged through the mail or at an OSR counter. There is a difference in the process when it comes to OSR or through an FI. If it comes through an FI the funds are available to the FI prior to settlement, they are paid seven working days before settlement, so they are available to the applicant on settlement. If it comes to OSR, because we do not have that extra control of the FI being involved, we will only accept an application after settlement.

CHAIR: So that is why you only have 30 percent of the business, of the activity?

Mr NEWBURY: Yes.

CHAIR: So people get that financial advantage by going through a financial institution?

Mr NEWBURY: They get the funds quicker and it is part of that life event basically of buying a home. We also do pre-payment checking at a rate of about 28 percent so that that can slow the process down. If it is randomly chosen to be checked prior to payment, that can add a couple of days to the process.

CHAIR: And that sampling is about 28 percent, is it?

Mr NEWBURY: It is, yes. It is based on risk. We check 10 percent of all applicants where the consideration is under \$300,000; if it is between \$300,000 and \$600,000 we do 60 percent and if it is over \$1 million we do every one of them.

CHAIR: It is pretty high sampling.

Mr NEWBURY: Yes.

CHAIR: Who performs those - OSR?

Mr NEWBURY: OSR staff.

CHAIR: And generally speaking - you have answered this question already - there have not been too many issues of concern arising from that sampling?

Mr NEWBURY: Since May we have done 4,550 and I think found 13 where there was prior ownership.

Mr WITHERS: Could I perhaps go back to the previous question and I might be able to help you just a little: I have in front of me a copy of a typical letter that we send to a financial institution after an audit. This is a letter that was actually sent and it just articulates the concerns that we had, so it may be helpful.

The Hon. PAM ALLAN: Do you want to table that?

Mr WITHERS: Certainly.

The Hon. PAM ALLAN: Do you believe the audit coverage of financial institutions and grant applications is adequate to give you sufficient assurance that all institutions and applicants are complying with legislative and OSR requirements and that fraudulent or duplicate payments are not occurring?

CHAIR: The legislative issue is the most important part.

Mr WITHERS: Yes, I am satisfied that the coverage is sufficient. When I say that I am thinking in terms not only of the audits of the financial institutions but the volume of individual applications that we audit. If there was a problem with a particular institution I would expect that those audits would show up that a large number were coming from one organisation or another, so yes, I am satisfied.

The Hon. PAM ALLAN: Has the compliance audit program been subject to independent review to ensure that it addresses the specific risks identified?

Mr WITHERS: It has not been subject to independent review, although I think our own internal audit people have had a look at it.

Mr ACHTERSTRAAT: And peer review to a certain extent with the other jurisdictions, although that is not independent either.

Mr UNDERHILL: We have looked at the program.

CHAIR: In relation to the process of checking interstate interests in property ownership, recommendation 6 in the report recommends that interstate ownership be checked for all applications selected for review as part of the compliance audit program. This recommendation was not accepted as implementation would not be cost effective. Could you explain why it would not be cost effective and whether there are any alternative strategies that may mitigate this risk?

Mr ACHTERSTRAAT: The recommendation was that all interstate ownership be checked. The system, because it is a national system, automatically checks whether somebody has been paid a grant before in other States. As to whether someone who has owned a property before 1 July 2000, the recommendation was there that we were to check the land titles records in every jurisdiction. The cost of doing that: There is a monetary cost and a time cost. From memory, they have averaged it out, and I am not sure of the figure, Mr Chairman, but I think it is about \$6 for every check. If you multiply that by eight States it is \$48 per application. We do not check every case of interstate ownership, but on occasion where the risk warrants it we are in a position where we can check interstate ownership if we think there is a high risk. I think our experience is that when there was some checking done on a random basis interstate the results did not indicate a very high risk. That is my understanding.

Mr WITHERS: There has not been one grant where we have asked for repayment based on identification of a prior ownership in another State.

The Hon. PAM ALLAN: If a husband has already owned a property, does that mean the wife is ineligible if it is in her name?

Mr ACHTERSTRAAT: Yes. If a husband and wife purchase a property and one of the parties on the contract has owned a property they are ineligible for the first home owner grant. For First Home Plus they may still be entitled to the New South Wales Government concessions on stamp duty if they meet the other criteria, under the threshold, et cetera.

