APRA ANNUAL REPORT 2006

The Australian Prudential Regulation Authority (APRA) is the prudential regulator of the Australian financial services industry.

It oversees Australia's banks, credit unions, building societies, life and general insurance companies and reinsurance companies, friendly societies and most of the superannuation industry. APRA is funded largely by the industries that it supervises. It was established on 1 July 1998.

APRA currently supervises institutions holding approximately $2.5 trillion in assets for 20 million Australian depositors, policyholders and superannuation fund members.

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Our vision is to be a world-class integrated prudential supervisor recognised for its leadership, professionalism and innovation.

Our core mission is to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions we supervise are met within a stable, efficient and competitive financial system.

We also act as the national statistical agency for the Australian financial sector and play a role in preserving the integrity of Australia's retirement incomes policy.

Our values underpin the critical role we play in protecting the financial well-being of the Australian community. High standards are required in everything we do. In our work and in our interactions with others, we value and seek to demonstrate:

Integrity

Collaboration

Professionalism

Foresight

Accountability

Our supervisory approach is forward-looking, primarily risk-based, consultative, consistent and in line with international best practice. The approach also recognises that management and boards of supervised institutions are primarily responsible for financial soundness.

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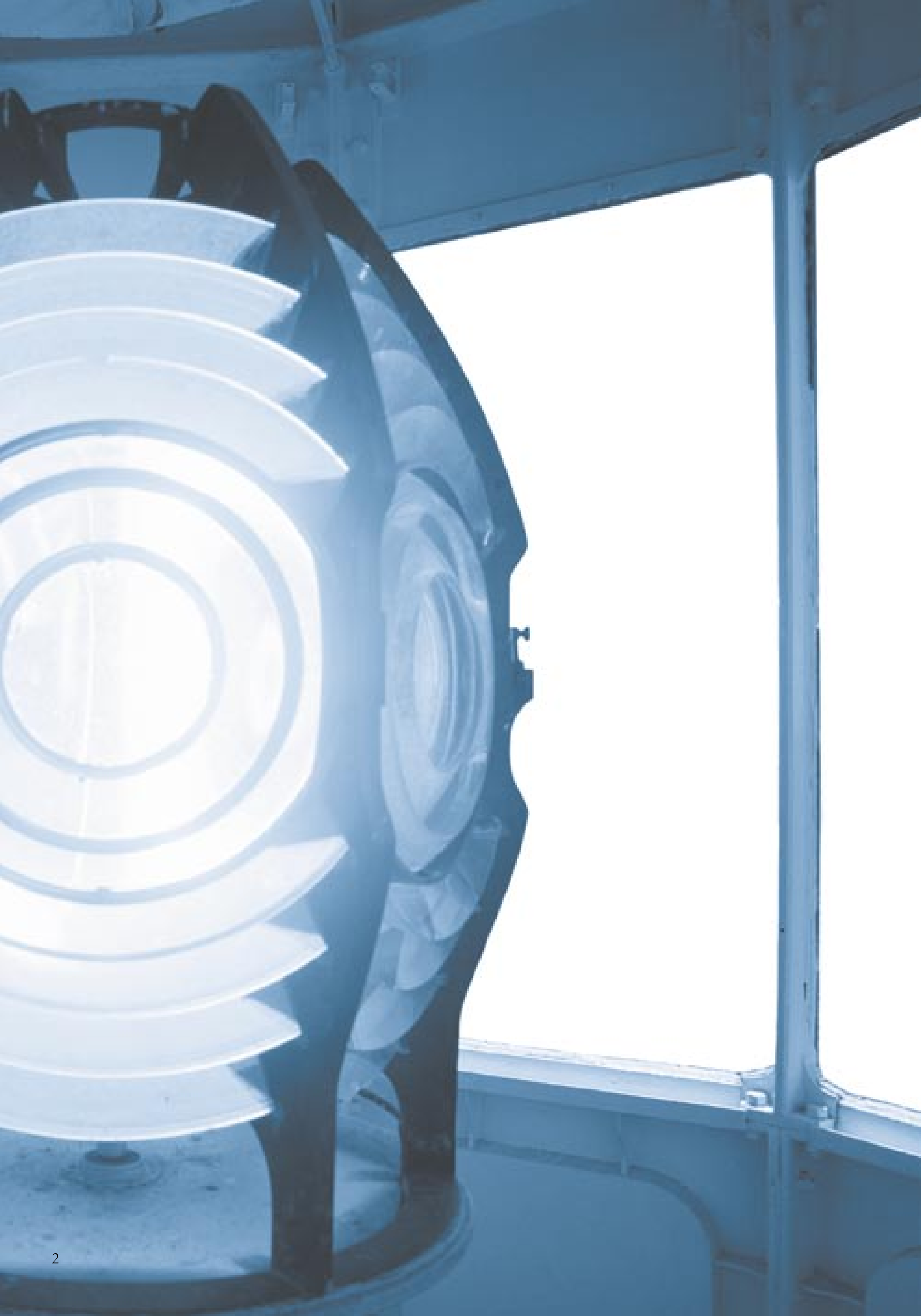

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From the Chairman

The year 2005/06 was APRA's most active in its relatively short history. The substantial task of licensing superannuation trustees was completed on time and other major reforms to Australia's supervisory framework were introduced, after extensive industry consultation. These initiatives, together with the increasing demands on APRA from its day-to-day supervision of financial institutions, were a considerable test of APRA's skills, energies and resources – one that, APRA's Executive Group believes, was passed very successfully.

The strengthening of the supervisory framework will, in important ways, reinforce standards of risk management and prudent business behaviour in the Australian financial system and improve its resilience. These benefits are easy to lose sight of when favourable economic times persist, as they have for a decade and a half now, but will stand Australia in good stead if and when the tide turns.

Australian financial institutions continued to prosper in 2005/06. Strong global conditions and the ongoing momentum in the Australian economy – with the unemployment rate at 30-year lows and brisk demand for finance from both households and businesses – provided an excellent operating environment. International equity markets performed well over most of the year and the Australian share market reached new record highs before, like international markets, encountering greater volatility towards year-end. The environment, nonetheless, had its challenges. In Australia and globally, central banks reduced the accommodative stance of monetary policy as inflationary pressures began to accumulate. Competition intensified across a range of financial products, including mortgage and small business lending and on-line deposits, various classes of life and general insurance business, and superannuation following the introduction of 'choice of fund' and portability. For deposit-taking institutions, the easing of credit standards over recent years has begun to reflect in an upward drift of housing loan arrears, albeit from a low base.

The Australian financial system remains well placed to deal with these challenges. Supervised institutions in the deposit-taking and insurance sectors are, generally speaking, well capitalised and soundly managed, with strong asset quality and buoyant profitability; general insurers have also continued to benefit from favourable claims experience. The superannuation and life insurance industries enjoyed high investment returns for the third consecutive year.

The prudential supervision framework

Recent reform initiatives have been part of a major upgrading of Australia's supervisory framework that the Government and APRA, working closely together, have pursued over the past five years. As a consequence, Australia now has a supervisory framework that compares well with any other mature economy. This has been acknowledged by the Government's Taskforce on Reducing Regulatory Burdens on Business and is also expected to receive strong affirmation from the International Monetary Fund following its recent review of Australia's financial soundness and regulatory arrangements.

The Government's reforms to superannuation safety are now in place. Operating requirements and standards covering the core elements of risk management and governance have been tightened and the comprehensive trustee licensing regime installed. By the end of the two-year transition period on 30 June 2006, APRA had licensed 307 trustees and registered around 6,900 superannuation funds managed by these trustees. The late arrival of applications – over half were received only in the three months prior to the closure of the licensing window – compounded the licensing task; nonetheless, all applications were thoroughly assessed and not one was 'waved through' because of time pressures.

The new licensing regime has accelerated the consolidation of the superannuation industry that had been under way for some years. The emergence of larger superannuation entities offering an array of products, outsourcing an increasing range of services and reliant on enhanced risk management practices, means that the superannuation industry, from a prudential perspective, now shares many of the characteristics of the other industries that APRA supervises. The challenge for APRA is to adjust its supervisory approach to be more appropriate to these larger and more complex superannuation entities.

In the deposit-taking and insurance industries, a key focus of recent reforms has been the calibre and decision-making processes of boards and senior management. Public confidence in the financial system depends critically on financial institutions having sound governance and conducting their affairs with a high degree of integrity and competence. To this end, and taking a harmonised approach across these industries, APRA introduced a new 'fit and proper' regime for responsible persons and brought its existing governance requirements into line with good industry practice. In other initiatives, APRA finalised the main elements of its second-round reforms in general insurance and addressed the adoption of international financial reporting standards. Good progress was also made on implementation of the new global capital adequacy regime for deposit-taking institutions.

During 2005/06, APRA revised its approach to prudential requirements with the aim of reducing the compliance burden on institutions while providing a strong and flexible supervisory framework. The previous emphasis on detailed rules has given way, in recent reforms, to more principles-based prudential standards and separate 'prudential practice guides', the latter providing non-binding guidance on meeting the standards and on prudent practices in the areas concerned. The revised approach, which will be rolled out to other parts of the supervisory framework where practicable, has been well received by industry. At the same time, a principles-based framework can be challenging for institutions and APRA supervisors alike; some institutions still hanker for prescription to provide certainty and, often, leverage for internal change.

APRA's capabilities

The move towards a more principles-based approach to the supervisory framework complements APRA's risk-based approach to the supervision of individual financial institutions. To be a vigilant, vigorous and effective prudential regulator – the commitment given by APRA's Executive Group – APRA must do two things very well. Firstly, it must identify and evaluate potential risks facing an institution at an early stage. Secondly, its supervisory response must be targeted, proportionate and timely. The development of APRA's supervisory processes and capabilities is directed squarely at these two objectives.

A robust system for identifying and assessing emerging risks in a supervised institution, and for deploying APRA resources, has been the centrepiece of APRA's supervisory work over the past three years. Accumulating experience with this risk-rating system confirms its contribution to effective and focused supervision. The greater majority of institutions identified as needing more intensive supervisory intervention over this period either lifted their game or left the industry in an orderly way – the latter a clear indication that APRA has no interest in unduly prolonging the life of an institution afflicted by poor management, inappropriate business strategies or inadequate capital. The exits were also achieved without any loss to depositors, policyholders or superannuation fund members. This is a gratifying result but one that cannot be guaranteed, especially in a less benign economic environment.

The supervisory judgments forming the basis of APRA's risk-rating system require a comprehensive and up-to-date analysis of the unique risk profile of each institution. To promote greater rigour and consistency in this analysis, a detailed APRA-wide supervisory framework was introduced last year and is being further embedded into day-to-day supervision activities. Ensuring that the framework is fully integrated with other APRA supervision tools is a strategic priority.

In the end, however, APRA's supervisory judgments and its effectiveness come down to the skills, acumen and commitment of its staff. Attracting, developing and retaining a high-calibre and motivated workforce is an absolute must for APRA. A campaign has been under way to build up staff numbers for front-line supervision of large and complex institutions, and in specialist risk, industry and technical areas, by attracting experienced staff from industry and the professions. APRA reached its staffing targets during 2005/06 and at year-end staff numbers (excluding fixed-term staff for superannuation licensing) were 592, an increase of two per cent over the year. Nonetheless, holding these numbers in the current 'hot' employment market for financial and risk management skills is a growing challenge. APRA has experienced high turnover among its younger staff, although turnover of more experienced supervisors has been much lower.

Staff turnover is an issue for many financial institutions at this time and APRA cannot escape the realities of the financial services marketplace. That said, APRA will continue to pursue high-quality appointments and will not lower its hiring standards simply to meet staffing targets. As well, a number of internal initiatives are being taken to enhance APRA's working environment, improve management capabilities and extend the range of learning and development opportunities, which include secondments to prudential regulators and major financial institutions abroad. A new *Statement of APRA Values* has also been launched to provide APRA staff with greater clarity about the important attributes and behaviours expected of them.

Looking ahead

APRA is now well past the peak in its reform agenda and the year ahead should be a welcome period of consolidation for both industry and APRA. Important work remains, in general and life insurance and on the new global capital adequacy regime for deposit-taking institutions, but APRA has no significant new regulatory initiatives planned. A year ago, APRA promised clear air for industry in 2006/07 and that promise will be honoured.

For individual financial institutions, the year ahead will require careful navigation. Ongoing strength of the global and Australian economies will continue to provide opportunities for good business and sensible risk-taking strategies. For the deposit-taking sector, however, higher interest rates and petrol prices will stretch the finances of heavily geared households. Credit quality may be at a turning-point and institutions will need to monitor credit decisions and debt-servicing capacity of customers closely if profitability is not to be eroded. APRA's refrain about the importance of strong and well-resourced risk management in good times is beginning to sound repetitive but it has never been more apposite, particularly in view of the pick-up in credit growth in the latter half of 2005/06.

Financial institutions face a broader challenge in meeting the expectations of owners and investors who have become accustomed to high rates of return across all the industries APRA supervises. High returns will prove transitory if, in seeking to emulate past successes, financial institutions are tempted into pursuing market share for its own sake, venturing into new territories, products or sectors ill-prepared, underpricing risk or cutting corners on risk management.

For APRA itself, a period of consolidation will enable it to focus its energies on further improving its efficiency and effectiveness. APRA's mission will also come under review. APRA performs a careful balancing of the objectives of financial safety and efficiency, competition, contestability and competitive neutrality. The Australian community clearly expects that the bias should be towards financial safety and that is how APRA has interpreted its mission. Industry sometimes expresses a different view on how the balance should be struck. In the end, it is for the Government to determine the appropriate weighting of different public policy objectives and APRA looks forward in coming months to the Government's 'Statement of Expectations' of APRA – part of a reform to the governance arrangements for statutory authorities – to provide clarity about its mission.

APRA Members in 2005/06 – (left to right) Mr Ross Jones, Dr John Laker and Mr Steve Somogyi

Our people

The progress APRA has been making on all fronts owes greatly to the tireless efforts of its staff. The work of a prudential regulator is complex, demanding and generally conducted out of the limelight; successes remain well hidden but any shortcomings face close public scrutiny. This makes it difficult for the Australian community to appreciate fully the dedication, breadth of talent and achievements of staff on which APRA now draws. APRA's Executive Group does see this at close hand, however, and we thank each one of our staff for responding so positively to the vital task of promoting the financial security of the Australian community.

On 30 June this year, Steve Somogyi's three-year term as an APRA Member came to an end. Steve was one of three Executive Group Members – the others being Ross Jones (Deputy Chairman) and myself – appointed to run APRA under new governance arrangements three years ago. During his time at APRA, Steve's wide-ranging financial experience, his business instincts and his industry networks did much to enhance APRA's commercial insights and pragmatism, particularly in the insurance sector. Steve has been replaced by John Trowbridge, whose three-year appointment took effect from 1 July. John also brings a depth of experience to APRA, having worked in and consulted to the financial sector, particularly the insurance industry, over a long and distinguished career.

Dr John F. Laker
Chairman

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APRA's supervisory activities in 2005/06

Authorised deposit-taking institutions

Strong domestic economic activity and robust credit growth, particularly in the second half of 2005/06, underpinned the continued sound performance of authorised deposit-taking institutions (ADIs). Business credit grew at its fastest pace since the late 1980s and housing lending growth, which had been slowing over the previous two years, picked up as the housing market regained momentum. The higher lending volumes again offset pressures on interest margins from more intense competition in both lending and retail deposit markets, and from increasing reliance by larger ADIs on relatively more expensive wholesale (often offshore) funding. Benefiting as well from growing non-interest income, particularly from wealth management activities, the ADI sector has for some time now enjoyed strong and stable profitability, comfortable capital buffers, and impaired assets that are at historically low levels. As a possible harbinger of future problems, however, the value of 'past due' loans has been edging up. Reflecting the competitive operating environment, the pronounced trend of consolidation among smaller ADIs has continued.

Credit standards

APRA's concerns about slippages in credit standards in housing lending are well documented. ADIs are venturing more actively into non-traditional mortgage products – such as 'low-doc' loans, reverse mortgages and interest-only mortgages – and into higher-risk business lending, including complex structured finance transactions. In this changing credit environment, APRA has been working closely with ADIs to review their credit policies and assess the robustness of their internal controls. In 2005/06, in the context of its tripartite arrangements with external auditors, APRA requested that a subset of ADIs commission reviews by their external auditors of their mortgage lending practices. Though some areas for improvement were identified – particularly in the verification of critical loan application data and in documentation – the internal control frameworks were assessed as broadly adequate and effective. APRA's attention is now switching increasingly to business lending, where strong competition and pursuit of market share have been putting pressure on lending standards and risk margins. Commercial property lending, a risky area for ADIs in the past, has also been growing strongly and APRA is keeping this development under watch.

During 2005/06, APRA undertook a survey of debt-serviceability criteria used by ADIs in approving loans. This has confirmed that ADIs have materially increased the maximum amount they are prepared to lend to any given borrower. The increase has come about via an industry shift from traditional debt-serviceability ratios, under which debt-servicing is constrained by gross income, toward income surplus models, in which borrowers are assumed to be willing to continue repaying their mortgages until they reach minimum 'subsistence' levels of family consumption. The survey has indicated a wide dispersion in maximum loan amounts across institutions, with the most aggressive ADIs typically being willing to lend almost twice as much as the most conservative ADIs to a hypothetical borrower with the same basic characteristics. APRA's assessment is now focusing on how much of the current ADI housing lending portfolio involves loans with very high debt-servicing ratios. The results of this assessment are expected to provide useful benchmarks on industry practice and enable APRA to direct its scrutiny to institutions pursuing more aggressive strategies.

Pricing for risk

Sustained good times create the danger that investors and financial intermediaries underestimate and underprice risk. This is a global issue: solid global growth and a benign credit environment over recent years have seen credit spreads fall to their lowest levels in a decade. For APRA, a particular focus has been developments in pricing for risk in the low-doc loan market. Although originally championed by lenders outside the ADI sector, low-doc loans – where borrowers self-certify their income because they lack the necessary documentation – are now offered by all the large ADIs and, aggressively in some cases, by a number of smaller ADIs. Experience in overseas markets indicates that low-doc loans are much more likely to default than conventional loans and this experience may yet assert itself in Australia, where the arrears rate for securitised low-doc loans is currently around three times as high as for conventional loans. From a prudential perspective, the concern is whether the higher risk of default of low-doc loans is being factored into their pricing. Low-doc loans are now being advertised at rates comparable to the 'headline' rate for mortgages with fully verified documentation and the spread between actual rates paid on low-doc and conventional loans has halved over the past few years. Time and an adverse turn in Australia's economic circumstances will tell whether this margin for risk is adequate.

Business continuity management

In April 2005, new prudential requirements for business continuity management for ADIs (and general insurers) came into effect. While the requirements mirrored good practice observed in the industry, APRA was aware that a number of ADIs had further work to do to implement and test procedures and infrastructure to ensure they could continue operations in the face of various types of disruptions. As a result, APRA provided a 12-month period for institutions to identify areas of non-compliance and establish rectification plans. Over the past year, APRA has been actively reviewing ADIs' progress on compliance with the new prudential standard in on-site operational risk reviews. Even now, a number of institutions have yet to comply fully, raising concerns that ADIs may not be as resilient to operational disruptions as their counterparts in some other jurisdictions. Where necessary, APRA will consider more directed guidance to institutions to accelerate their timetable to meet the prudential requirements.

Overseas visit program

During 2004/05, the Australian National Audit Office (ANAO) undertook a follow-up audit to assess the extent to which APRA had implemented recommendations made in the ANAO's 2001 performance audit of bank prudential supervision. In its report, which was tabled in July 2005, the ANAO found that APRA had implemented or made progress in implementing all of those recommendations.

One recommendation that was fully implemented in 2005/06 was the establishment of a structured review program of visits to Australian banks (and other APRA-regulated institutions) with material activities in offshore locations. During the year, APRA completed targeted reviews of:

- each of the major Australian banks' operations in New Zealand;
- certain Asian operations (including outsourced service centres) of a small number of Australian banks;
- the New Zealand operations of a major Australian life insurer; and
- the American operations of a major Australian general insurer.

These reviews were also used as an opportunity to share information and build relationships with the regulatory authorities in these jurisdictions.

Trans-Tasman Council on Banking Supervision

The Australian and New Zealand banking markets are among the most highly interdependent in the world. Australian banks have around an 85 per cent share of New Zealand banking system assets, and New Zealand banking assets comprise around 15 per cent of total assets of Australian-owned banks. Reflecting this high degree of interdependency, in February 2005 the Australian Treasurer and the New Zealand Minister of Finance established the Trans-Tasman Council on Banking Supervision as the next major step towards the development of a single trans-Tasman economic market in banking services.

The Council's aims are to enhance co-operation and information-sharing between respective supervisors of trans-Tasman banks; promote and regularly review trans-Tasman crisis response preparedness relating to events that involve banks that are common to both countries; and guide the development of policy advice to both governments. The Council is chaired jointly by the Secretaries to the Treasuries of Australia and New Zealand and also comprises senior officials from APRA, the Reserve Bank of Australia and the Reserve Bank of New Zealand (RBNZ).

In February 2006, in response to recommendations from the Council, the respective Ministers in Australia and New Zealand announced their intention to pursue legislative changes that will require APRA and the RBNZ to support each other in the performance of their regulatory responsibilities and to consider the impact of their actions on financial system stability in the other country. In doing so, it is intended that the banking supervisors in each country will be able to afford banks additional flexibility in how they structure their businesses within the trans-Tasman markets, and this is expected to bring compliance cost reductions and efficiency benefits.

The proposed legislative changes comprise:

- general provisions that require each regulator to support the other in fulfilling the other's statutory objectives and, wherever reasonably possible, to avoid actions that could have a detrimental effect on financial system stability in the other country;
- 'detrimental actions' to include specifically actions that interfere with or prevent the provision of outsourced services to a related party in the other country;
- a requirement that, where reasonably practical, the regulators consult each other before exercising a power that is likely to be detrimental to financial stability in the other's country; and
- a requirement that an administrator or statutory manager appointed to a bank advise the regulator if they have reasonable cause to believe that the proposed exercise of a function or power by them is likely to have a detrimental effect on financial stability in the other country.

These legislative changes are now being progressed in both countries. Ministers also agreed that the future work program of the Council will include looking at improved co-operation on crisis management, promoting seamless service provision for customers and sharing experiences on improving the quality of insurance regulation.

More generally, APRA continues to build a close and co-operative working relationship with the RBNZ. This includes regular information exchange, frequent meetings between supervisory staff, staff secondments, shared training, joint visits to Australian-owned banks in New Zealand and a co-ordinated approach to the cross-border implementation of Basel II under the Terms of Engagement signed in March 2005.

General insurance

Despite increasing competitive pressure on premiums in a number of business lines, the general insurance industry again performed well in 2005/06, with strong profits allowing capital buffers to be further augmented. After an earlier long run of poor underwriting results, the industry recorded its fourth consecutive year of solid profits on the back of continued favourable claims experience (not only in the public liability area following tort law reforms) and notwithstanding Cyclone Larry in March 2006. Some insurers have also been able to release claims reserves that have added materially to declared profits, which have been augmented by high investment earnings. Insurers have been embedding a more robust approach to the identification and management of risk, not just in underwriting and claims functions but holistically across their institutions. In this environment, APRA's supervisory priority has been to encourage business strategies, growth ambitions and pricing disciplines by insurers that are conducive to sustainable industry profits over the long term.

Capital adequacy

The capital position of the general insurance industry has strengthened by at least 50 per cent since the 2002 reforms of the prudential regime for general insurance. At present, the absolute level of capital held by the industry is more than twice the minimum required by APRA, consistent with an industry practice of holding a significant capital buffer to ensure that financial resources will be adequate to cope with adverse times. A continuation of these capital trends will, nonetheless, create pressure on insurers to improve capital efficiency. This may lead to greater use of innovative capital instruments, echoing developments in the ADI industry, and a different balance between equity and debt funding. In some cases, it may lead to returns of capital to shareholders if suitable acquisitions or growth opportunities cannot be found.

Pricing for risk

The general insurance industry in Australia and elsewhere has, for many years, been characterised by the 'premium cycle' – a relaxing of pricing discipline and underwriting standards for a period followed by increases in premiums and tighter coverage conditions. This cycle appears to have been attenuated in recent years. APRA's supervision activities indicate that insurers are continuing to be more disciplined in their approach to risk pricing notwithstanding that the peak of the latest cycle has now passed. Over the past 18 months, however, price competition has become more evident again with noticeable price reductions in some areas such as larger commercial property and professional indemnity insurance. It remains to be seen how the next phase of the premium cycle will play out.

APRA raises any concerns it may have about 'underpricing' with the boards and senior management of general insurers. To this point, APRA has seen little evidence of any substantial loss-leading in premium setting by Australian insurers or of insurers significantly increasing their risk profiles through the types of business they take on. Nonetheless, APRA will continue to watch this area closely.

Actuarial data integrity

The strength of APRA's prudential regime for general insurance depends critically on the valuations of insurance liabilities and calculations of risk margins. As part of its tripartite arrangements with external auditors, APRA in 2005/06 requested a targeted review of the integrity of actuarial data. External auditors of a number of insurers were asked to review the strengths and weaknesses of actuarial data integrity arrangements by considering, *inter alia*, the extent to which the Approved Actuary is required to adjust valuations as a result of data deficiencies and the degree to which data integrity is subject to regular internal and independent review, with assurances provided to the board. The reviews found, in the main, that insurers did have processes in place to ensure data integrity but these had often not been formalised and documented. During the course of the reviews, however, most of the insurers involved documented their processes and strengthened their controls. This will contribute to the processes being more robust and auditable in the future.

National Claims and Policies Database

In 2004/05, APRA established the National Claims and Policies Database (NCPD) for public and product liability and professional indemnity insurance. The NCPD is an initiative of the Government and will over time provide insurers, the community and Government with comprehensive information on these types of insurance. It will help insurers monitor claims costs and premium trends, assess risks, determine appropriate premiums and develop or enhance the products available for policyholders.

The first NCPD reports, covering the years 2003 and 2004, were released in August 2005 and the second set of reports, covering the year 2005, were released in July 2006. These aggregate industry reports include data on claims and policies submitted by all APRA-regulated general insurers providing these types of insurance. The reports give an indication of broad trends in the levels of premiums and claims costs across the industry, at a national and state level.

APRA has been working closely with insurers to improve the quality and quantity of information that is able to be included in NCPD reports. It continues to liaise with state and territory insurers so that relevant information on their portfolios can be included in future NCPD reports. APRA has also been working with industry to develop additional NCPD reports that will enable more detailed analysis to be undertaken by key risk factors (such as occupation groups or different product types within these insurance classes). Further work is needed to achieve an appropriate balance between the aims of providing useful additional information to the industry and public, and protecting the confidentiality and commercial sensitivity of the information provided by insurers.

