LEGISLATIVE ASSEMBLY FOR THE AUSTRALIAN CAPITAL TERRITORY

AUDIT (AMENDMENT) BILL 1993

Report Number 1 of the Standing Committee on Public Accounts

June 1993

RESOLUTION OF APPOINTMENT

On 27 March 1992 the ACT Legislative Assembly established a Standing Committee on Public Accounts with the following terms of reference:

(1) Examine –

(a) the accounts of the receipts and expenditure of the Australian Capital Territory;

(b) the financial affairs of authorities of the Australian Capital Territory; and

(c) all reports of the Auditor–General which have been laid before the Assembly;

(2) Report to the Assembly, with such comments as it thinks fit, any items or matters in those accounts, statements and reports, or any circumstances connected with them to which the committee is of the opinion that the attention of the Assembly should be directed; and

(3) Inquire into any question in connection with the public accounts which is referred to it by the Assembly and to report to the Assembly on that question.

INQUIRY TERMS OF REFERENCE

On 18 May 1993 the Legislative Assembly agreed to the following motion:

> That, notwithstanding the provisions of standing order 174 –
>
> (1) the Audit (Amendment) Bill 1993 be referred to the Standing Committee on Public Accounts for inquiry and report by 15 June 1993; and
>
> (2) on the Committee presenting its report to the Assembly resumption of debate on the question "That this Bill be agreed to in principle" be set down as an order of the day for the next day of sitting.

MEMBERSHIP

Mr Trevor Kaine MLA (Presiding Member)

Ms Annette Ellis MLA (Deputy Presiding Member)

Mrs Kate Carnell MLA

Mrs Ellnor Grassby MLA

Mr Michael Moore MLA (from 25 February 1993)

Secretary: Ms Karin Malmberg

RECOMMENDATIONS

The Committee recommends that:

- the Bill be amended to specify that contracts with external funds managers limit, to 5% of all moneys invested, the amount that may be invested using financial derivatives. (para 2.11)
- the Assembly agree to the Audit (Amendment) Bill 1993, conditional upon:
  - all investments by the Territory being undertaken through the ACT Borrowing and Investment Trust Account;
  - a broadly based management board be established to advise on and oversee the investment operations of Territory moneys through the ACT Borrowing and Investment Trust Account; and
  - the management board provide the Assembly with comprehensive information relating to all investment strategies and operating practices of external funds managers where used, in addition to annual financial statements and audit reports. (para 2.25)

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1 INTRODUCTION

Background

1.1 On 25 March 1993 the Treasurer presented the Audit (Amendment) Bill 1993 to the Legislative Assembly and tabled the associated explanatory memorandum. A background explanatory statement was later circulated to Members.

1.2 The purpose of the Bill is to amend the Audit Act 1989 to extent the use of financial derivatives to the investment of funds from Trust Accounts, enabling the Territory, where approved by the Treasurer, to use financial derivatives in the investment of any moneys standing to the credit of the Territory Public Account.

1.3 Financial derivatives provide investors with an agreed future price or interest rate for market securities and are used by fund managers as a means of protecting investment exposures from unfavourable price changes or interest rate movements.

1.4 The Bill will also enable the Treasurer to authorise the use of financial derivatives by persons under contract to the Territory who manage the investment of moneys belonging to specified Territory Trust Accounts without having to certify individual transactions.

1.5 Debate on the question that the Bill be agreed to in principle was adjourned on 25 March and resumed on 18 May. Following a further adjournment of the in principle debate Mr Moore moved that the Bill be referred to the Public Accounts Committee for inquiry and report by 15 June 1993.

Approach to inquiry

1.6 The Committee held two public hearings during the course of the inquiry. On 31 May the Committee heard evidence from officials of ACT Treasury on the scope of the Bill and the implications of the proposed amendments to the Audit Act 1989. On 7 June the Committee heard from Professor Allan Barton, Pro Vice–Chancellor (Finance and Fabric), Australian National University.