Mr NEWBURY: And basically they were not our rules, they were the rules laid down by the Commonwealth.

CHAIR: Recommendations 9 and 10 require system enhancements to prevent dummy users from being set up and unauthorised use of log-in IDs. These were scheduled for implementation by 30 September and 31 October 2002. What is the current status of these proposed actions?

Mr NEWBURY: They have all been done. The only variation to the recommendation was that we did not choose to go with the date of birth requirement, again because of privacy issues. There is a personal code number that they use instead of their date of birth, but we did not go with date of birth.

CHAIR: In relation to the risk arising because of the broad interpretation of the legislation, has the policy unit, the RAS, been successful in obtaining changes to the legislation to reduce the risk of abuse and, if so, could you give an example or examples?

Mr ACHTERSTRAAT: Yes, there have been a number of instances where we have changed the legislation. The most notable one is in relation to grants being paid to minors, people under 16 years of age. Originally the national legislation indicated that there was no age requirement. We have changed it in New South Wales so that if a person under 16 is making an application they have to establish to the chief commissioner that it is in fact their first home and they are going to reside in it for 12 months, so there is a real onus on them. That approach I think has been adopted now in one other State as well. There has been another change in relation to requiring persons to actually register the transfer of the land. There was a perceived concern some time ago that if a group of people could enter into contracts and sell the property amongst themselves but not register the land, then we would not have an audit trail necessarily in relation to those situations, so there is a requirement now that in order to get the grant it must be endorsed. There have been also some minor amendments in relation to administrative provisions to tighten it up.

Mr NEWBURY: Could I add that in relation to the under 16 issue there were no actual cases identified at that stage which led to the change, it was more that perhaps there was a perception that it could happen. Since the grant was brought in in July 2000 there have only been 19 grants paid to children under 16 and they have all been checked out by compliance. A number of them are in fact Public Trustee cases where the Public Trustee buys the property on behalf of the minor because perhaps the parents have been killed in an accident.

The Hon. PAM ALLAN: On the issue of unintentional data entry error and duplicate payments, improved name matching software was scheduled to be in production by 31 August 2002. Is this software now in use and is it operating satisfactorily? What are the benefits of this software over the previous matching system?

Mr NEWBURY: That software is in. It is a similar name match rather than having to be identical. It is obviously throwing up more cases now where it appears that the grant may have already been paid. Those cases when they are identified are suspended on the system, that is the status of the case, and until we satisfy ourselves - it has to be OSR staff that do it - that that grant has not been paid previously to the applicant they stay suspended. When they are cleared, then they can be paid.

The Hon. PAM ALLAN: So you are only using name matching?

Mr NEWBURY: Name matching, yes.

The Hon. PAM ALLAN: The internal audit report states that all staff have access to remove reported similar matches of applicants from the screen and there is no documentation of action taken by staff when similar matches occur. Do staff still have access to remove similar matches from the screen and are they now required to document action taken when similar matches are identified?

Mr NEWBURY: Yes.

The Hon. PAM ALLAN: How do you satisfy yourselves that there have been no duplicate payments to date?

Mr NEWBURY: Duplicate payments are cases - and this happens - where an applicant might go to more than one FI, they are shopping around, looking. Once the applicant has been paid on the system they cannot be paid again.

The Hon. PAM ALLAN: Okay, so it is not happening?

Mr NEWBURY: No.

CHAIR: In regard to people residing in the home once it has been purchased, what controls are used there?

Mr ACHTERSTRAAT: The legislation requires that within 12 months of ownership - this is roughly the case - the person must use that or reside in that as their principal place of residence. There is not necessarily a time factor on that, they do not have to be in there for the whole 12 months, in fact they do not even have to be in there for nine months. At the end of the day, we pay the grant before they move into the house, so we do not know whether they have met that condition subsequent. We do have an audit program then 12 months later to determine, on a selected basis, targeted audits and also random audits, whether the persons have in fact moved into the house.

The Hon. PAM ALLAN: By knocking on the door? How do you do it?

Mr ACHTERSTRAAT: There is a system in relation to data matching with utilities. Mr Withers might be able to fill us in a bit more, but it is to do with the electricity, we data match that and if the electricity is in someone else's name then prima facie we say to them: Did you really move in? We have had a couple of ADT cases where persons have not moved in within the 12 months, or at least one case, and we have had to take the grant off them at the tribunal level.