The NCPD is funded primarily by entities that contribute to it. Funding for the first two years was on a voluntary basis but, following amendments to legislation governing supervisory levies, a specific levy on contributors will be collected from 2006/07 onwards to recover NCPD costs. This will be done as part of APRA's normal annual levy process.

Life insurance and friendly societies

The life insurance industry enjoyed continued strong profitability and solvency over 2005/06, with high investment income and solid growth in revenue from risk insurance premiums more than offsetting a fall in revenue from traditional life products. The life insurance industry in Australia has been largely subsumed into the wealth management sector and around 90 per cent of its assets represent superannuation business. The major life insurers are generally arms of larger wealth management groups, which have themselves been experiencing very strong asset growth. Nonetheless, the share of total superannuation assets held by the life insurance industry has been in steady decline due to the success of alternative superannuation vehicles and of managed investment schemes, in some cases offered by entities that are part of the same wealth management group.

During 2005/06, APRA's supervision of the life insurance industry focused mainly on its preparations for superannuation licensing, discussed below. In almost all cases, superannuation trustees associated with major life insurers applying for a licence utilised risk management frameworks and policies that applied throughout their group; this has helped to strengthen risk management standards in the life industry as a whole. Unit pricing and legacy systems were ongoing prudential issues, which confront other superannuation providers as well.

The friendly society industry has continued to undergo significant rationalisation and change, with a number of friendly societies diversifying away from traditional lines of business. Those societies offering educational and prepaid funeral products have tended to enjoy the strongest growth. Further rationalisation, which may include the demutualisation of more friendly societies, is likely.

Unit pricing

In November 2005, after extensive industry consultation, APRA and the Australian Securities and Investments Commission (ASIC) jointly published *Unit Pricing – Guide to good practice* for the life insurance, superannuation and funds management industries. The guide provides a valuable benchmark for the management of the large volumes of life insurance and superannuation business provided by way of unit-linked products, and it has been well received and closely studied by industry. The increased complexity of investment products, the complex taxation environment, the large number of unit prices that are being determined daily and the limitations of some older IT systems have contributed to an environment in which unit pricing errors can easily occur. Such errors continue to be discovered, although the improved risk management framework that is being put in place by the major insurers should reduce the risk of errors in the future. The building of a strong control framework that identifies errors at an early stage is as important as rectification, which can be a costly and timeconsuming process. There are instances of errors costing more than $50 million in compensation, and taking up to two years before compensation is finalised and paid. Some insurers are providing compensation for the second time, partly because of new errors and partly because of errors in the original compensation. Working closely with ASIC, APRA is continuing to review aspects of unit pricing practice as part of its ongoing supervision of the life insurance and superannuation industries and expects that product providers will follow the good practices described in the guide.

Legacy products and systems

The long-term nature of traditional life insurance products, along with numerous product changes and enhancements, has resulted in multiple versions of similar products that will need continued support for many years. Industry consolidation has left many life insurers administering a variety of products on multiple administrative platforms that are ageing and where the maintenance of systems and product knowledge is proving difficult. This environment is a significant source of operational risk for the life insurance and superannuation industries.

APRA supports a simplification of the mechanism for rationalising products provided appropriate safeguards are in place to protect beneficiaries' interests. At the same time, any improvements in product rationalisation should be accompanied by industry efforts to reduce product complexity in the future. APRA has been in discussions with industry and the Treasury on this issue. The Government's Taskforce on Reducing Regulatory Burdens on Business (discussed in the following chapter) has recommended that a mechanism for rationalising legacy products be developed that balances achieving greater operational efficiency with ensuring that consumers of the product are not disadvantaged. The Government has agreed to this recommendation and will consult with stakeholders through its Corporate and Financial Services Regulation Review.

Superannuation

Sustained inflows and high investment returns led to further strong growth in superannuation industry assets over 2005/06, while the introduction of the new superannuation licensing regime accelerated the trend of consolidation among industry participants, particularly at the smaller end. APRA's major priority was to ensure the orderly introduction of the new regime by the end of the two-year transition period on 30 June 2006. This involved the completion of trustee licensing and fund registration, and working with trustees exiting the industry to finalise the transfer of member benefits and the winding-up of funds.

Superannuation licensing

The superannuation licensing regime – the main plank in the Government's superannuation safety reforms – requires trustees of all APRA-regulated superannuation entities to be licensed and all entities for which they are trustees to be registered. Trustees have to meet specific licence requirements covering matters such as risk management, as well as operating standards on fitness and propriety, adequacy of resources and outsourcing. Existing trustees who wished to continue their trustee operations beyond the end of the transition period had to obtain a licence. Trustees that chose not to be licensed or that failed to meet the licensing criteria had to transfer any funds they operated to a licensed trustee by the end of the transition period. All new trustees have to be licensed prior to commencing operations.

APRA had discretion to refuse to consider any further licence applications in the last six months of the transition period and, after providing industry with notice of its intentions, exercised this discretion by closing the licensing window on 17 February 2006. This was to ensure that all applications could be processed in an orderly fashion.

During the transition period, APRA received 325 applications for trustee licences. A total of 307 licences were issued, 17 applications were withdrawn and one was rejected as it did not meet the criteria. APRA staff gave over 400 presentations to industry and liaised with trustees individually on 1,700 occasions to assist them to understand and implement the new operating standards and licensing requirements.

APRA registered 6,885 funds (including 6,273 'Small APRA Funds') during the transition period. The trustees of around 800 funds indicated that they did not intend to seek licences and were required to make alternative arrangements for the entities under their trusteeship. Around 600 funds had completed their exit by the end of the transition period. The trustees of six funds that had not taken sufficient action to transfer members were replaced with APRA-appointed trustees and the remainder entered into formal undertakings with APRA to finalise alternative arrangements within a reasonable timeframe.

Revision of superannuation circulars and other guidance

During the year, APRA reissued a number of Superannuation Circulars and released 'frequently asked questions' (FAQs) to update guidance to trustees and others on issues which arise under the legislative and prudential framework for superannuation. The Superannuation Circulars on contributions and payment standards were revised to reflect legislative changes related to contributions splitting, portability of benefits, interdependency relationships and the work tests for members aged 65 and older. APRA will further review these circulars when legislation is enacted to implement the superannuation simplification proposals announced in the Commonwealth Budget for 2006/07.

The Superannuation Circular on investment management and investment choice was revised in consultation with Government and industry. The circular explains the responsibilities of trustees in relation to investment strategies and gives particular attention to the issue of asset diversification where investment choice is offered to members. The circular also provides guidance in relation to conflicts of interest that may arise in the implementation of investment strategies.

The FAQs released by APRA dealt with a number of issues, such as self-insurance, clearing houses, conflicts of interest, small defined benefit funds, extended public offer licensees and policy committees, outsourcing, custody of assets and risk management strategies and plans.

APRA also released an Information Paper, *Superannuation – Trustee Liability Insurance*, providing guidance to trustees on issues to consider when obtaining and reviewing liability insurance cover. This follows a 2005 survey of selected insurance brokers on the availability of professional indemnity insurance in the marketplace and the level of coverage bought by trustees. The paper concluded that the availability of trustee liability insurance is adequate. In APRA's view, the level and terms of liability insurance cover should reflect the nature, scale and complexity of the trustee's operations. APRA expects trustees to be able to demonstrate that the level and terms of insurance cover are prudent and reasonable to meet their obligations and to ensure they are acting in the best interests of members.

'Choice of fund' and portability

'Choice of fund' and revised requirements for the portability of benefits both took effect from 1 July 2005. These developments, which transfer decision-making with respect to fund choice to employees and members of funds, could have a significant impact on the development of the superannuation industry, even though most employees at present may be members of the default funds chosen by employers. At a practical level, choice of fund has led to an increased availability of clearing house services to assist employers to make contributions to multiple superannuation funds. Clearing house services are not regulated by APRA and, as noted above, after consultation with ASIC and the Australian Taxation Office (ATO), APRA released a FAQ on this topic. Employers and trustees have been made aware that contributions are outside the 'superannuation system' during the period that they are in clearing houses. In the choice of fund environment, trustees have been making greater use of advertising, marketing and sponsorship activities aimed at retaining existing members and attracting new members. APRA has written to all trustees reminding them of their duty to act in the best of interests of members in relation to the expenditure of fund monies.

Conflicts of interest

Conflicts of interest and how they were handled were a particular focus of the superannuation licensing process. Such conflicts can involve individual trustees and trustee directors or the use of related-party service providers. In APRA's view, it is critical that trustees fully understand their responsibilities and obligations when making decisions in their capacity as trustees. The duty of a trustee to act in the best interests of members is imposed by the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) and principles of trust law, and affects all trustee decisions. An effective corporate governance framework and conflicts of interest policy will assist trustees in carrying out their duties.

Prudential supervision approach for superannuation

The consolidation that has been taking place in the superannuation industry has seen the emergence of larger and more complex superannuation entities. An APRA-regulated superannuation fund (excluding small funds) now manages, on average, over seven times the level of assets it managed five years ago, a period in which total superannuation assets have less than doubled. The superannuation industry – in terms of size, complexity and growing sophistication of risk management – is increasingly resembling the other industries that APRA supervises, and APRA is moving to put the prudential supervision of superannuation funds on a similar basis as these industries.

Over the coming year, APRA's supervisory activities will concentrate on assessing how the enhanced risk management systems introduced as part of the licensing requirements are working in practice, as well as on implementation of the new operating standards on adequacy of resources, outsourcing and fitness and propriety, including management of conflicts of interest. In due course, APRA also intends to review sub-funds, the operation of eligible rollover funds and operational risk in major outsourced activities such as fund administration and custody.

Pandemic planning

While not wanting to overstate the potential risk for Australia, APRA believes it is prudent for financial regulators to ensure that Australia's financial system is as prepared as practically possible for a pandemic – whether arising from the current Avian flu threat or another source. APRA's interest is in ensuring that institutions are able to meet core obligations to depositors, policyholders and other beneficiaries and to maintain their financial viability. If an influenza pandemic were to eventuate, there is considerable uncertainty as to its duration and the extent of the population that might be affected; the impact on financial institutions might range from some increased staff absenteeism and reduction in business activity to a more substantial effect on profitability in a severe pandemic scenario.

APRA has been working on pandemic planning with financial institutions, the other financial regulators and with Government. The focus has been on identifying good planning practices, highlighting industry-level issues such as the identification of critical financial functions that need to be provided and functions that could be deferred during a pandemic, and analysing potential financial impacts on APRA-regulated institutions. These impacts raise issues such as insurance (and reinsurance) coverage for pandemic-related claims, the potential for increased loan arrears in industries most likely to be affected by a pandemic (such as tourism) and the overall macroeconomic impact, all of which are extremely difficult to quantify.

Beyond their own planning for the operational and business continuity risks, insurance companies in particular must assess whether they have sufficient capital to meet the additional pandemic-related claims for life, disability, business interruption and other claims that could result from a pandemic. While APRA does not intend to require additional capital to be held to cover exposures in all of the most extreme scenarios that can be envisaged, it is important that insurers have conducted adequate modelling and stress testing of portfolios to understand, and if necessary mitigate, their potential exposures under a range of plausible scenarios. ADIs also need to consider how they would deal with pandemic-affected borrowers and the potential impact on their loan portfolios.

Overall, APRA is satisfied with the level of seriousness with which larger regulated institutions are confronting the risk of an influenza pandemic, but there is still much work to do. Institutions have structured plans under way to develop their pandemic responses further. Most recognise that pandemic planning goes well beyond updating business continuity plans and must include scenarios involving a sustained impact on staffing levels.

APRA is developing guidance to assist institutions with their pandemic planning and is also assessing its own supervisory priorities and expectations in a pandemic. APRA is considering options for temporarily relaxing prudential requirements, should this become necessary, during a pandemic; however, institutions should not treat an expectation of regulatory forbearance as a substitute for sound planning and preparation.

APRA prudential reviews, consultations and tripartite meetings

Entity	2004/05	2005/06
ADIs	208	142
General insurers	81	126
Life insurers and friendly societies	39	32
Superannuation trustees	58	156
Superannuation funds	406	235
Conglomerates	23	29
Total	**815**	**720**

The table shows the number of prudential reviews, consultations and tripartite meetings conducted for 2004/05 and 2005/06. All of these activities are usually conducted 'on-site' (i.e. at the premises of an APRA-regulated institution). Prudential reviews and consultations are a critical part of APRA's supervisory regime and cover various aspects of the institution's operations and activities as determined by its risk profile. Tripartite meetings are discussions involving the institution, its auditor and APRA which focus on a specific topic commissioned by APRA for review by the auditor. The numbers do not include off-site activities associated with the assessment of applications for superannuation licences (i.e. the review of application material conducted at APRA's offices).

Enforcement activities

APRA's mandate to protect the interests of depositors, policyholders and superannuation fund members requires it, at times, to take enforcement action. Such action is the exception rather than the rule. APRA's preference is to identify weaknesses in a supervised institution at an early stage and to work co-operatively with that institution to remedy those weaknesses. In some instances, however, direct action may be required if an institution is unwilling or unable to respond appropriately or where the public interest requires APRA to take a stand on a significant issue. APRA devotes around seven per cent of its staffing resources to enforcement activity.

APRA's enforcement activity seeks to minimise financial losses to beneficiaries and, where losses are inevitable, to limit the immediate damage caused by a troubled entity (the 'containment effect'). APRA's actions may also send a public message in order to discourage unacceptable conduct (the 'deterrence effect'). The containment aspect is generally the more immediate priority, and may require keeping enforcement action confidential for a time so as not to compromise any rescue measures. Speed may be of the essence. Containment measures might include suspending or replacing the management of a failing entity, freezing the entity's assets, closing the entity to new business or, where necessary, arranging for an orderly exit. The deterrent aspect, on the other hand, is generally less urgent but requires wide publicity to have maximum impact. General deterrence can be an important consideration in enforcement action as a means of encouraging regulated industries to learn from past mistakes and misconduct.

During 2005/06, APRA undertook 364 enforcement actions. This figure is well down on the previous year, when enforcement activity was boosted by the issue of infringement notices to a number of superannuation funds that had failed to meet certain reporting obligations. More generally, there has been some fall-off in enforcement activity as actions, relating particularly to the failure of HIH Insurance, come to a conclusion. The enforcement workload now tends to involve a smaller number of more complex cases and, at times, vigorous legal challenges to its actions; such cases can consume substantial time and resources.

APRA is, quite rightly, subject to a range of accountability measures that limit its scope to take enforcement action that could be seen as excessive or capricious. Those measures include APRA's own governance arrangements; legislative and policy requirements on enforcement staff to act professionally, honestly, free from bias and in good faith; the possibility of performance audits by the Auditor-General and investigations of complaints by the Commonwealth Ombudsman; appearances before Parliamentary Committees, including Senate Estimates; and reviews of certain decisions by the Administrative Appeals Tribunal (AAT) and/or the Federal Court.

APRA's key enforcement powers are the ability to conduct a forensic investigation, to issue corrective directions and conditions, and to disqualify individuals from holding positions of responsibility in APRA-regulated industries on 'fit and proper' grounds. In 2005/06, seven APRA investigations were in progress, including some carrying over from previous years. Complex investigations typically span two or three financial years, reflecting the reality that the task of fact finding and evidence gathering is a slow and complex process, particularly where enforcement action is a likely consequence and procedural fairness has to be scrupulously observed.

During the year, APRA completed its investigation into the AXA Australia Staff Superannuation Plan and certain decisions by the former trustee. APRA's *2005 Annual Report* includes details of the investigation and an Enforceable Undertaking given by the former trustee. APRA subsequently decided to disqualify seven directors of the former trustee but these decisions were set aside by the AAT.

APRA's investigations into the use of 'sham' reinsurance arrangements designed to disguise the true financial position of a general insurance company are continuing. As previously reported, APRA in May 2005 accepted Enforceable Undertakings from Zurich Australia Insurance Limited (ZAIL) and Zurich Financial Services Australia Limited (ZFSA) which acknowledged that a financial reinsurance arrangement with reinsurer General & Cologne Re Group Australia (GCRA) had been improperly used to overstate ZAIL's profits in 2000 and thereby avoid breaching its regulatory solvency requirement, and that ZAIL's actuary, auditor and APRA had been misled. APRA is continuing to assess the fitness and propriety of a number of former Zurich Group personnel who were involved in the reinsurance arrangements, but does not plan to take any further action against the Zurich companies as a result of the Enforceable Undertakings provided.

During the year, APRA continued its investigation into the marketing and promotion of complex financial reinsurance products by General Reinsurance Australia Limited (General Re), previously operating as GCRA.

APRA is interested in the extent of certain reinsurance practices between 1996 and 2002. Evidence uncovered by that investigation has led to fit and proper assessments, yet to be completed, of a number of individuals formerly employed by the failed reinsurer New Cap Re and has supported action that was already under way in relation to a number of individuals involved in improper transactions with other counterparties.

Court action arising from an APRA investigation into the Wall & Ceiling Superannuation Fund progressed during the year. A number of former trustee directors and accounting advisers have been committed to stand trial over the management and operation of the Fund, which catered for around 140 members employed in the building supplies industry. The charges arise from alleged breaches of the 'sole purpose' provisions of the SIS Act and the alleged falsification of records for the purpose of deceiving APRA. APRA alleges the Fund was largely invested in unit trusts established to develop factories that were subsequently leased back to employer-sponsors of the Fund. APRA further alleges records were falsified to circumvent a tightening of anti-avoidance provisions for the 'in-house asset' rules of the SIS Act. The proceedings follow earlier successful prosecutions of a former trustee director of, and an accounting adviser to, the Fund, both of whom pleaded guilty to criminal offences. APRA had previously disqualified 12 individuals associated with the Fund from acting as trustees of any regulated superannuation fund. The Commonwealth Director of Public Prosecutions is prosecuting these matters.

In another quite different case, APRA has been investigating the unregulated entity Terra Nova Cache, established and managed by Mr David Siminton, self-proclaimed Governor of the 'Principality of Camside' in South Yarra, Victoria. APRA alleges that Mr Siminton has been conducting unauthorised retail 'banking' through Terra Nova Cache. APRA obtained court orders freezing assets and prohibiting Mr Siminton, who is an undischarged bankrupt, from conducting banking business. The orders successfully prevented a withdrawal of some $560,000 from Bendigo Bank in December 2005. APRA alleged Mr Siminton breached the court orders restraining his commercial activities and he has since been convicted for contempt of court and fined $55,000. The main case relating to APRA's charge that Terra Nova Cache is in breach of the *Banking Act 1959* has yet to be heard in the Federal Court. APRA has advertised in newspapers nationally seeking information from members of the public who have placed money with Mr Siminton or Terra Nova Cache.

A key enforcement technique for APRA is disqualification. APRA has the power to disqualify key personnel from playing senior roles in the deposit-taking, general insurance and superannuation industries where their dishonest, reckless or negligent conduct has contributed to a deterioration in a regulated institution's financial soundness or who have otherwise proved to be unfit to hold positions of responsibility. APRA also has power to disqualify auditors and actuaries under the *Life Insurance Act 1995*.

Disqualifications are administrative decisions made by APRA delegates on a 'balance of probabilities' basis and are posted in the Disqualification Register on APRA's website. The APRA delegates are not APRA staff, but have significant administrative law experience and are engaged by APRA to decide whether or not an individual should be disqualified. Disqualifications have a protective purpose but they can also have the collateral consequence of damaging an individual's employment prospects and reputation. APRA therefore takes particular care before disqualifying an individual judged not to be fit and proper. APRA also has a discretionary power under the enforceable undertaking provisions of the *Insurance Act 1973* and SIS Act to accept an undertaking from an individual not to hold a senior position for a set period of time in a general insurance or superannuation role, respectively, and such a course may occasionally prove to be a suitable alternative to disqualification.

Over the past four years, APRA has removed by disqualification or enforceable undertaking:

- 75 senior personnel in superannuation (another 11 were disqualified, but had their disqualifications overturned under internal or AAT review);
- 29 senior personnel in general insurance (another four individuals were disqualified but had their disqualifications overturned on internal review). In all but one case, the disqualifications applied to individuals involved one way or another with events leading up to the failure of HIH Insurance; and
- one senior person in the credit union industry.

Around 11 disqualified individuals have appeals under way in the AAT. Two individuals have been granted leave to appeal recent Federal Court decisions about APRA's powers and processes in the High Court.

Enforcement actions undertaken during 2005/06

	ADIs		Super-annuation		General insurance		Life insurance		Friendly societies		Other[1]		TOTAL	
	2005	**2006**	2005	**2006**	2005	**2006**	2005	**2006**	2005	**2006**	2005	**2006**	2005	**2006**
AAT/Federal Court review			7	**13**	10	**3**							17	**16**
Amendment of IOA[2]				**1**									0	**1**
Appointment of Acting Trustee			3	**1**									3	**1**
Appointment of liquidator/Inspector			2		1								3	
Civil litigation			13	**3**		**1**						**3**	13	**7**
Directions and contravention notices			403	**2**	33	**2**			2		25	**6**	453	**10**
Disqualification of auditors/directors		**1**	17	**22**	23	**12**						**1**	40	**36**
Enforceable Undertaking			2	**164**	1	**1**							3	**165**
Follow-up delayed contributions				**8**								**1**	0	**9**
Investigation action		**1**	36	**7**	23							**3**	59	**11**
Other action	1	**4**	7	**8**		**4**			1		3	**10**	12	**26**
Prosecution			7									**1**	7	**1**
Refer to other agency/police			36	**9**	12	**3**					30	**3**	57	**15**
Removal of trustee/ withdrawal of IOA/ revocation			0	**1**		**3**							0	**4**
Show cause letter	1	**2**	26	**52**	46	**7**		**1**	1				74	**62**
Total	**2**	**8**	**559**	**291**	**149**	**36**	**0**	**1**	**4**	**0**	**58**	**28**	**741**	**364**

1 Includes institutions not regulated by APRA suspected of conducting unauthorised financial activity.

2 Instrument of Approval.

3

The prudential supervision framework

In 2005/06, APRA completed major elements of its agenda to strengthen the prudential supervision framework in Australia. This agenda has not been largely of APRA's making. It has been driven, in part, by two global regulatory initiatives, running on international timetables: the new global capital adequacy regime for deposit-taking institutions (the new Basel Capital Framework) and the introduction of International Financial Reporting Standards. In part, it has also been driven by the conclusions of the HIH Royal Commission, supported by the Government, that the prudential framework for general insurers could be enhanced.

Whatever their origin, it is APRA's responsibility to ensure that the reforms are prudentially sound, practical to implement and relevant to the business of regulated institutions. For this reason, APRA has consulted extensively with interested parties, has sequenced the reforms to spread their impact and has provided sensible transition arrangements.

The prudential supervision framework, broadly speaking, includes both behavioural and technical prudential standards. The first group addresses matters such as risk management and the calibre and decision-making processes of boards and management. Since there is no compelling reason why behavioural standards should differ across APRA-regulated industries, APRA is committed to introducing such standards on a harmonised basis. In this spirit, it finalised harmonised prudential standards for 'fit and proper' and governance, and released draft prudential standards for outsourcing. APRA also finalised a risk and financial management prudential standard for general insurers that it intends to harmonise across the life insurance and friendly society industries. The second group of technical standards addresses matters such as capital requirements, risk measurement and asset and liability valuation. These tend to be more industry-specific.

During the year, APRA revised its approach to articulating its prudential requirements and guidance, which is now to be based on two prudential instruments. Prudential standards will, as before, set out APRA's minimum, and legally enforceable, requirements on specific prudential matters. APRA's intention is to develop flexible, principles-based prudential standards where this is appropriate but, in many instances, the standards will unavoidably retain detailed requirements. Prudential practice guides, a new instrument, will provide more detailed guidance – but not prescription – on how regulated institutions might comply with APRA's requirements and on prudent practice in the area concerned. APRA's new prudential standards on 'fit and proper' and governance, and on risk and financial management for general insurers, were released in this format.

Though widely welcomed, the new format is not without its challenges for APRA and regulated institutions. For APRA, the application of a more principles-based approach will place greater demands on its supervisors to consider how a set of principles is best applied in a particular situation. For regulated institutions, there will need to be an acceptance that supervisory judgment is likely to play an increased role in the application of prudential requirements. Greater flexibility on APRA's part will, inevitably, mean differences in outcomes as APRA tailors its approach to individual circumstances rather than provides a 'one size fits all' response.

Australia's prudential supervision framework and APRA's approach to supervision were the subject of two major reviews during 2005/06. The first was conducted by the International Monetary Fund (IMF) under its Financial Sector Assessment Program. The second formed part of a wide-ranging review of regulation by the Government's Taskforce on Reducing Regulatory Burdens on Business.

Harmonised prudential standards

Fit and Proper

APRA's proposals on the fitness and propriety of 'responsible persons' of ADIs, general insurers, life insurers and friendly societies were set out in two consultation papers released in March 2004 and June 2005. (Due to a different legislative framework, fit and proper issues in superannuation are addressed separately in a new operating standard). The proposals apply to directors, senior managers, auditors and (where relevant) actuaries of these institutions, and are intended to ensure that these persons have the appropriate skills, experience and knowledge to perform their roles, and act with honesty and integrity.

The first consultation paper attracted 38 submissions and the second 35 submissions. In response to issues raised in submissions and consultations, APRA amended aspects of its proposals and, in March 2006, released new and harmonised 'fit and proper' prudential standards, and separate prudential practice guides, that establish minimum benchmarks for acceptable practices for appointments to positions of responsibility. Taking a principles-based approach, the standards place the onus squarely on regulated institutions to have their own policies, and take all prudent steps, to ensure their responsible persons are fit and proper. APRA will use its powers in this area only when it has specific concerns about a responsible person which the institution cannot or will not take action to address. In developing its approach, APRA has where practicable harmonised its requirements with ASIC's fit and proper regime for responsible officers.

The standards come into effect from 1 October 2006.

Governance

APRA's initial governance proposals were included in its November 2003 discussion paper, *Prudential Supervision of General Insurance – Stage 2 Reforms*. A subsequent discussion paper in May 2005 set out revised governance proposals that would apply not only to general insurers but, as originally intended, to ADIs, life insurers and friendly societies as well. The second paper generated around 60 written submissions and APRA met with a large number of interested parties, several times in some cases. A number of the initial proposals were improved or clarified in response to comments and suggestions made.

In May 2006, APRA released new prudential standards on governance, and separate prudential practice guides, that set out minimum foundations for good governance of APRA-regulated institutions. The new standards harmonised APRA's governance standards and brought them into line with what has become accepted in Australia as good practice in corporate governance. The standards build on APRA's existing requirements in two main ways: they seek to promote greater independence on the part of the board, its chair and the board audit committee; and they require boards to establish and apply a formal policy on board renewal and procedures for assessing their own performance. In developing its framework, APRA has where possible aligned its requirements and definitions with the *Corporations Act 2001* and with the Australian Stock Exchange Corporate Governance Council's *Principles of Good Corporate Governance and Best Practice Recommendations*.