1.7 The Committee was also provided with a background paper by Treasury which outlined the proposal in more detail.

2 THE BILL

Purpose of the Bill

2.1 As stated in Chapter 1, the purpose of the Bill is to extent the use of financial derivatives to cover the investment of funds from Trust Accounts. The Bill will also enable the Treasurer to authorise the use of financial derivatives by persons under contract to the Territory who manage the investment of moneys belonging to specified Territory Trust Accounts without having to certify individual transactions.

2.2 It is noted that it is intended by the Treasury that the moneys of the ACT Superannuation Provision Trust Account only be invested under this proposal if agreed to by the Assembly, although the use of external funds managers and financial derivatives will be available to be used for all Trust Accounts, if so prescribed by the Treasurer. (See proposed clause 33F (2A).)

Concerns raised

2.3 During the in principle debate in the Assembly a number of concerns were raised, many of which were addressed by the background material provided by Treasury to the Committee prior to the hearing. The Committee believes that if this material had been available to the Assembly prior to the in principle debate, then the Committee's inquiry may not have been initiated.

2.4 The Bill has two major elements, the extension to Trust Funds of the use of financial derivatives and the use of external funds managers to manage the investments of Trust Accounts specified by the Treasurer.

2.5 A number of issues arose during the inquiry, principally the removal of the Executive from the management of and responsibility for the investment of the prescribed Trust Accounts. Also, on first examination of the Bill, it appeared that there was a lack of an investment strategy and management structure to ensure returns would be within acceptable levels of risk.

Financial derivatives

2.6 Section 4 of the Bill removes the current exclusion that prevents moneys standing to the credit of the Trust Fund being invested in financial derivatives.

2.7 Currently, management of Territory cash balances is undertaken through the ACT Borrowing and Investment Trust Account. The investments undertaken through the ACT Borrowing and Investment Trust Account are confined to the money market and Treasury uses its in–house expertise to manage those investments.

2.8 Treasury officials advised the Committee that returns from the money market in recent years have declined and there is considered to be a need to diversify the forms of investment that can be undertaken, in particular for superannuation funds which are longer term investments.

2.9 The Committee is somewhat concerned that the proposed amendment would move investment of Trust Account moneys, particularly superannuation funds, into relatively higher risk investments than are currently being undertaken, at a time when the returns from more conservative investments are lower than in the past. The volatility of the proposed forms of investments was acknowledged by Treasury officials who consider that the expertise of specialist external funds managers is necessary.

2.10 The Committee however notes that a diversified investment strategy is proposed, and it is also noted that the use of derivatives is proposed for only a relatively small proportion of total funds invested. The Committee believes that a maximum of 5% of total invested moneys should be invested in financial derivatives. The Bill should be amended to require this and this limit should be included in all contracts to ensure a continuation of a relatively conservative investment strategy.

2.11 The Committee recommends that:

- **the Bill be amended to specify that contracts with external funds managers limit, to 5% of all moneys invested, the amount that may be invested using financial derivatives.**

External funds managers

2.12 Treasury acknowledges that it does not have the experience or expertise in managing forms of investment other than the money market and as such it is proposed that external funds managers be contracted to undertake those investments if the amendment to the Act is agreed to.

2.13 Under the Audit Act the Treasury may enter into the transactions prescribed by the Act if certified by the Treasurer. The amendment proposes that this requirement not apply in relation to transactions entered into by external funds managers for the investment of funds of a Trust Account, subject to any conditions specified by the Treasurer.

2.14 Treasury advised that when using a funds manager the contract to be signed would specify constraints and parameters similar to those which would be in place if the Treasury was satisfying the Treasurer regarding transactions it was entering into.

2.15 The Committee is, however, concerned at the arms length relationship between the Territory and the funds managers, and the possible effect on public accountability. The Committee notes Treasury advice regarding the specifications and constraints contained in the contract, including the requirement for fidelity guarantee insurance, and that the contractors would be held responsible for any negligence, dishonesty, fraud etc.