Mr WITHERS: The main checks we carry out are to see whether the electricity has been connected in the name of the applicant and, secondly, to see whether the telephone has also been connected in the applicant's name. If the check throws up that neither of those things are in place we will ordinarily write to the applicant and say: Please show cause why we should not require repayment of the grant. The further check that we do is that we have a data matching program with the Rental Bond Board, so that will throw up most instances where the property may have been put out for lease, et cetera, and the same thing applies there.

(The witnesses withdrew)

(Luncheon adjournment)

RONALD HEGARTY, Director of Audit, Audit Office of New South Wales, Level 11, 234 Sussex Street, Sydney,

STEPHEN JOHN MCLEOD, Director of Audit, Audit Office of New South Wales, 234 Sussex Street, Sydney, and

JEFFREY FREDERICK DOSE, Audit Manager, Audit Office of New South Wales, Level 11, 234 Sussex Street, Sydney, sworn and examined:

CHAIR: We are inquiring into the New South Wales Aboriginal Land Council's mortgage loan investment scheme as you are aware. I will leave it to you as to whoever is the most appropriate person to answer the questions. Can you outline for the Committee the types of loans that were made by the council under this scheme?

Mr McLEOD: There were two types of loans. There were loans to local Aboriginal land councils, to be on lent to members of their community for housing development type spending, and there were loans, as it turned out, to commercial people at commercial rates, like property developer type people, that type of investment.

CHAIR: Commercial developments and residential developments?

Mr McLEOD: As I understand it, mainly commercial I think.

CHAIR: Can you explain in broad terms the Audit Office's concerns in relation to those mortgage loan investments?

Mr McLEOD: We first addressed these issues in the 1998-99 financial year audit, and having identified the mortgage scheme as something that was new and something that was high risk, we listed it as a key audit issue for that year. When we did the audit, we came across a number of issues, mainly in relation to the level and the quality of the documentation that was there to support the loans that had been made.

Our concerns were around areas such as mortgage policies not being on hand when we sought to look at them; valuation reports to properties not being available. Our major concern was, however, that there were a number of loans given valuations that were not done independently and there were also less important issues at the same time that caused us concern in relation to advances to some of the local Aboriginal land councils that did not include terms for repayment. At that early stage there was a loan to a commercial borrower that was already late and overdue. A bank account had been opened for the operation of the mortgage fund without the approval of the council, and there were some doubts about whether the mortgaged properties had actually been insured to cover any losses through fire or whatever. They were our major concerns at the end of the 1998-99 audit.

CHAIR: So what would be your recommended checks and balances for the loans to the other land councils, as opposed to the commercial loans?

Mr McLEOD: I think the checks and balances would probably be the same, no matter what the nature of the loan was. The thing that we wanted to do was to actually see that the terms of the Trustees Act had been followed, and that Act mainly talks about there being independent valuations obtained from the mortgaged properties, for obvious reasons. It also lays out some conditions regarding the amount of the advance in relation to the valuation of the property. You can only get a loan up to 66 percent of the valuation of the property. We were seeking to see documentation that supported that those actions had been followed and that normal practice for that type of operation was followed.

Mr GLACHAN: So you looked at this first in 1998 -

Mr McLEOD: 1998-99.

Mr GLACHAN: - you first raised this issue?

Mr McLEOD: Yes.

Mr GLACHAN: Have you looked at them since and have there been any changes?

Mr McLEOD: Yes, we have looked at them in the subsequent two years, 1999-2000 and 2000-2001. There have been changes to the extent that I think after that first year the council stopped making loans to commercial people. So while the problems were still there in terms of lack of documentation, the problems did not increase because they were no longer continuing to make loans of that nature. They have continued to make loans to local Aboriginal land councils and I think we had some minor concerns about those, but nothing to the degree of the first year that we looked at it.

Mr GLACHAN: So they have introduced better practices?

Mr McLEOD: Yes.

CHAIR: So there has been a sizeable response to the first time that the issue was raised in the Parliamentary report? I mean it may not be a complete and sufficient response, but a sizeable response?

Mr McLEOD: Yes, given the two years that have passed since we first put our concerns to the council, yes. My answer would be yes.