The standards come into effect from 1 October 2006. APRA has the flexibility to respond to genuine concerns from institutions that believe they have sound reasons for not meeting a specific requirement in the standards.

Outsourcing

In March 2006, APRA released a discussion paper and draft prudential standards on managing risk from outsourcing. The package represents a more principles-based approach detailing APRA's minimum outsourcing requirements but leaving the way open for institutions to develop their outsourcing policy in a way that meets the principles. The draft prudential standards are based largely on requirements currently in place for ADIs but introduce greater flexibility in the approach to intra-group outsourcing and deal explicitly with outsourcing to an offshore party ('offshoring'). On the latter point, APRA has proposed that regulated institutions consult with it prior to entering a material offshoring contract; however, APRA will not be approving individual arrangements. The general insurance industry had been consulted on the proposals as part of the second round of general insurance reforms, but a wider round of consultations has been undertaken because the new standards will be applied in identical form to the ADI, general insurance, life insurance and friendly society industries.

The outsourcing prudential standards are expected to be finalised in the early months of 2006/07 and be effective from 1 January 2007.

General insurance reform

Risk and financial management

APRA's second round of general insurance reforms, which commenced with its November 2003 discussion paper, took a major step towards completion with the release in February 2006 of three new prudential standards. Accompanying these standards were separate prudential practice guides, marking the introduction of APRA's more flexible approach to prudential guidance. The three standards address key recommendations of the HIH Royal Commission and form a crucial element of APRA's supervision of risk and financial management by general insurers. The standards were developed after extensive industry consultation, including a second discussion paper in May 2005 and two public forums co-hosted with the Insurance Council of Australia.

The standards clarify and strengthen APRA's previous requirements in risk and reinsurance management and emphasise the importance of documenting reinsurance contracts for greater certainty. They also cover changes to audit and actuarial reporting and valuation. The standards include requirements for a rigorous business plan addressing the insurer's ability to meet future capital requirements; an annual declaration on the accuracy and completeness of financial information; documentation of reinsurance arrangements including a reinsurance arrangements statement; prior approval of limited risk transfer arrangements; and preparation of an annual Financial Condition Report on each insurer by its Approved Actuary.

The new standards apply from 1 October 2006.

Conglomerates

In a further response to the recommendations of the HIH Royal Commission, APRA set out its initial proposals for the supervision of conglomerate groups involving general insurers in a discussion paper in May 2005. The focus of the proposals is contagion risk – the risk that adverse developments in activities conducted by other group members could affect the soundness of the regulated insurer (or insurers) in the group. The proposed consolidated approach addresses group structures and management, group capital adequacy, reinsurance and risk concentrations at group level, and intra-group exposures. The proposals aim to achieve a reasonable balance between protecting policyholder interests in the individual insurer and not unduly constraining efficient commercial business practices within the group. The proposals mirror many of the current practices of major general insurers in Australia and build on APRA's existing framework for the supervision of conglomerate groups involving ADIs.

Submissions received on these proposals were generally supportive of APRA's objective of reducing contagion risk but raised a number of specific issues. APRA's response to these issues will be set out in a second discussion paper, to be released in the first quarter of 2006/07. This paper will confirm the basic principle that APRA intends to pursue in consolidated supervision – namely, that the consolidated group should be held to the same minimum capital requirements that apply to the stand-alone Australian insurers in the group – and outline the main features of APRA's preferred approach.

After further consultation, APRA intends to finalise its prudential standards in this area in the last quarter of 2006/07.

Other reforms

International Financial Reporting Standards

Australia adopted the Australian equivalents of International Financial Reporting Standards (IFRS) from 1 January 2005, a reform which impacted in a number of ways on APRA's prudential and reporting framework for its regulated industries, other than superannuation. APRA's approach has been to align this framework with Australian Accounting Standards and principles, except where this would not be consistent with the intent and integrity of the framework.

During 2005/06, APRA completed its assessment of the prudential implications of IFRS for ADIs and, in June 2006, released revised prudential standards and guidance notes for this industry. These revisions were finalised after industry had had the opportunity to respond to five separate discussion papers on the prudential implications, at both an overview and specific level. The revised prudential standards decouple the definition of capital instruments eligible for Tier 1 capital from Australian Accounting Standards and bring APRA's approach to innovative capital instruments into line with international banking supervision practice. The revised standards also decouple the assessment of securitised assets for capital adequacy purposes from the accounting treatment and address some other adverse prudential outcomes flowing from the adoption of IFRS.

The revised prudential standards came into effect from 1 July 2006, with transition arrangements available.

Similar changes to the prudential standards for general insurers will be introduced following the completion of consultations on APRA's second-round reforms dealing with capital, assets in Australia and custodian arrangements. The changes will come into effect from 1 January 2007.

During 2005, the Life Insurance Actuarial Standards Board (LIASB) introduced new solvency and capital standards for the life insurance and friendly society industries to reflect changes introduced by the adoption of IFRS and to address other issues which had been identified in the previous standards. These changes were the subject of industry consultation during 2005 and became effective from 31 December 2005. For some life insurers, the new standards have led to increased solvency and capital adequacy requirements and APRA has indicated that it will provide transitional relief to affected insurers if necessary. At the same time, some elements in the previous standards that had potentially adverse capital consequences for some institutions have been amended.

In developing its prudential approach to the adoption of IFRS, APRA has been liaising with the Financial Reporting Council, the Australian Accounting Standards Board, the Australian Auditing and Assurance Standards Board, professional accounting bodies and overseas regulators. APRA has also participated in the Accounting Task Force of the Basel Committee on Banking Supervision (the Basel Committee), which is assessing the prudential issues raised by IFRS.

New Basel Capital Framework

The new capital adequacy regime for deposit-taking institutions, known as the Basel II Framework and released under the auspices of the Basel Committee, is a major global initiative designed to harness best practices in risk management into the regulatory process and provide more risk-sensitive capital requirements. The Basel II Framework will be implemented in Australia from 1 January 2008 through APRA's prudential standards. Preparing for this implementation required a significant commitment of APRA resources during 2005/06.

The vast majority of Australian banks, building societies and credit unions will use the Basel II standardised approaches in determining their regulatory capital requirement. The only Basel II capital requirements that will apply to most of these ADIs relate to credit and operational risk, for which draft prudential standards were released by APRA in 2005. These standards will be finalised after APRA completes further analysis of the quantitative impact of the proposals. Some changes to risk management and reporting systems to introduce more granularity will be required for ADIs using the standardised approaches but the changes should not be onerous.

ADIs wishing to adopt the more sophisticated approaches available under Basel II require approval from APRA. Those Australian-owned ADIs wishing to be accredited for these approaches from January 2008 had to apply to APRA by 30 September 2005. Subsidiaries of foreign-owned banks are on a different timetable and, in any event, APRA will co-ordinate its approval process for such ADIs with the home regulator of the parent bank.

Around half a dozen Australian-owned ADIs have applied for accreditation to adopt the more sophisticated Basel II approaches. If accredited, these ADIs will be able to use their own quantitative risk estimates as inputs into their regulatory capital requirement, rather than apply the supervisory rules of the standardised approaches. Given the importance of capital in maintaining the financial strength of an ADI, as well as market and public confidence in the institution, APRA believes the accreditation process must be robust. In their applications, ADIs had to undertake a detailed self-assessment of their compliance with the Basel II rules and address a number of other requirements that would demonstrate the extent to which the use of risk-based capital and associated risk-adjusted performance measurement permeates the management of the ADI's business. APRA also required that each ADI's application be signed off by its board.

ADI preparations for the advanced Basel II approaches have been demanding – in terms of resources, data and time – and those preparations have not ended with the applications. Applicants are continuing with their risk modelling work, with some substantially reviewing their systems and models to ensure that their quantitative risk estimates and supporting data meet the stringent initial and ongoing Basel II requirements. For its part, APRA has analysed the details of the applications and is undertaking on-site reviews and benchmarking exercises.

During 2005/06, APRA released draft prudential standards for the advanced Basel II approaches, dealing with the internal ratings-based approach to credit risk, the advanced measurement approaches to operational risk and interest rate risk in the banking book. A prudential standard on securitisation will be issued shortly. Later in 2006, APRA will release an amended market risk prudential standard and a second draft prudential standard for the advanced measurement approaches to operational risk.

During the year, the Basel Committee undertook a fifth quantitative impact study in order to evaluate its Basel II proposals as implementation dates approach. APRA was represented on the international working group that co-ordinated and analysed the study, and the Australian ADIs that have applied for accreditation participated along with banks from 30 other countries. Using the results of this study, the Basel Committee decided to maintain the current calibration of Basel II. The results for the Australian participants indicated a larger decline in minimum regulatory capital levels than in many other countries. That, at least in part, reflects the larger proportion of housing loans on the books of Australian ADIs compared to their overseas peers; in Australia's case, as well, the data on credit risk are reflective of a benign part of the economic cycle.

Importantly, the study captured only credit, operational and market risks and not interest rate risk in the banking book and the many other significant risks to which ADIs are exposed. Hence, the results do not capture the total amount of regulatory capital that will be required of those ADIs using the advanced Basel II approaches. Basel II also contains floors that prevent an ADI's capital requirement being substantially reduced as a result of applying the advanced approaches.

As it has stated before, APRA does not view Basel II as a vehicle for changing the competitive landscape for ADIs but as an opportunity to align regulatory capital more closely with the risks that ADIs assume and how well those risks are managed.

Purchased payment facilities

In November 2005, APRA finalised a prudential standard and authorisation guidelines for providers of purchased payment facilities or PPFs, a new class of ADIs. PPFs are new forms of payment instruments such as stored-value cards and internet-based payment systems ('electronic purses'). APRA's approach seeks to balance the need to protect the customers of PPFs with the objective of supporting the development of a competitive and innovative financial system. The new prudential standard recognises the unique characteristics of PPF providers within a consistent framework for the supervision of ADIs. The standard applies a simplified framework for capital adequacy, liquidity and operational risk to PPF providers that have stored value at risk. PPF providers must also meet ADI prudential standards on governance, fitness and propriety, outsourcing, business continuity management and auditing requirements.

Religious charitable development funds

In July 2006, APRA introduced a class exemption order that standardised the conditions under which religious charitable development funds can be exempted from the requirement to be authorised under the *Banking Act 1959*. APRA has traditionally granted exemptions to such funds (also known as 'church funds'), which are usually established to raise monies from the public in order to make loans that further the charitable purpose of the fund. The exemptions were granted on a case-by-case basis and were subject to various conditions. The new class order will simplify the exemption process and apply a consistent set of exemption conditions to all funds. The conditions preclude funds from offering transactional banking services; require increased disclosure that funds are not subject to APRA's prudential oversight; and limit advertising to printed material produced under the auspices of the sponsoring religious institution. In this way, the activities of religious charitable development funds will be more clearly demarcated from ADIs offering retail banking services.

Regulatory reviews

Financial Sector Assessment Program

During 2005/06, the IMF conducted a Financial Sector Assessment Program (FSAP) in relation to Australia. APRA participated actively in the Program.

The FSAP is an assessment by international experts of the stability of a country's financial system and its supporting infrastructure; it examines the system's strengths and potential vulnerabilities and how material sources of risk are managed.

As part of the Program, a 14-strong team of experts drawn from the IMF, overseas central banks, regulatory agencies and the private sector assessed Australia's observance of various international financial sector standards and codes. APRA's supervision of the banking and insurance industries was evaluated against the Basel Committee's *Core Principles for Effective Banking Supervision* (for banks) and the International Association of Insurance Supervisors (IAIS) *Insurance Core Principles* (for life and general insurance companies). The FSAP team also undertook a macroeconomic stress test of the capacity of the Australian financial system to deal with certain shocks. A number of Australian banks, together with APRA, the Reserve Bank of Australia and the Treasury, took part in the stress test modelling.

At the time of writing, the IMF was still to present its FSAP report on Australia to its governing body. Preliminary feedback, however, confirms that the FSAP team found Australia's approach to prudential regulation to be sound overall. Compliance with international standards was at a generally high level and implementation of APRA's risk-based supervisory approach was seen as in line with international best practice.

Taskforce on Reducing Regulatory Burdens on Business

In October 2005, the Prime Minister and the Treasurer announced the formation of the Taskforce on Reducing Regulatory Burdens on Business to identify actions for reducing any undue costs for business from Australian Government regulation. The Taskforce, chaired by Mr Gary Banks, Chairman of the Productivity Commission, delivered its report in January 2006. The Government released the report and its preliminary responses in April 2006 and its final responses in August 2006. The Government has agreed in full or in part to 158 of the Taskforce's 178 recommendations.

APRA met with the Taskforce and provided a range of material to assist it in its deliberations.

In the area of financial regulation, the Taskforce noted that Australia's financial and corporate sectors, and the associated regulatory structures, are highly regarded internationally. It went on to note that the broad policy framework has widespread support within business and the wider community in Australia. The Taskforce concluded, nonetheless, that several challenges need to be addressed to further promote a balanced and efficient regulatory environment in the financial and corporate sectors.

The Taskforce made one recommendation specific to APRA and 12 recommendations jointly relevant to APRA and ASIC. The Government accepted all of these recommendations and APRA is working with ASIC and the Government in response. APRA and ASIC have established a working group to identify and address any areas where there may be duplication or overlaps in the activities of the two agencies. The working group is currently focusing on financial and regulatory reporting, data collection, licensing and breach reporting.

The Taskforce has endorsed the importance of the Government's 'Statement of Expectations' of APRA (and ASIC) in providing guidance about the appropriate balance between the objective of financial safety and efficiency, competition, contestability and competitive neutrality. This was a recommendation of the earlier Uhrig Review (*Review of the Corporate Governance of Statutory Authorities and Office Holders,* 2003). The Government has confirmed that the 'Statement of Expectations' of APRA will convey the Government's expectations with regards to performance, objectives, values and broader Government policies.

More generally, the Government has decided to upgrade the oversight of new regulation, including through strengthening and reorienting the Office of Regulation Review (ORR) and improved cost-benefit analysis. Over recent years, APRA has had a 100 per cent record for compliance with the requirements of the ORR for Regulation Impact Statements on new prudential and reporting standards. APRA is conducting research into the measurement of costs of and benefits from prudential regulation to improve decision-making in this area.

In a further response to the Taskforce's recommendations, the Government has established a steering committee of Australian and State Government departments and agencies, chaired by the Treasury, to examine the case for introducing standard business reporting. APRA is represented on this committee. As the prime data collection agency for the financial sector, APRA has extensive experience in harmonising reporting requirements across agencies and collects data through advanced reporting systems.

APRA-regulated institutions

	Number			Assets ($ billion)[1]		
	30 Jun 05	30 Jun 06	% change	30 Jun 05	30 Jun 06	% change
ADIs[2]	236	223	-5.5	1,426.7	1,643.9	15.2
Banks	51	54	5.9	1,368.5	1,581.1	15.5
Building societies	14	14	0.0	16.3	17.9	9.8
Credit unions	164	148	-9.8	33.1	35.7	7.9
Other ADIs, including SCCIs	7	7	0.0	8.8	9.2	4.5
Representative offices of foreign banks	14	13	-7.1			
General insurers	133	133	0.0	80.0	83.4	4.3
Life insurers	37	35	-5.4	206.2 [3]	226.5[3]	9.8
Friendly societies	29	27	-6.9	6.3	6.6	4.8
Licensed trustees	6	307				
Approved trustees	140	22[4]				
Superannuation entities	8,732[5]	7,812[5]	-10.5	464.2	572.1	23.2
Public offer funds	266	222	-16.5	307.9	390.4	26.8
Non-public offer funds	995	603	-39.4	147.8	172.7	16.8
Small APRA funds	7,104	6,665	-6.2	3.1	3.2	3.2
Approved deposit funds	222	182	-18.0	0.4	0.5	25.0
Eligible rollover funds	15	17	13.3	5.0	5.3	6.0
Pooled superannuation trusts[6]	130	123	-5.4	45.5	48.5	6.6
Non-operating holding companies	10	12	20.0			
Total	**9,337**	**8,584**	**-8.1**	**2,183.5**	**2,532.5**	**16.0**

1 Asset figures for end June 2006 are based on most recent returns. Asset figures for end June 2005 have been revised slightly from APRA's *2005 Annual Report* in line with the audited returns received during the year.

2 The ADI classification does not include representative offices of foreign banks.

3 Total life office statutory fund assets backing Australian policyholder liabilities.

4 The legislation (Part 2 of the SIS Act) under which certain trustees were approved was repealed effective 1 July 2006. The 22 approved trustees did not seek an RSE licence and their approval to operate a superannuation entity lapsed on 1 July 2006.

5 Does not include uncontactable funds that are in the process of being formally wound up or transferred to the Australian Taxation Office. As at the end of June 2006, there were 127 such funds, down from 161 funds as at the end of June 2005.

6 Pooled superannuation trust assets are not included in totals as these assets are already recorded in other superannuation categories.

4

APRA's supervisory capabilities

In parallel with the upgrading of the prudential supervision framework, APRA has had a comprehensive program to enhance the quality and effectiveness of its core supervision activities. This program is based on:

- embedding a robust supervisory methodology for identifying and assessing weaknesses in a regulated institution;
- improving the rigour and consistency of its supervisory processes;
- building up its supervisory resources and skills, particularly to deal with larger and more complex financial institutions; and
- strengthening its statistical and research activities.

Supervisory methodology

APRA has two supervisory tools designed to ensure that its supervisors assess risks rigorously and consistently and that supervisory interventions are targeted and timely. The Probability and Impact Rating System (PAIRS) is a risk assessment model and the Supervisory Oversight and Response System (SOARS) guides supervisors in responding to identified risks. A substantial intellectual effort has gone into developing this framework, which was introduced in October 2002. By June 2006, around 1,330 institutions accounting for over 99 per cent of APRA-regulated assets had been PAIRS-rated and these ratings are regularly updated as new information comes to hand.

The PAIRS system provides a disciplined and systematic process to assess the unique risk profile of each regulated institution. The risk assessment covers the inherent risks facing the institution, the effectiveness of management and controls in mitigating these risks, and the extent of capital support to meet unexpected losses. Based on this assessment, regulated institutions are classified according to the probability that the institution will fail to honour its financial promises to beneficiaries (depositors, policyholders and superannuation fund members). A number of mechanisms, including benchmarking against similar institutions and comparisons with external credit ratings, are used to ensure that the PAIRS probability ratings are as accurate and consistent as possible. The PAIRS probability rating is then combined with an assessment of the potential impact of the institution's failure on the financial system, to complete the PAIRS rating.

SOARS supervisory stance

		PAIRS probability rating				
		Low	Medium		High	Extreme
			Low	High		
PAIRS impact rating	Extreme	Normal	Oversight	Mandated Improvement	Restructure	Restructure
	High	Normal	Oversight	Oversight	Mandated Improvement	Restructure
	Medium	Normal	Normal	Oversight	Mandated Improvement	Restructure
	Low	Normal	Normal	Oversight	Mandated Improvement	Restructure

Under the SOARS system, the risk ratings and impact of an institution help APRA to determine its supervisory response. Where PAIRS involves substantial calculation and judgment, SOARS is an overlay of supervisory stances on top of the PAIRS grid. The discipline is a critical one. Regulatory forbearance – that is, softening the supervisory response and prolonging the life of a troubled institution in the hope that a problem will solve itself – is not a discretion available to APRA supervisors. There are four supervisory stances involving increasing intensity in APRA's involvement, from routine supervision for 'Normal' institutions through to vigorous supervisory intervention for institutions in the 'Restructure' stance. The SOARS grid has been set so that the larger the regulated institution, the earlier and more proactively APRA responds to a given risk of failure.

At end June 2006, around 69 per cent of risk-rated institutions were in the 'Normal' stance, 30 per cent in 'Oversight', one per cent in 'Mandated Improvement' and one per cent in 'Restructure'.

Ideally, APRA would prefer to see institutions in the 'Normal' and 'Oversight' stances improving, or at least not deteriorating, and institutions in 'Mandated Improvement' and 'Restructure' moving to those other stances or exiting the industry, preferably without loss to beneficiaries. As a means of gauging the timeliness and effectiveness of APRA's intervention, APRA has been tracking the migration of institutions between the different supervisory stances over the past three years. The great majority of institutions in 'Mandated Improvement' or 'Restructure' at some point over this period have either improved or exited the industry, with no failures as such. Of the 168 institutions that have been in these two stances, 57 have improved, 16 remain in their SOARS category, one has been downgraded and 94 have exited. Within these numbers are 16 larger institutions that have been in 'Mandated Improvement' whose problems have largely been resolved or which, in three cases, have exited the industry without loss.

Table 1 – Entities in Mandated Improvement (2003–06)

Current stance	Total
Normal	10
Oversight	44
Mandated Improvement	9
Restructure	1
Exit	67
Total	**131**

Table 2 – Entities in Restructure (2003–06)

Current stance	Total
Normal	2
Oversight	1
Mandated Improvement	0
Restructure	7
Exit	27
Total	**37**

This retrospective provides strong evidence that APRA's proactive, risk-based supervisory approach, particularly for larger entities, has been effective in identifying problems and in helping to resolve them. The significant number of exits is also confirmation that the normal disciplines of the marketplace have been working. That said, it might be harder to achieve orderly exits on the scale of recent years if economic conditions were to become more adverse. Over the past three years, with asset markets strong and finance readily available, troubled institutions have been able to find willing buyers for their businesses or their assets.

APRA Supervision Framework

To promote greater rigour and consistency in front-line supervision, APRA has introduced an APRA-wide supervisory approach to performing and documenting on-site and off-site activities. The APRA Supervision Framework facilitates a structured and consistent approach by supervisors in both of its frontline divisions, irrespective of the size, nature and complexity of the institutions supervised. The Framework has been designed to complement the PAIRS/SOARS risk assessment and supervisory response tools.

The on-site components of the Framework, comprising a series of industry-based modules for supervisory assessment and minimum supervisory cycles, were implemented in 2004/05. Since then, various supporting procedures have been progressively added to the Framework, helping to increase its consistency and improve accountability and audit trails. During the superannuation licensing process, the Framework proved to be particularly useful for analysing licence applications and documenting licence assessments. Development of off-site components is well advanced and these will be fully operational in 2006/07.

While providing greater structure around the conduct of supervision, the Framework is not designed to stifle or restrict supervisory judgment and innovation, or the ability to adapt supervision activities to particular cases. Supervisors of institutions of differing size and complexity have flexibility in applying all or some modules at appropriate times, according to the assessed riskiness of that institution.

As part of its 2006–09 Strategic Plan, discussed in a following chapter, APRA is reviewing experience to date with the Framework to ensure that supervisory judgment and initiative are not being lost to a greater focus on process. The Plan assigns high priority to the integration of the Framework with the PAIRS/SOARS supervisory tools and APRA's tracking and scheduling tool for supervisory activity and issues. More complete integration of supervisory tools and systems will reduce duplication and inconsistencies and enhance APRA's efficiency and effectiveness.

APRA's staffing

APRA's program to build up its supervisory resources and skills, particularly those required for the supervision of large and complex financial institutions, met an important milestone in 2005/06 when overall staffing targets were reached. By year end, APRA's staff numbers were 592 (excluding fixed-term staff for superannuation licensing). This outcome was achieved in a very competitive labour market and despite continuing high voluntary turnover, which over the last two years has been running at over 15 per cent in operational divisions.

A major strategic priority for APRA is to attract, develop, manage and retain a highly skilled and motivated workforce. To this end, recent recruitment from industry at more senior levels has brought individuals with an average of nearly ten years' relevant experience into APRA. This recruitment, together with relatively low turnover at the senior echelons, has given APRA a senior management cadre made up of a relatively stable, strong group of experienced staff. However, retaining junior- to middle-level staff with three to five years' experience is a continuing challenge. Such staff become most attractive to industry just at the time they become very productive to APRA.

APRA has a number of initiatives under way aimed at creating a supportive work environment in which each staff member is clearly valued and encouraged to develop his or her full potential. The initiatives address management and leadership; systems and procedures; progression and recognition; and culture and communication. APRA is also committed to the continued recruitment of high quality graduates and to an extensive staff training program. In 2005/06, it delivered over 400 training courses to its staff, each of whom received an average of 6.7 training days.

During the year, APRA also launched a new *Statement of APRA Values*, reproduced on page 39, to give more detailed and relevant guidance on what APRA expects from its staff, in their interactions with their peers and the institutions which they supervise.

Among the main characteristics of APRA's current staffing:

- 19 per cent have come from predecessor agencies;
- the average length of time supervisors have spent in prudential supervision activities (including time with predecessor agencies) is 6.4 years;
- the average years of relevant industry experience of new recruits is seven years, but is closer to ten years for senior roles;
- around 95 per cent of supervisory staff have at least one professional qualification and about half of these have additional post-graduate qualifications; and
- the main professional training of APRA staff is accounting, finance and economics, but APRA also includes over 20 lawyers, over 30 actuaries or actuarial students, and a number of statisticians, mathematicians, risk analysts and finance academics.

APRA staff who resigned during 2005/06 had an average of 3.2 years of prudential supervision experience.

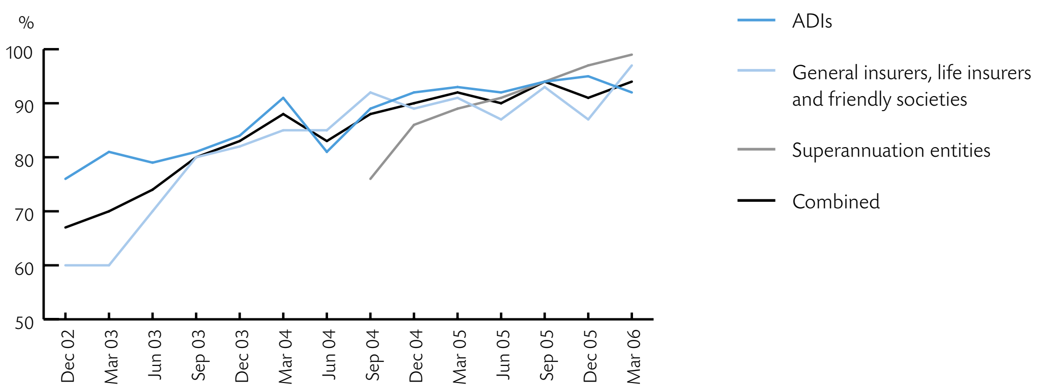
APRA's statistical capabilities

APRA is the central repository of financial sector statistical information in Australia and it collects financial statistics from a wide range of financial institutions, regulated and unregulated. Data on individual regulated institutions are a vital input into risk assessments by APRA supervisors. The data provide early warning of emerging risks within an individual institution and across industries, and this in turn drives supervisory action plans.

APRA also collects data on behalf of the Reserve Bank of Australia and the Australian Bureau of Statistics. APRA's published statistics inform many decision-makers in the Australian financial system – including policy-makers, market analysts, researchers and senior management of financial institutions – and ultimately contribute to a more stable, competitive and efficient financial system.