2.16 The Committee notes the external funds managers will be subject to audit by a registered company auditor and, in addition, the Auditor–General will be entitled to audit the performance of the external parties of their obligations.

Board of management

2.17 The Committee notes that the effect of subsection 4(c) of the Bill is to insert a new subsection into the Act to allow the Treasurer to specify that moneys standing to the credit of a Trust Account could be invested by an external funds manager, including the use of financial derivatives.

2.18 The Committee is of the view that the ACT Borrowing and Investment Trust Account should be the only vehicle through which investment of Territory funds is undertaken.

2.19 The Committee believes that a board of management should be established to advise on and oversee all investments undertaken through the ACT Borrowing and Investment Trust Account. This would also include the appointment and oversight of external funds managers. Through the board accountability to the Assembly and Executive would be achieved, including the advice of investment strategies and operational matters relating to borrowings and investments of the Territory.

2.20 The Committee considers that the board should comprise a broad base of expertise able to advise the Treasury in particular on dealings with external funds managers and a wide range of investments, expertise that Treasury acknowledges that it does not have.

2.21 Allied to the Committee's concern regarding accountability is the need to ensure that a clearly defined investment strategy exists and visible operational procedures are promulgated.

2.22 The Committee was satisfied that the proposals outlined in the background material regarding the proposed investment strategy and operational procedures should suffice.

2.23 In relation to the investment strategy, the Committee believes investment of all available Territory funds, not only superannuation funds, should be targeted towards productive enterprises and employment generating industries. The strategies pursued should be productive for both the Territory and the community.

Conclusion

2.24 The Committee supports the Bill as proposed but with certain conditions. All investments of the Territory should be made through the ACT Borrowing and Investment Trust Account and funds should not be invested directly from the ACT Superannuation Trust Account (or any other Trust Account). In addition, the Committee is of the view that a management board should be established to advise on and oversee all investment transactions of the Territory.

2.25 The Committee recommends that:

- **the Assembly agree to the Audit (Amendment) Bill 1993, conditional upon:**
    - **all investments by the Territory being undertaken through the ACT Borrowing and Investment Trust Account;**
    - **a broadly based management board be established to advise on and oversee the investment operations of Territory moneys through the ACT Borrowing and Investment Trust Account; and**
    - **the management board provide the Assembly with comprehensive information relating to all investment strategies and operating practices of external funds managers where used, in addition to annual financial statements and audit reports.**

Trevor Kaine MLA
Presiding Member
15 June 1993

Appendix A

LIST OF WITNESSES

31 May 1993

ACT Treasury

Mr M Woods
Mr C Bellchambers

7 June 1993

Professor A Barton, Pro Vice–Chancellor, Finance and Fabric

Appendix B

LEGISLATIVE ASSEMBLY FOR THE AUSTRALIAN CAPITAL TERRITORY

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Mr Trevor Kaine
Chairman
Public Accounts Committee

Dear Mr Kaine

REPORT NO.1 OF THE STANDING COMMITTEE ON PUBLIC ACCOUNTS JUNE 1993

We wish to advise that we dissent from the Committee's majority Report on the following grounds.

The need for a seperate Board of Management to oversight investment policy has not been established. We note that the Treasury already has available to it a range of advice both through the Government's appointed actuary and through a range of investment advisors. It is not clear what the appointment of a Board is designed to achieve.

The proposed role and status of the Board is also unclear. If the Board is to be advisory only it is difficult to see how it could appoint external funds managers and how its proposed accountability to the Assembly and the Executive is to be achieved.

We are concerned that prescribing a limit of 5% on the use of derivatives would restrict the level of protection that could be gained by using derivatives in various market situations.

It would seem preferable therefore to determine the use of derivatives according to the nature of the investments to be undertaken and for a limit to be defined in the investment contracts providing they are not used speculatively i.e. they must compliment the underlying investment strategy in terms of trends in the physical market.

Yours sincerely

ANNETTE ELLIS

ELLNOR GRASSBY