CHAIR: In relation to the loans to the other land councils, are you satisfied that the checks and balances in those, subsequent to your first report and even your second report, have been ones that addressed most of the risk issues involved?

Mr DOSE: Well, I must admit our main interest has been in the commercial mortgages. That is where our main fears were. At least with the local area land councils, they were paying their payments on time.

CHAIR: So there is no issue there about that?

Mr DOSE: No, there is not.

CHAIR: There are no risks that you are concerned about?

Mr DOSE: The commercial mortgages went bad almost immediately.

Mr GLACHAN: What security was on those loans?

Mr DOSE: The local Aboriginal land council loans?

Mr GLACHAN: No, the commercial loans.

Mr DOSE: It was a full commercial situation. They had certificate to title over the land, which is one of the things obviously we are checking for.

Mr GLACHAN: But to whom were they lending money?

Mr DOSE: To commercial developments.

Mr GLACHAN: Anybody who applied who was looking for a loan?

Mr DOSE: Well, generally. I do not know how that came about to select those people.

Mr McLEOD: They were not necessarily Aboriginal people.

CHAIR: On the mortgage loan investment write-offs, we understand a total of \$4.7 million has been written off to date. The major portion, \$4.4 million, relates to a single development. Do you believe any of this \$4.4 million is collectable?

Mr DOSE: I think we have got a case for collecting it. It appears that the original valuation was not an independent one and subsequent valuations even were not very accurate, but the first valuation that it was based on, which was not independent, looked very bad, right out of the - so I would think -

CHAIR: So on the issue of recoverability?

Mr McLEOD: On the issue of recoverability, I think it is fair to say that there is a legal right to recovery. Whether there is sufficient value in the asset that they are trying to recover, we cannot comment on that.

Mr DOSE: Any recovery against that, there would have to be subsequent legal action against the valuer.

Mr COLLIER: In non-performing mortgage investment loans, the council's largest exposure at the moment is a development with a balance outstanding at 30 September 2002 of \$9.6 million. Are you satisfied with the council's strategy to complete construction of the complex to lock up stage to recover the outstanding balance?

Mr DOSE: We can only talk about that really up to 30 September 2001. At that time, we went through the logic of that and the experts they referred to and it seems to be the best option on the information that we had. So we were satisfied that they reviewed it properly with a view to getting the best possible return.

Mr McLEOD: It was really a choice between selling the property as it stood, an incomplete building, or spending some money and taking it to completion.

Mr GLACHAN: Can you comment on when the project is expected to be completed, you do not know?

Mr McLEOD: No, we do not know.

Mr GLACHAN: And you do not know how much more money would need to be put into it?

Mr McLEOD: No.

CHAIR: Are you aware of the recent market report that the council secured in relation to the valuation?

Mr McLEOD: As Geoff said, the last time we actually had a look at it in detail was September 2001. So we have not seen any report after that time.

Mr HEGARTY: I think it is fair to say, Mr Chairman, that in discussions earlier this year with the chief executive of the council, I think the chief executive was confident that they would proceed to pretty well full recovery.

Mr COLLIER: Performing loans to Aboriginal land councils totalled approximately \$750,000 at 30 September 2002. Do you have any concerns about the recovery of those loans and are they performing to the terms of their agreements?

Mr McLEOD: As was mentioned earlier, we have completed an audit to 2001. We have not commenced the 2002 audit, so we have done no detailed work to enable us to comment.

CHAIR: But at that time you were happy with the performing loans?

Mr McLEOD: Yes, there were only two last time we did the audit and they were fine.

CHAIR: Do you agree, Mr Dose?

Mr DOSE: Well -

CHAIR: The performing ones?

Mr DOSE: The performing ones. There was not too many of them.

(The witnesses withdrew)

JEFFREY JOHN BRADFORD, Chief Executive Officer, New South Wales Aboriginal Land Council, Level 9, 33 Argyle Street, Parramatta, affirmed and examined, and

STEVEN NARAYAN, Manager, Financial Operations, New South Wales Aboriginal Land Council, 33 Argyle Street, Parramatta, sworn and examined:

CHAIR: You have made a submission. Is it your wish that the submission be included as part of the sworn evidence?

Mr BRADFORD: It may be, yes.

CHAIR: Do you wish to add to that submission?

Mr BRADFORD: No.