Against that background, APRA has been pursuing a continuous improvement program for the data it collects and the statistics it provides. As a consequence, the timeliness and accuracy of data collected across all industries, which are core to astute and timely risk assessments of regulated entities, have been considerably enhanced. Some 94 per cent of returns from regulated entities are now submitted by the statutory due dates, with the remainder usually submitted within the following week.

Returns submitted by the due date



APRA released three new statistical publications during 2005/06: the *Quarterly Bank Performance Statistics*, the *Quarterly Credit Union and Building Society Performance Statistics* and the *Half Yearly General Insurance Bulletin*. These publications will provide regular updates on the financial performance of the ADI and general insurance industries as well as the performance of individual general insurance companies. These publications, out of a suite of 12 regular statistical publications, are the latest publications to be modernised and improved as part of a revamp of APRA's publication suite. In releasing statistics, APRA follows international standards aimed at ensuring that users have greater certainty about the availability of data and that statistics are made available on an impartial basis. For example, the release dates for existing statistical publications are provided in advance on the APRA website.

Two other major priorities for APRA's statistics unit over 2005/06 were the introduction of the National Claims and Policies Database (NCPD) on public liability and professional indemnity insurance, and the adoption of IFRS. These two developments have been discussed earlier in this Report. APRA worked closely with regulated institutions to ensure a smooth transition to the new prudential reporting requirements that flow from APRA's prudential approach to the adoption of IFRS. APRA agreed transitional reporting arrangements enabling regulated institutions to use their IFRS-based financial reports and still comply with reporting requirements. This removed the dual reporting burden that some institutions would have encountered and ensured that APRA's statistics remained consistent and minor reporting anomalies were understood.

APRA's research capabilities

APRA has built a small but highly qualified applied research team whose aim is to identify and analyse issues that are likely to be of regulatory importance in the medium to long term. The team has developed expertise in analysing a range of issues, including potential stresses on ADI lending portfolios, lenders mortgage insurance risk and the performance of superannuation trustees; the team has also been supporting APRA's Basel II analytical work. Priorities for further analysis will be measures of risk in general insurance and capital issues.

After a gap of some years, the APRA internal working paper series was resumed and, over the year, four papers were placed on the APRA website. Two other papers were published in international journals and a further five papers were accepted for publication, subject to suitable revisions.

APRA has entered into research support agreements with three university groups to enhance prudential perspectives and encourage the development of academic expertise in the regulation of financial institutions. The first three projects under these arrangements will develop new models for investment, insurance and credit risks. APRA intends to continue supporting highly targeted academic research on a modest basis.

Statement of APRA Values

We play a critical role in protecting the financial well-being of the Australian community: as a result, high standards are required in everything we do. In our work and in our interactions with others, we value and seek to demonstrate:

Integrity

- We stand behind the statements and commitments we make.
- We are balanced and fair in the use of our authority and powers.
- We make decisions and perform our duties without personal bias.
- We take seriously our obligation to protect the confidentiality of information provided to us.

Collaboration

- We respect and value the views of others, both internal and external to APRA.
- We regularly seek the assistance and advice of others in APRA in our day-to-day work.
- We work and co-operate with our colleagues, and assist them to reach sound decisions and positive outcomes.

Professionalism

- We take pride in the quality of our work.
- We base our decisions on thorough and careful analysis.
- Once decisions are made, we act in a manner that respects those decisions and achieves the desired outcomes.
- We achieve timely and practical results, ensuring the benefits of regulating financial activity outweigh the costs and constraints we impose.

Foresight

- Our analysis of issues is forward-looking.
- Using all of the information available to us, we identify potential problems and actively pursue remedial action when necessary.
- We stay at the forefront of developments that affect our role by continually learning new skills and enhancing our knowledge.

Accountability

- We take responsibility for our decisions and the results of our actions.
- We never defer difficult decisions and actions, once a well-founded basis for these is identified.
- We hold ourselves to at least the same standards that we expect of regulated entities.
- We welcome independent scrutiny, and respond promptly to aspects of our performance that are identified as needing improvement.

Working and acting in these ways helps us achieve the high standards necessary for us to protect the financial well-being of the Australian community.

5 Co-operation and liaison

APRA maintains extensive links with other domestic and international regulatory agencies, and with industry groups and other interested parties, that help to strengthen its effectiveness as a prudential regulator and place its work squarely into the relevant international context. Domestically, APRA consults broadly with relevant stakeholders on the evolution of the prudential framework. Internationally, co-operation and liaison are important in aiding APRA's prudential oversight of internationally active financial institutions, identifying and managing new areas of risk and bringing Australian perspectives to global efforts to harmonise development of the international prudential supervision framework. An important priority for APRA in 2005/06 was increasing its engagement with prudential regulators in the Asia-Pacific region, in line with the Australian Government's commitment to assist regional governance and economic development.

Australia

APRA is one of three independent statutory agencies which, together, administer the regulation of the financial sector in Australia. The other two agencies are the Reserve Bank of Australia (RBA), which has responsibility for monetary policy, stability of the financial system and the safety and efficiency of the payments system, and the Australian Securities and Investments Commission (ASIC), which has responsibility for administration of the Corporations Law, disclosure and market conduct of Australian companies and financial services providers, and consumer protection in the financial system.

At the highest level, co-operation between these three agencies, and with the Australian Treasury, takes place through the Council of Financial Regulators. The Council operates as a forum for discussing regulatory issues and sharing information and views. Its main focus is to ensure that there are appropriate arrangements between the members for co-ordinating their activities in response to potential or actual pressures, and to advise the Government on the adequacy of Australia's financial system regulatory architecture. Over the past year, crisis management arrangements in the Australian financial system have attracted much of the Council's attention. In response to a request by the Treasurer, the Council has been consulting with the main industry groups in the finance sector on a proposed scheme that would provide depositors and policyholders in a failed financial institution with early access to at least some of their funds. Other matters considered by the Council have included pandemic planning, international developments in the regulatory framework including reporting standards, trans-Tasman banking regulation and the recommendations of the Taskforce on Reducing Regulatory Burdens on Business.

As part of the review of crisis management arrangements, a working group has been established under the auspices of the Council with the objective of ensuring that APRA is able to respond quickly to emerging financial distress in one or more regulated institutions. The work involves clarifying APRA's legal and regulatory powers in this area, and developing formal protocols to guide APRA's decision-making in a crisis situation and its interactions with other Council members and with Government.

APRA also meets regularly with the individual Council members under the terms of relevant Memoranda of Understanding (MoU). Over the year, meetings of the RBA/APRA Co-ordination Committee considered, among other things, emerging risk areas in the Australian financial system, operational risk events, co-ordination of crisis management arrangements, developments in the international regulatory architecture and results of member surveys on public attitudes to financial institution failure and on mortgage lending practices.

High-level meetings between APRA and ASIC cover a wide range of matters relating to financial institutions regulated by both agencies; there are separate and regular meetings to cover operational matters and enforcement issues. During 2005/06, the two agencies completed their review of unit pricing practices of life companies, superannuation providers and funds managers and jointly released a guide to good practice on unit pricing. There was also a particular focus on issues arising from superannuation licensing and choice and on the growth of 'deposit-like' products offered by unregulated institutions. Other areas of collaboration included product rationalisation and the potential risks for the financial system arising from pandemics. As discussed earlier, APRA and ASIC have formed a working group to respond to recommendations made by the Taskforce on Reducing Regulatory Burdens on Business.

APRA and the Treasury work closely on development of the regulatory framework and on associated legislative changes. Issues which received specific attention during 2005/06 included trans-Tasman banking regulation, Australia's participation in the IMF's Financial Sector Assessment Program (see page 29), International Financial Reporting Standards, the National Claims and Policies Database, Direct Offshore Foreign Insurers and Discretionary Mutual Funds, superannuation licensing and superannuation circulars.

APRA also meets regularly with various official and industry organisations. The former include AUSTRAC and the Private Health Insurance Administration Council (PHIAC) and State regulatory bodies for compulsory third-party (CTP) motor vehicle insurance (the Motor Accidents Authority of New South Wales and the Motor Accident Insurance Commission of Queensland). APRA also liaises with the Financial Reporting Council, the Australian Accounting Standards Board and the Australian Auditing and Assurance Standards Board. During the year, APRA contributed to the auditor independence activities of the Financial Reporting Council and worked with the Auditing and Assurance Standards Board to develop regulatory reports and guidance for auditors of superannuation funds.

APRA participates in the Banking and Finance Infrastructure Assurance Advisory Group (BFIAAG), established under the Government's Trusted Information Sharing Network (TISN). TISN is an umbrella public-private partnership framework aimed at protecting Australia's critical infrastructure across a number of key industries. BFIAAG includes representatives from many major financial institutions, financial markets, industry associations and State and Australian Government agencies. APRA views BFIAAG as important in focusing attention on the collective operational resilience of the financial system. APRA actively supports BFIAAG's key initiatives, which to date have included assessing and sharing information on risks to the financial sector arising from infrastructure dependencies and other potential systemic vulnerabilities, as well as industry-wide communication and co-ordination.

Industry organisations with which APRA liaises include the Australian Bankers' Association, Abacus–Australian Mutuals (the Association of Building Societies and Credit Unions), the Financial Industry Council of Australia, the International Banks and Securities Association, the Australian Finance Conference, the Investment and Financial Services Association, the Insurance Council of Australia, the Corporate Superannuation Association, the Australian Institute of Superannuation Trustees, the Association of Superannuation Funds of Australia, the National Credit Union Association and the Australian Friendly Societies Association. APRA also liaises with professional associations and institutes such as those for accountants, actuaries, administrators, auditors, company directors, financial planners, managers and trustees. APRA's regional offices also have wide-ranging liaison programs with regional offices of ASIC, industry bodies and professional associations.

APRA has taken a particular interest in the development or revision of the professional standards of the Institute of Actuaries of Australia on independent peer review, changes to the Institute's Code of Conduct and disciplinary scheme, and the preparation of valuation reports and financial condition reports for insurers. These all play an important part in the prudential framework for the industries in which actuaries are involved. Many APRA staff who are members of the Institute also participate actively in task forces and committees of the Institute covering the specific topics above and wider actuarial practice.

International liaison

With globalisation of financial systems proceeding apace, APRA's international liaison activities are critical in ensuring that it remains fully informed about emerging risks and developments in risk analysis and management. APRA has established arrangements for more effective exchange of information with a number of overseas regulators and, in 2005/06, signed MoUs with the Office of Thrift Supervision of the United States and with de Nederlandsche Bank, which is now the integrated prudential regulator for the Dutch financial services industry. Discussions on MoUs continue with a number of other prudential regulators.

APRA is also actively involved in a range of international groups and forums which are pursuing reforms to international regulatory frameworks. These include:

- International Association of Insurance Supervisors (IAIS). This group issues global insurance principles, standards and guidance papers, provides training and support on issues related to insurance supervision and organises meetings and seminars for insurance supervisors. The IAIS also works closely with other financial sector standard-setting bodies and international organisations to promote financial stability. Major priorities for the IAIS over 2005/06 have been developing a risk-based solvency framework for insurers and working with the International Accounting Standards Board (IASB) on insurance liability valuation and reporting. An APRA executive is chair of the IAIS Technical Committee, which has responsibility for the development, through a range of subcommittees, of IAIS principles, standards and guidance papers. Other IAIS work over the year encompassed disclosure, fit and proper requirements, asset/liability management, finite reinsurance and risk transfer, supervision of financial conglomerates and insurance fraud. APRA representatives provide input to much of the work undertaken by the IAIS and are particularly active in the Accounting, Insurance Contracts, and Solvency subcommittees. APRA staff are also members of an IAIS working group developing a multilateral MoU template.
- Basel Committee on Banking Supervision. Australia is not a member of this Committee but APRA is represented on a number of groups established under its auspices. These include the Core Principles Liaison Group (CPLG) and its Working Group on Capital, which are major vehicles for consultation between the Basel Committee and non-member countries.

The Basel II Framework continued to be the main topic for these groups during 2005/06. In June 2006, the Basel Committee in association with the CPLG issued a paper on *Home-host information sharing for effective Basel II implementation*; APRA was represented on the committee that drafted the paper. The CPLG also contributed to the redrafting of the *Core Principles for Effective Banking Supervision*. The Overall Capital/Quantitative Impact Study Working Group, in which APRA participates, assesses the quantitative impact of the Basel II Framework and aims to ensure that this impact is well understood. It undertook a fifth quantitative impact study during 2005/06, the results of which were released in June 2006. The Accord Implementation Group addresses implementation issues. APRA is a member of the Validation and Operational Risk subgroups, which are examining issues relating to the validation of banks' credit and operational risk estimates that will be used as inputs under the Basel II Framework. The Basel Committee periodically releases newsletters setting out the views of these subgroups and newsletters on a number of credit and operational risk matters were issued during 2005/06.

APRA participates as an observer on the Basel Committee's Accounting Task Force and contributes to its activities. The Task Force is assessing the impact of key international financial reporting standards on prudential regulation. During 2005/06, the Basel Committee approved guidance developed by the Task Force on sound credit risk assessment and valuation for loans, and the use of the fair value option for financial instruments issued by banks. APRA has integrated this guidance into its revised prudential standards and guidance notes for ADIs.

- Joint Forum. APRA and ASIC represent Australia on the Joint Forum, a body working under the umbrella of the Basel Committee, the IAIS and the International Organization of Securities Commissions (IOSCO).

  The work of the Joint Forum encompasses issues relating to financial conglomerates and other issues that are common across banking, insurance and securities sectors. Current activities include a study of regulatory and market differences across sectors, a working group on risk assessment and capital focusing on risk concentrations, a working group carrying out a cross-sector review of internal practice to manage customer suitability obligations for the sale of retail financial products and services, and a review of the implementation of the 1999 Joint Forum principles of conglomerate supervision.

  During 2005/06, APRA participated in a Joint Forum working group preparing a report on *High-Level Principles for Business Continuity*. The report, which was released in August 2006, addressed the responsibilities of financial regulators and financial institutions in implementing measures to ensure a resilient financial sector. It promotes a set of high-level principles that reflect the current systemic risk environment and the interdependencies of the global financial sector, with particular focus on preparing for and responding to major operational disruptions. The report provides authorities and financial institutions with a broad framework for developing business continuity arrangements closely tailored to their unique sectoral and local circumstances. APRA will consider how to implement relevant recommendations of the report in its own operations and supervisory activities.

- International Organisation of Pension Supervisors (IOPS). This body, representing supervisors of private pension systems, was formed in 2004 to become the global standards-setter for the pensions industry. APRA is on the foundation board of IOPS and a member of the Technical Committee. Over the year, APRA led a project on the licensing of pension funds being conducted in co-operation with the OECD, including developing draft guidelines. APRA also provided input to work on risk-based supervision.

- International Actuarial Association (IAA). The IAA is dedicated to research, education and development of the actuarial profession and practices and national actuarial associations. It also oversees development of standards and guidance relating to areas of international actuarial practice, such as for IFRS. Senior APRA staff have representative roles on IAA committees on behalf of the Institute of Actuaries of Australia (IAAust) and the IAIS. Amongst other tasks, one APRA staff member is chair of the Professionalism Committee and staff are involved in the Insurance Regulation Committee, which provides input to the work of the IAIS on an insurance solvency framework.

APRA also meets annually with integrated supervisory agencies from a number of countries to discuss issues arising out of the integrated supervisory model. At the eighth such conference, in May 2006, the subjects considered included quality management assessment and procedures, exercise of informal powers and aspects of integrated supervision.

Together with the RBA, APRA is a member of the Working Group on Banking Supervision of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), which brings together central banks, monetary authorities and banking supervisors within the region. The Working Group provides a forum to discuss regional financial and prudential developments, including implementation of the Basel II framework, and facilitates a number of training initiatives.

Technical assistance

With the encouragement of the Australian Government, APRA has been increasing its assistance activities in the Asia-Pacific region targeted at improving governance in the financial sector and regulatory agencies, developing financial sector regulatory architecture and building capacity of regional prudential supervisors. This work is funded principally by AusAID through the Australian Government's initiatives to improve governance in the region.

Under the Pacific Governance Support Program, APRA provides an intern program where supervisors from Pacific countries visit APRA for periods of up to four months to study aspects of supervisory principle and practice. In 2005/06, APRA hosted six internships of regulatory staff, three from Papua New Guinea, two from Fiji and one from Vanuatu. As part of the Program, APRA conducts training in on-site supervision techniques; over the year it conducted four such training visits to Papua New Guinea dealing with the supervision of superannuation funds. Supervisors from Fiji, Samoa, Solomon Islands and Vanuatu also participated.

APRA has also been increasing its engagement with Asia, particularly Indonesia. Under the Government Partnership Fund with Indonesia, APRA provides technical assistance on risk-based supervision and related matters to BAPEPAM-LK, the new Indonesian integrated regulatory agency for securities markets and non-bank prudential supervision. This takes the form of discussions with BAPEPAM-LK senior management and a series of three-month internships hosted at APRA (six over the year). APRA plans an ongoing intern program, secondments of APRA staff to BAPEPAM-LK and further contact at senior levels to develop this long-term relationship.

APRA represents Australia as an observer to the Association of Financial Supervisors of Pacific Countries (AFSPC). Among other things, this Association facilitates co-operation and information sharing, promotes capacity building and adoption of international standards and practices, and gives an international voice to Pacific supervisors. APRA regularly provides speakers and administrative support to AFSPC training events. APRA is also a member of the South-East Asia New Zealand and Australia (SEANZA) Forum of Banking Supervisors and the South-East Asian Central Banks (SEACEN) Conference of Directors of Supervision; it attends various Asia-Pacific Economic Co-operation (APEC) policy dialogues and symposia and is a member of the APEC Financial Regulators' Training Initiative (FRTI) Banking Supervisors' Advisory Group. APRA has continued to provide expert presenters to programs arranged by the Australian APEC Study Centre attached to Monash University, the SEACEN Institute and the Financial Stability Institute, the latter often in co-operation with various regional bodies. In November 2005 APRA, along with other Australian financial sector regulatory agencies, sponsored a meeting of the IMF Roundtable for Offshore and Onshore Supervisors and Standard-Setters in Sydney.

During the year, APRA hosted over 100 international delegations, a slightly higher number than the previous year. Visits were mainly from regulatory agencies, international and regional organisations, government and government agencies, industry bodies and private sector organisations. The main topics of interest were developments in life and general insurance regulation, pension fund regulation and supervision, APRA's approach to risk-based supervision and its PAIRS/SOARS tools, Basel II developments, operations of institutions operating across national borders and enquiries about establishing operations in Australia. Around half of the visits were from emerging market economies, particularly China and Indonesia.

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APRA's costs and performance

APRA's expenditure is devoted, directly or indirectly, to enhancing and implementing the prudential supervision framework in Australia and to its ongoing supervisory and enforcement activities. Its income comes mostly from annual levies on supervised entities.

Financial performance

APRA's expenditure

APRA's total operating expenditure in 2005/06 was $92.1 million. This included costs of $2.3 million in relation to the HIH Royal Commission, for which separate appropriations were received in 2001/02[1] and 2004/05, and costs of $1.7 million which are covered by additional revenue sources. Excluding these amounts, operating expenditure was $88.1 million, compared with the budget of $92.1 million.

The table shows the trend in net operating expenditure on prudential regulation and in APRA staff levels over the past five years. The numbers have been adjusted for items that do not form part of APRA's normal activities.

Operating expenditure and staff trends

	$ million	Average staffing level[2]
2001/02	55.8	407
2002/03	62.7	457
2003/04	71.5	496
2004/05	78.2	532
2005/06	88.1	592
2006/07 (budgeted)	92.1	582[3]

The running costs of APRA have risen from 2001/02 onwards as a consequence of more intensive supervision activities, a rebuilding of APRA's supervisory staff levels and an active program to upgrade the prudential framework. Having reached its staffing targets and completed major parts of its reform agenda in 2005/06, the budgeted growth in costs over 2006/07 is much lower than in previous years.

1 APRA received an appropriation of $4 million in 2001/02 specifically for the costs of the HIH Royal Commission. In addition, $2 million was appropriated in 2004/05 for further work on following up the recommendations of the Royal Commission. The appropriations have been spent over a number of years and will continue into 2006/07.

2 Staffing figures are average headcount over the year.

3 Full-time equivalent, excluding staff on long-term unpaid leave.

APRA's income

APRA is funded primarily from levies collected from supervised financial institutions, with a contribution from interest on funds invested, fees for services and miscellaneous cost offsets. Included within revenue in 2005/06 is $1.0 million of the separate appropriation from the Government in relation to the HIH Royal Commission and $2.7 million of fees from applications for a superannuation licence.

Levies are raised according to the *Financial Institutions Supervisory Levies Collection Act 1998* and six other Acts applying to the main industry sectors. Prior to the beginning of each financial year, the Minister announces the levy determinations for each industry sector with a rate to be applied on assets, subject to a minimum and maximum amount per institution, except for non-operating holding companies that are levied at a flat rate. The levies collected by APRA also cover some costs of ASIC and the ATO. The process includes detailed consultation with the main industry groups and the Treasury. Levies are based on industry sectors. The total levies collected by APRA for all three agencies in 2005/06 were $98.3 million, compared with the plan of $100.5 million.

APRA's total revenue from ordinary activities in 2005/06 was $95.1 million. After adjusting for HIH Royal Commission funding and additional revenue from the direct cost recoveries, net revenue was $92.3 million, compared with the original budget of $93.6 million.

Reserves

APRA had an operating surplus from ordinary activities of $2.9 million in 2005/06. This has increased accumulated reserves to $12.2 million. During the year, APRA returned to the Official Public Account an amount of $3.0 million of contributed equity that had been provided as temporary assistance for the introduction of the superannuation licensing regime.

Business planning and performance

The primary business outcome of APRA is to protect beneficiaries and to enhance public confidence in Australia's financial institutions through a framework of prudential regulation, which balances the objectives of financial safety and efficiency, competition, contestability and competitive neutrality. In 2005/06, APRA formalised its business planning process and introduced a three-year Strategic Plan designed to deliver this outcome in an efficient and effective way.

The Strategic Plan sets out APRA's strategic direction over the three financial years 2006/07 to 2009/10. The Plan identifies seven strategic objectives and the initiatives APRA will undertake to meet them. The objectives are to:

- conduct effective, ongoing supervision of all APRA-regulated entities in accordance with the APRA Supervision Framework;
- consolidate the prudential framework by completing APRA's major prudential reform agenda, promoting harmonised prudential standards across industries and examining ways of removing unnecessary regulatory burden;
- enhance the efficiency and effectiveness of APRA's supervisory tools and systems through better integration of tools, greater analytical support for PAIRS assessments, and workflow and document management;
- enhance APRA's effectiveness by continuing to ensure it recruits and retains the right people for the job, develops the skills and knowledge of its staff and deploys them where they are most needed in APRA;
- improve communications, both internally and externally, to ensure that APRA staff have the most up-to-date information about issues facing APRA and that Government, industry and the financial community are aware of and confident in the role and activities of APRA;

- remain well prepared for a crisis affecting APRA's own operations, a financial crisis in a regulated institution and a systemic crisis such as a pandemic or terrorism; and
- review management practices to ensure that APRA has robust risk management, internal systems and control processes.

The Strategic Plan forms the basis for annual divisional business plans and relevant objectives are also incorporated into individual performance plans. Overall performance against the Plan is reviewed on a quarterly and annual basis by the Executive Group.

APRA publishes two measures that provide a general quantitative indicator of its supervisory performance:

- the Performing Entity Ratio (PER), which is the number of APRA-regulated institutions which met their commitments to beneficiaries in a given year, divided by the total number of APRA-regulated institutions; and
- the Money Protection Ratio (MPR), which is the dollar value of liabilities to beneficiaries in Australia that remained safe in a given year, divided by the total dollar value of liabilities to beneficiaries in Australia in APRA-regulated institutions.

No prudential regulator can guarantee against failures of financial institutions. APRA does not pursue a zero failure objective. Such a level of safety is neither feasible nor desirable, and prudential regulation recognises that failures can occur. APRA's aim is to identify likely failures early enough so that corrective action can be initiated to prevent the failure, or appropriate wind-up or other exit strategies set in train to minimise losses to beneficiaries. Since APRA's inception in 1998, the annual PER has averaged 99.95 per cent and the annual MPR, which is dominated by the losses associated with HIH, has averaged 99.93 per cent.

APRA has been developing other indicators that might be useful as a guide to its supervisory performance. It intends to continue this work, taking into account matters that might be raised in the Government's 'Statement of Expectations' of APRA and the recommendations of the Government's Taskforce on Reducing Regulatory Burdens on Business.

Performing Entity Ratio (PER) and Money Protection Ratio (MPR)

Financial year	Number of failures[1]	Losses ($ million)	Number of institutions[2]	Protected Accounts[3] ($ million)	Annual PER %	Annual MPR %
1999	4	11	4,473	877,172	99.91	99.99
2000	3	308	4,406	993,949	99.93	99.97
2001	4	5,337[4]	4,350	1,043,111	99.91	99.49
2002	1	0	3,803	1,009,373	99.97	100.00
2003	5	20	3,252	1,068,081	99.85	99.99
2004	0	0	2,745	1,207,119	100.00	100.00
2005	0	0	2,099	1,346,253	100.00	100.00
2006	0	0	1,595	1,616,849	100.00	100.00

1 Failures exclude failures due to employer sponsors in superannuation funds. Failures also exclude unresolved cases. If the unresolved cases later become failures, the prior year measurements are changed accordingly.

2 The number of institutions excludes Small APRA Funds and representative offices of foreign banks.

3 Protected Accounts is an estimate of the funds protected by APRA as defined by relevant legislation and is less than the total assets held by APRA-regulated institutions, which were $2,532 billion at end-June 2006.

4 Includes HIH Group's estimated $5.3 billion loss incurred by creditors and policyholders, based on liquidator's advice to creditors in April 2002.

Governance

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Governance structure

APRA's governance structure is constituted in terms specified in Part 3 of the *Australian Prudential Regulation Authority Act 1998* and comprises a full-time Executive Group of at least three and no more than five Members. The Executive Group is responsible and accountable for the operation and performance of APRA.

APRA has the dual role of regulating bodies in the financial sector and developing the administrative practices and procedures to be applied in performing that regulatory role. In performing and exercising its functions and powers, APRA is required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

APRA's responsibilities include the development of regulatory and supervisory policies relating to the performance of its role as prudential regulator, including the making of prudential standards under relevant legislation.

The Executive Group meets formally on a monthly basis, and more frequently as required, to discuss and resolve the major prudential policy, supervisory and strategic issues facing APRA at the time. It also holds management group meetings with APRA's senior management team at least weekly for high-level information-sharing and decisions on more routine supervisory and organisational matters.

Members' attendance at Executive Group meetings from 1 July 2005 to 30 June 2006

	Meetings	Attended
John Laker	13	13
Ross Jones	13	13
Steve Somogyi*	11	11

* Steve Somogyi was granted leave of absence from APRA from 1 April to 30 June 2006.