CHAIR: Could you please outline what strategy the council and you, in your position as Chief Executive Officer of the New South Wales Aboriginal Land Council, have followed since 30 September 2001 to address the mortgage loan issues raised by the Auditor-General?

Mr BRADFORD: Yes. One of the main concerns was the Kestral property at Wollongong. As I said in my submission, I took up the position in June of 2001. I have had some experience in the building industry. When I looked at the Kestral property and saw the effect of disposing as is, it was possible that the council would lose close to \$2.5 million. The property was 80 percent complete. We were mortgagees in possession. It appeared to me that our best course of action would be to complete the premises and to attempt to recover all of the money that was outlaid. I had recently been involved in the completion and restoration of the Australia Hall in Elizabeth Street. That was a project of \$7.5 million which we were able, when I was the manager of the Metropolitan Local Aboriginal Land Council, to bring in on time and under budget. Since taking on that particular project there have been a number of problems that we have been confronted with, not the least being the collapse of HIH Insurance and the considerable problems we have now experienced with home warranty insurance.

The developer who was actually involved down there - he may be known to some of the members here - is Mr Bruce Maples. I have yet to come across a more unscrupulous person. The amount of rectification work that we will have to do on those premises will probably be close to \$1 million, I would say, yet there appears to be still enough fat, as I like to call it, in the building for us to recover our money. The last valuation that we received from our marketing people was that we could expect to receive somewhere between \$13.5 million and \$14 million for the completed premises. That allows us still, if we are not able to do anything over the insurance matters, to complete the building and still get our money back.

The next mortgage of real concern was Stonehaven, the one in South Australia, where I had little option other than to eventually take a loss on that particular premises. We have not given up; we are still actively involved in pursuing the valuers involved against their professional indemnity insurance. I am not convinced at this stage that there was not a great deal of skulduggery that went on in the way that that mortgage was obtained. I believe the valuations to be false and our legal team believe that we have a good case of possibly recovering our money from the valuer.

Some of the other mortgages, as you will see on the sheet submitted by myself in my submission, we have been able to fully recover by actively pursuing the people. Most of them, the ones that I have dealt with, appear to have the funds salted away and if you pursue them hard enough and long enough you eventually get your money back. I do believe that we will eventually make good on those loans. There is no more of that taking place, especially while I am the Chief Executive Officer of that organisation, because I do agree with some of the things that were said previously: It was just a soft touch, the way it was handled. As you will see, the previous financial controller is no longer with us, I terminated his employment. I terminated the relationship with the solicitors involved. The previous business manager is no longer in our employ. I think it is an episode that is regretful, it is extremely regretful, especially for me. I have spent all my time in the movement since the Land

Rights Act was enacted and, as an active member of my community, I was quite concerned at the losses that were being sustained by the New South Wales Aboriginal Land Council and that will not happen again.

CHAIR: So there have been no more mortgage loans since you started in 2001?

Mr BRADFORD: No, there have been some under consideration, not with these types of people. There was consideration for the Darkinjung Local Aboriginal Land Council, who you may have seen recently signed off on a very lucrative arrangement with the Mirvac Corporation and they have been seeking some funds from us to carry them through until the actual flow of capital starts to come from the Mirvac Corporation, but all of the prudent tests have been put in place. I have engaged a very reputable mortgage firm to do all the ground work and make sure that the securities we have are more than ample to cover any funds we may advance.

Mr COLLIER: You said, Mr Bradford, that you were of the view that somebody at least had made some false valuations. Given that that is the case, are there any police investigations or criminal proceedings that have been set in train in relation to that?

Mr BRADFORD: I think I may have mentioned in my submission that my first priority is to try and recover the organisation's funds and, if we are successful in that and have that satisfied, one then could start to look at how this came about.

Mr COLLIER: When the last loan was made, who was this to, what sum was involved and is it performing according to the terms of the agreement?

Mr BRADFORD: Which was our last loan? I would probably have to do a bit of research. You will have to forgive me there. My main concern has been recovery.

CHAIR: It is before your time.

Mr BRADFORD: Yes. There has been none made since I was there.

Mr NARAYAN: These had all been made in 1998-99.

Mr GLACHAN: For some years an investment committee controlled the scheme. When was the committee disbanded and who is responsible now for managing and monitoring the scheme?

Mr BRADFORD: The whole investment committee was disbanded not long after I took over. I found that that was one of the issues that needed to be dealt with. In my opinion, it failed to stack up to checks and balances. Any money now that comes out of the investment account has to be a decision of the full council.

CHAIR: Is there any monitoring on the performance and the collection of the mortgage loans that are outstanding by the council?

Mr BRADFORD: I report to council. I have been given the carriage of the recovery. Council only meet bi-monthly and, of course, the day-to-day operations of the organisation are my responsibility.

CHAIR: And council oversights your progress?

Mr BRADFORD: Well, yes, I prepare reports to council and keep them informed of the progress.

Mr NARAYAN: In addition to that, we usually provide monthly reports to the council which will show all the debtors and the loans so that they can see the movement on a month-to-month basis. With Anders we have collected the full \$1.1 million. The other one is Quinimont where we are hoping to get the full amount. A contract was signed just yesterday, so we will be able to recover

that in full. The other one is Travellers Oasis. We are still getting the rent of \$10,000 a month and there is a possibility that the owner is seeking refinance to pay off that one too. So hopefully we should be able to recover all of the outstanding loans.

Mr COLLIER: We understand that a loan of \$4.7 million has been written off and a major proportion, \$4.4 million, relates to one development. Could you please explain why it has been necessary to write these amounts off?

Mr BRADFORD: That goes back to the issue that I raised where I believe there was skulduggery in the way the valuations were presented to council. When that particular mortgage started to fail we had our solicitors and receivers that we had appointed on it and this is when we uncovered certain problems and we attempted to dispose of the properties. It went out to tender. The best offer we could get was the price which we eventually took, which was around the \$900,000 mark. We had to write the rest off. There was no way that we were going to get the value that that property was supposed to be worth. As I said, it was an inflated valuation; it was based on false expectations. There was a relationship, I believe, between the valuer and the person involved in receiving the funds, and I do not like to say this but--

CHAIR: We will not mention any names.

Mr BRADFORD: No, but I believe it has to be accepted that the council at that particular time was just a soft touch. There is no way that they would have got those funds if I had been there, I can assure you of that.

CHAIR: Do you anticipate being able to collect any of the \$4.7 million?

Mr BRADFORD: That is the one we are pursuing the action against the valuers professional indemnity.

CHAIR: How is that progressing?

Mr BRADFORD: It is good. It has got to the stage now where we are getting close to want to commence proceedings. We are hoping that it will be settled, that the insurance company may wish to talk to us and settle out of court.

Mr COLLIER: The other amounts written off, totalling approximately \$300,000, are steps being taken to recover these amounts, and, if not, why not?

Mr BRADFORD: Mr Jumeau?

Mr NARAYAN: We filed a bankruptcy notice against Mr Jumeau. That is the biggest one in there.

CHAIR: How much is that worth?

Mr NARAYAN: \$170,000. There is a bankruptcy notice that has been filed against him.

Mr COLLIER: When did you file that?

Mr NARAYAN: About two or three weeks, two weeks ago. What is happening is, it was very difficult to trace him. The solicitors Michell Sillar were trying to trace him and they could not but at last I think they found him in Perth somewhere. So now they have served the -

Mr COLLIER: Your solicitors are Michell Sillar, are they?

Mr NARAYAN: Yes, Michell Sillar are our solicitors. They managed to get hold of Jumeau, because what we thought is that after that we will go to the valuer. So what will happen is first we will issue a bankruptcy order on Jumeau, and if Jumeau fails and we cannot recover anything,

then the next alternative is that we can go and sue the valuer.

Mr GLACHAN: What sort of a property was this?

Mr BRADFORD: It was a type of a residential property. I will be honest with you, I have never paid a great deal of attention to the actual physical type of the properties, other than the Kestral property at Wollongong.

Mr GLACHAN: What was that, a block of units?

Mr BRADFORD: Yes, it was over on the North Shore somewhere. But he is like a number of the people, extremely slippery.

Mr NARAYAN: Yes. One is the land and the other one was a backpacker hostel and another one we are dealing with which we have said we might recover the full amount is Quinnimont which is vacant land at Airlie Beach. So mostly it was land. Jumeau was land too.