Details on APRA Members are provided on pages 58–59 of this Report.

Risk Management and Audit Committee

APRA's Risk Management and Audit Committee provides independent assurance and assistance to APRA's Executive Group on APRA's risk management and compliance framework and its external accountability responsibilities.

The Committee comprises an external chair (with casting vote), one external member, one member of APRA's Executive Group and one Executive General Manager (on a one-year rotation). In addition, regular attendees at Committee meetings are the General Manager – Risk Assessment and Internal Audit, the Chief Financial Officer and a representative of the Australian National Audit Office. The Chairman of APRA may attend by invitation.

During 2005/06, the members of the Committee were:

Ms Elizabeth Alexander AM
BCom (Melb), FCA, FCPA, FAICD
Chair

Ms Alexander, who has been appointed as Chair of the Committee for a five-year term, is a non-executive director of Boral Limited, CSL Ltd and DB RREEF and an advisor to Blake Dawson Waldron. She is also Deputy Chair of the Financial Reporting Council and a member of the Takeovers Panel. Ms Alexander is a former National President of the Australian Institute of Company Directors and of CPA Australia. A former partner of PricewaterhouseCoopers, she specialised in risk management and corporate governance issues.

Mr Norbury Rogers AO
BCom (Qld), AAUQ, BEcon (Hon) (Qld), FCA, FAICD
External member

Mr Rogers, who has been appointed for a five-year term, is a chartered accountant and company director and is a senior consultant to Ernst & Young, having spent many years as its Managing Partner and Senior Partner. Mr Rogers holds a number of directorships, including

Chairman of Golden Casket Lottery Corporation Limited and UniQuest Pty Limited and director of the Board of Business Management Limited and of Magellan Petroleum Australia Ltd. He is also a member of the compliance committee for Suncorp Metway Investment Management Limited.

Mr Steve Somogyi
APRA Member

Mr Brandon Khoo
(from 1 July 2005 to November 2005)
Executive General Manager – Specialised Institutions

Mr Tom Karp
(from November 2005 to 30 June 2006)
Executive General Manager – Supervisory Support

Attendance at Risk Management and Audit Committee meetings from 1 July 2005 to 30 June 2006

	Meetings	Attended
Elizabeth Alexander	5	5
Norbury Rogers	5	5
Steve Somogyi*	4	4
Brandon Khoo	1	1
Tom Karp	4	3

* Steve Somogyi was granted leave of absence from APRA from 1 April to 30 June 2006.

Risk Assessment and Internal Audit

The Risk Assessment and Internal Audit unit plays an important role in APRA's governance, assurance and compliance framework through a detailed and structured approach to the assessment of risks and the review of APRA's systems and processes.

The unit is independent of APRA's management structure and has a direct reporting line to the Chair of the Risk Management and Audit Committee. It is staffed by officers with extensive audit and prudential supervision experience.

The unit assists APRA Members and senior management to identify and address risks facing APRA by providing them and APRA's Risk Management and Audit Committee with assessments of high and significant risks at organisational and divisional levels. Risk management strategies to mitigate these risks are documented as part of the organisation's risk profile. Risks are reassessed on a regular and planned basis by management and the unit. Each year, following a comprehensive enterprise-wide risk assessment, a robust plan of internal audits is approved by the Executive Group and endorsed by the Risk Management and Audit Committee. The program covers specific aspects of APRA's supervisory and operational processes and its financial systems, and includes reviews of compliance with both internal and external requirements. Audit reviews make recommendations aimed at improving APRA's internal controls and processes, and set out detailed and agreed management action plans and timetables to address issues identified. The unit undertakes follow-up reviews and reports the results to the Executive Group and the Risk Management and Audit Committee.

Fraud risk management is an ongoing focus within APRA. A fraud control review was undertaken as part of the unit's 2005/06 work program, and this review led to the development of a comprehensive fraud control framework and the revision of APRA's Fraud Control Policy. All audits undertaken by the unit assess whether potential fraud exposures are appropriately addressed by APRA's processes and controls. There were no incidents of fraud reported for the year.

Other governance matters

The *Statutory report* provides details of various other aspects of governance in APRA, including executive and consultative committees.

APRA Members

Dr John Laker
BEc (Hons 1) (Syd), MSc PhD (London)
Chairman and Member

Dr Laker was appointed as a Member and Chairman of APRA for a five-year term, commencing 1 July 2003.

Dr Laker worked in the Commonwealth Treasury and International Monetary Fund before joining the Reserve Bank of Australia (RBA) in 1982. He held senior positions in the economic, bank supervision and international areas before becoming the RBA's London-based Chief Representative in Europe from 1991 to 1993. On his return to Australia, Dr Laker took up the position of Assistant Governor (Corporate Services) and, in 1998, was appointed Assistant Governor (Financial System) and Deputy Chair of the RBA's Payments System Board. Dr Laker is APRA's representative on the Payments System Board, the Council of Financial Regulators and the Trans-Tasman Council on Banking Supervision.

Mr (Kerry) Ross Jones
BA, MCom (Newcastle)
Deputy Chairman and Member

Mr Jones was appointed as a Member and Deputy Chairman of APRA for a five-year, term commencing 1 July 2003.

Mr Jones held the position of Commissioner at the Australian Competition and Consumer Commission (ACCC) with responsibilities for mergers and acquisitions and telecommunications. Mr Jones has worked as an economic consultant to the private and public sector and undertaken extensive work with the ACCC, the Trade Practices Commission and the Prices Surveillance Authority, as well as with a number of competition authorities overseas. Mr Jones is an Associate Professor in the School of Finance and Economics at the University of Technology Sydney (UTS). He was also the Chairman of the International Air Services Commission until the end of his term in August 2003.

Mr Steve Somogyi
MSc (Melb), SM (MIT), FIAA, FIA (UK),
ASA (USA), FAICD
Member to 30 June 2006

Mr Somogyi was appointed as a Member of APRA for a three-year term, commencing 1 July 2003. He was granted leave of absence from APRA from 1 April to 30 June 2006, prior to the expiry of his term.

Mr Somogyi has over 30 years' experience in the financial services and health care industries, including 27 years with National Mutual in the roles of Chief Manager for New Zealand, Associate Director – Operations and Chief Finance Executive. From 1998, he held a number of positions including Chief Financial Officer of Mayne Nickless Limited and Chief Executive Officer of CPI Group Limited.

Mr John Trowbridge
BSc (Syd), BE (Syd), BA (ANU), FIA, FIAA
Member from 1 July 2006

Mr Trowbridge was appointed as a Member of APRA for a three-year term, commencing 1 July 2006.

Mr Trowbridge founded Trowbridge Consulting in 1981, a firm which became a leading actuarial and management consulting firm during the next 20 years. He had previously worked with Commonwealth Treasury (Government Actuary's Office) and had also held senior executive positions with QBE Insurance. In his time as a consultant, Mr Trowbridge's clientele included all major Australian insurance companies, banks and wealth management companies, governments or government authorities in all Australian States and New Zealand, and numerous major industrial organisations. He was President of the Institute of Actuaries of Australia in 1998 and served as a member of the Treasurer's Financial Sector Advisory Council from 1998 to 2004. Since completing his consulting career in 2002, he has held executive and director positions with insurance and reinsurance companies and has also had advisory roles examining various financial sector issues.


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Statement by Members

In our opinion, the attached financial statements for the year ended 30 June 2006 are based on properly maintained financial records and give a true and fair view of the matters required by the Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*.

In our opinion, at the date of this statement, there are reasonable grounds to believe that the Authority will be able to pay its debts as and when they become due and payable.

Dr John F. Laker	Mr K. Ross Jones
Chairman	Deputy Chairman
17 August 2006	17 August 2006

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Income Statement for the year ended 30 June 2006

	Note	2006 $'000	2005 $'000
Income			
Revenue			
Revenues from Government	5A	81,637	79,188
Goods and services	5B	6,937	2,913
Interest	5C	2,573	2,216
Rental recoveries		816	492
Licence fees and other charges	5D	2,959	959
Insurance recoveries and other revenue	5E	130	59
Total revenue		95,052	85,827
Gains			
Revaluation decrement reversal	5F	–	274
Total gains		–	274
Total income		95,052	86,101
Expenses			
Employees	6A	60,051	53,078
Suppliers	6B	26,981	25,061
Depreciation and amortisation	6C	3,934	4,197
Finance costs	6D	234	250
Write-down and impairment of assets	6E	908	66
Total expenses		92,108	82,652
Operating result	12	2,944	3,449

The above statement should be read in conjunction with the accompanying Notes.

Balance Sheet as at 30 June 2006

	Note	2006 $'000	2005 $'000
Assets			
Financial assets			
Cash and cash equivalents	7A, 19B	13,432	15,024
Receivables	7B, 19B	2,803	2,993
Investments (s18 CAC Act)	7C, 19B	14,848	9,919
Total financial assets		31,083	27,936
Non-financial assets			
Infrastructure, plant and equipment	8A, 8B	4,426	5,868
Intangibles	8C	3,510	4,869
Other non-financial assets	8D	741	519
Total non-financial assets		8,677	11,256
Total assets		39,760	39,192
Liabilities			
Payables			
Suppliers	9A, 19B	2,788	–
Other payables	9B, 19B	1,587	3,783
Revenue in advance	9C, 19B	674	148
Total payables		5,049	3,931
Interest-bearing liabilities			
Leases	10	1,153	1,406
Total interest-bearing liabilities		1,153	1,406
Provisions			
Employee provisions	11A	16,054	15,419
Property provisions	11B	1,801	1,509
Total provisions		17,855	6,928
Total liabilities		24,057	22,265
Net assets		15,703	16,927
Equity			
Contributed equity		3,155	6,155
Reserves		367	1,123
Retained surpluses		12,181	9,649
Total equity		15,703	16,927
Current assets		31,824	28,455
Non-current assets		7,936	10,737
Current liabilities		19,226	16,276
Non-current liabilities		4,831	5,989

The above statement should be read in conjunction with the accompanying Notes.

Statement of Cash Flows for the year ended 30 June 2006

	Note	2006 $'000	2005 $'000
Operating activities			
Cash received			
Appropriations		81,715	79,885
Goods and services		7,645	1,417
Interest		2,506	2,203
Rental recoveries		815	492
Licence fees and other charges		2,959	959
Insurance recoveries and other revenue		130	59
Net GST recovered from ATO		1,439	2,064
Total cash received		97,209	87,079
Cash used			
Employees		(59,637)	(50,731)
Suppliers		(28,110)	(27,507)
Total cash used		(87,747)	(78,238)
Net cash from operating activities	12	9,462	8,841
Investing activities			
Cash received		–	–
Total cash received		–	–
Cash used			
Investments (s18 CAC Act)		(4,929)	(9,919)
Purchase of plant and equipment		(2,108)	(1,504)
Purchase of intangibles		(1,017)	(1,927)
Total cash used		(8,054)	(13,350)
Net cash used by investing activities		(8,054)	(13,350)
Financing activities			
Cash received			
Appropriations – contributed equity		–	3,000
Total cash received		–	3,000
Cash used			
Return 2004/05 appropriation (unused 2001/02 appropriation) to the Official Public Account		(3,000)	(2,100)
Total cash used		(3,000)	(2,100)
Net cash used by financing activities		(3,000)	900
Net increase/(decrease) in cash held		(1,592)	(3,609)
Cash at the beginning of the reporting period		15,024	18,633
Cash at the end of the reporting period	7A	13,432	15,024

The above statement should be read in conjunction with the accompanying Notes.

Statement of Changes in Equity for the year ended 30 June 2006

	2006 $'000	2005 $'000	2006 $'000	2005 $'000	2006 $'000	2005 $'000	2006 $'000	2005 $'000
	Accumulated results		Asset revaluation reserve		Contributed equity		Total equity	
Opening balance	9,649	5,416	1,123	382	6,155	5,255	16,927	11,053
Adjustment for errors[1]	(412)						(412)	
Adjustment for change in accounting policy[2]		784						784
Adjusted opening balance	9,237	6,200	1,123	382	6,155	5,255	16,515	11,837
Income and expense								
Revaluation adjustment			(756)[3]	741			(756)	741
Subtotal income and expenses recognised directly in equity			(756)	741			(756)	741
Net operating result	2,944	3,449					2,944	3,449
Total income and expenses	2,944	3,449	(756)	741			2,188	4,190
Transactions with owners								
Distribution to owners								
Returns on capital								
Other					(3,000)[4]	(2,100)	(3,000)	(2,100)
Contributions by owners								
Appropriation (equity injection)						3,000		3,000
Other – restructuring								
Sub-total transactions with owners					(3,000)	900	(3,000)	900
Closing balance at 30 June	12,181	9,649	367	1,123	3,155	6,155	15,703	16,927

1 Relates to an accounting error in 2004/05

2 AEIFRS effect on the financial statements as at 30 June 2005 (see Note 2)

3 Refers to the write-off of fit-outs in Head Office and Melbourne Office

4 Return of capital appropriation received in 2004/05 to fund the licensing of superannuation fund trustees

The above statement should be read in conjunction with the accompanying Notes.

Schedule of Commitments as at 30 June 2006

	2006 $'000	2005 $'000
By type[1]		
Capital commitments	–	–
Total capital commitments	–	–
Other commitments		
Operating leases	17,403	21,349
Operating subleases[2]	(798)	(1,053)
Total other commitments	16,605	20,296
Net commitments by type	16,605	20,296
Operating lease commitments		
One year or less	6,189	5,577
From one to five years	9,444	13,028
Over five years	972	1,691
Total operating lease commitments	16,605	20,296
Net commitments by maturity	16,605	20,296

Operating leases are non-cancellable and comprise:

Nature of lease	General description of leasing arrangement
Leases for office accommodation	Lease payments are subject to annual review to prevailing market rates. Office leases, with current expiry dates shown in brackets, are current for space in Sydney (various levels 2007 to 2008), Canberra (2007), Melbourne (2012), Adelaide (2009), Brisbane (2008) and Perth (2009).
Leases of office equipment – photocopiers	Lease payments are set for the period of the lease. APRA does not have the option to purchase the asset at the conclusion of the lease period.

The above schedule should be read in conjunction with the accompanying Notes.

1 Commitments are GST-inclusive where relevant

2 Comprises amounts receivable from other bodies for subleasing of office accommodation

Schedule of Contingencies as at 30 June 2006

	Note	2006 $'000	2005 $'000	2006 $'000	2005 $'000
		Claims for damages/costs		Total	
Contingent liabilities	13A				
Balance from previous period		(940)	(800)	(940)	(800)
New		(250)	(190)	(250)	(190)
Re-measurement		(140)	50	(140)	50
Liabilities crystallised		–	–	–	–
Obligations expired		–	–	–	–
Total contingent liabilities		(1,330)	(940)	(1,330)	(940)
Contingent assets	13B				
Balance from previous period		26	26	26	26
New		–	–	–	–
Re-measurement		–	–	–	–
Assets crystallised		(26)	–	(26)	–
Expired		–	–	–	–
Total contingent assets		–	26	–	26
Net contingent assets/(liabilities)		(1,330)	(914)	(1,330)	(914)

Details of each class of contingent liabilities and assets, including those not disclosed above because they cannot be quantified or are considered remote, are shown in Note 13: *Contingent liabilities and assets*.

The above schedule should be read in conjunction with the accompanying Notes.

Schedule of Administered Items

	Note	2006 $'000	2005 $'000
Income administered on behalf of Government			
for the year ended 30 June 2006			
Taxation revenue			
Financial Institutions Supervisory Levies	20A	98,302	97,110
Financial Assistance Levy	20A	3,042	32,736
Total taxation revenue		101,344	129,846
Total revenues administered on behalf of Government		101,344	129,846
Expenses administered on behalf of Government			
for the year ended 30 June 2006			
Supervisory Levy waivers and write-offs	20B	126	829
Financial Assistance Levy write-offs	20B	–	4
Other		(7)	–
Total expenses administered on behalf of Government		119	833
Assets administered on behalf of Government			
as at 30 June 2006			
Financial assets			
Cash	20C	–	246
Receivables – Supervisory Levies	20C	7	27
– Financial Assistance Levy	20C	315	3,947
Other	20C	(2)	–
Total assets administered on behalf of Government		320	4,220
Liabilities administered on behalf of Government			
as at 30 June 2006			
Total liabilities administered on behalf of Government		–	–

Schedule of Administered Items (continued)

	Note	2006 $'000	2005 $'000
Administered cash flows			
for the year ended 30 June 2006			
Operating activities			
Cash received			
Financial Institutions Supervisory Levies		98,481	97,321
Financial Assistance Levy		6,690	28,799
Cash received from Official Public Account for refunds		292	976
Total cash received		105,463	127,096
Cash used			
Refunds of overpayments of levies		(292)	(976)
Total cash used		(292)	(976)
Net cash from (used in) operating activities		105,171	126,120
Investing activities		–	–
Financing activities		–	–
Net increase (decrease) in cash held		105,171	126,120
Cash at the beginning of the reporting period		246	–
		105,417	126,120
Cash to Official Public Account		(105,417)	(125,874)
Cash at the end of the reporting period		–	246

APRA administers the collection of Financial Institutions Supervisory Levies and Financial Assistance Levy on behalf of the Government. While the revenues from Supervisory Levies are in part used to fund the operations of APRA, they are not directly available to be used by APRA for its own purposes. All administered collections are remitted to the Government's Official Public Account (see Note 1.22). Transactions and balances relating to levies are reported in Note 20 as *Administered items*.

Administered reconciliation table

for the year ended 30 June 2006

	2006 $'000	2005 $'000
Opening administered assets less administered liabilities	4,220	104
Plus administered revenues	101,344	129,846
Minus administered expenses	(119)	(833)
Administered transfers to/from Australian Government:		
Net transfers to Official Public Account	(105,125)	(124,897)
Closing administered assets less administered liabilities	320	4,220

The above schedule should be read in conjunction with the accompanying Notes.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 1. Summary of significant accounting policies

1.1 Basis of preparation of the financial statements

These financial statements are required by clause 1(b) of Schedule 1 to the *Commonwealth Authorities and Companies Act 1997* and are a general purpose financial report.

The continued existence of the Authority in its present form and with its present program is dependent on Government policy and on continuing appropriations by Parliament for the Authority's administration and programs.

The statements have been prepared in accordance with:

- Finance Minister's Orders (FMOs), being the *Commonwealth Authorities and Companies Orders (Financial Statements for reporting periods ending on or after 1 July 2005)*;
- Australian Accounting Standards issued by the Australian Accounting Standards Board (AASB) that apply for the reporting period; and
- interpretations issued by the AASB and Urgent Issues Group (UIG) that apply for the reporting period.

This is the first financial report to be prepared under Australian Equivalents to International Financial Reporting Standards (AEIFRS). The impacts of adopting AEIFRS are disclosed in Note 2.

The *Income Statement, Balance Sheet* and *Statement of Changes in Equity* have been prepared on an accrual basis and are in accordance with the historical cost convention, except for certain assets which, as noted, are at fair value. Except where stated, no allowance is made for the effect of changing prices on the results or the financial position.

The financial report is presented in Australian dollars and values are rounded to the nearest thousand dollars unless disclosure of the full amount is specifically required.

Unless alternative treatment is specifically required by an accounting standard, assets and liabilities are recognised in the *Balance Sheet* when and only when it is probable that future economic benefits will flow and the amounts of the assets or liabilities can be reliably measured. However, assets and liabilities arising under agreements equally proportionately unperformed are not recognised unless required by an accounting standard. Liabilities and assets that are unrecognised are reported in the *Schedule of Commitments* and the *Schedule of Contingencies* (other than unquantifiable or remote contingencies, which are reported at Note 13C).

Unless alternative treatment is specifically required by an accounting standard, revenues and expenses are recognised in the *Income Statement* when and only when the flow or consumption or loss of economic benefits has occurred and can be reliably measured.

Administered revenues, expenses, assets, liabilities and cash flows reported in the *Schedule of Administered Items* and related Notes are accounted for on the same basis and using the same policies as for Authority items, except where stated in Note 1.22.

1.2 Significant accounting judgments and estimates

In the process of applying the accounting policies listed in this note, APRA has made the following judgment that have the most significant impact on the amounts recorded in the financial statements:

- the fair value of leasehold improvements has been taken to be the market value of similar installations as determined by an independent valuer in 2005 and reviewed at year end.

No accounting assumptions or estimates have been identified that have a significant risk of causing a material adjustment to carrying amounts of assets and liabilities within the next accounting period.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

1.3 Statement of compliance

The financial report complies with Australian Accounting Standards, which include Australian Equivalents to International Financial Reporting Standards (AEIFRS).

Australian Accounting Standards require APRA to disclose Australian Accounting Standards that have not been applied, and standards that have been issued but are not yet effective.

The AASB has issued amendments to existing standards. These amendments are denoted by year and then number. For example, 2005–01 indicates amendment 1 issued in 2005.

The table below gives a description of the standards and amendments that will need to be adopted by APRA in the future. The nature of the impending changes within the table has been abbreviated and users should consult the full version available on the AASB's website to obtain the full impact of the change. The expected impact on the financial report of adoption of these standards is based on APRA's initial assessment at this date, but may change. APRA intends to adopt all of the standards upon their application date.

Title	Standard affected	Application date*	Nature of impending change	Impact expected on financial report
2005–1	AASB139	1 Jan 2006	Amends hedging requirements for foreign currency risk of a highly probable intra-group transaction.	No expected impact.
2005–4	AASB139, AASB132, AASB1, AASB1023 and AASB1038	1 Jan 2006	Amends AASB139, AASB1023, and AASB1038 to restrict the option to fair value through profit or loss and makes consequential amendments to AASB1 and AASB132.	No expected impact.
2005–5	AASB1 and AASB139	1 Jan 2006	Amends AASB1 to allow an entity to determine whether an arrangement is, or contains, a lease. Amends AASB139 to scope out a contractual right to receive reimbursement (in accordance with AASB137) in the form of cash.	No expected impact.
2005–6	AASB3	1 Jan 2006	Amends the scope to exclude business combinations involving entities or businesses under common control.	No expected impact.
2005–9	AASB4, AASB1023, AASB139 and AASB132	1 Jan 2006	Amends standards in regard to financial guarantee contracts.	No expected impact.
2005–10	AASB132, AASB101, AASB114, AASB117, AASB133, AASB139, AASB1, AASB1023 and AASB1038	1 Jan 2007	Amends requirements subsequent to the issuing of AASB7.	No expected impact.
2006–1	AASB121	31 Dec 2006	Changes in requirements for net investments in foreign subsidiaries depending on denominated currency.	No expected impact.
	AASB7 Financial instruments: disclosures	1 Jan 2007	Revises the disclosure requirements for financial instruments from AASB132 requirements.	No expected impact.

* Application date is for annual reporting periods beginning on or after the date shown.

1.4 Revenue

Revenue from the sale of goods, if any, is recognised when:

- the risks and rewards of ownership have been transferred to the buyer;
- the seller retains no managerial involvement nor effective control over the goods;
- the revenue and transaction costs incurred can be reliably measured; and
- it is probable that the economic benefits associated with the transaction will flow to the entity.

Revenue from rendering of services is recognised by reference to the stage of completion of contracts at the reporting date. The revenue is recognised when:

- the amount of revenue, stage of completion and transactions costs incurred can be reliably measured; and
- the probable economic benefits associated with the transaction will flow to the entity.

The stage of completion of contracts at the reporting date is determined by reference to the proportion that costs incurred to date bear to the estimated total costs of the transaction.

Receivables for goods and services, which have 30-day terms, are recognised at the nominal amounts due less any provision for bad and doubtful debts. Collectability of debts is reviewed at balance date. Provisions are made when collectability of the debt is no longer probable.

Interest revenue is recognised using the effective interest method as set out in AASB139.

Revenues from Government

APRA is funded primarily through levies imposed on the industries it supervises. While these levies, known as the Financial Institutions Supervisory Levies, are administered transactions collected on behalf of the Government and paid into the Consolidated Revenue Fund (CRF), an amount equal to the net levy revenue, less an amount specified by the Minister in an annual determination made under subsection 50(1) of the *Australian Prudential Regulation Authority Act 1998* (APRA Act), is payable to APRA as a Special Appropriation, in accordance with subsections 50(2), (3) and (5) of the APRA Act. The amounts specified in the Minister's Determinations are retained in the CRF to cover the costs of providing market integrity and consumer protection functions for prudentially regulated institutions, functions that are conducted by other Australian Government entities. The calculation of the Special Appropriation is shown at Note 4.

Amounts appropriated for departmental (Authority) outputs for the year (adjusted for any formal additions and reductions) are recognised as revenue, except for certain amounts that relate to activities that are reciprocal in nature, in which case revenue is recognised only when it has been earned.

Resources received free of charge

Services received free of charge are recognised as revenue when and only when a fair value can be reliably determined and the services would have been purchased if they had not been donated. Use of those resources is recognised as an expense.

Contributions of assets at no cost of acquisition or for nominal consideration are recognised at their fair value when the asset qualifies for recognition.

There were no resources received free of charge in 2005/06 (2004/05: $Nil).

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

1.5 Transactions with the Government as owner

Equity injections

Amounts appropriated as 'equity injections' for a year (less any formal reductions) are recognised directly in contributed equity in that year. APRA received a cash injection of $3 million in 2004/05 to fund superannuation licensing activities. This temporary funding was returned to the Government in 2005/06.

Restructuring of administrative arrangements

Net assets received from or relinquished to another Commonwealth agency or authority under a restructuring of administrative arrangements are adjusted at their book value directly against contributed equity.

Other distributions to owners

The FMOs require that distributions to owners be debited to contributed equity unless in the nature of a dividend.

1.6 Employee benefits

As required by the Finance Minister's Orders, APRA has early adopted AASB119 Employee Benefits as issued in December 2004.

Liabilities for services rendered by employees are recognised at the reporting date to the extent that they have not been settled.

Liabilities for 'short term employee benefits' (as defined in AASB119) and termination benefits due within twelve months are measured at their nominal amounts.

The nominal amount is calculated with regard to the rates expected to be paid on settlement of the liability.

All other employee benefit liabilities are measured as the present value of the estimated future cash outflows to be made in respect of services provided by employees up to the reporting date.

Leave

The liability for employee benefits includes provision for annual leave and long service leave. No provision has been made for sick leave as all sick leave is non-vesting and the average sick leave taken in future years by employees of APRA is estimated to be less than the annual entitlement for sick leave.

The leave liabilities are calculated on the basis of employees' remuneration, including the Authority's employer superannuation contribution rates, to the extent that the leave is likely to be taken during service rather than paid out on termination.

The liability for long service leave has been recognised and measured at the present value of the estimated future cash flows to be made in respect of all employees at the end of the financial year. The estimate of the present value of the liability takes into account attrition rates and pay increases through promotion and inflation.

Separation and redundancy

Provision is made for separation and redundancy benefit payments in cases where APRA has developed a detailed formal plan for the terminations and has informed the employees affected that it will carry out the terminations.