Mr GLACHAN: If they paid a certain amount for the land, it has got to be worth that amount again, has it not?

Mr NARAYAN: No, like Quinnimont, the valuation when they gave the loan was \$2.1 million and now we are getting a valuation which is \$950,000, and then there was a deal signed with somebody else for \$825,000 and the receiver received \$82,500, but we rejected it because, as I explained, Lang Walker was putting in about \$80 million in the Airlie Beach resort. Definitely, if he is putting in the money, that place might be coming up. The same guy who defaulted on that has come back and offered us \$1.4 million. Then what has happened is he got a loan of \$1 million but the other guy who was giving him the \$400,000 pulled out at the last minute. So that is why we had to go back to another person who is offering us \$1.3 million in cash plus \$800,000 in contrabart dollars, which is only acceptable in the Gold Coast.

Mr COLLIER: What sort of dollars?

Mr NARAYAN: Contrabart dollars, 1.3 million.

Mr GLACHAN: I would not take anything like that. I would take hard cash and check that it is genuine notes too. I would hold them up to the light one by one.

Mr NARAYAN: That is the one that they have signed the contract in Queensland at the moment.

Mr COLLIER: Time share accommodation, is it?

Mr BRADFORD: It only operates apparently around the Gold Coast area.

Mr GLACHAN: These valuers, are they registered valuers?

Mr BRADFORD: If we go back to the Stonehaven issue, yes.

Mr GLACHAN: They are registered valuers, members of a professional organisation?

Mr BRADFORD: Yes. That is why we are pursuing them.

Mr GLACHAN: Can we go to the non-performing investments loans, the council's largest exposure at the moment is the development that has a balance outstanding at 30 September 2002 of \$9.6 million. What is your strategy for recovering that? You are having a crack at the valuer?

Mr BRADFORD: No, that is the property I referred to where we are now mortgagee in possession. It is an eight storey, 32 unit apartment building, and that is the one we have been having

considerable problems with over the lack of insurance. I am at a loss as to how the developer was allowed to get away with what they have got away with down there. There are documents missing from the council involved down there; they seem to have disappeared. I think he had 100 notices served on him by WorkCover. I mean, we are yet to tackle that issue. Our main concern, of course, is to get the building finished and get our money back.

CHAIR: When do you expect that to happen?

Mr BRADFORD: I would like to have it finished, hopefully early in the New Year, because we do not want to run into a downturn in the market, because that could really affect our ability to recover the money.

Mr GLACHAN: So what is it going to cost you to finish the job? Have you got an estimate of that?

Mr BRADFORD: I think we would be looking for another \$2.5 million.

Mr GLACHAN: What will you get back then when you sell the units?

Mr BRADFORD: If we take the lower end of the market reports, it would be \$13.5 million.

Mr GLACHAN: Will that mean that you will get all your money back?

Mr BRADFORD: That is what it looks like at the moment. We cannot make a profit on it of course, because we are only the mortgagee in possession and the next person in line for their money is the National Australia Bank. If there is anything left over, it will go to probably the National Australia Bank.

Mr COLLIER: So you rank ahead of them?

Mr BRADFORD: Yes.

Mr COLLIER: You are the first mortgagee, are you?

Mr BRADFORD: Yes.

Mr COLLIER: Being ahead of the bank is something positive.

Mr BRADFORD: Yes.

CHAIR: So how did you obtain the valuation and what process did you undertake?

Mr BRADFORD: On?

CHAIR: On this project?

Mr BRADFORD: The current valuation?

CHAIR: Yes.

Mr BRADFORD: The receiver managers were Smith Hancock, and when I decided that we would proceed with the building to finish it, I retained the services of the receiver managers for probity purposes. As an organisation, I wanted to stay well and truly at arms length of dealing with any contractors and so forth, so there could be no question as to the integrity as to how the issue was being handled, and then the obtaining of the valuations was given to the receiver managers. That was David Nelson and Partners, a well respected firm in that area, and also the premier unit disposal group in Wollongong, Bevans, provided the valuation. We get two. Both marketing reports, the end result is very similar, although their valuations on each individual unit vary slightly. One may be dearer and

one may be cheaper, but the end result, the gross amount is roughly the same, around the \$13.5 million to \$14 million.