Superannuation

Certain employees of APRA are members of the Commonwealth Superannuation Scheme (CSS), the Public Sector Superannuation Scheme (PSS) or the PSS accumulation plan (PSSap). The CSS and PSS are defined benefit schemes for the Commonwealth. The PSSap is a defined contribution scheme. The liability for defined benefits is recognised in the financial statements of the Australian Government and is settled by the Australian Government in due course. APRA makes employer contributions to the Australian Government at rates determined by an actuary to be sufficient to meet the cost to the Government of the superannuation entitlements of APRA's employees.

APRA also makes employer contributions to the Reserve Bank Officers' Superannuation Fund for former employees of the Reserve Bank of Australia now employed by APRA.

For all other employees, employer contributions are made to other superannuation (accumulation) funds, as nominated by the employee (see Note 6A).

The liability for superannuation recognised at 30 June 2006 represents outstanding contributions for the final fortnight of the year.

1.7 Leases

A distinction is made between finance leases and operating leases. Finance leases effectively transfer from the lessor to the lessee substantially all the risks and rewards incidental to ownership of leased non-current assets. An operating lease is a lease that is not a finance lease. In operating leases, the lessor effectively retains substantially all such risks and benefits.

Where a non-current asset is acquired by means of a finance lease, the asset is capitalised at either the fair value of the leased property or, if lower, the present value of minimum lease payments at the inception of the contract and a liability recognised at the same time for the same amount. Leased assets are amortised over the period of the lease.

The discount rate used is the interest rate implicit in the lease. Leased assets are amortised over the period of the lease. Lease payments are allocated between the principal component and the interest expense.

Operating lease payments are expensed on a straight-line basis that is representative of the pattern of benefits derived from the leased assets.

1.8 Borrowing costs

All borrowing costs are expensed as incurred.

1.9 Cash

Cash means notes and coins held and any deposits held at call with a bank or financial institution. Cash is recognised at its nominal amount.

1.10 Financial risk management

APRA's activities expose it to normal commercial financial risk. As a result of the nature of APRA's business and internal and Australian Government policies dealing with the management of financial risk, APRA's exposure to market, credit, liquidity, cash flow and fair value interest rate risk is considered to be low.

1.11 Investments

Investments are initially measured at cost.

After initial recognition, financial assets are measured at their fair values except for:

- loans and receivables which are measured at amortised cost using the effective interest method;
- held-to-maturity investments which are measured at amortised cost using the effective interest method; and
- investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such equity instruments, which are measured at cost.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

1.12 Derecognition of financial assets and liabilities

As prescribed in the Finance Minister's Orders, APRA has applied the option available under AASB1 of adopting AASB132 and 139 from 1 July 2005 rather than 1 July 2004.

Financial assets are derecognised when the contractual rights to the cash flows from the financial assets expire or the asset is transferred to another entity and the risks and rewards of ownership are also transferred.

Financial liabilities are derecognised when the obligation under the contract is discharged or cancelled or expires.

For the comparative year, financial assets were derecognised when the contractual right to receive cash no longer existed. Financial liabilities were derecognised when the contractual obligation to pay cash no longer existed.

1.13 Impairment of financial assets

As prescribed in the Finance Minister's Orders, APRA has applied the option available under AASB1 of adopting AASB132 and 139 from 1 July 2005 rather than 1 July 2004.

Financial assets are assessed for impairment at each balance date.

Financial assets held at amortised cost

If there is objective evidence that an impairment loss has been incurred for loans and receivables or held-to-maturity investments held at amortised cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's original effective interest rate. The carrying amount is reduced by way of an allowance account. The loss is recognised in profit and loss.

Financial assets held at cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because it cannot be reliably measured, or a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is the difference between the carrying amount of the asset and the present value of the future cash flows discounted at the current market rate for similar assets.

Available for sale financial assets

If there is objective evidence that an impairment loss on an available for sale financial asset has been incurred, the amount of the difference between its cost, less principal repayments and amortisation, and its current fair value, less any impairment loss previously recognised in profit and loss, is transferred from equity to the profit and loss.

Comparative year

The above polices were not applied for the comparative year. For receivables, amounts were recognised and carried at original invoice amount less a provision for doubtful debts based on an estimate made when collection of the full amount was no longer probable. Bad debts were written off as incurred.

Other financial assets carried at cost that were not held to generate net cash inflows, were assessed for indicators of impairment. Where such indicators were found to exist, the recoverable amount of the assets was estimated and compared to the assets' carrying amount and, if less, reduced to the carrying amount. The reduction was shown as an impairment loss.

1.14 Interest-bearing loans and borrowings

Government loans where applicable are carried at the balance yet to be repaid. Interest is expensed as it accrues.

1.15 Trade creditors

Trade creditors and accruals are recognised at their nominal amounts, being the amounts at which the liabilities will be settled. Liabilities are recognised to the extent that the goods or services have been received (and irrespective of having been invoiced).

1.16 Contingent liabilities and contingent assets

Contingent liabilities and contingent assets are not recognised in the *Balance Sheet* but are discussed in the relevant Schedules and Notes. They may arise from uncertainty as to the existence of a liability or asset, or represent an existing liability or asset in respect of which settlement is not probable or the amount cannot be reliably measured. Remote contingencies are part of this disclosure. A liability or asset is recognised when its existence is confirmed by a future event, settlement becomes probable (virtually certain for assets) or reliable measurement becomes possible.

1.17 Acquisition of assets

Assets are recorded at cost on acquisition, except as stated below. The cost of acquisition includes the fair value of assets transferred in exchange and liabilities undertaken. Financial assets are initially measured at their fair value plus transaction costs where appropriate.

Assets acquired at no cost, or for nominal consideration, are initially recognised as assets and revenues at their fair value at the date of acquisition, unless acquired as a consequence of restructuring of administrative arrangements. In the latter case, assets are initially recognised as contributions by owners at the amounts at which they were recognised in the transferor entity's accounts immediately prior to the restructuring.

1.18 Property (infrastructure), plant and equipment

Asset recognition threshold

Purchases of infrastructure, plant and equipment are recognised initially at cost in the *Balance Sheet*, except for purchases costing less than $5,000, which are expensed in the year of acquisition.

The initial cost of an asset includes an estimate of the cost of dismantling and removing the item and restoring the site on which it is located. This is particularly relevant to 'make good' provisions in property leases taken up by APRA where there exists an obligation to restore the property to its original condition. These costs are included in the value of APRA's leasehold improvements with a corresponding provision for the 'make good' taken up.

Revaluations

Infrastructure, plant and equipment are carried at fair value, being revalued with sufficient frequency such that the carrying amount of each asset is not materially different, at reporting date, from its fair value. Valuations undertaken in each year are as at 30 June.

Fair values for each class of assets are determined as shown below:

Asset class	Fair value measured at:
Leasehold improvements	Depreciated replacement cost
Computer hardware and office equipment	Market selling price

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Revaluation adjustments are made on a class basis. Any revaluation increment is credited to equity under the heading of asset revaluation reserve except to the extent that it reverses a previous revaluation decrement of the same asset class that was previously recognised through profit and loss. Revaluation decrements for a class of assets are recognised directly through profit and loss except to the extent that they reverse a previous revaluation increment for that class.

Any accumulated depreciation as at the revaluation date is eliminated against the gross carrying amount of the asset and the asset restated to the revalued amount.

Depreciation and amortisation

Depreciable plant and equipment assets are written off to their estimated residual values over their estimated useful lives to APRA using, in all cases, the straight-line method of depreciation. Leasehold improvements are amortised on a straight-line basis over the lesser of the estimated useful life of the improvements or the unexpired period of the lease.

Depreciation/amortisation rates (useful lives) and methods are reviewed at each reporting date and necessary adjustments are recognised in the current, or current and future reporting periods, as appropriate.

Depreciation and amortisation rates applying to each class of depreciable asset are based on the following useful lives:

Asset class	2006	2005
Computer hardware and office equipment	**3 to 12 years**	3 to 12 years
Leasehold improvements	**Lesser of 10 years or lease term**	Lesser of 10 years or lease term

Impairment

All assets were assessed for impairment at 30 June 2006. Where indications of impairment exist, the asset's recoverable amount is estimated and an impairment adjustment made if the asset's recoverable amount is less than its carrying amount.

The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of the future cash flows expected to be derived from the asset. Where the future economic benefit of an asset is not primarily dependent on the asset's ability to generate future cash flows, and the asset would be replaced if APRA were deprived of the asset, its value in use is taken to be its depreciated replacement cost.

No indicators of impairment were found for assets at fair value.

1.19 Intangibles

APRA's intangibles comprise internally developed software and purchased software for internal use. These assets are carried at cost.

Software is amortised on a straight-line basis over its anticipated useful life. The useful lives of APRA's software are the lesser of five years or assessed useful life (2005: Lesser of five years or assessed useful life).

All software assets were assessed for indications of impairment at 30 June 2006.

1.20 Taxation

APRA is exempt from all forms of taxation except fringe benefits tax and the goods and services tax (GST).

Revenues, expenses and assets are recognised net of GST:

- except where the amount of GST incurred is not recoverable from the Australian Taxation Office; and
- except for receivables and payables.

1.21 Changes in accounting policies

A review of APRA's policy relating to the asset recognition threshold which had applied since 2002 resulted in the threshold being raised from $3,000 (the level that applied in 2005) to $5,000. The new threshold better reflects the profile of the APRA asset register by removing low value items without materially reducing the written-down value of plant and equipment assets, and facilitates more efficient asset management and recording. The effect in the current and prior periods is:

Asset class	Increment/(decrement) to asset class	Contra account
Computer hardware and office equipment	**2006: ($447,000)** 2005: NIL	Current year result

1.22 Reporting of administered activities

Administered revenues, expenses, assets, liabilities and cash flows are disclosed in the *Schedule of Administered Items* and related Notes.

Except where otherwise stated below, administered items are accounted for on the same basis and using the same policies as for Authority items, including the application of Australian Accounting Standards.

Administered cash transfers to and from the Official Public Account

Revenue collected by APRA for use by the Government rather than by the Authority is administered revenue. Collections are transferred to the Official Public Account (OPA) maintained by the Department of Finance and Administration. Conversely, cash is drawn from the OPA to make payments under Parliamentary appropriation on behalf of the Government. These transfers to and from the OPA are adjustments to the administered cash held by the Authority on behalf of the Government and reported as such in the *Statement of Cash Flows*, in the *Schedule of Administered Items* and in the *Administered reconciliation table* in Note 20D. Thus the *Schedule of Administered Items* largely reflects the Government's transactions, through the Authority, with parties outside the Government.

Revenue

All administered revenues relate to the core operating activities performed by the Authority on behalf of the Australian Government. These revenues are not directly available to be used by the Authority for its own purposes and are remitted to the OPA.

APRA undertakes the collection of certain levies on behalf of the Government. These comprise Financial Institutions Supervisory Levies, the Financial Assistance Levy and levy late payment penalties collected under the *Financial Institutions Supervisory Levies Collection Act 1998*. In addition, APRA still collects some late lodgement penalties in relation to certain superannuation returns that were due by 31 October 1999. These administered items are distinguished from Authority items, throughout these financial statements, by background shading.

Administered revenue arising from levies on superannuation entities (including the Financial Assistance Levy) is recognised upon issue of invoice while administered revenue in respect of levies on all other entities is recognised on the date it becomes due and payable to APRA or on the date the payment is received, whichever occurs first. Levies are recognised at the nominal amounts due less any provision for bad or doubtful debts. The collectability of debts is reviewed at balance date. Provisions are made when collection of the debt is judged to be less, rather than more, likely.

Expenses

Administered expenses arising from waiver and write-off of levy debts are recognised at the time of approval by delegated Authority officers.

Waivers of levies under the *Financial Institutions Supervisory Levies Collection Act 1998* are shown at Note 22, as required by the FMOs. Waivers generally occur due to a change of status of a supervised entity during the year, resulting in the annual levy being wholly or partly waived.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 2. The impact of the transition to AEIFRS from the previous AGAAP

	2005 $'000	2004 $'000
Reconciliation of total equity as presented under AGAAP to that under AEIFRS		
Total equity under previous AGAAP	16,748	11,053
Adjustments to retained earnings:		
Provision for doubtful debts	2	–
'Make good' assets	782	689
Expense adjustments	(605)	–
	179	689
Adjustments to other reserves:		
Asset revaluation reserve	–	–
Total equity translated to AEIFRS	**16,927**	**11,742**
Reconciliation of profit or loss as presented under previous AGAAP to AEIFRS		
Prior year profit as previously reported	4,054	2,067
Adjustments:		
Depreciation	(605)	689
Prior year profit translated to AEIFRS	**3,449**	**2,756**

The cash flow statement presented under previous AGAAP is equivalent to that prepared under AEIFRS.

There was no AEIFRS impact on the Authority's administered accounts.

AEIFRS requires the recording of assets reflecting future estimated restoration costs. Amounts for 'make good' provisions in existing accommodation leases (operating) have been taken up accordingly.

The operating result has been adjusted for the additional depreciation on 'make good' assets.

APRA has not restated comparatives for financial instruments. The adjustments between AEIFRS and the previous AGAAP have been taken up at 1 July 2005.

Note 3. Events after the balance sheet date

No events occurring after balance sheet date were noted.

Note 4. Calculation of APRA Special Appropriation

The APRA Special Appropriation is calculated in accordance with the provisions of s50 of the APRA Act as outlined at Note 1.4. Details are as follows:

	2006 $'000	2005 $'000
Table 1 – Summary		
Current year levies and penalties (see note 20A, Table 1)	98,302	97,110
Less: Waivers and write-offs (see Note 20B)	(126)	(829)
Net current year levies and penalties (see Table 2 below)	98,176	96,281
Less: Amounts retained in the CRF (see Table 3 below)	(17,539)	(19,069)
Total APRA Special Appropriation (see Table 4 below)	80,637	77,212
Table 2 – Net current year levies and penalties by levy type		
Superannuation funds	41,476	39,858
Authorised deposit-taking institutions	30,099	30,735
Life insurers and friendly societies	9,752	10,294
General insurers	16,849	15,290
Retirement savings account providers	–	104
Total net current year levies and penalties	98,176	96,281
Table 3 – Amounts retained in the CRF by levy type[1]		
Superannuation funds	(12,089)	(12,749)
Authorised deposit-taking institutions	(2,210)	(2,560)
Life insurers and friendly societies	(1,760)	(2,040)
General insurers	(1,480)	(1,720)
Total amount retained in CRF	(17,539)	(19,069)
Table 4 – Equivalent amounts of levy payable to APRA under the APRA Special Appropriation by levy type		
Superannuation funds	29,387	27,109
Authorised deposit-taking institutions	27,889	28,175
Life insurers and friendly societies	7,992	8,254
General insurers	15,369	13,570
Retirement savings account providers	–	104
Total APRA Special Appropriation	80,637	77,212

[1] As determined by the Minister in accordance with subsection 50(1) of the *Australian Prudential Regulation Authority Act 1998*.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 5. Income

	2006 $'000	2005 $'000
Note 5A. Revenues from Government		
Special Appropriation (see Note 4)	80,637	77,212
Annual Appropriation 2001/02 brought forward	–	976
Annual Appropriation	1,000	1,000
Total revenues from Government	81,637	79,188
Note 5B. Sales of goods and services		
Fees for service	2,900	942
Development of capital adequacy model for ADIs (Basel II)	3,875	1,800
Miscellaneous other services	162	171
Total sales of goods and services	6,937	2,913
Rendering of services to:		
Related entities	766	684
External entities	6,171	2,229
Total rendering of services	6,937	2,913
Note 5C. Interest		
Deposits at bank	654	720
Commonwealth and State Government securities	1,919	1,496
Total interest	2,573	2,216
Note 5D. Licence fees and other charges		
Licence fees from finance sector entities	227	310
Superannuation trustee applications	2,662	564
Fees from foreign bank representative offices	70	85
Total licence fees and other charges	2,959	959
Note 5E. Insurance recoveries and other revenue		
Other revenue relating to recovery of prior year court costs and prior year compensation matters	6	24
Recovery from Reserve Bank of Australia for Scholarship	14	25
Recovery from Comcover prior year commissions	–	8
Other recoveries	110	2
Total insurance recoveries and other revenue	130	59
Note 5F. Reversals of previous asset write-downs		
Non-financial assets:		
Infrastructure, plant and equipment revaluation decrement reversal	–	274
	–	274

Note 6. Operating expenses

	2006 $'000	2005 $'000
Note 6A. Employee expenses		
Salaries and wages	50,333	46,125
Superannuation	7,146	4,770
Leave and other entitlements	2,041	1,974
Separation and redundancy	311	32
Other employee expenses (see Note 1.6)	220	177
Total employee expenses	60,051	53,078
Note 6B. Supplier expenses		
Provision of goods – related entities	–	–
Provision of goods – external entities	2,930	2,119
Rendering of services – related entities	5,564	3,721
Rendering of services – external entities	12,089	13,107
Operating lease rentals*	6,177	5,696
Workers' compensation premiums	221	418
Total supplier expenses	26,981	25,061

* These comprise minimum lease payments only.

Note 6C. Depreciation and amortisation

	2006 $'000	2005 $'000
Depreciation		
Infrastructure, plant and equipment	2,013	1,748
Amortisation		
Intangibles – computer software	1,921	2,449
Total depreciation and amortisation	3,934	4,197

The aggregate amounts of depreciation or amortisation expensed during the reporting period, for each class of depreciable asset, are as follows:

	2006 $'000	2005 $'000
Computer hardware and office equipment	741	594
Leasehold improvements	1,272	1,154
Intangibles	1,921	2,449
Total depreciation and amortisation	3,934	4,197

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 6. Operating expenses (continued)

	2006 $'000	2005 $'000
Note 6D. Finance costs		
Unwinding of discount on make good provision	234	250
Total finance costs expense	234	250
Note 6E. Write-down and impairment of assets		
Leasehold improvements – revaluation decrement	–	45
Infrastructure, plant and equipment – write-off	447	21
Internally developed software – impairment	461	–
Total write-down of assets	908	66

Note 7. Financial assets

	2006 $'000	2005 $'000
Note 7A. Cash and cash equivalents		
Cash at bank	13,429	15,020
Cash on hand	2	2
Deposits at call	1	2
Total cash and cash equivalents	13,432	15,024
Note 7B. Receivables		
Special Appropriation	26	130
Less: Allowance for doubtful debt related to outstanding levy debt	(19)	(2)
Net appropriations receivable	7	128
Goods and services	2,264	2,203
Less: Provision for doubtful debts	(1)	–
Net goods and services	2,263	2,203
Accrued interest receivable	157	90
GST receivable from the Australian Taxation Office	376	572
Total receivables (net)	2,803	2,993
All receivables are current assets.		
Receivables (gross) are aged as follows:		
Current	1,311	2,958
Overdue by:		
– Less than 30 days	1,486	–
– 30 to 60 days	1	7
– 60 to 90 days	1	6
– more than 90 days	24	24
	1,512	37
Total receivables (gross)	2,823	2,995
The allowance for doubtful debts is aged as follows:		
Current	–	–
Overdue by:		
– Less than 30 days	–	–
– 30 to 60 days	–	–
– 60 to 90 days	–	–
– more than 90 days	(20)	(2)
Total allowance for doubtful debts	(20)	(2)
Note 7C. Investments under s18 of the CAC Act		
Government securities*	14,848	9,919
	14,848	9,919

* These securities have terms of up to 90 days. They are guaranteed by the issuing government and are traded in active markets. Effective interest rates average 5.41 per cent (2005: 5.23 per cent). Interest is paid at maturity.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 8. Non-financial assets

	2006 $'000	2005 $'000
Note 8A. Infrastructure, plant and equipment		
Computer hardware and office equipment		
– fair value	1,307	1,140
– accumulated depreciation	(526)	–
– work in progress	192	545
Total computer hardware and office equipment	973	1,685
Leasehold improvements		
– fair value	4,536	4,183
– accumulated amortisation	(1,120)	–
– work in progress	37	–
Total leasehold improvements	3,453	4,183
Total infrastructure, plant and equipment (non-current)	4,426	5,868

The revaluation performed in 2004/05 was in accordance with the revaluation policy stated at Note 1.18 – *Property (infrastructure), plant and equipment* and was completed by an independent valuer, the Australian Valuation Office. All assets were assessed for impairment at 30 June 2006 using internal expertise.

Note 8. Non-financial assets (continued)

	$'000 Computer hardware and office equipment	$'000 Leasehold improvements	$'000 Total

Note 8B. Analysis of infrastructure, plant and equipment

Table A — Reconciliation of infrastructure, plant and equipment at valuation

	Computer hardware and office equipment	Leasehold improvements	Total
As at 1 July 2005			
Gross book value	**1,685**	**4,183**	**5,868**
Accumulated depreciation/amortisation	–	–	–
Opening net book value	**1,685**	**4,183**	**5,868**
Additions:			
by purchase	470	1,299	1,769
Net revaluation increment/(decrement)	–	(757)	(757)
Depreciation/amortisation expense	(741)	(1,272)	(2,013)
Disposals:			
Other disposals by sale and write-off (net book value)	(447)	–	(447)
Other movements	6	–	6
As at 30 June 2006			
Gross book value	1,499	4,573	6,072
Accumulated depreciation/amortisation	(526)	(1,120)	(1,646)
Closing net book value	973	3,453	4,426

As a result of the revaluation of infrastructure, plant and equipment to fair value at 30 June 2005, the accumulated depreciation/amortisation for these assets was reduced to nil, having been written back against the gross book value to comply with AASB 1041.

	Computer hardware and office equipment	Leasehold improvements	Total
As at 30 June 2006			
Gross value	192	37	229
As at 30 June 2005			
Gross value	545	–	545

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 8. Non-financial assets (continued)

	2006 $'000	2005 $'000
Note 8C. Intangible assets		
Computer software:		
– internally developed – in progress	82	1,319
– purchased – in progress	195	257
– internally developed – in use	7,427	6,067
– purchased – in use	2,883	2,418
	10,587	10,061
Accumulated amortisation	(7,077)	(5,192)
Total intangibles (non-current)	3,510	4,869

	$'000 Computer software internally developed	$'000 Computer software purchased	$'000 Total
Table A – Reconciliation of intangibles			
As at 1 July 2005			
Gross book value	7,386	2,675	10,061
Accumulated amortisation	(3,968)	(1,224)	(5,192)
Opening net book value	3,418	1,451	4,869
Additions:			
Purchase/internally developed	570	453	1,023
Movements:			
Other	–	–	–
Depreciation/amortisation	(1,446)	(475)	(1,921)
Impairments recognised in the operating result	–	–	–
Disposals:			
Other disposals	(448)	(13)	(461)
As at 30 June 2006			
Gross book value	7,509	3,078	10,587
Accumulated amortisation	(5,415)	(1,662)	(7,077)
Closing net book value	2,094	1,416	3,510

Note 8. Non-financial assets (continued)

	2006 $'000	2005 $'000
Note 8D. Other non-financial assets		
Prepayments	741	519
Total other non-financial assets (current)	741	519

All prepayments are current.

Note 9. Payables

	2006 $'000	2005 $'000
Note 9A. Supplier payables		
Trade creditors	2,788	–
Operating lease rentals	–	–
Total supplier payables	2,788	–

All supplier payables are current.

	2006 $'000	2005 $'000
Note 9B. Other payables		
Accrued expenses	1,481	3,569
GST payable to the Australian Taxation Office	106	214
Total other payables	1,587	3,783

All other payables are current.

	2006 $'000	2005 $'000
Note 9C. Revenue in advance		
Unearned fees and charges	674	148
Total revenue in advance	674	148

All revenue in advance is current.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 10. Interest-bearing liabilities

	2006 $'000	2005 $'000
Lease incentives	1,153	1,406
Total interest-bearing liabilities	1,153	1,406
Other interest-bearing liabilities are represented by:		
Current	404	312
Non-current	749	1,094
	1,153	1,406

Note 11. Provisions

	2006 $'000	2005 $'000
Note 11A. Employee provisions		
Salaries and wages	3,120	3,446
Leave and other benefits	12,910	11,872
Other	24	101
Total employee provisions	16,054	15,419
Current	13,640	11,446
Non-current	2,414	3,973
	16,054	15,419
Note 11B. Other provisions		
Provisions for surplus leased space	–	170
Provisions for 'make good'	1,801	1,339
Total other provisions	1,801	1,509
Current	133	587
Non-current	1,668	922
	1,801	1,509

Note 11. Provisions (continued)

	$'000 Surplus leased space	$'000 Provision for 'make good'	$'000 Total
Carrying amount at beginning of period	170	1,339	1,509
Additional provisions made – net	–	399	399
Unwinding of discounted amount arising from the passage of time	(170)	63	(107)
Amount owing at end of period	–	1,801	1,801

APRA leases premises in Sydney, Melbourne, Canberra, Brisbane, Perth and Adelaide. There was a small area of surplus leased space in the Canberra office at commencement of 2005/06, which was sub-let during the year to an existing sub-tenant.

In the lease conditions of all locations except Canberra, Adelaide and Level 17, 400 George Street Sydney, there is a requirement for APRA, upon expiration of the lease, to restore the premises to the condition they were in at commencement of the lease. The required level of 'make good' provision is being accumulated for each location over the term of the various leases.

Note 12. Cash flow reconciliation

	2006 $'000	2005 $'000
Reconciliation of cash per *Balance Sheet* to *Statement of Cash Flows*:		
Cash at year end as per *Statement of Cash Flows*	13,432	15,024
Balance Sheet items comprising above cash:		
'Financial asset – cash'	13,432	15,024
Reconciliation of operating result to net cash from operating activities:		
Operating surplus/(deficit) from ordinary activities	2,944	4,054
Non-cash items		
Depreciation/amortisation	3,934	3,869
Net write-down of non-financial assets	1,236	–
Prior year adjustment	(412)	–
Revaluation decrement reversal	–	(274)
Infrastructure, plant and equipment revaluation decrement	–	45
Loss on disposal of assets	–	21
(Increase)/decrease in net receivables	196	101
(Increase)/decrease in prepayments	(222)	62
(Increase)/decrease in accrued revenue	(6)	(13)
Increase/(decrease) in revenue in advance	526	(913)
Increase/(decrease) in employees' provisions	635	2,320
Increase/(decrease) in suppliers' payables	(781)	(882)
Increase/(decrease) in other provisions	1,412	45
Net cash from/(used by) operating activities	9,462	8,841

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 13. Contingent liabilities and assets

Note 13A. Contingent liabilities

At 30 June, the Authority was engaged in a number of legal actions brought against it by various parties relating to disqualification of persons as trustees or to hold positions of responsibility in the general insurance industry, review of decisions by the Administrative Appeals Tribunal and actions brought by APRA against parties in relation to enforcement of the requirements of the legislation administered by APRA. The costs that might be incurred relate mainly to legal counsel and those associated with the legal proceedings. The quantum of the liabilities has been based on estimates provided by the legal practitioners representing the Authority.

Note 13B. Contingent assets

As stated in Note 13A, the Authority is engaged in a number of legal cases at 30 June. The contingent asset represents an estimate of the legal costs arising from these actions likely to be recovered by APRA. The estimates have been provided by the legal practitioners representing the Authority or on judgments already entered.

Note 13C. Unquantifiable contingencies

Of the legal matters unresolved at 30 June 2006, a number of the cases were at a stage where it was not possible to quantify the amounts of any eventual payments that may be required in relation to these claims.

Note 14. Remuneration of APRA Members

APRA Members are appointed by the Governor-General under Part 3 of the *Australian Prudential Regulation Authority Act 1998* and remuneration is set by the Remuneration Tribunal under the *Remuneration Tribunal Act 1973*. Total remuneration as determined by the Tribunal for 2005/06 was Chairman $531,470 (2004/05: $509,110); Deputy Chairman $444,700 (2004/05: $425,990); and Member $423,010 (2004/05: $405,210). Any difference between the Tribunal determination and the remuneration reported below is due to additional reunion allowance payable to the Member, changes in unused annual and long service leave entitlements accumulated in the year, and the leave of absence of the Member from 1 April 2006 to 30 June 2006.

	2006 Number	2005 Number
The remuneration of APRA Members is shown below in the relevant remuneration bands:		
$390,000–$404,999	1	–
$420,000–$434,999	–	1
$435,000–$449,999	–	1
$480,000–$494,999	1	–
$525,000–$539,999	–	1
$555,000–$569,999	1	–
Total number of APRA Members	3	3
	$	$
Total remuneration received or due and receivable by APRA Members	1,438,022	1,396,310

Note15. Related party disclosures

Transactions with APRA Member-related entities

There were no related entity transactions in 2005/06 (2004/05: $Nil) in respect of APRA Members.

Loans to APRA Members and Member-related entities

There were no loans made to APRA Members or Member-related entities in 2005/06 (2004/05: $Nil).

Note 16. Executive remuneration

	2006 Number	2005 Number
The remuneration of officers is shown below in the relevant income bands:		
$145,000–$159,999	–	1
$160,000–$174,999	–	1
$175,000–$189,999	1	1
$190,000–$204,999	1	3
$205,000–$219,999	5	5
$220,000–$234,999	4	5
$235,000–$249,999	6	5
$250,000–$264,999	4	–
$265,000–$279,999	2	–
$280,000–$294,999	–	–
$295,000–$309,999	–	–
$310,000–$324,999	–	–
$325,000–$339,999	1	3
$340,000–$354,999	2	1
$355,000–$369,999	1	–
$370,000–$384,999	–	–
$385,000–$399,999	1	–
Total	28	25
	$	$
The aggregate amount of total remuneration of executives shown above is:	7,168,539	5,865,546

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 17. Remuneration of auditors

	2006 $	2005 $
The cost of financial statement audit services provided to the Authority were:		
Australian National Audit Office	**96,000**	88,850

No other services were provided by the Auditor-General.

Note 18. Average staffing levels

	2006	2005
The average staffing levels for the Authority during the year were:	**592**	532

Note 19. Financial instruments

Note 19A. Interest rate risk

Financial instrument	Note	Floating interest rate		Fixed interest rate maturing in 1 year or less		Fixed interest rate maturing in 1 to 5 years		Fixed interest rate maturing in >5 years		Non-interest bearing		Total		Weighted average effective interest rate	
		2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006	2005
		$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	$'000	%	%
Financial assets															
Cash at bank and deposits at call	7A	13,430	15,022	–	–	–	–	–	–	–	–	13,430	15,022	5.19	4.96
Cash on hand	7A	–	–	–	–	–	–	–	–	2	2	2	2	n/a	n/a
Investments: Government securities	7C	–	–	14,848	9,919	–	–	–	–	–	–	14,848	9,919	5.41	5.23
Appropriations receivable	7B	–	–	–	–	–	–	–	–	7	128	7	128	n/a	n/a
Goods and services receivable	7B	–	–	–	–	–	–	–	–	2,263	2,203	2,263	2,203	n/a	n/a
Accrued interest	7B	–	–	–	–	–	–	–	–	157	90	157	90	n/a	n/a
Other receivables	7B	–	–	–	–	–	–	–	–	376	572	376	572	n/a	n/a
Total financial assets (recognised)		13,430	15,022	14,848	9,919	–	–	–	–	2,805	2,995	31,083	27,936		
Total assets												39,760	39,192		
Financial liabilities															
Revenue in advance	9C	–	–	–	–	–	–	–	–	674	148	674	148	n/a	n/a
Trade creditors	9A,9B	–	–	–	–	–	–	–	–	4,375	3,783	4,375	3,783	n/a	n/a
Total financial liabilities		–	–	–	–	–	–	–	–	5,049	3,931	5,049	3,931		
Total liabilities												24,057	22,265		

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 19. Financial instruments (continued)

Note 19B. Fair values of financial assets and liabilities

	Note	2006 $'000 Total carrying amount	2006 $'000 Aggregate fair value	2005 $'000 Total carrying amount	2005 $'000 Aggregate fair value
Financial assets					
Cash	7A	13,432	13,432	15,024	15,024
Government securities	7C	14,848	14,848	9,919	9,919
Receivables for goods and services	7B	2,803	2,803	2,993	2,993
Total financial assets		31,083	31,083	27,936	27,936
Financial liabilities (recognised)					
Trade creditors	9A,9B	4,375	4,375	3,783	3,783
Revenue in advance	9C	674	674	148	148
Total financial liabilities (recognised)		5,049	5,049	3,931	3,931

Note 19C. Credit risk exposures

APRA's maximum exposure to credit risk at reporting date, in relation to each class of recognised financial assets, is the carrying amount of those assets as indicated in the *Balance Sheet*.

The economic entity has no significant exposures to any concentrations of credit risk.

All figures for credit risk referred to do not take into account the value of any collateral or other security.

This note also applies to APRA's administered financial instruments and is therefore not reproduced at Note 20.

Note 20. Administered items

Note 20A. Income administered on behalf of Government

	2006 $'000	2005 $'000
Revenues		
Taxation		
Financial Institutions Supervisory Levies:		
Current year levies and penalties (see Table 1)[1]	98,302	97,110
Current year levies recognised in previous period	–	–
	98,302	97,110
Financial Assistance Levy and penalties (see Table 2)	3,042	32,736
Total taxation	101,344	129,846
Total revenues administered on behalf of Government	101,344	129,846

Table 1 – Financial Institutions Supervisory Levies revenue by levy type – Current year levies and penalties[2]

	2006 $'000	2005 $'000
Levy:		
Superannuation funds	41,528	39,899
Authorised deposit-taking institutions	30,099	30,735
Life insurers and friendly societies	9,752	10,513
General insurers	16,849	15,713
Retirement savings account providers	–	104
Total levies	98,228	96,964
Late payment penalties:		
Superannuation funds	69	146
Total late payment penalties	69	146
Late lodgement penalties:		
Superannuation funds	5	–
Total late lodgement penalties	5	–
Total current year levies and penalties	98,302	97,110

[1] Current year levies and penalties include amounts for past years' levies and penalties invoiced in the current year.

[2] Table 1 provides revenue details by levy type for the current and past years' levies (including where applicable current year amounts paid and recognised in the previous year).

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 20. Administered items (continued)

Note 20A. Income administered on behalf of Government (continued)

	2006 $'000	2005 $'000
Table 2 — Financial Assistance Levy and penalties		
Levy No. 2001/02:1 (Superannuation)		
Levy	(1)	–
Penalties	–	1
	(1)	1
Levy No. 2001/02:2 (Superannuation)		
Levy	(14)	3,547
Penalties	–	–
	(14)	3,547
Levy No. 2002/03:1 (Superannuation)		
Levy	(174)	22,728
Penalties	26	–
	(148)	22,728
Levy No. 2003/04:1 (Superannuation)		
Levy	(29)	6,460
Penalties	–	–
	(29)	6,460
Levy No. 2004/05:1 (Superannuation)		
Levy	3,229	–
Penalties	5	–
	3,234	–
Total Financial Assistance Levy and penalties	3,042	32,736

Note 20. Administered items (continued)

Note 20B. Expenses administered on behalf of Government

	2006 $'000	2005 $'000
Expenses:		
Net write-down of assets		
Financial Institutions Supervisory Levies		
Levies and late payment penalties waived (see Table 1), Note 22	(111)	(577)
Levies and late payment penalties written-off (see Table 2)	(15)	(252)
Other	7	–
	(119)	(829)
Financial Assistance Levy		
Levies and late payment penalties written-off (see Table 3)	–	(4)
Total expenses administered on behalf of Government	(119)	(833)

Table 1 — Financial Institutions Supervisory Levies – Levies and late payment penalties waived by levy type

	2006 $'000	2005 $'000
Superannuation funds	(111)	(154)
General insurers	–	(423)
Total levies and late payment penalties waived	(111)	(577)

Table 2 — Financial Institutions Supervisory Levies – Levies and late payment penalties written-off by levy type

	2006 $'000	2005 $'000
Superannuation funds	(15)	(34)
Life insurers and friendly societies	–	(218)
Total levies written-off	(15)	(252)

Table 3 — Financial Assistance Levy – Levies and late payment penalties written-off

	2006 $'000	2005 $'000
Financial Assistance Levy No. 2001/02: 1 (Superannuation)	–	(4)
Total Financial Assistance Levies written-off	–	(4)

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 20. Administered items (continued)

Note 20C. Assets administered on behalf of Government

	2006 $'000	2005 $'000
Financial assets		
Cash		
Cash at bank	–	246
Receivables		
Financial Institutions Supervisory Levies		
Superannuation levies	26	53
Less: Provision for doubtful debts	(19)	(26)
Net Financial Institutions Supervisory Levies receivable	7	27
Financial Assistance Levy receivable	315	3,947
Other	(2)	–
Total receivables	320	3,974
Total financial assets	320	4,220
Total assets administered on behalf of Government	320	4,220
Receivables which are overdue are aged as follows:		
Not overdue	1	13
Overdue by:		
– Less than 30 days	309	3,950
– 30 to 60 days	1	7
– 60 to 90 days	1	6
– more than 90 days	29	24
Total levies receivable	341	4,000
The provision for doubtful debts is aged as follows:		
Not overdue	–	–
Overdue by:		
– Less than 30 days	–	–
– 30 to 60 days	–	–
– 60 to 90 days	–	–
– more than 90 days	(19)	(26)
Total provision for doubtful debts	(19)	(26)
Other	(2)	–
Total receivables (net)	320	3,974

Note 20. Administered items (continued)

Note 20D. Administered reconciliation table

	2006 $'000	2005 $'000
Opening administered assets less administered liabilities at 1 July	4,220	104
Plus administered revenues	101,344	129,846
Less administered expenses	(119)	(833)
Plus transfers from Official Public Account for refunds	292	976
Less transfers to Official Public Account	(105,417)	(125,873)
Closing administered assets less administered liabilities as at 30 June	320	4,220

Note 20E. Administered financial instruments

Administered interest rate risk

	Note	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Financial instrument		Non-interest bearing		Total	
Financial assets (recognised)					
Cash	20C	–	246	–	246
Receivables	20C	322	3,974	322	3,974
Other	20C	(2)	–	(2)	–
Total financial assets (recognised)		320	4,220	320	4,220
Total assets		320	4,220	320	4,220
Financial liabilities		–	–	–	–

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 21. Appropriations

The tables in Note 21A and Note 21B report on appropriations made by the Parliament out of the Consolidated Revenue Fund (CRF) in respect of the Authority. When received by the Authority, the payments made are legally the money of the Authority and do not represent any balance remaining in the CRF. Note 21C relates to a Special Appropriation, which is administered on behalf of the Government.

Note 21A. Acquittal of Authority to draw cash from the Consolidated Revenue Fund for Ordinary Annual Services Appropriations

	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Particulars	Departmental outputs		Total	
Appropriation Act No. 1 (2005/06)				
Purpose: funding of APRA – Outcome 1				
Balance carried forward from previous year	–	–	–	–
Available for payments from CRF	1,000	1,000	1,000	1,000
Cash payments made out of CRF	(1,000)	(1,000)	(1,000)	(1,000)
Balance carried forward to next year	–	–	–	–

Note 21. Appropriations (continued)

Note 21B. Acquittal of Authority to draw cash from the Consolidated Revenue Fund – Special Appropriations (limited amount)

	2006 $'000	2005 $'000	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Particulars	Outcome 1		Equity		Total	
***Australian Prudential Regulation Authority Act 1998* – section 50**						
Purpose: funding of APRA						
Amount available carried from previous period	105	1,778	–	–	105	1,778
Prior year balance adjustment	(306)	(8)	–	–	(306)	(8)
Appropriation for reporting period	80,637	77,212	–	3,000	80,637	80,212
Available for payments	80,436	78,982	–	3,000	80,436	81,982
Cash payments made during the year	(80,409)	(78,877)	–	(3,000)	(80,409)	(81,877)
Amount available carried to the next period	27	105	–	–	27	105
Represented by: Appropriations receivable	27	105	–	–	27	105

Note 21C. Acquittal of Authority to draw cash from the Consolidated Revenue Fund – Special Appropriations (refund provisions)

	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Particulars	Administered		Total	
***Financial Management and Accountability Act 1997* – section 28**[1]				
Purpose: to refund overpayments of levies by financial institutions				
Cash payments made during the year	(292)	(976)	(292)	(976)
Total charged to Special Appropriation	(292)	(976)	(292)	(976)
Budget estimate	–	–	–	–

[1] Department of Finance and Administration is responsible for this Special Appropriation.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 22. Compensation and debt relief

	2006 $	2005 $
20 waivers of amounts owing to the Commonwealth were made pursuant to section 12 of the *Financial Institutions Supervisory Levies Collections Act 1998.* (2005: 139)	111,639	576,930
	111,639	576,930

Note 23. Assets held in trust

Services for other Governments and non-agency bodies account

This account existed under the predecessor agency, the Insurance and Superannuation Commission. Upon transformation of that agency to APRA on 1 July 1998, there was a nil balance in that account and no transactions have occurred since that time. Balance at 30 June 2006 is nil.

Tunstall Bond Superannuation Fund Trust Account

This account was established by APRA following a Deed of Settlement entered into between APRA and the former Trustees of the Tunstall Bond Superannuation Fund, arising from legal proceedings against the former Trustee under the *Superannuation Industry (Supervision) Act 1993*. Under the Deed the former Trustees are required to pay certain amounts to APRA to be held in trust by APRA until ordered by the court to disperse the funds in a manner to be determined. Total receipts include interest earned on the amounts paid by the former Trustee.

	2006 $'000	2005 $'000
Total held at beginning of period	369	–
Total receipts during reporting period	43	369
Total payments during reporting period	(412)	–
Total held by APRA at the end of the reporting period (cash)	–	369

Note 24. Special account

Superannuation Protection Account

This account was established under section 234 of the *Superannuation Industry (Supervision) Act 1993* to facilitate the payment and recovery of financial assistance provided to superannuation fund members suffering adverse outcomes resulting from fraud and misappropriation by fund trustees. There were no transactions to this account in 2005/06 (2004/05: $Nil). All financial assistance payments by Treasury and recoveries by APRA made to date have been transacted directly from and to the Consolidated Revenue Fund.

Note 25. Reporting of outcomes

Note 25A. Outcomes of the Authority

APRA is structured to meet the following outcome:

Outcome 1: To enhance public confidence in Australia's financial institutions through a framework of prudential regulation, which balances financial safety and efficiency, competition, contestability and competitive neutrality.

Only one output group is identified for the outcome. The output group consists of three outputs: policy development, surveillance program and prudential advice.

Note 25B. Net cost of outcome delivery

	2006 $'000	2005 $'000
	Outcome 1	
Expenses		
Administered	119	833
Departmental	92,108	82,652
Total expenses	92,227	83,485
Costs recovered from provision of goods and services to the non-government sector:		
Administered	–	–
Departmental	9,130	3,188
Total costs recovered	9,130	3,188
Other external revenues		
Administered:		
Financial Institutions Supervisory Levies	98,302	97,110
Financial Assistance Levy	3,042	32,736
Total Administered	101,344	129,846
Departmental:		
Sale of goods and services – to related entities	766	684
Interest	2,574	2,216
Revenue from sale of assets	–	–
Rental recoveries	815	492
Insurance recoveries and other revenue	130	59
Total Departmental (Authority)	4,285	3,451
Total other external revenues	105,629	133,297
Net cost/(contribution) of outcome	(22,532)	(53,000)

The output reporting is derived from the APRA internal activity system which captures the time spent by each employee on the three published outputs: policy development, surveillance program and prudential advice. Expenses are tracked for each cost centre and aggregated for each output. Expenses relating to the HIH Royal Commission are treated under prudential advice. Revenue is apportioned based on the weighted average percentages for each output.

The net costs shown include intra-government costs that would be eliminated in calculating the actual budget outcome.

Notes to and Forming Part of the Financial Statements for the year ended 30 June 2006

Note 25. Reporting of outcomes (continued)

Note 25C. Departmental (Authority) revenues and expenses by output groups and outputs

	2006 $'000	2005 $'000	2006 $'000	2005 $'000	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Outcome Group 1	Output 1.1.1		Output 1.1.2		Output 1.1.3		Total	
	Policy development		Surveillance program		Prudential advice			
Operating expenses								
Employees	7,987	8,386	50,262	42,303	1,802	2,388	60,051	53,078
Suppliers	3,588	3,960	22,584	19,974	809	1,128	26,981	25,061
Finance costs	31	40	196	199	7	11	234	250
Depreciation and amortisation	523	663	3,293	3,345	118	189	3,934	4,197
Write-down of assets	121	10	760	53	27	3	908	66
Total operating expenses	12,250	13,059	77,095	65,874	2,763	3,719	92,108	82,652
Funded by:								
Revenues from Government	10,858	12,512	68,330	63,113	2,449	3,564	81,637	79,188
Sale of goods and services	923	460	5,806	2,322	208	131	6,937	2,913
Rent recoveries	109	78	683	392	24	22	816	492
Interest	342	350	2,154	1,766	77	100	2,573	2,216
Net gains from disposal of assets	–	–	–	–	–	–	–	–
Reversal of previous asset write-downs	–	43	–	218	–	12	–	274
Licence fees and other charges	394	152	2,476	764	89	43	2,959	959
Insurance recoveries and other revenue	17	9	109	47	4	3	130	59
Total operating revenues	12,643	13,604	79,558	68,622	2,851	3,875	95,052	86,101

The Authority's outcome and outputs are described at Note 25A.

The net costs shown include intra-government costs that would be eliminated in calculating the actual Budget outcome.

Note 25. Reporting of outcomes (continued)

Note 25D. Administered revenues and expenses by outcome

	2006 $'000	2005 $'000
	Outcome 1	
Administered revenues		
Financial Institutions Supervisory Levies	98,302	97,110
Financial Assistance Levy	3,042	32,736
Total administered revenues	101,344	129,846
Administered expenses		
Levies waived	111	577
Levies written-off	15	252
Financial Assistance Levy written-off	–	4
Other	(7)	–
Total administered expenses	119	833

The Authority's outcome and outputs are described at Note 25A.

The net costs shown include intra-government costs that would be eliminated in calculating the actual Budget outcome.

Australian National
Audit Office

INDEPENDENT AUDIT REPORT

To the Minister for Revenue and Assistant Treasurer

Scope

The financial statements and Members' responsibility

The financial statements comprise:

- Statement by Members;
- Income Statement, Balance Sheet and Statement of Cash Flows;
- Statement of changes in equity;
- Schedules of Commitments and Contingencies;
- Schedule of Administered Items; and
- Notes to and forming part of the Financial Statements

of the Australian Prudential Regulation Authority (the Authority) for the year ended 30 June 2006.

The Members are responsible for preparing the financial statements that give a true and fair view of the financial position and performance of the Australian Prudential Regulation Authority, and that comply with Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*, Accounting Standards and mandatory financial reporting requirements in Australia. The Members are also responsible for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial statements.

Audit Approach

We have conducted an independent audit of the financial statements to express an opinion on them to you. Our audit has been conducted in accordance with the Australian National Audit Office Auditing Standards, which incorporate the Australian Auditing and Assurance Standards, to provide reasonable assurance as to whether the financial statements are free of material misstatement. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive, rather than conclusive, evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

While the effectiveness of management's internal controls over financial reporting was considered when determining the nature and extent of audit procedures, the audit was not designed to provide assurance on internal controls.

PO Box A456 Sydney South NSW 1235
130 Elizabeth Street
SYDNEY NSW
Phone (02) 9367 7100 Fax (02) 9367 7102

We have performed procedures to assess whether, in all material respects, the financial statements present fairly, in accordance with Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997*, Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Authority's financial position, and of its financial performance and cash flows.

The audit opinion is based on these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial statements; and
- assessing the appropriateness of the accounting policies and disclosures used, and the reasonableness of significant accounting estimates made by the Members.

Independence

In conducting the audit, we have followed the independence requirements of the Australian National Audit Office, which incorporate the ethical requirements of the Australian accounting profession.

Audit Opinion

In our opinion, the financial statements of the Australian Prudential Regulation Authority:

(a) have been prepared in accordance with Finance Minister's Orders made under the *Commonwealth Authorities and Companies Act 1997;* and

(b) give a true and fair view of the Australian Prudential Regulation Authority's financial position as at 30 June 2006 and of its performance and cash flows for the year then ended, in accordance with:

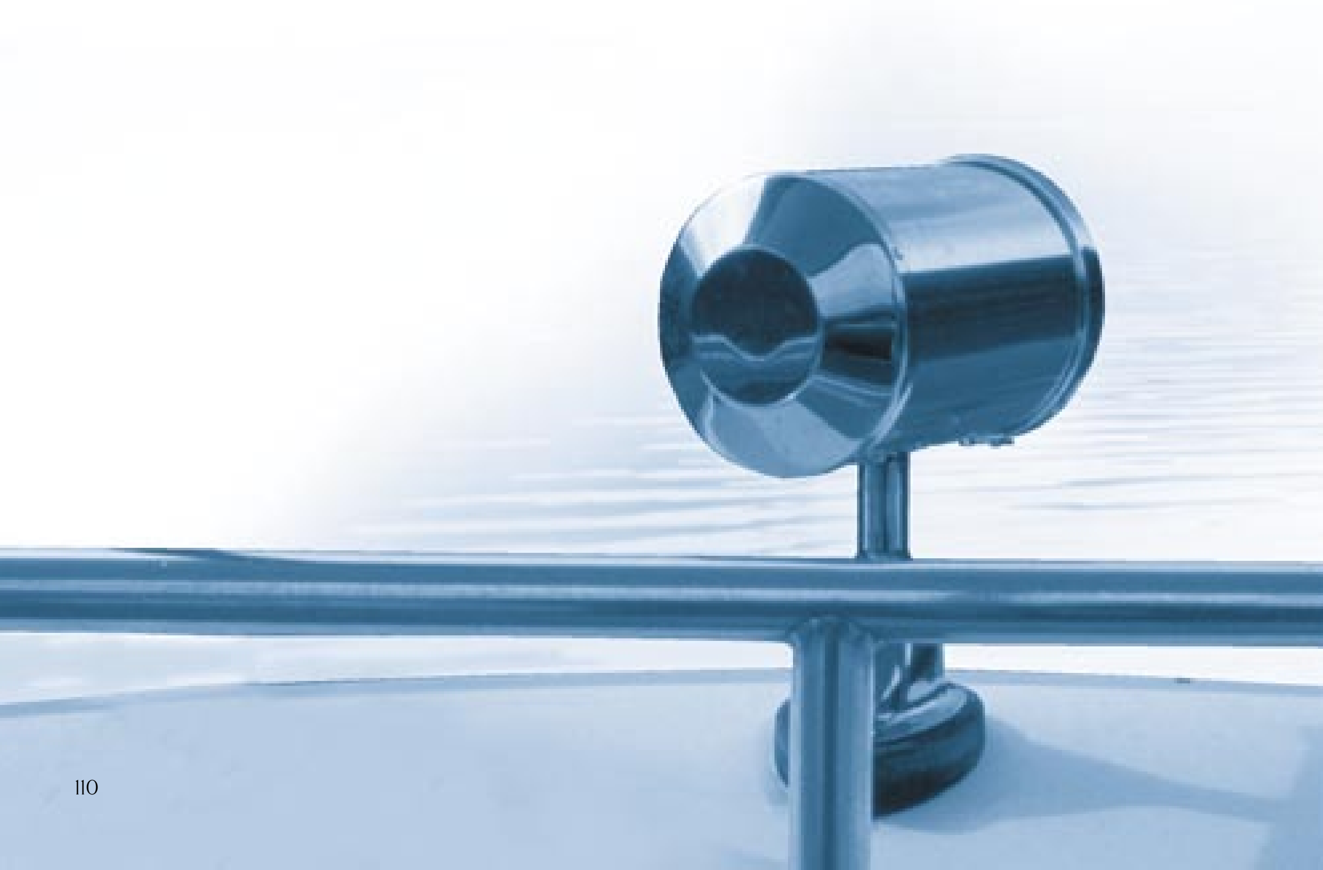
(i) the matters required by the Finance Minister's Orders; and

(ii) applicable Accounting Standards and other mandatory financial reporting requirements in Australia.

Australian National Audit Office

P Hinchey
Senior Director
Delegate of the Auditor-General

Sydney
17 August 2006



9

Statutory report

Statutory reporting requirements

APRA reports in accordance with the following Commonwealth legislation and other requirements:

- *Australian Prudential Regulation Authority Act 1998*;
- *Commonwealth Authorities and Companies Act 1997*;
- *Environment Protection and Biodiversity Conservation Act 1999*;
- *Equal Employment Opportunity (Commonwealth Authorities) Act 1987*;
- *Freedom of Information Act 1982*;
- *Occupational Health and Safety (Commonwealth Employment) Act 1991*; and
- *Commonwealth Fraud Control Guidelines* and Department of the Prime Minister and Cabinet guidelines.

Australian Prudential Regulation Authority Act 1998 (APRA Act)

Report under section 59

Section 59 of the APRA Act requires APRA to report on:

- the activities of ADI statutory managers within the meaning of the *Banking Act 1959* and persons conducting investigations under Division 2 of Part II and section 61 of that Act; and
- the exercise during the year of APRA's powers under Part 15 of the *Retirement Savings Accounts Act 1997* (RSA Act) and Part 29 of the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

APRA did not appoint any ADI statutory managers or persons to conduct an investigation under Division 2 of Part II or section 61 of the *Banking Act 1959* during 2005/06. There were no continuing appointments during the year.