Mr GLACHAN: You mentioned earlier that you were a bit concerned about home warranty insurance and the HIH collapse. That should be settled within the next couple of weeks, should it not?

Mr BRADFORD: I hope so. The real concern, or an issue that would have made life easier - the Government has appointed an assessor to go out and have a look at all these problems and we would probably be dealing or underwriting the cost of repairs as a result of the collapse of HIH, but we have been unable at this stage to establish whether this particular developer actually had any insurance with HIH. It is claimed that he did. The receiver for HIH has not been able to find any evidence at this stage, and certain files from Wollongong council seem to have disappeared. So we have been unable to find any documents down there attached to their development approvals evidencing that Mr Maples actually had home warranty insurance.

Mr GLACHAN: What if he did not, what happens then?

Mr BRADFORD: Well, we go back to the issue that first-off the main concern is to finish the premises and dispose of them, then chase up the various parties involved to see whether it is anyone else's fault. Now that could take us years. I do not have that luxury. The main concern is there appears to be enough in the building to allow us to do the rectification work and to complete the building. The home warranty issue, from the time that we took over until now, looks like being resolved in the next couple of weeks, so that will not be a hold-up for us proceeding, but the rectification work it looks like we are going to have carry ourselves at this particular time.

Mr GLACHAN: Can you give us an example of some of the rectification work?

Mr BRADFORD: Yes, the brickwork, storeys of it, not tied off to the studs. There were ties put in there and never nailed off. We have had to scaffold areas up there now to stop them from collapsing. There was no guarantee that it would stay there. We have had to pull linings out in the walls of those units to check that the brickwork was actually tied off because it has been cracking. When we have done that, there are some ties there, but some have never been nailed off and others just never reached the stud, and they were not stainless steel, as required with any building closer than three kilometres to the sea, they were just the galvanised ties that would have eventually rusted away anyway.

Mr GLACHAN: Who was supposed to inspect that at the time?

Mr BRADFORD: Wollongong Council. That is the question you have to ask yourself: How could this be signed off? I am preparing a submission to John Aquilina, who is the Minister for Department of Fair Trading. I would like them to have an inspection of those particular premises to be aware of what is going on. It is really, really worrying.

CHAIR: The other significant non-performing loans at 30 September 2002 total \$2.1 million. What has the council done to collect these outstanding balances?

Mr NARAYAN: Is that Quinimont? That is \$1.1 million. That is the one where the contract has just been signed for \$1.3 million plus 800,000 contrabart dollars. The other one is Travellers Oasis where we are still getting rent, but the present owners want to pay it and they are looking to refinancing. I think the lease on that property expires in March.

Mr GLACHAN: They are paying you rent?

Mr NARAYAN: Yes, they are paying rent, we are collecting rent and we have appointed the receiver, so it is being paid straight to the receiver and the receiver has given them time until January to paint the place before the renewal of the lease in March and they are looking for refinance to pay that.

CHAIR: With the Quinimont deal, are you accepting that offer with the funny dollars?

Mr NARAYAN: Well, \$1.3 million cash, and the 800,000 is the funny dollars, but if we can use it for something else--

Mr GLACHAN: But how are you going to use funny dollars?

Mr NARAYAN: Well, if we want to buy something from the Gold Coast, we might be able to buy stationery, I don't know.

CHAIR: Is that the only offer you received?

Mr NARAYAN: Yes. Well, as I said, we evaluated it at \$950,000.

CHAIR: Right, so you are recovering your money, more than your money?

Mr BRADFORD: Yes.

CHAIR: But nonetheless there might be an opportunity to recover even more?

Mr BRADFORD: There has not been to date.

CHAIR: So you have tried that?

Mr BRADFORD: Yes.

Mr GLACHAN: What about loans to other Aboriginal Land Councils. Are they performing?

Mr NARAYAN: Yes, they are performing.

Mr GLACHAN: No worries about that?

Mr BRADFORD: No.

Mr NARAYAN: No, we have control over them because we do the funding and we deduct each quarter from the funding.

CHAIR: Mr Bradford, is there anything else you would like to tell the Committee?

Mr BRADFORD: No.

CHAIR: We want to congratulate you on the work that you are doing in recovering this lost money, and you too, Mr Narayan. We wish you the very best of luck.

(The witnesses withdrew)

(The Committee adjourned at 2.50 p.m.)