APRA exercised its powers under Part 15 of the RSA Act and under Part 29 of the SIS Act as set out below:

Exemption number	Date	Provision of SIS Act/regulations exempted
172	27/07/2005	Regulation 9.29
173	02/11/2005	Subsection 93(4)
174	07/09/2005	Regulations 9.08, 9.09, 9.17, 9.23, 9.24, 9.29 and 9.30
175	09/09/2005	Subsection 93(3)(a)
176	30/09/2005	Subregulation 6.34(3)
177	07/10/2005	Subsection 93(4)
178	Not issued	Not issued
179	24/11/2005	Subregulations 9.04D(1), (2) and (3)
180	23/12/2005	Subregulations 9.04D(1), (2) and (3); 9.04I(1) and (3)
181	21/12/2005	Subsection 93(4)

Exemption number	Date	Provision of SIS Act/regulations exempted
182	19/12/2005	Regulation 6.33
A1 of 2006	25/01/2006	Subregulation 6.17(2)
A2 of 2006	27/01/2006	Subsection 93(4)
A3 of 2006	27/01/2006	N/A (revocation)
A4 of 2006	27/01/2006	N/A (revocation)
A5 of 2006	06/03/2006	Subregulation 6.18(3)
A6 of 2006	06/02/2006	Subregulations 9.04D(1), (2) and (3)
A7 of 2006	18/05/2006	Subsection 93(4)
A8 of 2006	09/02/2006	Subsection 93(4)
A9 of 2006	28/02/2006	N/A (revocation)
A10 of 2006	28/02/2006	Subregulation 9.11(1)
A11 of 2006	06/03/2006	Regulation 6.29
A12 of 2006	14/03/2006	Subsection 93(4)
A13 of 2006	19/04/2006	Subregulation 4.16(3)
A14 of 2006	17/03/2006	N/A (revocation)
A15 of 2006	17/03/2006	Subsection 93(4)
A16 of 2006	23/03/2006	Subregulation 9.04D(1)
A17 of 2006	23/03/2006	Subregulation 9.04D(1)
A18 of 2006	23/03/2006	Subregulation 9.04D(1)
A19 of 2006	27/03/2006	Subregulation 9.04D(1)
A20 of 2006	19/04/2006	Paragraph 93(3)(a)
A21 of 2006	31/03/2006	Subsection 93(4)
A22 of 2006	12/04/2006	Subregulation 9.04D(1)
A23 of 2006	18/04/2006	Subregulation 9.04D(1)
A24 of 2006	28/04/2006	Subregulation 9.04D(1)
A25 of 2006	28/04/2006	Subregulation 9.04D(1)
A26 of 2006	28/04/2006	Subregulation 9.04I(1)
A27 of 2006	Not issued	Not issued
A28 of 2006	19/05/2006	Paragraph 93(3)(a)
A29 of 2006	Not issued	Not issued

Exemption number	Date	Provision of SIS Act/regulations exempted
A30 of 2006	25/05/2006	Subregulations 6.18(1) and 6.19(1)
A31 of 2006	02/06/2006	Subsection 93(3)
A32 of 2006	01/06/2006	Subsection 93(3)
A33 of 2006	09/06/2006	Subsection 93(4)
A34 of 2006	08/06/2006	Subsection 93(4)
A35 of 2006	05/06/2006	Subsection 93(4)
A36 of 2006	07/06/2006	Subsection 93(4)
A37 of 2006	09/06/2006	Subregulation 9.04D(1)
A38 of 2006	13/06/2006	Subregulation 9.04D(1)
A39 of 2006	13/07/2006	Subregulation 9.04D(1)
A40 of 2006	27/06/2006	Regulations 4.16 and 4.17
A41 of 2006	29/06/2006	Subsection 93(4)
A42 of 2006	30/06/2006	Regulations 4.16 and 4.17
A43 of 2006	30/06/2006	Regulations 4.16 and 4.17
A44 of 2006	30/06/2006	Subsection 93(4)
A45 of 2006	30/06/2006	Regulations 4.16 and 4.17
A46 of 2006	29/06/2006	Regulation 6.29
A47 of 2006	30/06/2006	Regulations 4.16 and 4.17
A48 of 2006	30/06/2006	Regulations 4.16 and 4.17
A49 of 2006	30/06/2006	Regulations 4.16 and 4.17
A50 of 2006	29/06/2006	Regulations 4.16 and 4.17
A51 of 2006	30/06/2006	Regulations 4.16 and 4.17
A52 of 2006	30/06/2006	Regulations 4.16 and 4.17
A53 of 2006	30/06/2006	Regulations 4.16 and 4.17
A54 of 2006	30/06/2006	Regulations 4.16 and 4.17
A55 of 2006	Not issued	Not issued
A56 of 2006	30/06/2006	Regulations 4.16 and 4.17
A57 of 2006	30/06/2006	Regulations 4.16 and 4.17
A58 of 2006	30/06/2006	Regulations 4.16 and 4.17
A59 of 2006	31/07/2006	Regulations 4.16 and 4.17
A60 of 2006	30/06/2006	Regulations 4.16 and 4.17

Modification declaration number	Date	Provision of RSA regulations modified
Class		
1 of 2006	29/06/2006	Regulation 4.24

Modification declaration number	Date	Provision of SIS regulations modified
Non-class		
A1 of 2006	23/03/2006	Regulation 6.34
A2 of 2006	15/05/2006	Regulation 6.34
A3 of 2006	27/06/2006	N/A (revocation)
A4 of 2006	27/06/2006	Regulation 6.34
A40 of 2006	20/06/2006	Regulation 6.34
Class		
26	22/07/2005	Regulation 5.08
Revocation	01/09/2005	N/A
1 of 2006	28/04/2006	Division 6.7
2 of 2006	29/06/2006	Regulation 4.16
3 of 2006	29/06/2006	Regulation 6.21

Commonwealth Authorities and Companies Act 1997 (CAC Act)

Auditor-General's activities

In July 2005, the Australian National Audit Office (ANAO) tabled its report on a follow-up audit that was conducted in 2004/05 to assess APRA's implementation of recommendations arising out of the ANAO's 2001 performance audit of bank prudential supervision. The report noted that APRA had fully implemented a number of recommendations from the 2001 review and made progress in implementing the others. There were no new recommendations arising from the follow-up audit. The ANAO's findings were discussed in the APRA's *2005 Annual Report*.

In addition, see page 108 of the *Financial statements* of this Report.

Executive Group attendance

See page 56 of the *Governance* section of this Report.

Executive Group qualifications

See pages 58–59 of the *Governance* section of this Report.

Statement by Members

See page 61 of the *Financial statements* in this Report.

Courts and tribunals

Over 2005/06, a number of judicial and Administrative Appeals Tribunal (AAT) decisions had, or may have, a significant effect on APRA's operations. These involved:

- *Kamha v APRA,* in which the Full Bench of the Federal Court upheld the scope of APRA's disqualification powers. The High Court refused an Application for Leave to Appeal;
- *X &Y v APRA*, in which the Full Bench of the Federal Court upheld the extent of APRA's disqualification powers and the use of documentation obtained under the *Royal Commissions Act 1902*. The High Court has granted Leave to Appeal the latter matter;
- *VBN & Ors v APRA*, in which the Federal Court defined APRA's obligations to the AAT in respect of legal advices; and
- *VBN & Ors v APRA*, in which the AAT imposed confidentiality orders and both operational and implementation stays in respect of certain APRA decisions.

APRA's supervisory capabilities section of this Report contains details of court and tribunal decisions relating to enforcement action taken by APRA during the year.

Enabling legislation and information on purpose and functions

APRA's purpose, powers and functions are set out in sections 8, 9, 9A and 11 of the APRA Act.

APRA's purpose is to regulate bodies in the financial sector in accordance with the laws of the Commonwealth that provide for prudential regulation and retirement income standards, and for developing the administrative practices and procedures to be applied in performing that regulatory role. In performing and exercising its functions and powers, APRA is required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

The Government has announced that, from 1 July 2007, APRA's financial arrangements will come under the *Financial Management and Accountability Act 1997* (FMA Act). This follows an assessment of APRA's governance arrangements against the principles and templates of the *Review of the Corporate Governance of Statutory Authorities and Office Holders* (the Uhrig Review). Legislative amendments will be made in 2006/07 to enable APRA to comply with FMA Act requirements.

Financial statements

See page 61 of the *Financial statements* in this Report.

Indemnities and insurance premiums

APRA entered into indemnity agreements with APRA Members and, as required, officers consistent with, and to the extent allowed by, section 27M of the CAC Act.

APRA Members and officers are covered by the professional indemnity insurance cover of the Commonwealth-managed insurance fund, Comcover. The generic terms and conditions of the insurance cover provided by Comcover to Commonwealth agencies are available on the Comcover website: www.finance.gov.au/comcover. Under the conditions of the policy, APRA is prohibited from disclosing the specific nature and limit of the liabilities covered and the amount of the premium.

Location

See page 128 of this Report.

Organisation chart

See pages 124–25 of this Report.

Parliamentary committees

Avenues for APRA to be accountable to the Parliament are through Parliament's *ad hoc* and standing committees, and through specific references on legislation or issues of particular interest to Parliamentary committees.

During 2005/06, APRA Members and officers made themselves available for public hearings before the Senate Economics Legislation Committee (sitting as Senate Estimates) on 3 November 2005 and on 16 February and 31 May 2006.

Privacy Commission

There were no investigations by the Privacy Commissioner under section 36 of the *Privacy Act 1988* during 2005/06. No reports were served under section 30 of the Act. The Privacy Commissioner made no determinations under section 52, nor did APRA seek any under section 72.

There were no adverse or favourable comments made by the Privacy Commissioner in respect of APRA's operations.

Privacy inquiries relating to APRA should be addressed to:

The Privacy Officer
Legal Services
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3424

Responsible Ministers

The Hon Peter Costello MP, Treasurer of the Commonwealth of Australia, has portfolio responsibility for APRA.

He is assisted in this by the Minister for Revenue and Assistant Treasurer who, since 27 January 2006, has been the Hon Peter Dutton MP; prior to that the Minister was the Hon Mal Brough MP.

Review of operations and prospects

See the narrative section of this Report, beginning on page 4.

Risk Management and Audit Committee attendance

See page 57 of the *Governance* section of this Report.

Statement on governance

See the *Governance* section of this Report.

Environment Protection and Biodiversity Conservation Act 1999

Ecologically sustainable development and environmental performance

Under section 516A of the *Environment Protection and Biodiversity Conservation Act 1999*, APRA is required to report on its contribution to ecologically sustainable development and other environmental matters.

In early 2003, APRA released its Environmental Policy Statement, which reinforced its commitment to managing environmental matters and to the implementation of an Environmental Management System.

In the *Energy Use in the Australian Government's Operations – Report for 2004–2005*, the Department of the Environment and Heritage showed that overall energy consumption per person in APRA offices was 9,016 MJ, which was well below the target of 10,000 MJ/person.

APRA continues to take practical steps to reduce energy consumption in its main tenancies, with zone-controlled lighting systems for after-hours use and recycling of printer cartridges, paper and cardboard. In addition, APRA has contracted to utilise above the recommended level of green power when renewing energy contracts.

Equal Employment Opportunity (Commonwealth Authorities) Act 1987 (EEO Act)

Workplace diversity program report

APRA is continuing to take a proactive and innovative approach in meeting its responsibilities under the EEO Act. This includes the creation of flexible and inclusive employment that values and utilises the contribution of people of different backgrounds, experiences, perspectives and abilities. This strategy retains the essential EEO principles in relation to non-discrimination and equal employment opportunity, and also recognises the broader concept of diversity in ensuring a tolerant workplace free from all forms of harassment.

In 2005/06, a Workplace Diversity Taskforce chaired by an Executive General Manager examined how APRA can support and make best use of its highly diverse workforce. The Taskforce focused on a number of key diversity issues including increasing the number of women in management, attracting and retaining mature age workers, exploring employer-sponsored childcare options and developing management knowledge and capabilities to support staff in achieving work/life balance. Strategies recommended by the Taskforce are being implemented and will be reviewed over the next twelve months.

EEO staff data – Staff diversity as at 30 June 2006

Level	Female	Male	ATSI	NESB1	NESB2	PWD
Level 1	53	22	0	11	2	2
Level 2	74	53	0	24	13	0
Level 3	77	87	0	50	3	0
Level 4	45	96	0	31	2	1
Senior	14	70	0	13	2	1
Executive	0	6	0	1	0	0
Total	**263**	**334**	**0**	**130**	**22**	**4**

ATSI Aboriginal and Torres Strait Islander
NESB1 Non-English-speaking background, first generation
NESB2 Non-English-speaking background, second generation
PWD People with disability

Freedom of Information Act 1982 (FOI Act)

The FOI Act provides the public with a general right of access to documents held by Commonwealth agencies, including APRA. This general right is limited by exceptions needed to protect essential public interests or the privacy and business affairs of those who give information to APRA or the Commonwealth.

In 2005/06, APRA received seven applications under the FOI Act, including one application for internal review.

During the year, FOI applications were dealt with as follows:

Granted in full	0
Granted in part	7
Access refused	0
Withdrawn	0
Transferred to another agency	0
On hand at 30 June 2006	0
Total	**7**

Charges collected were $650.00 and the estimated cost of handling FOI requests in 2005/06 was $4,500.

In March 2006, the Commonwealth Ombudsman released his report *Scrutinising Government – Administration of the Freedom of Information Act 1982 in Australian Government Agencies*. The Ombudsman investigated the processes of a number of Commonwealth agencies, including APRA, when dealing with FOI requests. APRA co-operated with the investigation by answering a questionnaire and providing a number of files. The Ombudsman made the following general comments in relation to APRA's handling of FOI requests:

- the standard of decision letters was good and met all requirements of section 26 of the FOI Act;
- fees and charges letters were generally good, explaining the basis on which charges were estimated; and
- requests were generally acknowledged within 14 days of receipt.

Initial contact for requests under FOI Act

Requests under the FOI Act should be made in writing, together with the prescribed fee, to:

The FOI Co-ordinator
Legal Services
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3424

Access to documents

APRA is increasingly using the internet to make its publications available to the public on the APRA website, free of charge. Some publications, however, attract a charge. The website contains application forms, regulatory information, prudential statements, circulars and guidelines covering the types of entities that APRA regulates.

In addition, a list of documents that are used by APRA in making decisions or recommendations for the purposes of legislation administered by APRA, made under section 9 of the FOI Act, has been lodged with the Freedom of Information Controller at National Archives of Australia in Canberra.

Questions about publications should be made to:

Public Affairs
Australian Prudential Regulation Authority
GPO Box 9836
Sydney NSW 2001
Phone: 02 9210 3000
Fax: 02 9210 3170

Categories of documents

APRA maintains the following categories of documents covered by section 8(1) (a)(iii) of the FOI Act:

- documents open to public access as part of a public register in accordance with an enactment where access is subject to a fee or other charge:
  - accounts and auditor certificates relating to general insurers available under the former section 122 of the *Insurance Act 1973*;
- other documents available for purchase by the public in accordance with arrangements made with APRA:
  - life insurance publications (financial diskette containing annual data and market statistics from half-yearly data);
- documents made available to the public free via APRA's website at www.apra.gov.au:
  - lists of regulated entities and industry bodies;
  - prudential standards and rules made under the *Banking Act 1959*, the *Insurance Act 1973* and the *Life Insurance Act 1995*, guidance notes and prudential practice guides;
  - superannuation circulars and guidance notes relating to the *Superannuation Industry (Supervision) Act 1993* and the *Retirement Savings Accounts Act 1997*, and 'frequently asked questions' on superannuation industry issues;
  - statutory instruments issued by APRA, including modification declarations, determinations and approvals;
  - transitional prudential standards made under the *Financial Sector Reform (Amendments and Transitional Provisions) Regulations 1999*;
  - reporting standards made under the *Financial Sector (Collection of Data) Act 2001* together with reporting forms and instructions for the lodgement of returns;
  - transfer rules made under the *Financial Sector (Transfers of Business) Act 1999*;
  - class consent under section 66 of the *Banking Act 1959*;
  - market statistics (including APRA's *Insight* and various industry-based statistical performance publications) and other research material;
  - policy discussion papers;
  - media releases and other news updates;
  - copies of Enforceable Undertakings issued by APRA and the APRA Disqualification Register;
  - seminar papers and copies of speeches given by APRA Members and officers;
  - APRA *ADI Points of Presence* (concerning the availability of banking services in rural and regional areas);
  - corporate information;
  - procedural guidelines;
  - enabling legislation; and
  - indexed file list for the purposes of Senate Continuing Order No. 6.

Occupational Health and Safety (Commonwealth Employment) Act 1991 (OHS Act)

Details of investigations and other matters as prescribed

The following information is presented in accordance with section 74 of the OHS Act.

In compliance with reporting obligations under the OHS Act, there were:

- no investigations conducted during the year that related to undertakings carried on by APRA;

- no tests conducted on any plant, substance or thing in the course of such investigations;
- no directions to APRA by an investigator that the workplace not be disturbed; and
- no prohibition or improvements and provisional notices given to APRA.

Measures taken to ensure health, safety and welfare of employees and contractors

Responsibilities imposed by the OHS Act were identified and allocated to individual staff members. This included the identification and training of four new health and safety staff representatives in Brisbane (one), Melbourne (one) and Sydney (two).

Procedures for dealing with health and safety issues are published on APRA's intranet site and are included in staff induction programs.

APRA's policy and procedures are maintained with the assistance of a consultant occupational therapist and ergonomic specialists to identify, assess and control hazards associated with work processes, particularly computer-based work. Sessions informing staff of the ideal ergonomic set-up for their individual workstations have been held in Sydney and Canberra, with further sessions planned for regional offices.

First-aid services for the treatment of work-related injury or illness, including appropriately trained first-aid officers, are situated at all work locations. Rehabilitation services and support are provided to injured employees with ongoing consultation for affected employees.

OHS policies including establishment of staff committees and selection of health and safety representatives

APRA has arrangements for consultation on all OHS issues, including maintenance of the Occupational Health and Safety (OHS) Committee with four staff and four management representatives.

The OHS Committee (see below) satisfies legislative requirements, including meeting at least every three months and providing all staff with access to minutes of the meetings.

Statistics requiring the giving of notice under section 68

During the year, 23 incidents were notified to APRA, none of which required a report to Comcare as required by section 68 of the OHS Act. The incidents were in the following locations:

Location	Number
On APRA premises	6
Home to work/work to home	12
Other	5
Total	**23**

Other reporting

Commonwealth Disability Strategy

APRA continues to ensure that there are no obstacles to those with disabilities contained in its employment practices and procedures or to public access to information through APRA's distribution channel, the internet. For those services that are not provided electronically (particularly early release of superannuation benefits), there is ongoing assessment to ensure that particular groups are not excluded either by virtue of financial circumstance or physical or intellectual disability.

A comprehensive action plan to ensure adherence to the Commonwealth Disability Strategy has yet to be finalised.

Commonwealth Fraud Control Guidelines

Fraud control

The Chairman of APRA certifies that he is satisfied that:

- fraud risk assessments and fraud control plans have been prepared that comply with the *Commonwealth Fraud Control Guidelines*;
- appropriate fraud prevention, detection, investigation and reporting procedures and processes are in place; and
- annual fraud data have been collected and reported in compliance with the *Commonwealth Fraud Control Guidelines*.

Consultancies

APRA's policy on procurement includes specific provisions on consultants and contractors. Considerations prior to engagement include whether in-house resources are available; the cost-effectiveness of the operation and whether the project is essential; availability of funds; a selection and evaluation process resulting in fair competition, effective services and value for money; project definition and outcomes; and superannuation implications.

The main purposes for which consultants were engaged in 2005/06 were audit services; training; financial and accounting services; IT consultancies; legal advice; litigation services; recruitment selection, administration and outplacement and counselling; and professional services.

In 2005/06, the total number of consultants engaged was 75 and the total amount paid was $5.1 million.

Consultative arrangements

APRA consults extensively with regulated entities, industry bodies and other interested parties prior to formulating or amending prudential policies or finalising prudential standards.

Executive and consultative committees from 1 July 2005 to 30 June 2006

Management Group

This Group comprises the APRA Members and the Executive General Managers and is responsible for high-level information-sharing and decisions on more routine supervisory and organisational matters. It meets weekly or more frequently as required.

Leadership Team

The Leadership Team, which comprises APRA Members, Executive General Managers and General Managers, meets twice a year to develop APRA's strategic and business plans, to monitor performance against plans and to discuss major operational issues.

Industry groups

There are four groups, comprising representatives of the various Divisions of APRA, and they cover the following industry sectors:

- ADIs;
- superannuation;
- general insurance; and
- life insurance.

These groups are the key forum for addressing and seeking an APRA-wide consensus on emerging industry issues. Their main roles are to liaise with industry so as to identify emerging trends and to act as a sounding board for prudential policy issues in APRA-regulated industries, prior to presentation of these issues to the Executive Group.

Basel II Steering Group

The Group comprises representatives of the various Divisions of APRA. It provides a forum for discussion of issues relating to the interpretation and implementation of Basel II in Australia, to ensure consistency of approach within APRA.

Cross-Divisional Licensing Committee

This Committee comprises representatives from across APRA and seeks to assist supervisors considering licence applications and ensure consistency in licensing practice and application across all APRA-regulated industries. It provides APRA-wide guidance on issues which need to be considered in licensing submissions and, after consideration of an application, recommends to the relevant Executive General Manager action to be taken.

Information Technology Governance Committee

The Committee comprises an APRA Member, the four Executive General Managers, and the General Manager - Business Services. The Committee's primary role is to ensure that the implementation of IT plans and policies is aligned with APRA's business needs and priorities.

Policy Steering Group

The Group's role is to provide advice to relevant Policy, Research and Statistics staff on APRA's preferences for new prudential policy formation. It reviews policy priorities and provides input to the direction of APRA's policy program. It has a broad spectrum of representatives from various Divisions and of the specialist industry groups and is chaired by an Executive General Manager.

Occupational Health and Safety Committee

The Committee includes both staff and management representatives. It focuses on issues to do with the health, safety and well-being of staff and ensures that these are integrated into broader management systems and practices.

Staff Consultative Group

The Group facilitates communication and consultation with all APRA staff below the senior management level on the terms and conditions of their employment (including the Human Resources Policy Manual) and the impact of these on APRA's organisational culture and values.

Workplace Diversity Taskforce

See Workplace diversity program report on page 118 of this Report.

Performance pay

APRA has a performance bonus system, designed in consultation with staff and management and covering all employees. For 2005/06, the aggregate bonus pool was just over $2.7 million. Bonuses were paid in late July 2006.

Staff statistics

Staff by location and full-time/part-time as at 30 June 2006

Location	Full-time	Part-time	Total
Adelaide	5	0	5
Brisbane	17	4	21
Canberra	24	14	38
Melbourne	69	5	74
Perth	6	1	7
Sydney	428	24	452
Total	**549**	**48**	**597***

Staff by division and full-time/part-time as at 30 June 2006

Division	Full-time	Part-time	Total
Corporate	105	18	123
Diversified Institutions	102	4	106
Policy, Research and Statistics	74	7	81
Specialised Institutions	139	15	154
Supervisory Support	129	4	133
Total	**549**	**48**	**597***

* Including five staff on fixed-term contracts for superannuation licensing.

Executive General Manager
Diversified Institutions
Wayne Byres

- General Manager
  Branch 1
  Puay Sim
- General Manager
  Branch 2
  Graham Johnson
- General Manager
  Branch 3
  Denis Wilkinson
- General Manager
  Branch 4
  Helen Rowell

Executive General Manager
Specialised Institutions
Brandon Khoo

- General Manager
  Central Region
  Senthamangalam Venkatramani
- General Manager
  South West Region
  Stephen Glenfield
- General Manager
  Superannuation Licensing
  Tony Randle

Executive Group
Dr John Laker (Chairman)
Mr Ross Jones (Deputy Chairman)
Mr John Trowbridge (Member)

Risk Management and Audit Committee

- Executive General Manager Supervisory Support **Tom Karp**
  - General Manager Industry Technical Services **Heidi Richards**
  - General Manager Actuarial Services **David Rush**
  - General Manager Specialist Risk Services **Vacant**
  - General Counsel Legal Services **Patrick Meaney**
  - General Manager Enforcement **Darryl Roberts**
  - General Manager Resilience and Response Development **David Lewis**
- Executive General Manager Policy, Research and Statistics **Charles Littrell**
  - General Manager Policy Development **Keith Chapman**
  - Program Director Basel II **Bernie Egan**
  - General Manager Statistics **Steve Davies**
- Secretary **Thea Rosenbaum**
- Chief Financial Officer **Jim Flaye**
- General Manager Human Resources **Peter Vodicka**
- General Manager Business Services **Colin Cayless**
- General Manager Risk Assessment and Internal Audit **Paul Thompson**
- Head of Public Affairs **Stuart Snell**

AASB	Australian Accounting Standards Board
AAT	Administrative Appeals Tribunal
ACCC	Australian Competition and Consumer Commission
ADI	Authorised deposit-taking institution
AEIFRS	Australian Equivalents to International Financial Reporting Standards
AFSPC	Association of Financial Supervisors of Pacific Countries
AGAAP	Australian Generally Accepted Accounting Principles
ANAO	Australian National Audit Office
APEC	Asia-Pacific Economic Co-operation
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AUSTRAC	Australian Transaction Reports and Analysis Centre
BFIAAG	Banking and Finance Infrastructure Assurance Advisory Group
CAC Act	*Commonwealth Authorities and Companies Act 1997*
CPLG	Core Principles Liaison Group
CRF	Consolidated Revenue Fund
EEO	Equal Employment Opportunity
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
FAQs	Frequently asked questions
FMA Act	*Financial Management and Accountability Act 1997*
FMO	Finance Minister's Order
FOI Act	*Freedom of Information Act 1982*
FSAP	Financial Sector Assessment Program (of the IMF)
GST	Goods and services tax
IAA	International Actuarial Association
IAAust	Institute of Actuaries of Australia
IAIS	International Association of Insurance Supervisors

IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOPS	International Organisation of Pension Supervisors
IOSCO	International Organization of Securities Commissions
LIASB	Life Insurance Actuarial Standards Board
MoU	Memorandum of Understanding
MPR	Money Protection Ratio
NCPD	National Claims and Policies Database
OECD	Organisation for Economic Co-operation and Development
OHS	Occupational Health and Safety
OPA	Official Public Account
ORR	Office of Regulation Review
PAIRS	Probability and Impact Rating System
PER	Performing Entity Ratio
PHIAC	Private Health Insurance Administration Council
PPF	Purchased payment facility
RBA	Reserve Bank of Australia
RBNZ	Reserve Bank of New Zealand
RSA Act	*Retirement Savings Accounts Act 1997*
RSE	Registrable superannuation entity
SCCI	Specialist credit card institution
SEACEN	South-East Asian Central Banks
SEANZA	South-East Asia New Zealand and Australia (Forum of Banking Supervisors)
SIS Act	*Superannuation Industry (Supervision) Act 1993*
SOARS	Supervisory Oversight and Response System
TISN	Trusted Information Sharing Network
UIG	Urgent Issues Group

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